THE LAW REFORM COMMISSION OF HONG KONG

REPORT ON BANKRUPTCY

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INTRODUCTION

Terms of reference

1. On 14th September 1990, under powers granted by the Governor-in-Council on 15 January 1980, the Attorney General and the Chief Justice referred the following topic to the Law Reform Commission:

> *"(1) To review the law and practice relating to the insolvency of both individuals and bodies corporate in Hong Kong, and in particular-*
>
> > *(a) the provisions of the Bankruptcy Ordinance, Chapter 6, in their application both to business and non-business debtors; and*
> >
> > *(b) the winding-up provisions of the Companies Ordinance, Chapter 32*
>
> *taking into account existing and proposed legislation in other jurisdictions, and in particular the UK Insolvency Act 1986 and Chapter 11 of the U.S. Bankruptcy Code, and to consider what reforms are necessary or desirable.*
>
> *(2) To submit an early interim report on -*
>
> > *(a) such changes in the Bankruptcy Ordinance as are considered to be required for simplifying bankruptcy procedures, and*
> >
> > *(b) any other aspects of insolvency law or practice which the Commission considers should be introduced in advance of the Commission's final report."*

2. The Law Reform Commission appointed a sub-committee to examine this topic, chaired by Professor Edward L G Tyler, Professor and Head of Department of Professional Legal Education at the City University of Hong Kong and a former member of the Law Reform Commission. The other members of the sub-committee are:

> Mr Mark Bradley, Solicitor, Deacons
>
> Mr Graham Cheng OBE JP, Chairman, Taching Petroleum Co Ltd
>
> Mr Cheung Wood-lun, Secretary, Hong Kong & Kowloon Cement & Concrete Construction Trade Workers

(resigned in February 1993)

Mr Nicholas Etches, Accountant, KPMG Peat Marwick

Mr Stefan Gannon, General Counsel to the Hong Kong Monetary Authority

Mr David Hague, Accountant, Price Waterhouse (appointed in January 1993)

Mr Robin Hearder JP, Official Receiver

Ms Barbara Martin, Solicitor, Carey & Lui

Mr Michael Page, Senior Manager, Hong Kong & Shanghai Banking Corporation Ltd

Mr Winston Poon, Barrister

Mr Ian Robinson, Accountant, Ernst & Young

3. The Secretary to the sub-committee was Jeremy Glen, Senior Solicitor in the Official Receiver's Office, who was seconded to the Law Reform Commission for the purposes of this report and who was responsible for the task of drafting the sub-committee report which forms the basis of this Commission report. We record here our appreciation of the immense amount of hard work devoted to this project by the members and secretary of the sub-committee. This report addresses part (2)(a) and certain aspects of part 2(b) of the terms of reference. The sub-committee is now working on some of the other aspects of the reference and the Commission expects to issue two further reports in due course before the reference is complete.

Summary of work

4. The sub-committee held its first meeting on 12th November 1990 and met a total of 53 times in completing its report on bankruptcy.

5. The sub-committee concentrated on consideration of aspects of the Bankruptcy Ordinance which the Official Receiver had originally referred to as requiring amendment. In addition to the Official Receiver's proposals, the sub-committee received submissions on other aspects of the Bankruptcy Ordinance and some of these have been incorporated in this Report.

6. In August 1993, the sub-committee issued a Consultative Document[1], setting out its initial proposals on bankruptcy. The submission period lasted for ten weeks to the

[1] See paragraph 11 below.

middle of October 1993 and the sub-committee received over seventy responses. Twenty of these were substantive with wide ranging comment on the topics addressed in the Consultative Document. It is fair to say that, while reservations were expressed about certain issues, the Consultative Document was generally welcomed.

7. The sub-committee's final report was considered by the Commission at four meetings, from December 1993 to March 1994. The final text of this Report was agreed in March 1995 after some outstanding issues were resolved. Where the conclusions in this final Commission report differ from those of the sub-committee, we have endeavoured to make this clear.

8. The Bankruptcy Ordinance (Cap 6) is almost entirely based on the Bankruptcy Act of 1914 in England and Wales. The Bankruptcy Act 1914 was replaced in 1986 by the Insolvency Act 1986[2] which was the result of a Report of the Review Committee on Insolvency Law and Practice, commonly referred to as "the Cork Report".[3] In 1988 the Law Reform Commission of Australia published a Report on its General Insolvency Inquiry, commonly referred to as "the Harmer Report".[4] The Harmer Report has led to some amendments having recently been made to bankruptcy law in Australia under the Bankruptcy Amendment Act 1991 and to the new Corporations Law[5].

9. The changes in the laws of bankruptcy and the different attitude towards bankruptcy, with greater emphasis on rehabilitation rather than punishment, brought out in the Cork and Harmer Reports makes it opportune for bankruptcy law to be reconsidered in Hong Kong. While not ignoring other jurisdictions we have been influenced by the changes in both England and Wales and Australia and have sought to adapt them to the best advantage of Hong Kong. We acknowledge that weight has been given to the provisions of the Insolvency Act. We view this as a positive approach as we see no advantage in ignoring the body of case law that is building up around the Insolvency Act. At the same time, we have adopted provisions from other jurisdictions when we have considered them to be more appropriate. We would note that throughout this Report we make recommendations based on provisions in other jurisdictions, in particular the Insolvency Act and the Australian Bankruptcy Act 1966, as amended[6]. We have not referred to all the supporting rules in the legislation relating to each recommendation but we wish to emphasise that it is our general intention that the relevant supporting rules be adopted in respect of each recommendation.

10. The Commission has taken account of the socio-economic background of bankruptcy in Hong Kong and has considered the statistics available through the Official Receiver's Office.[7] We have also considered the policy aspects of bankruptcy law. Both the

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2 See paragraph 11 below.
3 See paragraph 11 below.
4 See paragraph 11 below.
5 Corporate Law Reform Act 1992.
6 See paragraph 11 below.
7 See the statistics in Annexures 1 and 2 of this Report.

Cork and Harmer Reports have set out the general position and we do not need to repeat it for the purposes of this Report.[8]

Abbreviations

11. For the sake of brevity, when we refer to "he" we mean "he or she" unless the context implies otherwise. For the sake of conciseness, we have used abbreviated forms in respect of the following reports and legislation.

"The Consultative Document"

The paper issued in August 1993 by the Insolvency sub-committee of the Hong Kong Law Reform Commission containing the sub-committee's preliminary proposals on bankruptcy reform.

"The Cork Report"

The Report of the United Kingdom Review Committee on Insolvency Law and Practice under the Chairmanship of Sir Kenneth Cork.[9]

"The Companies Ordinance"

This refers to the Hong Kong Companies Ordinance (Cap 32).

"The Harmer Report"

General Insolvency Inquiry: a Report of the Law Reform Commission of Australia under the Chairmanship of Mr Ron Harmer.[10]

"The Insolvency Act"

This refers to the United Kingdom Insolvency Act of 1986.

"The Insolvency Rules"

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8 See the Cork Report, Chapter 1, and the Harmer Report, Chapters 1 and 2.

9 "Insolvency Law and Practice"; Report of the Review Committee; United Kingdom, June 1982. Cmnd 8558.

10 Report No. 45, September 1988.

This refers to the United Kingdom Insolvency Rules of 1986.

‘‘The sub-committee’’

This refers to the Law Reform Commission’ s Insolvency Sub-committee.

CHAPTER 1

GROUNDS FOR PRESENTING A BANKRUPTCY PETITION

The present law

1.1 When a debtor commits an act of bankruptcy that act entitles a creditor to present a petition to the court for a receiving order to be made against the debtor for the protection of the debtor's estate. The interpretation section of the Bankruptcy Ordinance defines "available act of bankruptcy" as "being any act of bankruptcy available for a bankruptcy petition at the date of the presentation of the petition on which the receiving order is made".[11]

1.2 The Bankruptcy Ordinance sets out the ways in which a debtor can commit an act of bankruptcy. Section 3(1) reads as follows:

> *"A debtor commits an act of bankruptcy in each of the following cases -*
>
> > *(a) if in Hong Kong or elsewhere he makes a conveyance or assignment of his property to a trustee or trustees for the benefit of his creditors generally;*
> >
> > *(b) if in Hong Kong or elsewhere he makes a fraudulent conveyance, gift, delivery or transfer of his property or of any part thereof;*
> >
> > *(c) if in Hong Kong or elsewhere he makes any conveyance or transfer of his property or any part thereof, or creates any charge thereon, which would be void as a fraudulent preference if he were adjudged bankrupt;*
> >
> > *(d) if with intent to defeat or delay his creditors he does any of the following things, namely, departs out of Hong Kong, or being out of Hong Kong remains out of Hong Kong, or departs from his dwelling-house or usual place of business, or otherwise absents himself, or begins to keep house, or removes his property or any part thereof beyond the jurisdiction of the court;*
> >
> > *(e) if execution against him has been levied by seizure of his goods under process in an action, or proceeding in the court, and the goods have been either sold or held by the bailiff for 21 days;*

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[11] Bankruptcy Ordinance (Cap 6), section 2.

Provided that, where an interpleader summons has been taken out in regard to the goods seized, the time elapsing between the date at which such summons is taken out and the date at which the proceedings on such summons are finally disposed of, settled or abandoned shall not be taken into account in calculating such period of 21 days;

(f) if he files in the court a declaration of his inability to pay his debts or presents a bankruptcy petition against himself;

(g) if a creditor has obtained a final judgment or final order against him for any amount, and execution thereon not having been stayed, has served on him in Hong Kong or, by leave of the court, elsewhere, a bankruptcy notice under this Ordinance, and he does not, within 7 days after service of the notice, in case the service is effected in Hong Kong, and in case the service is effected elsewhere, then within the time limited in that behalf by the order giving leave to effect the service, either comply with the requirements of the notice or satisfy the court that he has a counter-claim set off or cross demand which equals or exceeds the amount of the judgment debt or sum ordered to be paid, and which he could not set up in the action in which the judgment was obtained or the proceedings in which the order was obtained;

For the purposes of this paragraph and of section 4, any person who is for the time being entitled to enforce a final judgment or final order shall be deemed to be a creditor who has obtained a final judgment or final order;

(h) if the debtor gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts."

Discussion

Abolition of acts of bankruptcy

1.3 The Official Receiver proposed that Hong Kong should abolish acts of bankruptcy and replace them with provisions based on the Insolvency Act.[12]

1.4 The Official Receiver proposed that a statutory demand need not issue out of the court and that both the form and rules in relation to the statutory demand as provided for in the Insolvency Act be adapted for use in Hong Kong.[13] The Official Receiver noted that the

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12 Insolvency Act 1986, Part IX, sections 264 to 271 (in relation to creditors' petitions).

13 The Insolvency Rules 1986, rules 6.1 to 6.5. See paragraph 11 of the Introduction.

present form of petition would need to be examined and amended to take account of the recommended changes.

1.5 The concept of acts of bankruptcy is a term of art which not only forms the basis on which a petition is grounded but also has other consequences within the Bankruptcy Ordinance. If our recommendation to abolish acts of bankruptcy is followed it will necessitate changes to other parts of the Bankruptcy Ordinance, such as to the jurisdiction of the court [14] and to the doctrine of relation back.[15] The concept of acts of bankruptcy has been described in the following terms:

> *"The commission by the debtor of at least one act of bankruptcy is the fact which gives the bankruptcy court jurisdiction to make a receiving order in respect of his estate and is to be treated as a statutory recognition of his insolvency. Such an act of bankruptcy must be proved to have been committed within three months before the presentation of the petition [section 6(1)(c)], and any act so proved must be recited in the receiving order. It is to the date of the first of such acts that the title of the trustee in bankruptcy relates back under (section 42)."*[16]

1.6 The Cork Report recommended the complete abolition of the concept of acts of bankruptcy, commenting:

> *"Most of them (acts of bankruptcy) are obsolete or obsolescent; their abolition will greatly simplify and modernise the law of bankruptcy. If the position is analyzed, it will be found that, with the exception of the debtor's failure to comply with a bankruptcy notice, none of them is needed in order to enable a creditor to present a bankruptcy petition in a proper case. Every creditor who wishes to initiate insolvency proceedings against a debtor must allege and prove that he is a creditor and, except in the cases of future and contingent or prospective debts, this involves alleging and proving that the debtor has failed to pay a debt presently due to the applicant and not bona fide disputed on reasonable grounds. Such failure on the part of a corporate debtor has always been sufficient to justify the conclusion that the debtor is insolvent and ought to be wound up."*[17]

1.7 There is already provision in Hong Kong under the Companies Ordinance[18] for a statutory demand not grounded on a judgment debt. The Companies Ordinance provision is closer to the terms of section 267 of the Insolvency Act than to the terms of section 3(1) of the Bankruptcy Ordinance. Section 178(1) of the Companies Ordinance provides that:

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14 See Chapter 2.
15 See Chapter 14.
16 Williams and Muir Hunter on Bankruptcy, 19th edition, page 1.
17 The Cork Report, paragraph 529.
18 See paragraph 11 of the Introduction

"(1) A company shall be deemed to be unable to pay its debts -

> *(a) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding $5,000 then due, has served on the company, by leaving it at the registered office of the company, a demand under his hand requiring the company to pay the sum so due, and the company has for 3 weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or*
>
> *(b) if execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or*
>
> *(c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company."*

1.8 In England and Wales, the Insolvency Act, section 267(2), provides that a creditor's petition in bankruptcy may be presented to the court in respect of a debt or debts only if, at the time that the petition is presented:

> *"(a) the amount of the debt, or the aggregate amount of the debts, is equal to or exceeds the bankruptcy level,*
>
> *(b) the debt, or each of the debts, is for a liquidated sum payable to the petitioning creditor, or one or more of the petitioning creditors, either immediately or at some certain, future time, and is unsecured,*
>
> *(c) the debt, or each of the debts, is a debt which the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay, and*
>
> *(d) there is no outstanding application to set aside a statutory demand served (under section 268 below) in respect of the debt or any of the debts."*

1.9 Section 268 of the Insolvency Act defines "inability to pay" in the following terms:

"(1) For the purposes of section 267(2)(c) the debtor appears to be unable to pay a debt if, but only if, the debt is payable immediately and either-

> *(a) the petitioning creditor to whom the debt is owed has served on the debtor a demand (known as the statutory demand) in the prescribed form requiring him to pay the debt or to secure or compound for it to the satisfaction of the creditor, at least 3 weeks have elapsed since the demand was served and the demand has been neither complied with nor set aside in accordance with the rules, or*
>
> *(b) execution or other process issued in respect of the debt on a judgment or order of any court in favour of the petitioning creditor, or one or more of the petitioning creditors to whom the debt is owed, has been returned unsatisfied in whole or in part.*

(2) For the purposes of section 267(2)(c) the debtor appears to have no reasonable prospect of being able to pay a debt if, but only if, the debt is not immediately payable and -

> *(a) the petitioning creditor to whom it is owed has served on the debtor a demand (also known as "the statutory demand") in the prescribed form requiring him to establish to the satisfaction of the creditor that there is a reasonable prospect that the debtor will be able to pay the debt when it falls due,*
>
> *(b) at least 3 weeks have elapsed since the demand was served, and*
>
> *(c) the demand has been neither complied with nor set aside in accordance with the rules."*

1.10 In addition to the provisions of the Insolvency Act we also looked at the law in other jurisdictions. In particular, we were influenced by the Harmer Report in identifying the grounds on which a petition may be presented to the court.[19]

1.11 We agree with the Official Receiver and recommend that acts of bankruptcy should be abolished. The situation in Hong Kong is much the same as that described in the Cork Report in that many of the acts of bankruptcy are never used. There is a need to redefine the basis on which a petition can be presented with emphasis on the particular needs of Hong

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[19] The Harmer Report, paragraphs 365 to 368.

Kong. We are not breaking new ground here but accept that the Cork and Harmer Reports have correctly identified that acts of bankruptcy are obsolete. We have been concerned with identifying the circumstances which should replace the existing acts of bankruptcy and in our discussions we drew on the Insolvency Act and the Harmer Report.

1.12 We identified three of the present acts of bankruptcy that are currently used in Hong Kong as grounds on which to base a petition. These are the failure by a debtor to comply with the terms of a bankruptcy notice (statutory demand), the unsatisfied execution of a judgment debt, and the absconding debtor.

Failure to comply with a statutory demand

1.13 The Harmer Report stated that 95 per cent of cases of acts of bankruptcy were achieved by the non-compliance of the debtor with a bankruptcy notice.[20] Practitioners on the insolvency sub-committee were of the view that this figure probably reflects the position in Hong Kong although there are no statistics available.

1.14 The Harmer Report dealt in some depth with the advantages and disadvantages of whether a demand should be supported by a judgment. The principal advantages of not having a demand based on a judgment were summarised as being that it would simplify procedures, reduce the cost and time involved in fulfilling the present requirements and enable suspected insolvents to be flushed out and addressed at an earlier time than is possible under the existing procedure, with all of which we agree. The Harmer Report felt that these advantages would be outweighed by instances where debtors fail, for whatever reason, to resist a statutory demand even though there may be a genuine dispute. The Harmer Report added that the time and cost of first obtaining a judgment before issuing a bankruptcy notice would at least ensure that a debtor is given a fair opportunity to resist a claim. The Harmer Report recommended that a statutory demand should be supported by a judgment debt.[21]

1.15 We are inclined to give more weight to the advantages identified by the Harmer Report. The concerns expressed in the Harmer Report do not seem to have been reflected by experience under the Insolvency Act and the Companies Ordinance, both of which provide for a statutory demand that is not based on a judgment. We are persuaded therefore that the immediacy of a demand not based on a judgment debt would be a potent weapon for creditors and recommend the introduction of a form of demand that would require a debtor to pay a debt or to secure or compound for it within 21 days of service of the demand and the failure to satisfy such demand should be a ground for presenting a bankruptcy petition.

1.16 We approve of the terms of the Insolvency Rules, rule 6.5(4), which provides that the court may set aside a demand if:

> *"(a) the debtor appears to have a counterclaim, set-off or cross demand which equals or exceeds the amount of the debt or debts specified in the statutory demand; or*

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[20] The Harmer Report, paragraph 360.

[21] The Harmer Report, paragraph 373.

(b) the debt is disputed on grounds which appear to the court to be substantial; or

(c) it appears that the creditor holds some security in respect of the debt claimed by the demand, and either rule 6.1(5)[22] is not complied with in respect of it, or the court is satisfied that the value of the security equals or exceeds the full amount of the debt; or

(d) the court is satisfied, on other grounds, that the demand ought to be set aside."

1.17 Cases where there is a dispute on the debt are usually dealt with on the hearing of a bankruptcy petition. The Insolvency Rules advance the hearing of a dispute based on the grounds set out in rule 6.5(4) to a time before the hearing of the petition.[23] There is no evidence that the changes effected by the Insolvency Act have increased the amount of litigation about disputed debts and accordingly we recommend the adoption of rules 6.1 to 6.5 of the Insolvency Rules.

Unsatisfied execution of a judgment debt

1.18 We have no difficulty in recommending that the unsatisfied execution of a judgment against the property of a debtor should also be an event on which a bankruptcy petition can be grounded.

Absconding debtors

1.19 Section 3(1)(d) of the Bankruptcy Ordinance is a seldom used act of bankruptcy. It provides, *inter alia*, that a debtor commits an act of bankruptcy if with intent to defeat or delay his creditors he departs out of Hong Kong, or, being out of Hong Kong, remains out of Hong Kong.

1.20 The sub-committee on insolvency considered that a refinement of the provision could prove useful to creditors and proposed in the Consultative Document that:

"a petition may be presented in respect of a debt if at the time the petition is presented a debtor intends to depart or has departed out of Hong Kong

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22 Rule 6.1(5) provides that if the creditor holds any security in respect of the debt the full amount of the debt shall be specified, but that the statutory demand shall specify the nature of the security and the value which the creditor puts on it as at the date of demand, and the amount of which payment is claimed by the demand shall be the full amount of the debt, less the amount specified as the value of the security. One submission was concerned that the valuation of the security for the purpose of making a statutory demand should not bind a creditor as regards his proof of debt. We confirm that the purpose of the statutory demand should be to establish the debt and that the valuation of security given in the statutory demand should not bind a creditor in terms of the amount claimed in his proof of debt.

23 The Insolvency Rules 1986, rule 6.4.

knowing that a necessary consequence of his departing would be to defeat or delay his creditors notwithstanding that his absence from Hong Kong had nothing to do with his debts".

1.21 The Consultative Document stated that the removal of assets out of Hong Kong into China was causing concern and that, with the trend towards the manufacturing base moving into China it was likely that the problem would increase. Practitioners on the sub-committee advised that in some cases assets were flagrantly removed from the jurisdiction, leaving no assets for creditors to claim against.

1.22 In addition, the sub-committee noted that with the approach of the change of sovereignty in 1997, there were instances of individuals accumulating debts in Hong Kong who had no intention of repaying them, in the knowledge that they intended to emigrate. The sub-committee's understanding was that absconding was a common event and that credit card companies had been hit by debtors running up large bills against their credit cards and then leaving Hong Kong. At our request, an attempt was made to gather evidence of such instances. The result of this investigation was that, while there was plenty of anecdotal evidence of such happenings, most of the banks and professional organisations canvassed were unwilling or unable to provide a convincing body of hard evidence.

1.23 The sub-committee also believed that the outward looking and international nature of Hong Kong (reflected, for example, by the absence of exchange control regulations) acted against creditors and left them more exposed to the easy movement of all kinds of assets out of the territory by debtors who wanted to avoid their obligations.

1.24 The Consultative Document proposal prompted several submissions. We were advised that, while there was support for the proposal, there were also reservations expressed that the proposal would be open to abuse by creditors who could, on spurious grounds, seek to prevent a debtor leaving Hong Kong. The sub-committee did not believe that this would be likely to happen as any creditor who abused the provision would incur the displeasure of the court and would be open to the sanction of costs being awarded against him.

Consequences of the presentation of a petition

1.25 There is no doubt that the very act of presenting a bankruptcy petition is capable of triggering a solvency crisis and causing serious harm to an individual's financial position, business and reputation. All those whose business involves extending credit to individuals could be expected to act as soon as a petition was advertised as having been presented against one of their customers. They would be likely to cut off any further credit and to demand immediate repayment since they may otherwise be left behind in a scramble of creditors for the apparently insolvent person's available assets. Once such a scramble began, it would be very difficult to stop. If the individual was a trader, his trading partners would be likely to refuse to supply him with any further goods or services on credit and to call in any trade debts. He would be likely to lose any new business deals being negotiated. Even if he was able

to overcome the problem, his subsequent credit rating would be likely to suffer merely because a petition was presented.

An opportunity to pay

1.26 Under the present law, a petition can only be presented where a debtor commits an act of bankruptcy. Acts of bankruptcy involve situations where a debtor acknowledges his own insolvency, the creditor can show that the debtor is dishonestly trying to defeat his creditors, or the debtor has been successfully sued to judgment but has not satisfied the judgment debt. These are plainly cases where the debtor has had a fair opportunity to pay the debt but has proven himself unable or unwilling to do so. Moreover, in the cases where he has been successfully sued to judgment, it is established that the debt cannot lawfully be disputed.

1.27 The proposed ground would not require a creditor to believe that a debtor was insolvent, nor would a creditor need to believe or assert that the reason for a debtor's leaving or absence was to evade or delay repayment. It would not be necessary to prove these matters. It would be sufficient to show knowledge on the part of a debtor that a necessary consequence of departure would be to defeat or delay creditors, no matter that there was some compelling reason for leaving Hong Kong. The rationale is that a debtor would know perfectly well whether the effect of departure would result in loss to creditors.

1.28 The proposed ground would not provide the safeguard of a prior statutory demand or judgment or other notice to the debtor before the creditor would be allowed to issue the petition. The ground would not require the creditor to believe that a debtor was insolvent, merely that he was likely to delay repayment, nor would the creditor need to believe or assert that the reason for the debtor's leaving or absence was to evade or delay repayment. It is specifically proposed that the ground should be available notwithstanding that his absence from Hong Kong had nothing to do with his debts.

1.29 A petition may be issued even where a debtor was still in Hong Kong if the creditor had grounds to believe that a debtor intended to depart realising that his absence would inevitably delay payment of the debt. Hence, if the creditor was mistaken or malicious, the damage done by presenting the petition without prior warning would occur before a debtor could demonstrate that he was willing and able to pay.

Where the debtor has already departed from Hong Kong

1.30 It is arguable that if a debtor had already made good his escape with all his assets a subsequent bankruptcy order leading to the appointment of a trustee in bankruptcy would be in vain if there were no assets on which to operate. This, however, applies as much to any other set of circumstances where an adjudication order is made against a bankrupt. The truth in many bankruptcies is that creditors do not know the extent of a debtor' s assets until the trustee in bankruptcy has had an opportunity to investigate the estate. Even if a petitioning

creditor knows that a debtor has certain assets, he is unlikely to know the extent of the debtor' s liabilities.

1.31 Where a bankrupt has fled, the remedy pursued by a creditor could be influenced by the level of judicial co-operation between Hong Kong and the country to which he had gone. Thus, if the other country had an arrangement with Hong Kong for the reciprocal enforcement of judgments or if, by its conflict of laws rules, it recognised Hong Kong judgments on debts incurred in Hong Kong, then it might be more effective to obtain judgment by default in Hong Kong and then to enforce it against the debtor in the other country, executing against his assets there.

1.32 Alternatively, it may be desirable to instruct lawyers in the other country to sue the debtor there, assuming that actions based on debts incurred in Hong Kong are permitted, perhaps in order to restrain him from further removing his assets and so to facilitate execution in that country. If various creditors brought such actions, bankruptcy proceedings in the other jurisdiction may be appropriate.

1.33 If judicial co-operation was such that a trustee in bankruptcy appointed by the Hong Kong court would be recognised in the other country, then Hong Kong bankruptcy proceedings might in some cases be useful. However, this can be done on existing grounds for a petition and does not involve any emergency procedures for urgent relief. An advertised statutory demand followed by a petition would do as well.

1.34 The proposed ground might or might not be used by a creditor where a debtor has already fled Hong Kong, though at that stage it is probable that a creditor would use one of the other grounds to present a petition. A creditor may consider that it would be useful to bankrupt a debtor who has fled Hong Kong leaving debts as, under our recommendations, where a bankrupt has departed from Hong Kong and he has not complied with a request by the trustee to return to Hong Kong bankruptcy should not begin, or may be suspended, until the bankrupt returns.[24] Thus, the bankruptcy order would remain in effect until such time as the bankrupt returned. This, of course, might be of no consequence to some absconding bankrupts but those that returned to Hong Kong, for any reason, could be arrested at the immigration checkpoint if there was a warrant out for their arrest.

Where the debtor has not departed from Hong Kong

1.35 Where the debtor had not yet left Hong Kong and there was evidence that he was fraudulently incurring debts, never intending to pay them, and was about to emigrate, a number of existing procedures may be invoked. However, all these procedures would involve emergency orders being obtained to restrain the debtor from dealing with his assets or leaving the country. Merely issuing a bankruptcy petition on the new ground would not achieve this but, combined with the other remedies, it would serve ultimately to vest a bankrupt' s property in the

[24] See paragraph 17.49.

trustee. This would be an advance on the obtaining of, say, a *Mareva* injunction, which only has the effect of freezing the assets of a debtor.

1.36 In addition to *Mareva* injunctions, a creditor may seek interim orders for the delivery up of property and the appointment of interim receivers to take over assets or prohibition orders may in some cases be obtained to stop the defendant leaving the jurisdiction until a judicial hearing can be arranged. These emergency procedures are well-known and contain provisions to balance the interests of the plaintiff and the defendant.

Conclusion

1.37 We have considered the arguments for and against the proposed ground with care. We have decided, by a majority, and having regard to the unanimous decision of the sub-committee in favour of the proposal, to recommend that a petition for bankruptcy may be presented in favour of a debt if at the time the petition is presented a debtor intends to depart or has departed out of Hong Kong, knowing that a necessary consequence of his departing would be to defeat or delay his creditors notwithstanding that his absence from Hong Kong had nothing to do with his debts.

1.38 We acknowledge the concern expressed that there is a risk that some debtors might have petitions presented against them by creditors trying to use the provision as a form of blackmail. We do not consider that this is likely to be a significant problem, as the court can be relied on to dismiss unmeritorious petitions when the debtor presents his case.

1.39 We recognise that a person might legitimately have to leave Hong Kong urgently or unexpectedly in circumstances where he is unable to make proper arrangements for his debts but that he may intend to see to these matters on his return. However, a debtor has an obligation to meet his debts as they fall due, failing which he leaves himself open to action by his creditors, who would not be aware of a debtor's good intentions. A prudent debtor should take steps to advise his creditors of his situation, either before departure or from abroad, and so pre-empt bankruptcy proceedings by his creditors, especially in circumstances where there is a chance that action will be taken. The adoption of the new ground for presenting a bankruptcy petition would sound a warning to debtors that they are responsible for repayment of their debts and that they neglect their responsibilities at their peril.

1.40 We accept that the consequences of presenting a bankruptcy petition would be serious for a debtor but it would be within the power of a debtor to have a petition withdrawn or dismissed if he was not insolvent. It is not uncommon for bankruptcy petitions to be withdrawn. We do not believe that the new ground would present any hardship to a reasonable and prudent debtor. It would, however, in our view provide an effect means for creditors to protect their interests from less scrupulous debtors.

Expediting the presentation of the petition

1.41 The Official Receiver proposed, and we recommend, that the procedure for expediting the presentation of a petition under section 270 of the Insolvency Act should be adopted. This provides that the 3 weeks' grace period given to a debtor under section 268(1)(a) of the Insolvency Act can be curtailed if there is a probability that the debtor's assets will be diminished during the grace period. This provision should be helpful to a creditor who fears that a debtor is about to abscond with his assets.

1.42 We appreciate that this recommendation will only be useful in certain circumstances but believe that it, and our recommendation on absconding debtors, would give creditors some assistance.

Individual voluntary arrangements

1.43 We have considered the position of a debtor who defaults under a form of voluntary arrangement. At present the only forms of voluntary arrangements available in Hong Kong are compositions and schemes of arrangement under section 20 of the Bankruptcy Ordinance but in the chapter on voluntary arrangements later in this report we recommend that a default by a debtor in his obligations under a voluntary arrangement should provide a ground on which a petition can be presented.[25]

Recommendations

- **Acts of bankruptcy should be abolished.**

- **A debtor should be deemed to be unable to pay his debts if he fails to comply with the terms of a statutory demand. The statutory demand need not be based on a judgment and should require a debtor to pay a debt or to secure or compound for it within 21 days of service of the demand and the failure to satisfy such demand should be a ground for presenting a bankruptcy petition.**

- **The court should be able to set aside a statutory demand if a debtor appears to have a counterclaim, set-off or cross demand which equals or exceeds the amount of the debt or debts specified in the statutory demand; or the debt is disputed on grounds which appear to the court to be substantial; or it appears that the creditor holds some security in respect of the debt claimed by the demand, and either rule 6.1(5) of the Insolvency Rules is not complied with in respect of it, or the court is satisfied that the value of the security equals or exceeds the full amount of the debt; or the court is satisfied, on other grounds, that the demand ought to be set aside; following the Insolvency Rules, rule 6.5(4).**

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[25] See paragraphs 6.14 and 6.24(q).

- **Rules 6.1 to 6.5 of the Insolvency Rules relating to statutory demand should be adopted generally.**

- **An unsatisfied execution of a judgment against the property of a debtor should be an event on which a bankruptcy petition may be grounded.**

- **A petition may be presented if, at the time the petition was presented, a debtor intends to depart or has departed out of Hong Kong, knowing that a necessary consequence of his departing would be to defeat or delay his creditors, notwithstanding that his absence from Hong Kong had nothing to do with his debts.**

- **The provisions of sections 267 and 268 of the Insolvency Act should be adopted generally. In particular, the grace period of 3 weeks given to a debtor to comply with the terms of a statutory demand should be capable of curtailment if there is a probability that the debtor's assets will be diminished during that time.**

- **In the event of a default by a debtor under the terms of a voluntary arrangement the supervisor of, or any person bound by, a voluntary arrangement may present a petition to the court for a bankruptcy order to be made against the debtor.**

CHAPTER 2

JURISDICTION OF THE COURT

The present law

2.1 It is necessary for the bankruptcy provisions to set out the criteria by which a debtor becomes amenable to the jurisdiction of the court. The Official Receiver has proposed that the criteria for establishing the jurisdiction of the court should be changed, a recommendation that to some degree follows as a consequence of our recommendation in the previous chapter that acts of bankruptcy should be abolished but which is also influenced by a widening of the jurisdiction of the court under the corresponding provisions of the Insolvency Act.

2.2 In Hong Kong there are two provisions in the Bankruptcy Ordinance that, firstly, define and, secondly, distinguish the meaning of the word "debtor".

2.3 Section 3(2) of the Bankruptcy Ordinance defines a "debtor" as including:

> *" ... any person, whether a British subject or not, who at the time when an act of bankruptcy was done or suffered by him -*
>
> *(a) was personally present in Hong Kong; or*
>
> *(b) ordinarily resided or had a place of residence in Hong Kong; or*
>
> *(c) was carrying on business in Hong Kong, personally or by means of an agent or manager; or*
>
> *(d) was a member of a firm or partnership which carried on business in Hong Kong."*

2.4 Section 6(1), which sets out the conditions on which a creditor may petition, distinguishes section 3(2) by providing that a creditor shall not be entitled to present a bankruptcy petition against a debtor unless, *inter alia*,:

> *"(d) the debtor is domiciled in Hong Kong, or within a year before the date of the presentation of the petition has ordinarily resided, or had a dwelling-house or place of business, in Hong Kong, or has carried on business in Hong Kong, personally or by means of an agent or manager, or is or within the said period has been a member of a firm or partnership of persons which has carried on*

business in Hong Kong by means of a partner or partners or an agent or manager."

Discussion

2.5 The definition of debtor under the Bankruptcy Ordinance gives the Court jurisdiction over a wide range of people in providing that the debtor need not be a British subject but that he must have been present, ordinarily resident, carrying on business, or a member of a firm or partnership which carried on business in Hong Kong at the time of the act of bankruptcy.

2.6 Sections 3(2) and 6(1)(d) of the Bankruptcy Ordinance are virtually the same as sections 1(2) and 4(1)(d) of the English Bankruptcy Act 1914. Williams on Bankruptcy distinguished the sections by stating that section 3(2) defines who is a "debtor" for the purposes of the Ordinance with particular reference to the moment of the act of bankruptcy. For example, a debtor who was ordinarily resident in Hong Kong at the time of the act of bankruptcy would come within section 3(2)(b). Section 6(1)(d), however, deals with the debtor's amenability to a petition being presented against him by reference to the date of the presentation of the petition and the period of one year before its presentation. A debtor who has carried on business in Hong Kong within a year of the presentation of the petition would come within section 6(1)(d). Williams noted that section 6(1)(d) does not come into operation unless the debtor is within section 3(2).[26]

Widening the jurisdiction

2.7 The Official Receiver has proposed that section 265 of the Insolvency Act, which establishes the geographic and time connections between the debtor and the English bankruptcy system, should be adopted for use in Hong Kong. The Official Receiver has noted that the abolition of the concept of acts of bankruptcy would necessitate an amendment to sections 3(2) and 6(1) of the Bankruptcy Ordinance in any event, the same situation as when the legislation was amended in England and Wales under the Insolvency Act . The Official Receiver also noted that the conditions or connecting factors under section 265 appear to widen the geographic and time connections between the debtor and the bankruptcy system. The reference to citizenship is dropped and the time period for residency or having carried on business is increased from one to three years. Section 265 of the Insolvency Act provides:

"(1) A bankruptcy petition shall not be presented to the court under section 264(1)(a) or (b)[27] unless the debtor -

(a) is domiciled in England and Wales,

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[26] Williams and Muir Hunter on Bankruptcy, 19th edition, pages 52 and 53.

[27] That is, by an individual's creditor or creditors or by the individual himself.

(b) is personally present in England and Wales on the day on which the petition is presented, or

(c) at any time in the period of 3 years ending with that day-

(i) has been ordinarily resident, or has had a place of residence, in England and Wales, or

(ii) has carried on business in England and Wales.

(2) The reference in sub-section (1)(c) to an individual carrying on business includes -

(a) the carrying on of business by a firm or partnership of which the individual is a member, and

(b) the carrying on of business by an agent or manager for the individual or for such a firm or partnership."

2.8 The Cork Report said that the abolition of the acts of bankruptcy would remove the confusing and unnecessary distinction between the definitions of debtor for the purpose of founding the jurisdiction of the court which are contained in sections 3(2) and 6(1)(d), a sentiment that we endorse.[28] We believe that section 265 of the Insolvency Act satisfactorily establishes the jurisdiction of the court in most respects. We approve of the widening of the jurisdiction from one to three years in respect of residence and carrying on business. We have, however, some reservation about the lack of a reference to citizenship.

2.9 The question of the debtor's citizenship has been commented on in the following terms:

> *"..., the mere fact that the debtor happens to be a citizen of the United Kingdom is of no relevance to the question whether the English bankruptcy court enjoys jurisdiction over him. By the same token, a person who is a citizen of a foreign country is not on that account immune from the bankruptcy jurisdiction of the English courts, and may be adjudicated here provided that at least one of the connecting factors specified in section 265 is established in relation to him. The section therefore has the function of prescribing what kind and degree of "minimum contact" with this country will suffice for the purpose of our law, so as to confer jurisdictional competence upon our courts."*[29]

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[28] The Cork Report, paragraphs 532 and 533.

[29] The Law of Insolvency; Ian F. Fletcher, 1990, at page 68.

2.10 We are uncertain, however, about the actual effect of there being no reference to citizenship in the definition of debtor though we know of no challenge having been made to the jurisdiction of the court under the Insolvency Act on this ground. Before 1914 the position was that only British subjects and foreigners residing in England could be adjudicated bankrupt there. This was altered in the Bankruptcy Act 1914 by the equivalent of section 3(2) of the Bankruptcy Ordinance which introduced the present definition of debtor and made specific reference to citizenship.[30] In *Theophile v The Solicitor General*, Lord Porter effectively said the inclusion of a specific reference to citizenship displaced the:

> *"... presumption that Parliament does not assert or assume jurisdiction which goes beyond the limits established by the common consent of nations."*

Lord Porter added that:

> *"Whatever limitation may formerly have been put on the meaning of the word debtor, a wider sense has now been given to it; it includes not only persons who were in the past subject to the English bankruptcy law, but a new class consisting of persons who are not British subjects or domiciled in this country but carried on business in England at the time when the act of bankruptcy was committed."*[31]

2.11 We recommend that the provisions of section 265 of the Insolvency Act replace the present provisions on jurisdiction of the court. We are concerned, however, that the scope of the provision should not be curtailed by the absence of a reference to nationality and we recommend that the following reference to nationality should be inserted in the Hong Kong equivalent of section 265:

> *"(1) A bankruptcy petition shall not be presented to the court under section 264(1)(a) or (b) unless the debtor, irrespective of nationality,..."*

Having assets in Hong Kong at the date of the bankruptcy order

2.12 The sub-committee on insolvency proposed, by a majority, the adoption of a further ground for establishing jurisdiction, that of a debtor having assets in Hong Kong at the date of the bankruptcy order, as an alternative to the conditions that must be satisfied in establishing jurisdiction under section 265 of the Insolvency Act.

2.13 The proposal was made on the basis that there would be occasions when a creditor would have advance knowledge of a debtor having assets in the territory at a future date. In such circumstances, it would be useful for a creditor to be able to present a petition in advance of the date when the assets reach the territory. The idea was that a creditor would be placed in a position where he could time the hearing of the petition, and the making of the

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30 See The Conflict of Laws; Dicey and Morris, 10th edition, at page 692.

31 *Theophile v The Solicitor General*; [1950] AC 195 and 200.

bankruptcy order, to coincide with the arrival of the assets. The sub-committee also considered that the proposal would be useful to a creditor whose debt did not come within the other conditions for establishing jurisdiction. It was agreed that, with increasingly sophisticated trade and business practices, it would be easy and convenient for a debtor, against whom none of the other criteria to establish jurisdiction would apply, to deliberately place assets in the territory in order to avoid creditors.

2.14 The sub-committee took the view, however, that such a provision should not be open-ended in its terms and that a petition relying on this ground should set out the reasons for the petitioner's belief that there would be assets in the territory. The sub-committee noted that it had proposed in its Consultative Document that the petition should be presented not more than twenty eight days before the date when the assets were expected to arrive in the territory and that if the petitioner subsequently found that he needed an extension of time it could only be obtained by application to, and with the leave of, the court. On further consideration, the sub-committee decided to delete the time limit from the proposal and emphasised that assets must be in the jurisdiction at the date of the hearing before a bankruptcy order could be made.

2.15 The submissions received on the proposal were generally favourable. One submission, however, had reservations on the basis that, as there was no requirement for the debt upon which the petition would be based to have arisen in Hong Kong or be subject to Hong Kong law, there was a possibility that a foreign creditor could use the Hong Kong courts to bankrupt a person with no other connection with Hong Kong, on a debt incurred elsewhere, merely because the debtor had an asset in Hong Kong. It was further submitted that if such was the case it would be difficult to administer the estate from Hong Kong.

2.16 The sub-committee acknowledged this argument and also recognised that the recommendation could involve the Hong Kong courts in extra-territorial jurisdiction which would create a danger that foreign recognition of Hong Kong bankruptcy orders might be affected. The sub-committee stated that, while it could not predict how a foreign court would react to (what the sub-committee believed would be) a unique provision, it took the view that the intention of the proposal was not to seek to expand the influence of the Hong Kong courts but to provide a pragmatic provision that would allow a creditor to present a petition in a jurisdiction where there were assets rather than in a jurisdiction that would be more convenient for access to the debtor personally but where there were no assets. Any difficulties involved in administering an estate from Hong Kong would be a matter that would need to be considered by a petitioning creditor, who would need to weigh the amount of a debtor's known debts against the value of the assets that could be recovered in Hong Kong and elsewhere on foot of a bankruptcy order made by the Hong Kong court.

2.17 A similar proposal was discussed in the Harmer Report, which considered recommending a property connection to establish jurisdiction. It commented on the need for a territorial connection as follows:

> *"The recognition among nations of each other's laws (known as international comity) is important in insolvency law. To be acceptable from the aspect of overseas recognition and possible enforcement, the*

insolvency law of a country should operate only in respect of persons whose financial affairs have a sufficient territorial nexus with the country. The present law defines that connection in terms of a debtor's presence in Australia or where, by reason of a debtor's involvement in, for example, a business in Australia, there is a probability that the insolvency of the debtor arose from the conduct of that business or there is some likelihood that there may be property of the debtor in Australia upon which a bankruptcy order would operate. The time at which this territorial connection must exist for bankruptcy proceedings under the existing law is the time of commission of the act of bankruptcy. If, as has been recommended, the concept of the act of bankruptcy is removed and bankruptcy jurisdiction is premised upon available evidence of insolvency, it is necessary to alter the existing criteria of territorial connection and the time at which such a connection is relevant."[32]

2.18 The Harmer Committee had proposed, in the Discussion Paper[33] which preceded the Harmer Report, a further criterion of the presence of property in the jurisdiction at the time the application (the equivalent of the petition under the sub-committee' s proposals) for a bankruptcy order was filed. The Harmer Report ultimately decided not to recommend this provision, accepting a submission that there was no need to add the property ground as other criteria would, in most cases, be sufficient.[34]

2.19 The sub-committee' s proposal was innovative and thought provoking but ultimately we have decided not to adopt it. We note that the proposal did not attract significant disapproval in submissions on the Discussion Paper and it is fair to say that the proposal has not been adopted more because of difficulties in putting it into effect (illustrated, for example, by the probability that it could create difficulties for the Hong Kong courts in applying extra-territorial jurisdiction) rather than out of sympathy for a debtor whose only connection with Hong Kong was to place assets here.

2.20 The jurisdictional criteria we have recommended require that a debtor must have a sufficient connection with Hong Kong for a petition to be presented against him. At present, and under our recommendations, sufficient connection is established by domicile, residence or business connections with Hong Kong, or by personal presence in Hong Kong on the day on which the petition is presented. Domicile, residence and business all imply that the debtor has or had a physical presence in Hong Kong. Jurisdiction based on having assets in Hong Kong would not require a debtor ever to have been present in Hong Kong.

2.21 It is an established principle of the common law applied in Hong Kong that the courts do not seek to exercise jurisdiction over persons and disputes indiscriminately. Jurisdiction will only be asserted where there is a sufficient connection between the person or dispute in question and Hong Kong. Examples of a sufficient connection are cases where:

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32 Harmer Report, paragraph 395.

33 Discussion Paper No. 32, paragraph 257.

34 See section 43(1) of the Bankruptcy Act 1966.

(a) the defendant is present in Hong Kong and was served with the writ in Hong Kong;

(b) the defendant is a company which, while not registered in Hong Kong, has established a place of business in Hong Kong;

(c) the defendant has submitted to the Hong Kong courts' jurisdiction over disputes with the plaintiff;

(d) although abroad when the writ is issued, the defendant is domiciled in Hong Kong or ordinarily resides in Hong Kong;

(e) the suit is about a contract made and/or broken in Hong Kong and/or governed by Hong Kong law;

(f) the suit is about land situated in Hong Kong; and

(g) the action is for a tort committed against the plaintiff in Hong Kong.

2.22 Hong Kong, and most other legal systems, expect other countries similarly to limit their exercise of jurisdiction. Where a foreign state's law is thought to go too far, and for example, purports by extra-territorial legislation to control the conduct of non-nationals outside that state's territory, judicial acts based on such laws will be denied recognition and assistance. For example, a judgment given under another state's law against someone insufficiently connected to that country to justify exercise of jurisdiction under the Hong Kong conflict of laws rules would be refused enforcement here.

2.23 The right of the Hong Kong court to make persons bankrupt must likewise be based on that bankruptcy being sufficiently connected to Hong Kong. It is for this reason that sections 3(2) and 6(1) of the Bankruptcy Ordinance exist.

2.24 Thus, only a debtor who commits an act of bankruptcy can be made bankrupt in Hong Kong and a person is not to be regarded as a debtor for this purpose unless he was personally present in Hong Kong, or ordinarily resided or had a place of residence in Hong Kong or was carrying on business in Hong Kong, or was part of a firm carrying on business in Hong Kong when the act of bankruptcy occurred. These conditions refer to the time of the act of bankruptcy.

2.25 Section 6(1) of the Bankruptcy Ordinance goes on to add a further restriction relating to the time of presenting the petition. Even assuming the section 3(2) conditions are met, the creditor cannot wait too long before petitioning the court. The petition will not be entertained if by the time it is presented, the debtor, if not domiciled here, has left Hong Kong or has stopped doing business here more than a year earlier. In other words, where jurisdiction is based on personal presence and business activity here, that connection must remain fresh before the court exercises jurisdiction.

2.26 Under the Insolvency Act, this jurisdictional requirement is relaxed. Since acts of bankruptcy have been abolished, the domicile and presence requirements no longer refer both to the conduct underlying the petition and the presentation of the petition. They now only relate to the time when the petition is presented. They also extend the period for petitioning from one to three years. Accordingly, a petition which would be rejected as too stale under our rules, has two more years of shelf-life under the Insolvency Act.

2.27 Nevertheless, the English court continues to restrict its assertion of jurisdiction to cases where the person to be made bankrupt is domiciled in England and Wales, is personally present there on the day the petition is presented, or has ordinarily resided or carried on business there up to three years before the day when the petition is presented.

2.28 The sub-committee proposed to follow suit. It suggested, however, that jurisdiction should also be based on the debtor having assets in Hong Kong at the date of the bankruptcy order, a basis which does not occur under the Insolvency Act or elsewhere.

2.29 Jurisdiction based on assets would go far beyond any recognised basis for jurisdiction to be exercised by Hong Kong courts in accordance with established conflict of laws principles and with international comity. Moreover, jurisdiction based on assets would be unworkable in so far as it seeks to confer jurisdiction not at the stage of invoking that jurisdiction, but prospectively, when the court happens to hear the petition and decides whether to make the order.

2.30 The sub-committee suggested this as an independent ground for founding jurisdiction. The requirements are very slight. Thus, the mere fact of a debtor having assets, of whatever value, in Hong Kong suffices to clothe the court with jurisdiction.

2.31 The assets need have nothing to do with the debt founding the petition. It would be enough if the debtor happened to have bought shares in the local stock market and asked a bank or stockbroker to hold them as custodian. Even trading assets in transit or being re-exported through Hong Kong would suffice.

2.32 Such a ground for jurisdiction is qualitatively different from the existing grounds and those adopted under the Insolvency Act. It does away with the need for any personal connection between the debtor and Hong Kong. He need never even have visited Hong Kong, let alone be domiciled here, or to have ordinarily resided here or done business here, whether within a year, three years or even ten years before the date of the petition.

2.33 Since acts of bankruptcy would be abolished, no jurisdictional connection based on those acts would be needed. The transaction and debt underlying the petition therefore need have no connection whatever with Hong Kong. Such a tenuous basis for the exercise of jurisdiction would probably not be accepted by the Hong Kong court in its general civil jurisdiction. In addition, if adopted, foreign courts are likely to perceive the jurisdiction as unreasonable and to refuse judicial recognition and support.

2.34 This is all the more so where jurisdiction could be based on the unprecedented ground of the mere anticipation of assets coming into the territory at some undefined time between issuing the petition and the court hearing when the order is to be made. Not only does this make the jurisdictional basis even more tenuous, it would be unworkable as a jurisdictional rule.

2.35 Jurisdiction based on assets does not enable the court to know, at the time when its jurisdiction is invoked, whether it does or does not have legal power to hear the case. Its jurisdiction can only be confirmed or denied retrospectively at the hearing when it is asked to make or refuse the bankruptcy order. Only then can it enquire into the facts to determine whether the assets have in fact come into Hong Kong. This is wholly unsatisfactory, particularly if the debtor should seek to challenge that jurisdiction in the meantime.

2.36 Finally, the jurisdictional ground of having assets in the territory would not, by itself, be sufficient to initiate the bankruptcy process against a debtor. We have referred above[35] to the necessity to establish grounds for presenting a petition under section 3 of the Bankruptcy Ordinance. In chapter 1 of this report, recommendations are made for the adoption of new grounds on which a bankruptcy petition may be based. We consider that the jurisdictional criterion of having assets in Hong Kong grounded on a statutory demand which was not based on a judgment would be too severe on debtors and could be open to abuse by creditors. The practicalities of such a situation would demand that a statutory demand would have to be served outside the jurisdiction in every case, as the debtor would not be in Hong Kong, and it would be unreasonable to expect the courts to exercise jurisdiction in such circumstances.

Benefit accruing

2.37 The sub-committee proposed a further independent ground for the court exercising jurisdiction, that "the court should have jurisdiction to make a bankruptcy order if there was the possibility of a benefit accruing to a creditor or creditors by the making of the order". The sub-committee suggested that the adoption of this proposal would put into statutory effect a common law principle which has been applied in the English courts in relation to overseas companies through the court's jurisdiction to wind up unregistered companies under the Companies Act 1985 even though they have never carried on business there.

2.38 The sub-committee based this suggestion on certain English cases involving the winding up in England of foreign unregistered corporations, namely:

(a) *Re Compania Merabello San Nicholas SA* [1973] Ch 75;[36]

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[35] See paragraph 2.23.

[36] Lloyd's subrogated to Spanish creditor's claim against a one-ship Panamanian company regarding shipment of a cargo of fertilizer to Spain. The company was inactive and had no assets in Panama. The directors could not be found but they had agents in England who had already been wound up. They also had a P&I Club in England which was declining to indemnify the ship owner against the claim. The creditor got judgment in England against the ship-owning company and applied to wind it up. The object was to invoke the Third Parties (Right against Insurers) Act 1930 so that it could

(b) *Allobrogia Steamship Corp* [1978] 3 All ER 423;[37]

(c) *Re Eloc Electro-Optieck and Communicative BV* [1982] Ch 43;[38]

2.39 We do not believe that the cases cited justify the proposal. It has never been the law, even in company cases, that possible benefit to the creditors is a sufficient basis for the assumption of a winding-up jurisdiction.

2.40 More recent authorities[39] [40] make it clear that there are at least three conditions to be satisfied before the court will assume jurisdiction to make a winding up order against the foreign company:

(a) there must be a sufficiently close connection between the foreign company sought to be wound up and the English forum;

(b) there must be a reasonable possibility of benefit accruing to the creditors should it be wound up in England; and

(c) there should not be any other forum in which it would be more appropriate for the winding up to take place.

2.41 It is apparent that the benefit principle is a negative rule. It stresses that the court is unwilling to entertain petitions to wind up foreign unregistered companies unless there is likely

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claim indemnity payments against the Panamanian Company's P&I Club. The winding up was permitted.

37 Again, a claim in England under the Third Parties (Rights against Insurers) Act was the object of a winding up. Three foreign plaintiffs had unsatisfied English judgments. They sought to wind up a Liberian company. An English P&I Club appeared to resist the petition. The potential right against the P&I Club gave a sufficient connection for the court to assume English jurisdiction.

38 A Dutch company without a place of business in England employed the two petitioners to carry on its business in England and Wales. They were unfairly dismissed and got judgment in England against the Dutch company for this. But the company had no assets in England, it having ceased trading and being insolvent. The petitioners wanted to seek payment out of a redundancy fund set up under English Employment Protection Act. To qualify, they needed first to wind up the company. The benefit rule was explained as a negative condition of assuming jurisdiction. On the facts, there was ample connection with England to justify assumption of jurisdiction.

39 *Re A Company (No. 00359 of 1987)* [1988] Ch 210. A Liberian company which had directors resident in England and which operated through London ship agents contracted to buy a ship, such purchase being financed by a loan from an English bank which would take mortgage on the ship. The company defaulted on the loan after taking delivery of the vessel. Jurisdiction to wind up was held to require a sufficiently close connection with England. This was established on the facts. There was also no other forum more appropriate. Since there was a reasonable possibility of benefit accruing to creditors, the winding up order would be made.

40 *Re A Company (No. 003102 of 1991), ex p. Nyckeln Finance Co Ltd* [1991] BCLC 539. A Guernsey company carried on business in London although it was not a registered foreign corporation. The person who ran it resided in England as did the petitioner. There was a sufficiently close connection and no other jurisdiction more appropriate. There was a reasonable possibility of benefit to creditors. Note also Dicey & Morris, The Conflict of Laws, 12th edition, pages 1117 to 1123.

to be real benefit accruing to the creditors within the jurisdiction. It is inappropriate as a basis for jurisdiction, standing alone.

2.42 Caution should also be exercised about extrapolating from cases about winding up unregistered foreign corporations to bankruptcy principles affecting individuals. In the company cases, the court is generally faced with a company which is not a going concern in any other jurisdiction. This includes companies which were set up to facilitate use of a flag of convenience in Panama or Liberia or for tax purposes in a tax haven, and which never had their control or business in the place of their incorporation. Sometimes it is clear that the foreign company, although previously active, has effectively ceased business and is a mere shell in its place of incorporation or at its former place of business. In such circumstances, the only real commercial life or asset remaining for the corporation may be in found in England, or Hong Kong, in the form, say, of a potential insurance or welfare claim. In such a case, the only real connection can safely be said to be with England or Hong Kong by virtue of that asset, there being no competing seat of business or more appropriate forum. Where, however, an individual is concerned who is living and carrying on activities abroad, the court should not lightly be invested with jurisdiction to pronounce him a bankrupt. Even if some assets are to be found in Hong Kong, the court declines jurisdiction if another forum is the more appropriate to deal with his possible bankruptcy.

2.43 We have concluded that it would be inappropriate to found jurisdiction to make a bankruptcy order on the possibility of a benefit accruing to a creditor or creditors by the making of the order.

Bankruptcy jurisdiction

2.44 All bankruptcy petitions are presented in the High Court of Hong Kong. Since 1987 a number of straightforward and interlocutory matters have been heard by a Master in Chambers and since 1991 Masters have also been able to hear in court any uncontested bankruptcy petitions, applications to rescind receiving orders or annul adjudications, approval of compositions and schemes of arrangements, and applications for discharge.[41] All other matters such as disputed petitions and any other matters which a Master wishes to refer to the Judge in Bankruptcy are heard by the Judge in Bankruptcy.

2.45 We considered whether there would be any benefit, in terms of savings in time and costs, in transferring the bankruptcy jurisdiction to the District Court. The idea was rejected after taking the following matters into consideration:

> (a) There is only one District Court in Hong Kong and it deals primarily with criminal matters, whilst civil jurisdiction at present is limited to matters below $120,000. As bankruptcy petitions often exceed $120,000 there would be problems in hearing petitions of over that amount in the District Court.

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[41] See Ordinance No. 78 of 1991 amending the Bankruptcy Ordinance, sections 98(1) and 99(3).

(b) The High Court has a judge who concentrates on company and insolvency matters. There is no guarantee that the District Court could or would appoint a specialist judge.

(c) There has been considerable delegation, as outlined above, to the Masters who are now experienced in bankruptcy matters. The District Court would be unable to delegate as we understand that there is only a small number of Registrars in the District Court and they are not legally qualified.

(d) Giving jurisdiction to the District Court would in effect add an extra tier to judicial proceedings as appeals from the District Court would go to the High Court instead of being heard by the High Court initially. This would have implications in terms of costs and time.

(e) The Official Receiver considers that there would only be marginal savings in terms of costs if the District Court had jurisdiction as the statutory deposit and the Official Receiver's fees and charges would remain the same and there would be no significant change in solicitor's own client costs.

Recommendations

- **The criteria, based on section 265 of the Insolvency Act, by which a debtor, irrespective of nationality, can become subject to the jurisdiction of the court should be:**

  (a) domicile in Hong Kong; or

  (b) personal presence in Hong Kong on the day on which the petition is presented; or

  (c) having been ordinarily resident or having had a place of residence in Hong Kong at any time within 3 years of the date of presentation of the petition; or

  (d) having carried on business in Hong Kong (as interpreted by section 265(2) of the Insolvency Act) within 3 years of the date of presentation of the petition.

CHAPTER 3

MINIMUM DEBT

The present law

3.1 The Bankruptcy Ordinance provides that a creditor is not entitled to present a bankruptcy petition against a debtor unless the debt owing by the debtor to the petitioning creditor (or, if two or more creditors join in the petition, the aggregate amount of debts owing to the several petitioning creditors) amounts to more than $5,000. The debt must be for a liquidated sum payable either immediately or at some certain future time.[42]

3.2 There is no minimum debt amount set down under the Bankruptcy Ordinance where a debtor petitions the court for his own bankruptcy.[43]

Discussion

3.3 The Official Receiver proposed that the amount of the minimum debt should be increased to $10,000. The Official Receiver noted that the minimum debt of $5,000 was introduced in 1976 and that inflation has eroded the effect of this amount since then.[44]

3.4 The Official Receiver also proposed that the new amount of $10,000 should be protected from the effects of inflation by provision being made for periodic adjustments by subsidiary legislation.

3.5 In England and Wales the bankruptcy level or minimum debt is set at £750 on a creditor's petition under section 267 of the Insolvency Act with provision for the Secretary of State to vary the amount by order. The Scottish provision is similar.

3.6 Under the Australian Bankruptcy Act the minimum debt amount on a creditor's petition is A$1,500.[45] The Harmer Report recommended that the amount should be increased to A$2,000 and that this should be open to adjustment.[46]

3.7 The provisions for minimum debt in respect of a creditor's petition under the Singapore Bankruptcy Act are identical to the Hong Kong provisions except that the minimum

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42 Bankruptcy Ordinance, section 6(1) and (2).

43 Bankruptcy Ordinance, section 10(1).

44 By 1990, $15,900 was the equivalent of $5,000 in 1976. Source: the Consumer Price Index 'A' (1990).

45 Bankruptcy Act 1966, section 44.

46 The Harmer Report, paragraph 393.

debt amount is about one half of the Hong Kong amount.[47] In New Zealand the minimum debt amount is considerably lower at NZ$200 on a creditor's petition.[48]

3.8 There is no provision for a minimum debt in respect of a debtor's petition in any of the jurisdictions examined.

Individual employees

3.9 In making his proposal the Official Receiver noted that in practice very few petitions are presented for amounts of less than $10,000 but that consideration should be given to the rights of individual employees whose right to petition for the bankruptcy of an employer could be restricted by an increase in the amount of the minimum debt. At present an employee is unable to petition for the bankruptcy of an employer if he is owed less than $5,000. An increase would prevent employees from petitioning for amounts of less than $10,000.

3.10 The concern was that an individual employee could be excluded from petitioning against an employer by an increase in the minimum debt. Several employees would be unlikely to be affected as they could avail of the aggregation provision under section 6 of the Bankruptcy Ordinance. It appears, however, that employees who have a claim for less than the minimum amount are protected by the Protection of Wages on Insolvency Ordinance, which empowers the Commissioner for Labour to make ex-gratia payments from the Protection of Wages on Insolvency Fund to employees in certain circumstances.[49] Employees who would otherwise be prevented from presenting a bankruptcy petition against their insolvent employer solely because the claim, or the aggregate amount of claims, did not exceed the amount laid down by the Bankruptcy Ordinance, would qualify for relief from the Protection of Wages on Insolvency Fund.

New minimum debt amount

3.11 It is our view that there should be an amount set down below which a bankruptcy petition cannot be presented. We are of the opinion, however, that the present minimum debt amount of $5,000 is too low. A person should not be exposed to the rigours of bankruptcy for such a small amount, a view that we believe is borne out in practice as the Official Receiver and other practitioners have advised that petitions for less than $10,000 are rare.

3.12 We recommend that the amount of the minimum debt should be increased to $10,000 as we believe that this is a more realistic amount on which to ground a bankruptcy petition. As bankruptcy has serious consequences for a person petitioned against, the legal standard, in the form of a minimum debt below which a petition cannot be presented, should be retained at an appropriate level.

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47 Bankruptcy Act 1888, section 5.

48 Insolvency Act 1967, section 23.

49 Protection of Wages on Insolvency Ordinance, (Cap 380) sections 16 and 18.

3.13 We are concerned that the fixed amount we recommend should not be neglected in the way that the present amount has been and we therefore recommend that the minimum debt amount should be supported by subsidiary legislation allowing the Financial Secretary, on the recommendation of the Official Receiver, to increase or decrease the amount of the minimum debt when appropriate. In order to give effect to this we recommend the introduction of a new provision that would allow the Financial Secretary to review the amount of minimum debt annually and to make adjustments. The minimum debt amount could be inserted in a schedule to the Bankruptcy Ordinance. We understand that a useful precedent for this is contained in the Banking Ordinance.[50]

Debtor's petition

3.14 We recommend that there should be no provision for a minimum debt in respect of a debtor's petition for his own bankruptcy. This is in line with the position at present not only in Hong Kong but in all the jurisdictions examined.

Recommendations

- **The amount of the minimum debt for a creditor's petition should be raised to $10,000.**

- **The minimum debt amount should be reviewed annually and should be capable of amendment by subsidiary legislation rather than by amendment of the primary legislation.**

- **There should be no minimum debt amount on a debtor's own petition for bankruptcy.**

[50] Banking Ordinance (Cap 155) section 135(3).

CHAPTER 4

PETITIONER' S STATUTORY DEPOSIT

The present law

4.1 A creditor presenting a petition for the bankruptcy of a debtor must at present deposit $10,000 with the Official Receiver to cover the Official Receiver's initial costs and expenses of administration of the estate. A debtor who petitions for his own bankruptcy must also deposit $10,000 with the Official Receiver.

4.2 The amount of the statutory deposit is provided for under Bankruptcy Rule 52(1) which also provides that the court may from time to time direct that further sums be paid by the petitioner to cover fees and expenses to be incurred by the Official Receiver. A petition cannot be filed in court until the statutory deposit has been paid to the Official Receiver.

4.3 The Official Receiver is obliged under Bankruptcy Rule 52(2) to account to the petitioning creditor or to the petitioning debtor's estate for money deposited by them. The Bankruptcy Ordinance, section 37(1)(d), provides that the taxed costs of the petitioner, unless disallowed by the court, have a priority over all other claims except for the fees and expenses of the Official Receiver, the actual expenses incurred in realising any of the assets of the debtor, and the remuneration of any special manager. The petitioner's costs, which include the deposit, therefore rank above wages and statutory debts.

Discussion

Reduction in the amount of the statutory deposit

4.4 The Official Receiver proposed that the amount of the statutory deposit should remain the same in respect of a creditor's petition but that consideration should be given to reducing the amount of the deposit on a debtor's petition either by half or entirely. The Official Receiver estimated, in early 1991, that $5,000 was sufficient to cover the expenses of a debtor's petition but that this needed to be balanced against the possible prejudice to a debtor who was in such poor financial circumstances that he could not afford to pay the deposit. The Official Receiver advised us that the number of petitions presented by debtors each year may be counted in single figures and usually amount to only two or three. The Official Receiver estimated that a reduction in or the abolition of the debtor's deposit would not strain the resources of his office. We are aware that the numbers of debtor's petitions in the England and Wales is on the increase and that in 1991 over 40 per cent of all bankruptcy petitions were presented by debtors. This figure should be looked at in the context of the explosion in the numbers of bankruptcies over the last few years in that jurisdiction. We understand that in the early to mid 1980's personal insolvencies varied between 5,000 and 8,500 annually but that in 1990 there were 12,058 bankruptcies, in 1991 there were 32,632 and in 1993 there were over 24,900. Some of the increase can be explained by recession and other business related issues but there is an argument that the bankruptcy provisions of the Insolvency Act have taken away much of the stigma from bankruptcy. It seems that the bankruptcy provisions of the Insolvency Act do not hold the same terrors for debtors as the provisions they replaced. It remains to be seen what impact our recommendations, if adopted, will have on the attitude to bankruptcy in Hong Kong.

4.5 The Official Receiver pointed out that the same arguments do not apply to the costs involved in a creditor's petition as generally the issues involved in a creditor's petition are more complicated and contentious. In addition, a debtor who petitions for his own bankruptcy acts voluntarily whereas a debtor subject to a creditor's petition is often hostile or negative and more likely to obstruct the administration of the estate. The Official Receiver has advised us that in some cases his costs can amount

to $9,860 but that for most cases, which are summary[51], this amount would be reduced to less than $5,000 when certain expenses relating to advertising, gazetting and land searches, are deducted. For instance, the cost of advertising and gazetting the receiving order and then the adjudication order is $2,200 in each case. Under our recommendations there would only be a single order made which would halve the cost of advertising and gazetting.

4.6 On the question of advertising in the *Gazette* we are surprised at the costs involved as quoted by the Official Receiver. Out of the $9,860 quoted by the Official Receiver, $6,600 is taken up with advertising orders and the first meeting of creditors. We have no influence over the cost of advertising in newspapers but we would request that the costs of advertising in the *Gazette* be looked at. In particular, we understand that a considerable percentage of the costs of printing is the cost of paper and we note that the *Gazette* is printed on good quality paper. We suggest that consideration ought to be given to publishing the *Gazette* on cheaper paper. We also suggest that consideration be given to increasing the number of notices per page in the *Gazette* by more efficient layout. We suggest that consideration be given to taking out the centre line and printing notices across the width of the page, that headings and sub-headings could use the full width of the page, and that addresses of solicitors and liquidators *etcetera* need not dedicate a line to each part of the address. We note, for example from Supplement Number 6 to the *Gazette* of 5th November 1993, that only a little over three Companies Ordinance and Bankruptcy Ordinance notices are contained on each page and feel that this can be improved upon and still satisfy the statutory requirements.

4.7 We compared the amount of the petitioner's deposit required in Hong Kong with other jurisdictions. In England and Wales a creditor's deposit is £240 and a debtor's deposit is one half that.[52] In Australia the deposit on a creditor's petition is A$300 with no deposit required on a debtor's petition.[53] In New Zealand there is no statutory deposit on a creditor's petition although there is a nominal deposit on a debtor's petition.[54] It is interesting to note that the amount of the statutory deposit required in all these jurisdictions is considerably lower than the amount required in Hong Kong.

4.8 The amount of the statutory deposit under the Bankruptcy Ordinance was increased in 1985 from $1,000 to $10,000. We understand that the increase was instigated by the Government as a matter of policy to restrict the number of petitions and that the number of petitions did fall at that time. The present deposit would seem therefore to be an arbitrary amount imposed for considerations other than the interests of petitioners.

4.9 We believe that the statutory deposit should be sufficient to give the Official Receiver the initial impetus to realise assets which can then be put to use by him in administering the estate. Problems arise, however, where insufficient assets are realised to administer the estate or to finance the recovery of assets as, for example, where legal proceedings are necessary to recover assets. Bankruptcy Rule 52(1) provides that the court may direct a petitioner to deposit additional sums with the Official Receiver to cover his fees and expenses. The Official Receiver has made application to the court under this provision when he considered that the amount of the deposit was too low to cover his costs and expenses in a particular case. In the event of a petitioner refusing to provide additional funds on the direction of the court, the Official Receiver would probably apply Bankruptcy Rule 158A, which provides that where a debtor against whom a receiving order has been made has no available assets, the Official Receiver shall not be required to incur any expense in relation to the estate unless the court otherwise directs.

4.10 We are of the view that there is a correlation between the amount of the statutory deposit and the amount of the minimum debt and that the statutory deposit should be a fraction rather than a multiple of minimum debt. Recourse to bankruptcy proceedings should be within the financial reach of as many people as possible and should not be allowed to become the domain of the well-to-do or large institutions. In particular, bankruptcy proceedings should be within the reach of small businesses as the threat of bankruptcy is a potent one which should not be diminished by the imposition of an unnecessarily

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51 See paragraph 4.15.

52 Statutory Instrument No.2030 of 1986. We understand that the Official Receiver has a minimum fee in bankruptcy of £340 plus a stationery fee of £175 making a total fee of £515 inclusive of the statutory deposit.

53 Bankruptcy Act 1966, 4th Schedule, rule 179.

54 Insolvency Act 1968, sections 21 and 23.

large deposit. In this regard we have kept in mind the other expenses that are at present involved in a creditor reaching the point where he is able to present a petition for bankruptcy based on a judgment debt. Our recommendations on statutory demands would make recourse to bankruptcy a cheaper option for creditors to consider.[55]

4.11 A contrary view put to us was that the purpose of the statutory deposit is to finance the initial administration of the estate, that the amount of the statutory deposit on a creditor's petition is satisfactory at present, and should in future be maintained at a sufficient level to cover the costs and expenses of the Official Receiver in an average case.

4.12 A view was also expressed that a reduction in the deposit could lead to an increase in spite or nuisance petitions. We believe, however, that the motives of a petitioner should not be the concern of the legislature.

4.13 We recommend a reduction in the amount of the statutory deposit for both creditors' and debtors' petitions to $5,000 in the belief that this amount should be sufficient for the Official Receiver to cover his initial costs and expenses in most cases and to put him in a position where assets have been realised which can be applied to administer the estate in most cases founded on a creditor's petition. This level of statutory deposit would seem to us to be a more reasonable and appropriate sum for creditors to deposit than the present amount.

4.14 In cases where the Official Receiver requires more money to continue the administration through legal proceedings or other investigations he must be prepared to approach creditors that much sooner than at present for further financial support, either through a meeting of creditors or under Bankruptcy Rule 52(1). If creditors are not prepared to give the Official Receiver further financial support the Official Receiver would be left with no alternative but to scale down the administration of the estate.

Summary procedure

4.15 The Official Receiver explained that the summary procedure mechanism contained in section 112A of the Bankruptcy Ordinance should give the Official Receiver early warning as to whether a case requires further funding. All cases in the Official Receiver's Office are reviewed after initial investigation to establish whether they satisfy the criteria for summary administration. The test under section 112A is whether the property of a debtor is likely to exceed in value $200,000. If the estate is not likely to exceed $200,000 the first meeting of creditors may be dispensed with and if the debtor is made bankrupt the Official Receiver is appointed trustee of the estate without a committee of inspection. The section states that other modifications may be prescribed with a view to saving expense and simplifying procedure.[56] Cases where there are realisable assets but with insufficient cash to pursue them should also be identified at this stage.

Adjustment of the statutory deposit

4.16 We believe that the same arguments apply to the statutory deposit as apply to minimum debt in relation to preventing the statutory deposit from being eroded by inflation and accordingly we recommend that provision should be made in the Bankruptcy Ordinance for the amount of the statutory deposit to be reviewed annually and for the Financial Secretary, on the recommendation of the Official Receiver, to increase or decrease the amount of the deposit when appropriate. As with minimum debt, we recommend that the provision should be inserted in a schedule to the Bankruptcy Ordinance to facilitate

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55 See paragraph 1.15.

56 The $200,000 criteria under section 112A was introduced in 1985. In the six years 1986 to 1991, over 1500 receiving orders were made. Summary procedure orders were subsequently made in about 75% of cases. Source : Official Receiver's Office. See the statistics annexed. The text of section 112A is set out in paragraph 8.6.

ease of amendment.[57] If the Official Receiver subsequently makes a case that the statutory deposit is too low it can be increased within a short period of time through the annual review procedure.

Recommendations

- **The statutory deposit should be reduced to $5,000 in respect of both creditors' and debtors' petitions.**

- **The amount of the statutory deposit should be reviewed annually and should be capable of amendment by subsidiary legislation rather than by amendment of the primary legislation.**

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[57] See paragraph 3.13. We agreed on the figure of $5,000 in early 1991. Since then Hong Kong has had high inflation. It will probably be necessary to re-adjust the amount recommended if the principles behind our recommendation are adopted.

CHAPTER 5

BANKRUPTCY ORDERS

The present law

5.1 The Bankruptcy Ordinance provides for two stages of court order that lead to bankruptcy. The first stage is the receiving order which may be made on the hearing of a petition for bankruptcy by the court. At the hearing of a petition the practice is for the court to ask a debtor whether he is able to pay the debt. If the debtor answers that he cannot pay his debts or if he is not present at the hearing, then, in the normal course of events the court makes a receiving order. If the answer is that he is able to pay his debt the court may consider adjourning the hearing to a later date to allow the debtor time to pay but it is unlikely that the court would consider an adjournment of more than two weeks, unless the petitioner agrees to a longer adjournment of up to a month if negotiations are taking place.

5.2 The making of a receiving order has two effects. Firstly, it deprives a debtor of his assets and places them in the hands of the Official Receiver. Secondly, it protects a debtor from proceedings or the threat of proceedings against him by his creditors. A receiving order does not, however, make a debtor bankrupt.

5.3 The second stage is the adjudication order. It is only when an adjudication order is made that a debtor becomes bankrupt. The effect of an adjudication order is that title to the property of the bankrupt vests in the trustee, which allows the trustee to realise assets and, in due course, make a dividend distribution to creditors. In the period between the receiving order and the adjudication order, the Official Receiver must call or seek to dispense with the first meeting of creditors, conduct or dispense with the public examination of the debtor, and get the debtor's statement of affairs.

Discussion

Single bankruptcy order

5.4 The Official Receiver has proposed that the Bankruptcy Ordinance should be amended to abolish the two stage procedure of receiving order and adjudication order and that it should be replaced by a single bankruptcy order. The Official Receiver is of the opinion that the two stage procedure is unnecessary as no purpose is served by the gap in time between the making of the receiving and adjudication orders that cannot be compensated for by provisions that would allow a debtor to seek a moratorium on proceedings against him and for a new procedure for individual voluntary arrangements.[58] We agree with the Official Receiver and recommend the adoption of a single bankruptcy order.

5.5 A single bankruptcy order would have the effect of removing the current restriction on the Official Receiver's powers in relation to the property of a debtor on the making of a receiving order. Instead of the Official Receiver merely becoming receiver of the debtor's property, which places the Official Receiver in a neutral role of taking control of a debtor's assets and of protecting the estate, the property would vest in the Official Receiver, as trustee, immediately, as on the making of an adjudication order.

5.6 The single bankruptcy order procedure is well established in New Zealand and Australia and recent reviews of insolvency law in those jurisdictions have not made any recommendations for changing the single order system.[59]

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[58] See Chapter 6.

[59] New Zealand Insolvency Act 1967, section 26 and Australian Bankruptcy Act 1966, section 43.

5.7 The Insolvency Act in England and Wales has also adopted the single bankruptcy order, acting on a recommendation of the Cork Report [60] which commented that most people considered a person to have "gone bankrupt" in any event on the making of a receiving order. The Report added that the theory that the period between the receiving and bankruptcy orders allows a debtor to either pay his creditors in full or put a compromise or scheme of arrangement to his creditors does not work in practice as the costs involved in paying the statutory charges and those of the Official Receiver make it difficult for most debtors to produce sufficient funds to come to an arrangement and to pay the charges.[61] We are in full agreement with these statements.

5.8 While no figures are available on the number of debtors who either pay their debts in full or make an arrangement with their creditors before bankruptcy the Official Receiver and practitioners agree that it is unusual for a debtor to settle his debts after the making of a receiving order. Even in cases where settlement is made after the making of a receiving order it is arguable that some of the cases involve brinkmanship on the part of debtors who wait until the last possible moment before paying. Under our recommendations the date for payment by such debtors would be brought forward.

5.9 We believe that the introduction of a single bankruptcy order will not have a detrimental effect on the opportunities provided for debtors to pay their debts. Debtors would have sufficient notice that they must pay their debts through the statutory demand procedure. Our recommendations in relation to voluntary arrangements would give debtors every opportunity and encouragement to negotiate with their creditors. In order to give effect to this we recommend that every statutory demand and bankruptcy petition should be accompanied by a notice in a prescribed form setting out the bankruptcy procedures that would be followed in the event of the debtor not paying or arranging with his creditors and also advising debtors on voluntary arrangements. The notice should also explain that should a debtor be unable to pay his debts it would be in his own interests to apprise his creditors of the situation and to seek to enter into a voluntary arrangement with them.

Consumer debtors

5.10 In making our recommendation we have considered the position of consumer debtors. We believe that the voluntary arrangement procedure should benefit consumer debtors as it enables them to seek an accommodation with their creditors at any time. At present, a debtor commits an act of bankruptcy if he gives notice to his creditors that he is unable to pay his debts. [62] Our recommendation that acts of bankruptcy should be abolished, when taken with our recommendations regarding voluntary arrangements, should provide an effective procedure for consumer and other non-business related debtors to settle or arrange their debts.

5.11 We do not believe that consumer debtors would be prejudiced by the introduction of a single bankruptcy order. The process of statutory demand followed by a petition and bankruptcy order would be a cheaper process for creditors to undertake. The benefit of this to bankrupts, albeit back-handed, would be that their estates should be liable to lower petitioners' costs and the costs of creditors having to obtain a judgment before petitioning for bankruptcy would not usually arise.

Secured creditors

5.12 Secured creditors should retain the power to realise or otherwise deal with a security after the making of a bankruptcy order.[63] We recommend that no change should be made to the rights of secured creditors in this regard except in so far as the rights of dependants of the bankrupt are affected under our recommendations on the family home.[64]

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60 Insolvency Act 1986, section 264.

61 The Cork Report, paragraph 125.

62 Bankruptcy Ordinance, section 3(1)(h).

63 Bankruptcy Ordinance, section 12(2).

64 See paragraphs 13.37 to 13.46.

Interim receiver

5.13 Under the Bankruptcy Ordinance, the court may appoint the Official Receiver to be the interim receiver of the property of a debtor and to take possession of the property or any part of it if at any time after the presentation of the petition and before the making of a receiving order it is shown to be necessary for the protection of the estate.[65] We see no reason to change this section. The court should still be able to appoint an interim receiver at any time between the presentation of the petition and the making of the bankruptcy order if the circumstances warrant it.

Proceedings against a bankrupt

5.14 The Bankruptcy Ordinance has separate provisions relating to the taking or continuing of proceedings against the property or person of the debtor on the presentation of the petition and, later, on the making of a receiving order. Section 14(1) of the Bankruptcy Ordinance provides that:

> *"The court may at any time after the presentation of a bankruptcy petition either stay any action, execution or other legal process against the property or person of the debtor or allow it to continue on such terms as it may think just."*

Section 12(1) of the Bankruptcy Ordinance makes no mention of proceedings in being in providing that:

> *"On the making of a receiving order the Official Receiver shall be thereby constituted receiver of the property of the debtor, and thereafter, except as directed by this Ordinance, no creditor to whom the debtor is indebted in respect of any debt provable in bankruptcy shall have any remedy against the property or person of the debtor in respect of the debt, or shall commence any action or other legal proceedings, unless with the leave of the court and on such terms as the court may impose."*

5.15 We prefer the corresponding provisions of the Companies Ordinance which make it clear that proceedings in being may be restrained. Section 181 of the Companies Ordinance provides that, in the period between the presentation of the petition and the making of a winding up order, where any action or proceeding against the company is pending in the High Court or the Court of Appeal, the company or any creditor or contributory may apply to the court in which the action or proceedings is pending for a stay of the proceedings and where any action or proceedings is in any other court or tribunal the application may be made to the High Court to restrain further proceedings. Section 186 of the Companies Ordinance further provides that when a winding up order has been made, or a provisional liquidator has been appointed, no action or proceedings shall be proceeded with or commenced against the company except by leave of the court and subject to such terms as the court may impose.

5.16 We therefore recommend that the provisions of section 14(1) of the Bankruptcy Ordinance should be retained as it corresponds to section 181 of the Companies Ordinance but that the provisions of section 12(1) should be amended to bring it into line with section 186 of the Companies Ordinance by providing that on the making of a bankruptcy order no action or proceedings shall be proceeded with or commenced against the property or person of a bankrupt by any person except by leave of the court and subject to such terms as the court may impose.

Recommendations

- **The two stage system of receiving order and adjudication order should be abolished and replaced with a single bankruptcy order.**

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[65] Bankruptcy Ordinance, section 13.

- **A prescribed notice should be served with every statutory demand and bankruptcy petition advising debtors of the consequences of ignoring the proceedings and also advising them of the individual voluntary arrangement procedure.**

- **The rights of secured creditors should remain unchanged and they should retain the power to realise or otherwise deal with a security after the making of the bankruptcy order, except in so far as the rights of dependants of the bankrupt are concerned.**

- **The power of the court to appoint an interim receiver should remain unchanged.**

- **Section 12(1) of the Bankruptcy Ordinance should be amended to provide that on the making of a bankruptcy order no action or proceeding shall be proceeded with or commenced against the property or person of a bankrupt except by leave of the court and subject to such terms as the court may impose.**

CHAPTER 6

INDIVIDUAL VOLUNTARY ARRANGEMENTS

The present law

6.1 There are two forms of compromise a debtor can make with his creditors under the Bankruptcy Ordinance: compositions and schemes of arrangement. A composition has been described as a form of agreement with creditors whereby "the debtor personally retains, or resumes, control of his assets and agrees to pay a certain sum to his creditors from the proceeds accruing to him" whereas a scheme of arrangement "involves the debtor's making over his assets to a trustee who thereafter administers them in accordance with the terms of the scheme".[66] "Individual voluntary arrangement" is the expression used in the Insolvency Act for the procedure which has replaced arrangements in England and Wales.

6.2 The Official Receiver has no statistics available on the numbers of compositions and schemes of arrangement that are proposed but advises that they are not widely used, nor are there any statistics on informal arrangements made between debtors and creditors. Compositions are, however, more frequently proposed by debtors than are schemes. The Cork Report noted that in the ten years prior to 1982 there were only twenty-six compositions or schemes in England and Wales.[67]

6.3 The Official Receiver believes that the present provisions on compositions and schemes of arrangement (hereinafter called "arrangements") could be improved on and, while making no specific recommendation, has pointed to the procedures adopted under Part VIII of the Insolvency Act and to the recommendations of the Harmer Report. We also considered Chapters 7 and 13 of the U.S. Bankruptcy Code.

6.4 The Official Receiver acknowledges that there would be problems in adopting the individual voluntary arrangement procedures under the Insolvency Act, one of the main ones being the question of determining who should administer an arrangement.

6.5 The Bankruptcy Ordinance, section 20, contains the main provision on arrangements and provides that:

> *"(1) Where a debtor intends to make a proposal for a composition in satisfaction of his debts or a proposal for a scheme of arrangement of his affairs, he shall, within 4 days of submitting his statement of affairs or within such time thereafter as the Official Receiver may fix, lodge with the Official Receiver a proposal in writing, signed by him, embodying the terms of the composition or scheme which he is desirous of submitting for the consideration of his creditors and setting out particulars of any sureties or securities proposed.*
>
> *(2) In such case the Official Receiver shall hold a meeting of creditors before the public examination of the debtor is concluded, and send to each creditor before the meeting a copy of the debtor's proposal with a report thereon; and if at that meeting a majority in number and three-fourths in value of all the creditors who have proved resolve to accept the proposal, it shall be deemed to be duly accepted by the creditors, and when approved by the court shall be binding on all the creditors.*

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66 The Law of Insolvency, Ian F. Fletcher, 1st edition, page 40.

67 The Cork Report, paragraph 617.

(3) The debtor may at the meeting amend the terms of his proposal, if the amendment is in the opinion of the Official Receiver calculated to benefit the general body of creditors.

(4) Any creditor who has proved his debt may assent to or dissent from the proposal by a letter addressed to the Official Receiver so as to be received by him not later than the day preceding the meeting, and any such assent or dissent shall have effect as if the creditor had been present and had voted at the meeting.

(5) The debtor or the Official Receiver may, after the proposal is accepted by the creditors, apply to the court to approve it, and notice of the time appointed for hearing the application shall be given to each creditor who has proved.

(6) The application shall not be heard until after the public examination of the debtor has been concluded, or dispensed with under section 19A. Any creditor who has proved may be heard by the court in opposition to the application, notwithstanding that he may at a meeting of creditors have voted for the acceptance of the proposal.

(7) For the purpose of approving a composition or scheme by joint debtors the court may, if it thinks fit and on the report of the Official Receiver that it is expedient so to do, dispense with the public examination of any of the joint debtors if they are or any one of them is prevented from attending the examination by illness or absence from Hong Kong but one at least of such joint debtors shall be publicly examined.

(8) The court shall before approving the proposal hear a report of the Official Receiver as to the terms thereof and as to the conduct of the debtor, and any objections which may be made by or on behalf of any creditor.

(9) If the court is of opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal.

(10) If any facts are proved on proof of which the court would be required either to refuse, suspend or attach conditions to the debtor's discharge were he adjudged bankrupt, the court shall refuse to approve the proposal unless it provides reasonable security for the payment of not less than 25 per cent on all the unsecured debts provable against the debtor's estate.

(11) In any other case the court may either approve or refuse to approve the proposal.

(12) If the court approves the proposal, the approval may be testified by the seal of the court being attached to the instrument containing the terms of the proposed composition or scheme, or by the terms being embodied in an order of the court.

(13) A composition or scheme accepted and approved in pursuance of this section shall be binding on all the creditors so far as relates to any debts due to them from the debtor and provable in bankruptcy.

(14) A certificate of the Official Receiver that a composition or scheme has been duly accepted and approved shall, in the absence of fraud, be conclusive as to its validity.

(15) The provisions of a composition or scheme under this section may be enforced by the court on application by any person interested, and any disobedience of

an order of the court made on the application shall be deemed a contempt of court.

(16) If default is made in payment of any instalment due in pursuance of the composition or scheme, or if it appears to the court on satisfactory evidence that the composition or scheme cannot, in consequence of legal difficulties or for any sufficient cause, proceed without injustice or undue delay to the creditors or to the debtor, or that the approval of the court was obtained by fraud, the court may, if it thinks fit, on application by the Official Receiver or the trustee or by any creditor, adjudge the debtor bankrupt and annul the composition or scheme, but without prejudice to the validity of any sale, disposition or payment duly made or thing duly done under or in pursuance of the composition or scheme. Where a debtor is adjudged bankrupt under this subsection, any debt provable in other respects, which has been contracted before the adjudication, shall be provable in the bankruptcy.

(17) If under or in pursuance of a composition or scheme a trustee is appointed to administer the debtor's property or manage his business or to distribute the composition, section 29 and Part V shall apply as if the trustee were a trustee in a bankruptcy and as if the terms "bankruptcy", "bankrupt" and "order of adjudication" included respectively a composition or scheme of arrangement, a compounding or arranging debtor and an order approving the composition or scheme.

(18) Part III shall, so far as the nature of the case and the terms of the composition or scheme admit, apply thereto, the same interpretation being given to the words "trustee", "bankruptcy", "bankrupt" and "order of adjudication", as in subsection (17).

(19) No composition or scheme shall be approved by the court which does not provide for the payment in priority to other debts of all debts directed to be so paid in the distribution of the property of a bankrupt.

(20) The acceptance by a creditor of a composition or scheme shall not release any person who under this Ordinance would not be released by an order of discharge if the debtor had been adjudged bankrupt."

6.6 The Bankruptcy Ordinance, section 21, provides for the effect of the acceptance and approval of an arrangement and provides that:

" Notwithstanding the acceptance and approval of a composition or scheme, the composition or scheme shall not be binding on any creditor so far as regards a debt or liability from which under the provisions of this Ordinance the debtor would not be released by an order of discharge in bankruptcy, unless the creditor assents to the composition or scheme."

6.7 The Bankruptcy Ordinance, section 25, extends the operation of section 20 to any time after the adjudication of bankruptcy. In such a case, if the court approves an arrangement it may annul the bankruptcy and vest the property of the bankrupt in him or in such other person as the court may appoint, on such terms and conditions as the court may declare. Section 25(3) is similar in effect to section 20(16) in that if an arrangement fails the court may adjudge the debtor bankrupt and annul the arrangement.

Discussion

6.8 We are satisfied that the present provisions do not fulfil the purpose for which they were intended, that of providing a debtor or bankrupt with a means of avoiding or extricating himself from

bankruptcy by satisfying the claims of creditors to an acceptable level, taking into account the circumstances of the debtor or bankrupt.

6.9 It is interesting to look at arrangements from the perspective of both debtors and creditors to understand why they are seldom used. From the point of view of a debtor, one of the principal problems is that arrangements are essentially reactionary as they only become available to a debtor after the commencement of bankruptcy proceedings against him. Even before bankruptcy proceedings commence a debtor is hampered as the Bankruptcy Ordinance provides that a debtor may commit an act of bankruptcy if he makes a conveyance or assignment of property to a trustee for the benefit of his creditors generally.[68] Far from helping a debtor who wants to take action to avoid bankruptcy this provision can deter a debtor from taking the initiative.

6.10 It is also probable that many debtors are unaware of the availability of arrangements until a receiving order has been made and the Official Receiver has conducted an initial interview. By this stage a debtor is some distance down the road to bankruptcy and the opportunity to put forward an arrangement may have been affected by costs building up against him. In most cases, this involves the costs of obtaining the judgment on which the bankruptcy petition is usually based and the petitioner's legal costs in the bankruptcy proceedings together with the costs and expenses of the Official Receiver. The costs and expenses of the petitioner and of the Official Receiver would have to be paid in priority to all other debts in any arrangement unless the petitioner agrees to waive his priority. The Official Receiver's costs, however, must be paid.[69]

6.11 Creditors who have pursued debtors to the point of bankruptcy are usually pragmatic and will accept a reduced amount rather than face an average wait of four years for an ordinary dividend, if a dividend is paid.[70] The alternative of a practical and effective arrangement whereby creditors receive some of their debt back in a relatively short period of time should be attractive to creditors.

Effect of recommendation for single bankruptcy order

6.12 If the provisions on arrangements remain as they are and our recommendation that receiving and adjudication orders be replaced by a single bankruptcy order is adopted, debtors would no longer have the benefit of the period between the making of the receiving order and the making of the adjudication order to put an arrangement into effect. This is not a consequence that we would wish to see as it would disadvantage debtors by only leaving the period between the presentation of the petition and the making of a bankruptcy order to put an arrangement into effect.

6.13 These problems can be overcome by allowing a debtor to pre-empt bankruptcy proceedings by making his own application to the court for an interim order that would impose a moratorium on bankruptcy and other proceedings against him by his creditors, thus placing all creditors in the same position and preventing any creditor from taking action that might give him an advantage over other creditors. The debtor would then be given time to put a proposal to his creditors for the orderly realisation

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68 Bankruptcy Ordinance, section 3(a). This would be abolished under our recommendations. See Chapter 2.

69 Bankruptcy Ordinance, section 37(1)(a), (b) and (d).

70 In the 3 year period 1987/88 to 1989/90 there were 160 cases where first and final preferential dividends were paid, the average time for declaration of dividend being 4.31 years. Over the same period there were 125 cases where first and final ordinary dividends were paid, the average time being 4.28 years. In the 3 year period 1985/86 to 1987/88 in all cases where preferential dividends were paid the average rates of dividend were 59.01%, 59.32% and 73.87% respectively. Over the same period the average rates of ordinary dividend in all cases where dividends were paid were 14.56%, 29.41% and 31.72% respectively. Source: Official Receiver's Office.

of his assets without the necessity of bankruptcy. This is the effect of the provisions introduced in England and Wales under the Insolvency Act 1985 and which were carried over to the Insolvency Act 1986.[71] The Australian Bankruptcy Act, Part X, also has voluntary administration provisions that allow a debtor to seek to make an arrangement with his creditors under the protection of the court. The Harmer Report has recommended the introduction of a simpler and less costly alternative to Part X that would also provide for a moratorium.[72]

6.14 We favour the abolition of the present provisions and recommend that they be replaced by provisions based on the individual voluntary arrangement procedures under the Insolvency Act .[73] There are two aspects to this recommendation. The first is who should be permitted to supervise individual voluntary arrangements. This represents a considerable problem as Hong Kong is a small jurisdiction and it is doubtful that there would ever be sufficient numbers of individual voluntary arrangements in bankruptcy alone to justify a qualification for insolvency practitioners. The second is concerned with the procedure to be adopted. Individual voluntary arrangements have been recognised as one of the successes of the Insolvency Act and have been more widely used than had been anticipated. The procedure is flexible, allowing debtors to put any form of proposal to creditors. As with compositions and schemes, voluntary arrangements can also be put into effect after a bankruptcy order has been made. It is, we believe, a well thought out piece of legislation which offers an incentive to debtors to sort out their financial difficulties in a structured way without having to be made bankrupt.

Insolvency practitioners

6.15 Under the Insolvency Act, an insolvency practitioner may act as supervisor of a voluntary arrangement proposed by a debtor which is approved by creditors.[74] The Cork Report had recommended the establishment of insolvency practitioners, the broad aim being to ensure a high standard of competence as well as integrity in persons eligible for appointment as insolvency practitioners, qualities that were considered lacking in some liquidators and trustees.[75]

6.16 An insolvency practitioner is usually involved in a proposal by a debtor firstly as the debtor's nominee, that is, the person who advises the debtor whether his proposal meets the criteria laid down by the Act to constitute a voluntary arrangement,[76]and, secondly, as the supervisor of the voluntary arrangement if it is accepted by creditors. In practice, therefore, an insolvency practitioner conducts the entire proceedings on behalf of the debtor from the application for an interim order through the steps of preparing and making the proposal, the statement of affairs, the nominee's report to the court on the proposal, the calling and chairing of the creditors' meeting, the handing over of the debtor's property to the supervisor and the miscellaneous reporting and accounting involved in the administration of a voluntary arrangement.

6.17 We do not underestimate the importance of insolvency practitioners in the success of individual voluntary arrangements under the Insolvency Act and recognise the responsibility placed on them by the provisions.[77] There can be little doubt that insolvency practitioners under the Insolvency Act have generally achieved high standards.

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71 Insolvency Act 1986, sections 252 and 253.

72 The Harmer Report, paragraph 432.

73 See paragraph 1.43.

74 Insolvency Act 1986, Part XIII and see section 388(2)(c).

75 The Cork Report, Chapters 15 to 17.

76 Insolvency Act 1986, section 253 and rule 5.3.

77 In 1988 there were 7,717 bankruptcy orders and 779 individual voluntary arrangements in England and Wales (or 9.90 bankruptcy orders for every 1 voluntary arrangement). In 1989 the figures were 8,138 orders and 1,224 arrangements (6.64 to 1); 1990, 12,058 orders and 1,927 arrangements (6.25 to 1); 1991, 22,632 orders and 3,002 arrangements (7.53 to 1); 1992, 32,106 orders and 4,686 arrangements (6.85 to 1). The 1993 provisional figures

6.18 In the context of this report, however, we do not feel that we are able to recommend the introduction of insolvency practitioners purely for the administration of individual voluntary arrangements. If a qualification for insolvency practitioners is to be introduced in Hong Kong most of their practice must necessarily come from the administration of companies in financial difficulties. The administration of individual voluntary arrangements would form a less significant part of such a practice. The question of the use of insolvency practitioners in the liquidation of companies will be considered in our second interim report. This still leaves the problem of who should be allowed to act on behalf of a debtor in the formulation, presentation and implementation of a proposal.

6.19 We do not believe that most solicitors and accountants would be interested in the administration of voluntary arrangements involving small asset values and we doubt that many proposals would be of sufficient value to carry the costs of a practitioner and make a reasonable payment to creditors.

6.20 We considered whether the Official Receiver could act as administrator but the Official Receiver has advised that it could be argued that he had a conflict of interest in being involved in the preparation of a proposal. The Official Receiver pointed out that, if he recommended to the court that it was not worthwhile calling a meeting of creditors to consider a debtor's proposal, the debtor would be adjudicated bankrupt. The Official Receiver considered that, in such circumstances, he could be accused of not being impartial as he would probably be appointed trustee of the estate. The Official Receiver therefore indicated that it would not be appropriate for him to be the nominee of a proposal and we appreciate his argument.

6.21 There is, however, no question in our minds that our recommendation for the introduction of a voluntary arrangement procedure is the touchstone for our other major recommendations, such as the recommendations for a statutory demand that is not based on a judgment debt and for a single bankruptcy order. Without a voluntary arrangement procedure, these recommendations would probably be too severe on debtors. We are not prepared to recommend, however, that the administration of individual voluntary arrangements should be open to all-comers within the professions that have been traditionally involved in bankruptcy matters. We consider that the criteria for the administrator of a voluntary arrangement should be those of experience and competence in bankruptcy matters, honesty, integrity, and the abilities to meet large claims and to obtain insurance bonding.

6.22 We consider that two alternatives are worthy of consideration and we recommend that the Administration adopt one of these as the availability of and access to an individual voluntary arrangement procedure is crucial to other major recommendations in the report:

1. Notwithstanding the Official Receiver's reservations, a special Government office, as a unit of the Official Receiver's Office, should be established to carry out the administration of individual voluntary arrangements.

2. A panel of suitably qualified practitioners willing to act as administrators should be established. Practitioners could apply for inclusion in the panel. The Official Receiver would be the approving authority.

6.23 The advantage of either of these recommendations is that they would ensure that only those experienced in bankruptcy law and procedure would administer voluntary arrangements.

The voluntary arrangement procedure

(i) Ordinary debtors

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are 24,958 orders and 5,679 arrangements (4.39 to 1), a significant increase in the ratio of voluntary arrangements to bankruptcies. Source: Society of Practitioners of Insolvency, Annual Review 1993.

6.24 We approve, for the most part, of the procedure for the conduct of voluntary arrangements as detailed in Part VIII of the Insolvency Act and Part V of the Insolvency Rules and recommend its adoption.[78] The procedure, in the case of a debtor who is not an undischarged bankrupt, is that he may initiate a proposal for an arrangement before a bankruptcy order is made against him in the following terms:

(a) the debtor must secure the services of a licensed insolvency practitioner to act as nominee of a proposal. (section 253)

(b) only a debtor who on the day of the making of the application was an undischarged bankrupt or was able to petition for his own bankruptcy can make an application provided that no previous application had been made by the debtor in the last 12 months. (section 255)

(c) the debtor prepares a proposal for the nominee on which the nominee will make a report to the court. The nominee requires full disclosure by the debtor who must prepare a statement of affairs. The nominee may require the debtor to make additional disclosure. (sections 256; rules 5.2, 5.6 and 5.9)

(d) the proposal must contain a justification as to why creditors may be expected to accept a voluntary arrangement. The proposal should set out in detail the debtor's assets with an estimate of their values and details of any charges on assets in favour of creditors and the extent to which any assets are to be excluded from the arrangement together with particulars of assets that are to be included in the arrangement. The nature and amount of the debtor's liabilities should be set out with details of the manner in which they are proposed to be met, modified, postponed or otherwise dealt with. The proposal should then detail how preferential creditors are to be treated, how associates of the debtor who are also creditors are to be treated, whether there have been transactions at an undervalue or extortionate credit transactions, whether any guarantees exist, the duration of the arrangement, dates for distribution with estimates of amounts of each distribution, remuneration and expenses of the nominee and supervisor, whether guarantees are to be offered by any person other than the debtor, how funds held for distribution are to be invested, how the debtor's business, if he has one, will be conducted during the course of the arrangement, whether the debtor will arrange other credit facilities and if so how debts so arising will be paid, the functions of the supervisor of the arrangement, and full details of the proposed supervisor of the arrangement. (rule 5.3)

(e) the application to the court for an interim order is made by affidavit exhibited to which would be a copy of the proposal and a notice endorsed by the nominee that he intends to act. If an insolvency practitioner is not prepared to endorse a proposal the debtor cannot make an application for an interim order. The affidavit should state, *inter alia*, the reasons for making the application and give particulars of any execution or legal process commenced against the debtor. (rule 5.5)

(f) the court may make an interim order, which expires after 14 days, in which time the nominee must prepare a report on the proposal but the court may extend the term of the interim order on the application of the nominee if the nominee needs more time for preparation or if the creditors need time to consider the proposal. (sections 255 and 256)

(g) while an interim order is in force, no bankruptcy petition relating to the debtor may be presented or proceeded with and no other proceedings, execution or other legal process may be commenced or continued against the debtor or his property except with the leave of the court. (section 252)

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[78] Reference is made to the individual sections and rules at the end of each procedural point.

(h) the nominee's report must state whether, in the opinion of the nominee, it is worth calling a meeting of creditors to consider the proposal. If the nominee considers that the debtor has failed to comply with his obligations relating to the proposal or if he considers that it would be inappropriate for a meeting of creditors to be summoned to consider the proposal the court may discharge the interim order with the result that the debtor will lose the benefit of the moratorium and proceedings, including bankruptcy proceedings, can commence or continue against him. (section 256)

(i) where the nominee reports to the court that a meeting of creditors should be summoned the nominee shall summon a meeting, unless the court otherwise directs, within 14 to 28 days of the report being filed in court. The nominee is usually the chairman. The meeting may be adjourned for up to 14 days to allow time to amend the terms of the proposal. (section 257 and rules 5.13, 5.15 and 15.19)

(j) notice of the meeting should be given to all creditors specified in the debtor's statement of affairs, and to any other creditors that the nominee is aware of, at least 14 days before the meeting. The notice should be accompanied by a copy of the proposal, the statement of affairs and the report of the nominee. (rule 5.13)

(k) for any resolution of the meeting on the proposal or any modification to pass there must be a majority in excess of three-quarters in value of the creditors present in person or by proxy and voting on the resolution. A majority in excess of one-half in value is required in respect of any other resolution. No vote is allowed in respect of an unliquidated amount or any debt whose value is not ascertained unless the chairman agrees to an estimated minimum value for the purpose of entitlement to vote. If the chairman rejects a claim the creditor can appeal to the court and if the appeal is successful the court may order that another meeting be summoned or make such other order as it thinks just. (rule 5.17 and 5.18)

(l) the chairman must make a report to court on a meeting within four days of its conclusion. (rule 5.22)

(m) if a proposal is accepted by creditors it becomes binding on all those creditors who had notice of and were entitled to vote at the meeting. The approval of the court is not required. No proposal may be accepted that affects the rights of secured creditors unless the secured creditors affected agree. Preferential creditors are similarly protected. (section 258)

(n) within 28 days after the report to the court, any decision of the meeting may be challenged in the court by the debtor, any creditor, or by the nominee and the court may revoke or suspend any approval made at a meeting of creditors or may give directions for the summoning of a further meeting to consider a revised proposal but only on the grounds that the approved voluntary arrangement unfairly prejudices the interests of a creditor or if there has been a material irregularity at or in relation to the meeting. (section 262)

(o) once a proposal takes effect, the supervisor of the voluntary arrangement proceeds to put the terms of the arrangement into effect. The supervisor must be a qualified insolvency practitioner and will in most cases be the nominee. The actions of the supervisor can be appealed to the court by the debtor, creditors or by any other person dissatisfied by any act, omission or decision of the supervisor and on such application the court may confirm, reverse or modify any decision of the supervisor or give him directions. The supervisor may also apply to the court for directions. There are also provisions for the replacement of the supervisor. (section 263)

(p) the supervisor is accountable to the Secretary of State and may be required by the Secretary of State at any time to produce records and accounts for inspection. The supervisor is also obliged to keep records and accounts where he is required to carry on

the business of the debtor, or to realise his assets, or to otherwise administer or dispose of any funds and to at least every 12 months send abstracts of receipts and payments to the court. (rules 5.24 and 5.26)

(q) in the event of a default by the debtor, the supervisor or any person bound by the voluntary arrangement may present a petition to the court for a bankruptcy order to be made against the debtor.[79] The court shall only make a bankruptcy order when it is satisfied that the debtor has failed to comply with his obligations under the voluntary arrangement; or that information that was false or misleading in any material particular or which contained material omissions was contained in the statement of affairs or in any other document supplied by the debtor in connection with the arrangement or was otherwise made available by the debtor to his creditors or in connection with the creditors' meeting; or that the debtor had failed to do all such things as may for the purposes of the voluntary arrangement have been reasonably required. (sections 264 and 276)

(r) the Secretary of State maintains a register of voluntary arrangements which contains certain details of voluntary arrangements and which is open to public inspection. (rule 5.27)

6.25 We had reservations about the inability of the procedure to bind those creditors who did not have notice of, or were not entitled to vote at, the meeting of creditors[80] but understood that, although it appeared to weaken the effectiveness of the procedure, it was not a problem in practice. We received a submission, however, which disagreed with this and which stated that the inability of the procedure to bind such creditors caused difficulties in practice. We are of the view that for the procedure to be effective it must bind all creditors and we therefore recommend that unidentified creditors should be bound by an arrangement. We consider that protection should be given to creditors and recommend that notice of the meeting of creditors should be advertised in one English and one Chinese language newspaper printed in Hong Kong. We note that the procedure provides protection for appeal to the court by creditors or by any other person who is dissatisfied by the actions of the supervisor.[81]

6.26 The procedure does not bind creditors whose claims are unliquidated unless an estimated minimum value is agreed for the purpose of entitlement to vote.[82] We consider that creditors with unliquidated claims should also be bound by an arrangement and recommend that the procedure for establishing a valuation should be the same as the procedure we have set out in our recommendation on tort claims in Chapter 15.

6.27 The voluntary arrangement procedure imposes a moratorium on proceedings against the debtor.[83] It appears from a recent English decision that proceedings under section 252(2) of the Insolvency Act do not include distress for arrears of rent by a landlord.[84] We do not consider that landlords should be exempt and recommend that they should be bound by the moratorium.

(ii) Undischarged bankrupts

6.28 Voluntary arrangements are also available to an undischarged bankrupt[85] and although most of the procedures outlined above apply to both debtors and undischarged bankrupts there are some provisions that apply only to undischarged bankrupts. There are two major attractions for an undischarged bankrupt in seeking a voluntary arrangement. Firstly, on the approval of a proposal by creditors the court may annul the bankruptcy or modify the terms of the administration of the bankruptcy. Secondly, the

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79 See paragraph 1.43.

80 See paragraph 6.24(k) and (m) of the procedure, above.

81 See paragraphs (j) and (o) of the procedure.

82 See paragraphs (k) and (m) of the procedure.

83 See paragraph (g) of the procedure.

84 *McMullen & Sons Ltd v Cerrone* The Times, 10th June 1993.

85 See paragraph 6.24(b).

approval of a voluntary arrangement by creditors means that the bankrupt is able to obtain an annulment without having paid his debts in full as would otherwise be required under the Insolvency Act.[86]

6.29 The main distinguishing features of voluntary arrangements for undischarged bankrupts are:

(a) the application to court for an interim order may be made by the bankrupt, his trustee in bankruptcy, if any, or the Official Receiver. Before this, however, the bankrupt must have given notice of the hearing of the application to the Official Receiver and his trustee. The Official Receiver and the trustee must also be served with a copy of the nominee's report on the proposal. (section 253 and rule 5.10)

(b) in addition to creditors who were creditors at the date of the bankruptcy order, creditors whose debts arose after the making of the bankruptcy order must also be summoned to the creditors' meeting. The effect of this is that such creditors, who would normally be excluded from lodging a proof in the bankruptcy, are made parties to any voluntary arrangement that may be approved by the creditors' meeting and are therefore bound by the terms of the voluntary arrangement. (section 257)

(c) the annulment of the bankruptcy order by the court will not be made until 28 days after the nominee's report on the creditors' meeting is made to the court so as to allow time for decisions of the meeting to be challenged in the court. (section 261)

6.30 We recommend that the individual voluntary arrangement procedure should be available to undischarged bankrupts.

6.31 We believe that the individual voluntary arrangement procedure under the Insolvency Act can be adopted in its entirety with the exception of the provisions that relate to the Secretary of State and subject to a decision on who should administer voluntary arrangements.

Recommendations

- **An individual voluntary arrangements procedure based on Part VIII of the Insolvency Act and its supporting rules should be introduced whereby a debtor can seek an interim order of the court for a moratorium on proceedings against him while he seeks to reach an arrangement with his creditors as to his debts.**

- **Two alternatives for the administration of individual voluntary arrangements are put forward for consideration:**

  1. **That a special Government office, as a unit of the Official Receiver's Office, be established to carry out the administration of individual voluntary arrangements.**

  2. **That a panel of suitably qualified practitioners willing to act as administrators be established. Practitioners could apply for inclusion in the panel. The Official Receiver would be the approving authority.**

- **All creditors, other than secured creditors, should be bound by a voluntary arrangement. Notice of the meeting of creditors should be advertised in one English and one Chinese language newspaper printed in Hong Kong.**

- **Creditors with unliquidated claims should be bound by a voluntary arrangement. The procedure for establishing a valuation should be the same as the procedure set out in the recommendation on tort claims in Chapter 15.**

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[86] Insolvency Act 1986, section 282(1).

- **Landlords should be bound by the moratorium and should not be able to exercise the remedy of distress for arrears of rent.**

- **The individual voluntary arrangement procedure should also be available to undischarged bankrupts.**

CHAPTER 7

ANNULMENT OF THE BANKRUPTCY ORDER

The present law

7.1 The Bankruptcy Ordinance provides the court with the power, in certain circumstances, to annul adjudication orders against bankrupts and to rescind receiving orders against debtors. Section 33 of the Ordinance provides that:

> *"(1) Where in the opinion of the court a debtor ought not to have been adjudged bankrupt, or where it is proved to the satisfaction of the court that the debts of the bankrupt are paid in full, the court may, on the application of any person interested, by order annul the adjudication.*
>
> *(1A) The court may, on the application of the Official Receiver, by order -*
>
> *(a) rescind a receiving order made against a debtor; or*
>
> *(b) annul an adjudication of bankruptcy made against a bankrupt,*
>
> *if the court is satisfied that the assets for division among the unsecured creditors after payment of all costs, charges and expenses and the debts which are preferential under this Ordinance are not and will not be sufficient to pay a dividend of 15 per cent, and that it is desirable in all the circumstances of the case for such order to be made.*
>
> *(2) Where an order is made under this section rescinding a receiving order or annulling an adjudication, all sales and dispositions of property and payments duly made, and all acts theretofore done, by the Official Receiver, trustee or other person acting under their authority, or by the court, shall be valid, but the property of the debtor, if he has been adjudged bankrupt, shall vest in such person as the court may appoint, or in default of any such appointment revert to the debtor for all his estate or interest therein on such terms and subject to such conditions, if any, as the court may declare by order.*
>
> *(3) Notice of the order rescinding a receiving order or annulling an adjudication shall be forthwith gazetted and shall be advertised in at least 2 local newspapers, one of which shall be Chinese, or as may be prescribed.*
>
> *(4) For the purposes of this section, any debt disputed by a debtor shall be considered as paid in full if the debtor enters into a bond, in such sum and with such sureties as the court approves, to pay the amount to be recovered in any proceeding for the recovery of or concerning the debt, with costs, and any debt due to a creditor who cannot be found or cannot be identified shall be considered as paid in full if paid into court."*

7.2 This section will need to be amended if our recommendation for a single bankruptcy order to replace the present system of receiving and adjudication orders is adopted as the court will no longer need the power to rescind receiving orders.

7.3 The Bankruptcy Ordinance differs from the corresponding provision under the Bankruptcy Act 1914 in terms of "the 15 per cent rule" under section 33(1A). [87] The 15 per cent rule is now limited to an application by the Official Receiver and the court must take into consideration whether it is desirable in all the circumstances of the case that an order for rescission or annulment be made.

7.4 Apart from the 15 per œnt rule, there are two grounds on which a bankruptcy can be annulled. The first is where the adjudication ought not to have been made. Where proceedings are founded on a judgment, the court may inquire into the validity of the judgment for any sufficient reason, such as fraud, but a bankrupt cannot bring an action to set the judgment aside, on any ground, while the adjudication order stands, for the cause of action is vested in the trustee. A bankrupt must therefore persuade the trustee that there are grounds for applying to set the judgment aside.

7.5 The second ground for annulment is where it is proved to the satisfaction of the court that the debts of a bankrupt have been paid in full. This provision is viewed strictly by the court and devices that attempt to get around the provision for full payment, such as unconditional releases of debts, are not regarded as equivalent to payment in full. A bankrupt is not entitled to annulment even if all his creditors consent. Even where a bankrupt's debts are paid in full the court has discretion to refuse to annul and may refuse on the ground of the bankrupt's misconduct, such as concealment of assets or falsification of his statement of affairs.

7.6 The court may, however, approve a composition or scheme of arrangement for payment of a percentage of the debts due to creditors and may make an order annulling the bankruptcy and vesting the property of a bankrupt in him or in such other person as the court may appoint, on such terms and conditions as the court may declare.[88]

Discussion

Power of the court to annul a bankruptcy order

7.7 The Insolvency Act made some changes to the court's power to annul. In the case of an annulment where the bankruptcy order ought not to have been made the words "*on any grounds existing at the time the order was made*" are added to the Insolvency Act.[89] The Official Receiver proposed that these words should be added to section 33(1) of the Bankruptcy Ordinance. The addition of the Insolvency Act wording would fix the relevant time for deciding whether an order should have been made. We note that the Insolvency Act emphasises that the court may annul a bankruptcy order whether or not the bankrupt has been discharged from bankruptcy.[90] We recommend that these provisions should be adopted in the Bankruptcy Ordinance.[91]

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87 Bankruptcy Act 1914, section 29. The 15% rule referred to should not be confused with the 15% rule under section 9(3) of the Bankruptcy Ordinance which provided, *inter alia*, that if the court was not satisfied that the assets for division among unsecured creditors after payment of all costs, charges and expenses and preferential debts would be sufficient to pay a dividend of 15% the court could by order annul the adjudication. The effect was that it was difficult in some cases for a petitioner to have a receiving order made. The rule was repealed in 1986 (Ordinance 45 of 1986, section 2). See *re Antony Lo Hong-sui and anon, Ex-parte British Columbia Financial Corp. (H.K.) Ltd.* [1985] HKLR 371.

88 Bankruptcy Ordinance, section 25(2).

89 Insolvency Act 1986, section 282(1)(a).

90 Insolvency Act 1986, section 282(3).

91 In order to pre-empt possible confusion, we would point out that the effect of an annulment after discharge from bankruptcy would be to wipe the slate clean for the individual affected. This would mean that if subsequently adjudicated bankrupt, the individual would be considered to be bankrupt for the first time and would thus be automatically discharged from bankruptcy after three years, subject to objection. See Chapter 17 on Discharge.

7.8 The Official Receiver also proposed the adoption of the provision under the Insolvency Act that, if the bankruptcy debts and expenses have all, since the making of the order, been either paid or secured for to the satisfaction of the court, the court may annul the order.[92] This provision would change the emphasis under the Bankruptcy Ordinance as it is would no longer be essential that the debts have been fully paid in cash so long as the court is satisfied that the debts have been fully secured. We recommend that it should be left to the discretion of the court to decide whether debts have been properly paid or secured for.

Annulment after discharge

7.9 Under the Insolvency Act the court may annul an order even though the bankrupt has been discharged, thus giving broad scope for the rectification of injustice.[93] There is no corresponding provision under the Bankruptcy Ordinance. We view this as a positive provision and recommend that it be adopted.

Advertising and gazetting of annulment

7.10 The Official Receiver recommended that the requirement to gazette and advertise annulments and rescissions should be dispensed with. We consider the recommendation sensible in terms of saving costs and considerate in terms of not burdening a bankrupt with unnecessary publicity. We do not think that any particular purpose is served in most cases by gazetting and advertising. The Official Receiver's proposal reflects the position under the Insolvency Act which does not require the annulment of a bankruptcy order to be advertised.[94]

7.11 It may, however, be in a former bankrupt's interest to make known the annulment. In such a case it should be open to a former bankrupt to apply to the court to have the annulment advertised as there may be unusual circumstances to consider.[95] We therefore recommend that a provision be inserted in section 33(1) of the Bankruptcy Ordinance to the effect that where the court orders the annulment of a bankruptcy order it should have the discretion to make such order as to advertising and gazetting and the costs thereof as it thinks fit.

7.12 We also consider that on annulment a bankrupt should be entitled to request a certificate from the Official Receiver confirming that the bankruptcy order has been annulled.

On the application of any person interested

7.13 Under the Bankruptcy Ordinance, section 33(1), an application for annulment may be made on the application of any person interested but the meaning of "person interested" is not defined. The

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92 Insolvency Act 1986, section 282(1)(b).

93 Insolvency Act 1986, section 282.

94 Insolvency Act 1986, section 282 and rule 6.212.

95 In the case of *re a Debtor*, No.707 of 1985, Times 21.1.1988, it was held by the Court of Appeal that on the rescission of a receiving order the aggrieved party was sufficiently exonerated by the usual practice of the court in giving consequential directions. In this case the direction was that a notice be placed in The London Gazette in prescribed form stating that the receiving order ought not to have been made, and a letter drafted in the same form be sent by the Official Receiver to those notified of the original order. Where the original order had been made through an innocent error of the petitioner, it was undesirable for the court to depart from the usual practice by directing that the notice should contain any further elaboration of the circumstances. The appeal took place because the debtor wanted the notice to include further information about the error which caused the original order to have been made.

Insolvency Act dispensed with the requirement that the applicant should have an interest and is silent as to who should make the application. Under the present law an interested person includes the trustee in bankruptcy and the personal representatives of the bankrupt but does not include a person having an interest based on family sentiment or similar feelings alone.[96]

7.14 In most cases an application for annulment would be made either by the trustee or by the bankrupt but there could be circumstances where an application could be made by another party. We recommend therefore that the discretion as to who should be allowed to make an application should lie with the court.

The 15 per cent rule

7.15 The Official Receiver may apply to the court for a rescission of a receiving order or annulment of an adjudication order if he can satisfy the court that the assets of a debtor or bankrupt for division among the unsecured creditors after the payment of all costs, charges, expenses and preferential debts are not and will not be sufficient to pay a dividend of 15 per cent and that it is desirable in all the circumstances for such an order to be made.[97]

7.16 The Official Receiver advised that he has never used the rule and that he is more likely to make use of section 112A of the Bankruptcy Ordinance, which provides for a summary procedure in cases where the value of the estate is not likely to exceed $200,000.

7.17 In our opinion the continued existence of the 15 per cent rule goes against the principle of assisting a bankrupt to be financially rehabilitated as it seems to contemplate some vague circumstance where the Official Receiver might abrogate his responsibilities to a bankrupt. That the Official Receiver has never availed of the provision and can conceive of no reason why he ever should is a compelling argument that the provision is redundant. The effect of a successful application by the Official Receiver under section 33(1A) would be that a person whom the Official Receiver acknowledges to be bankrupt would lose the protection against his creditors that is provided by bankruptcy. We believe that this is not a desirable situation and recommend that it should be removed from the Bankruptcy Ordinance.

Individual voluntary arrangements [98]

7.18 The question of annulment also arises in relation to individual voluntary arrangements. Where a proposal for an individual voluntary arrangement is approved by creditors under the Insolvency Act the court may annul the bankruptcy order or give such directions as it thinks fit.[99] As we have recommended that the Insolvency Act provisions on individual voluntary arrangements should be adopted into the Bankruptcy Ordinance we also recommend that the court should have the power to annul a bankruptcy order on the approval of an individual arrangement by creditors and/or give such directions with respect to the conduct of the bankruptcy and the administration of the bankrupt's estate as it thinks appropriate for facilitating the implementation of an approved voluntary arrangement.

Recommendations

- **The words "on any grounds existing at the time the order was made", adopted from the Insolvency Act, section 282, should be inserted into section 33(1) of the Bankruptcy Ordinance.**

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96 Williams on Bankruptcy, 19th edition, page 147; see *re Beesley ex parte Beesley -v- The Official Receiver and others*, [1975] 1 AER 385. In Beesley the court gave a restricted meaning to the term "person interested".

97 Bankruptcy Ordinance, section 33(1)(A).

98 See Chapter 6.

99 Insolvency Act 1986, section 261.

- **The court should have the power to annul a bankruptcy order if the bankruptcy debts and expenses have all, since the making of the order, been either paid or secured for to the satisfaction of the court; following the Insolvency Act, section 282.**

- **The court should have the power to annul a bankruptcy order even though the bankrupt has been discharged; following the Insolvency Act, section 282.**

- **Where the court orders the annulment of a bankruptcy order it should have the discretion to make such order as to advertising and gazetting and to the costs thereof as it thinks fit.**

- **On the annulment of a bankruptcy order, a bankrupt should be entitled to request a certificate from the Official Receiver confirming that the bankruptcy order has been annulled.**

- **The discretion as to who should be allowed to make an application for annulment should lie with the court.**

- **The 15 per cent rule under section 33(1A) of the Bankruptcy Ordinance should be abolished.**

- **The court should have the power to annul a bankruptcy order on the approval of an individual voluntary arrangement by creditors and/or give such directions with respect to the conduct of the bankruptcy and the administration of the bankrupt's estate as it thinks appropriate for facilitating the implementation of an approved voluntary arrangement; following the Insolvency Act, section 261.**

CHAPTER 8

MEETINGS OF CREDITORS

The present law

8.1 In the course of the administration of an estate in bankruptcy there may be cause for more than one meeting of creditors to be held. The first meeting of creditors, however, is chaired by the Official Receiver and is usually held within three months of the date of the making of the receiving order. It has three primary functions which need to be considered. Firstly, the meeting provides creditors with an opportunity to consider any proposal by the debtor for settling his debts either in full or by way of composition or scheme of arrangement. Secondly, in the absence of any proposal by the debtor, or if a proposal is rejected by creditors, the creditors may resolve to request the court to adjudicate the debtor bankrupt and to appoint a person named by the creditors, usually the Official Receiver, to be trustee of the estate of the debtor. Thirdly, creditors may elect a committee of inspection from among their number. Subsequent meetings of creditors may be called to consider any matters that arise in the administration of an estate.

8.2 Section 17(1) of the Bankruptcy Ordinance provides that:

> *"As soon as may be after the making of a receiving order against a debtor a general meeting of his creditors (in this Ordinance referred to as the first meeting of creditors) shall be held for the purpose of considering whether a proposal for a composition or scheme of arrangement shall be accepted, or whether it is expedient that the debtor shall be adjudged bankrupt, and generally as to the mode of dealing with the debtor's property."*

8.3 Section 82(2) provides that:

> *"The trustee may from time to time summon general meetings of the creditors for the purpose of ascertaining their wishes, and it shall be his duty to summon meetings at such times as the creditors, by resolution, either at the meeting appointing the trustee or otherwise may direct, and it shall be lawful for any creditor, with the concurrence of one-fourth in value of the creditors (including himself), at any time to request the trustee or Official Receiver to call a meeting of the creditors, and the trustee or the Official Receiver shall call such meeting accordingly within 14 days:*
>
> *Provided that the person at whose instance the meeting is summoned shall, if so required, deposit with the trustee or the Official Receiver, as the case may be, a sum sufficient to pay the costs of summoning the meeting, such sum to be repaid to him out of the estate if the court so directs."*

8.4 The Meetings of Creditors Rules are subsidiary legislation under the Bankruptcy Ordinance which details many of the procedures of the meeting of creditors.[100] In addition, Bankruptcy Rules 100 to 108 make general provision for the service of notice of the meeting on the debtor, the giving and advertising of notice to creditors, adjournment of meetings, resolutions, and quorum.

8.5 A further provision, seldom used, is contained in section 100B which provides that the court may, on the application of the Official Receiver, by order dispense with the first meeting of creditors required under section 17. The section also provides that the court may order, by ballot and the use of voting letters if appropriate, that the wishes of creditors be ascertained for the purpose of accepting or rejecting any composition or scheme of arrangement under sections 20 or 25.

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[100] Bankruptcy Ordinance (Cap 6 D1).

8.6 Section 112A, which has application to small bankruptcies, provides that:

"(1) Subject to subsection (2), where a petition is presented by or against a debtor and -

(a) the court receives proof to its satisfaction; or

(b) the Official Receiver reports to the court,

that the property of the debtor is not likely to exceed in value $200,000, the court may make an order that the debtor's estate be administered in a summary manner, and thereupon the provisions of this Ordinance shall apply subject to the following modifications -

(ia) the Official Receiver may dispense with the summoning of the first meeting of creditors required under section 17, and instead apply to the court for an order adjudging the debtor bankrupt;

(i) if the debtor is adjudged bankrupt the Official Receiver shall be the trustee in the bankruptcy;

(ii) there shall be no committee of inspection, and the Official Receiver may do all things which may be done by a trustee with the permission of a committee of inspection;

(iii) such other modifications as may be prescribed with a view to saving expense and simplifying procedure, but nothing in this section shall permit the modification of the provisions of this Ordinance relating to the examination or discharge of the debtor.

(2) The court may, upon the application of the Official Receiver, at any time before the discharge of the debtor rescind an order made under subsection (1) and thereupon the administration shall proceed as if the order had not been made."

Discussion

Discretion in the Official Receiver whether to hold a first meeting

8.7 The present provisions on the first meeting must be amended if our recommended change from a two stage bankruptcy procedure to a single bankruptcy order is adopted. A single order procedure would diminish the importance of the first meeting of creditors as one of its principal functions, that of resolving whether a debtor should be adjudicated bankrupt, would become redundant as a debtor would be bankrupt by the time the first meeting was held. In addition, our recommendation for the introduction of a voluntary arrangement procedure would also reduce the importance of the first meeting as a proposal under the voluntary arrangement procedure would first be considered by the nominee who would decide whether it was necessary to summon a meeting of creditors to consider a proposal. Consequently, we do not believe that the remaining functions of the first meeting require a meeting in every bankruptcy.

8.8 In any event we see no purpose in the Official Receiver going through the motions of convening meetings that in many cases are not attended by anyone or by insufficient numbers of creditors to make a quorum. This has already been recognised to some extent in the Bankruptcy Ordinance as section 112A contemplates the dispensing of the first meeting of creditors where the property of a debtor is not likely to exceed $200,000.

8.9 The Official Receiver considered that it would save time and money if the power to decide whether to hold a first meeting of creditors was vested in the trustee. The Official Receiver recommended the adoption of sections 293 and 294 of the Insolvency Act as he considered them to be more flexible than the present provisions.

8.10 The Official Receiver detailed the savings that could be achieved by adopting sections 293 and 294. The Official Receiver reported, taking the present procedure under section 112A as his model, that the discretion whether to hold a meeting of creditors would be of great benefit. The use of the section 112A procedure could result in the Official Receiver not having to follow up to fourteen separate routine functions relating to meetings of creditors, e.g., notice to creditors of adjourned meetings and the report to court on resolutions passed in the first meeting of creditors, resulting in savings of up to $16,500 per case.

8.11 We recommend that the provisions of section of 293 of the Insolvency Act should be adopted giving the Official Receiver the discretion whether to hold a first meeting of creditors. Section 293 imposes a duty on the Official Receiver to decide, within twelve weeks of the date of the bankruptcy order, whether to summon a general meeting of creditors for the purpose of appointing a trustee of the bankrupt's estate. If the Official Receiver decides not to summon a meeting he shall, within the twelve weeks, give notice of his decision to the court and to all known creditors. The Official Receiver becomes trustee when he gives such notice to the Court.

Meeting at the request of creditors

8.12 Section 294 of the Insolvency Act provides that, where the Official Receiver has not yet summoned or has decided not to summon a general meeting of creditors, any creditor may request the Official Receiver to summon one. If the request is made with the concurrence of not less than one quarter in value of creditors the Official Receiver is obliged to summon the meeting. We consider that section 294 would provide creditors who believe that a meeting of creditors should be held with an appropriate means to counterbalance the Official Receiver's discretion whether to hold a first meeting and accordingly we recommend its adoption.

8.13 We note that this recommendation attracted some comment when the insolvency sub-committee's Consultative Document was published. Indeed, there was a minority view expressed in the sub-committee that it is in the public interest that a first meeting should be held in every bankruptcy to provide an opportunity for minority creditors to raise issues of importance which might not otherwise be addressed. This was considered particularly important in circumstances where a minority of creditors could not gain the support of one quarter in value of creditors to force a meeting as required under section 294. In addition, one submission felt that the Official Receiver should not be able to dispense with the first meeting and that creditors' interests generally should not be diluted for the Official Receiver's administrative convenience. Another submission said that a first meeting should be held if any one creditor so requests. We have taken note of these comments but nevertheless consider that the recommendation covers these concerns. If one creditor requests the Official Receiver to summon a meeting we are convinced that the Official Receiver would do so if the reasons supporting the request are sufficiently persuasive.

Quorum

8.14 The number of creditors required for a quorum under the Bankruptcy Ordinance is three creditors present or represented at the meeting, or all creditors if their number does not exceed three.[101] It has been the experience of the Official Receiver and other practitioners that, in many cases, interested creditors have arrived for meetings only to find that the quorum requirement could not be met with the result that a meeting could not be held. In such cases informal meetings are sometimes held, especially when the debtor is present. Under the Insolvency Rules in England and Wales, only one creditor entitled to vote

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[101] Meetings of Creditors Rules, rule 24.

needs to be present to make a quorum, a reduction from the requirement of three creditors under the old provisions.[102] The position is the same in New Zealand.[103]

8.15 We recommend that the presence of one creditor should be sufficient to constitute a quorum. In this context it is noted that under our recommendations the meeting of creditors will no longer vote on whether the debtor should be adjudicated bankrupt.

Consolidation of provisions in the Bankruptcy Ordinance

8.16 The provisions relating to meetings of creditors are scattered throughout the Bankruptcy Ordinance and Rules and can be confusing.[104] We recommend that the provisions should be consolidated in the Ordinance and Bankruptcy Rules and that the present Meetings of Creditors Rules should have proper margin notes. We considered adopting the Insolvency Rules on meetings of creditors but found them unnecessarily detailed for the needs of Hong Kong. We consider that the Bankruptcy Ordinance and Rules are adequate when taken with our recommendations though they will be slightly more detailed.

Recommendations

- **The Official Receiver should have a discretion whether to hold a first meeting of creditors; following the Insolvency Act, section 293.**

- **Where the Official Receiver has not yet summoned or has decided not to summon a general meeting of creditors any creditor may request the Official Receiver to summon one. If the request is made with the concurrence of not less than one quarter in value of the creditors the Official Receiver should be obliged to summon the meeting; following the Insolvency Act, section 294.**

- **The quorum should be reduced to one creditor present or represented at a meeting; following the Insolvency Rules, rule 12.4A.**

- **All provisions should be consolidated in the Bankruptcy Ordinance and the Bankruptcy Rules and the Rules should have proper margin notes.**

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102 Insolvency Rules 1986, rule 12.4A.

103 Insolvency Act 1967, section 38.

104 See the Bankruptcy Ordinance, section 17, the Bankruptcy Rules, rules 100 to 108, and the Meetings of Creditors Rules.

CHAPTER 9

CREDITORS' COMMITTEE AND THE CONTROL AND DUTIES OF THE TRUSTEE

The present law

9.1 A committee of inspection ("committee") is a committee of creditors consisting of two or more persons appointed by fellow creditors entitled to vote at a meeting of creditors. Its purpose is to superintend the administration of a bankrupt's property by the trustee. In practice, most bankruptcies do not have a committee as membership requires an investment in time and effort that most creditors are not prepared to give. In the absence of a committee the trustee is obliged to seek the permission of the court to carry out any act for which he is required to obtain the permission of the committee under the Bankruptcy Ordinance.

9.2 Section 24 of the Bankruptcy Ordinance sets out the main provisions relating to the composition of the committee and provides as follows:

> *"(1) The creditors qualified to vote may at their first or any subsequent meeting, by resolution, appoint a committee of inspection for the purpose of superintending the administration of the bankrupt's property by the trustee.*
>
> *(2) The committee of inspection shall consist of 2 or more persons, possessing one or other of the following qualifications -*
>
> *(a) that of being a creditor or the holder of a general proxy or general power of attorney from a creditor:*
>
> *Provided that no creditor and no holder of a general proxy or general power of attorney from a creditor shall be qualified to act as a member of the committee of inspection until the creditor has proved his debt and the proof has been admitted; or*
>
> *(b) that of being a person to whom a creditor intends to give a general proxy or general power of attorney:*
>
> *Provided that no such person shall be qualified to act as a member of the committee of inspection until he holds such a proxy or power of attorney, and until the creditor has proved his debt and the proof has been admitted.*
>
> *(3) The committee of inspection shall meet at such times as they shall from time to time appoint, and failing such appointment, at least once a month, and the trustee or any member of the committee may also call a meeting of the committee as and when he thinks necessary.*
>
> *(4) The committee may act by a majority of their members present at a meeting, but shall not act unless a majority of the committee are present at a meeting.*
>
> *(5) Any member of the committee may resign his office by notice in writing signed by him and delivered to the trustee.*
>
> *(6) If a member of the committee becomes bankrupt, or compounds or arranges with his creditors, or is absent from 5 consecutive meetings of the committee, his office shall thereupon become vacant.*

(7) Any member of the committee may be removed by an ordinary resolution at any meeting of creditors of which 7 days' notice has been given stating the object of the meeting.

(8) On a vacancy occurring in the office of a member of the committee the trustee shall forthwith summon a meeting of creditors for the purpose of filling the vacancy, and the meeting may by resolution appoint another creditor or other person eligible as above to fill the vacancy:

Provided that if the trustee is of the opinion that it is unnecessary for the vacancy to be filled he may apply to the court and the court may make an order that the vacancy shall not be filled, or shall not be filled except in such circumstances as may be specified in the order.

(9) The continuing members of the committee, provided there be not less than 2 such continuing members, may act notwithstanding any vacancy in their body.

(10) If there be no committee of inspection any act or thing or any direction or permission by this Ordinance authorised or required to be done or given by the committee may be done or given by the court on the application of the trustee."

9.3 The Bankruptcy Ordinance sets out what the trustee of an estate can and cannot do without the permission of the committee.[105] Section 60 gives the trustee certain powers to deal with the property of the bankrupt without the permission of the committee and states that:

" Subject to the provisions of this Ordinance and to any order of the court, the trustee may do all or any of the following things -

(a) sell all or any part of the property of the bankrupt (including the goodwill of the business, if any, and the book debts due or growing due to the bankrupt), by public auction or private contract, with power to transfer the whole thereof to any person or company, or to sell the same in parcels, and any transfer of a business of a bankrupt by the Official Receiver or trustee shall be deemed to be exempted from the provisions of the Transfer of Businesses (Protection of Creditors) Ordinance;

(b) give receipts for any money received by him, which receipts shall effectively discharge the person paying the money from all responsibility in respect of the application thereof;

(c) prove, rank, claim and draw a dividend in respect of any debt due to the bankrupt;

(d) exercise any powers the capacity to exercise which is vested in the trustee under this Ordinance and execute any powers of attorney, deeds and other instruments for the purpose of carrying into effect the provisions of this Ordinance. "

9.4 Section 61 of the Bankruptcy Ordinance sets out a list of actions a trustee may take only with the permission of the committee:

" The trustee may, with the permission of the committee of inspection, do all or any of the following things-

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[105] But see Disagreements between the Committee and the Trustee at paragraphs 9.28 to 9.31.

(a) carry on the business of the bankrupt so far as may be necessary for the beneficial winding up of the same;

(b) bring, institute or defend any action or other legal proceeding relating to the property of the bankrupt;

(c) employ a solicitor or other agent to take any proceedings or do any business which may be sanctioned by the committee of inspection;

(d) accept as the consideration for the sale of any property of the bankrupt a sum of money payable at a future time subject to such stipulations as to security and otherwise as the committee think fit;

(e) mortgage or pledge any part of the property of the bankrupt for the purpose of raising money for the payment of his debts;

(f) refer any dispute to arbitration, or compromise any debts, claims and liabilities, whether present or future, certain or contingent, liquidated or unliquidated, subsisting or supposed to subsist between the bankrupt and any person who may have incurred any liability to the bankrupt, on the receipt of such sums, payable at such times and generally on such terms as may be agreed on;

(g) make such compromise or other arrangement as may be thought expedient with creditors or persons claiming to be creditors in respect of any debts probable under the bankruptcy;

(h) make such compromise or other arrangement as may be thought expedient with respect to any claim arising out of or incidental to the property of the bankrupt, made or capable of being made on the trustee by any person or by the trustee on any person;

(i) divide in its existing form amongst the creditors, according to its estimated value, any property which from its peculiar nature or other special circumstances cannot be readily or advantageously sold.

The permission given for the purposes of this section shall not be a general permission to do all or any of the above-mentioned things but shall only be a permission to do the particular thing or things for which permission is sought in the specified case or cases."

9.5 The relationship between the trustee and the committee is further defined under section 82 which provides that:

"(1) Subject to the provisions of this Ordinance, the trustee shall, in the administration of the property of the bankrupt and in the distribution thereof amongst his creditors, have regard to any directions that may be given by resolution of the creditors at any general meeting or by the committee of inspection, and any directions so given by the creditors at any general meeting shall, in case of conflict, be deemed to override any directions given by the committee of inspection.

(2) The trustee may from time to time summon general meetings of the creditors for the purpose of ascertaining their wishes, and it shall be his duty to summon meetings at such times as the creditors, by resolution, either at the meeting appointing the trustee or otherwise may direct, and it shall be lawful for any creditor, with the concurrence of one-fourth in value of the creditors (including himself), at any time to request the trustee or Official Receiver to call a meeting

of the creditors, and the trustee or Official Receiver shall call such meeting accordingly within 14 days:

Provided that the person at whose instance the meeting is summoned shall, if so required, deposit with the trustee or the Official Receiver, as the case may be, a sum sufficient to pay the costs of summoning the meeting, such sum to be repaid to him out of the estate if the court so directs.

(3) The trustee may apply to the court in the manner prescribed for directions in relation to any particular matter arising under the bankruptcy.

(4) Subject to the provisions of this Ordinance the trustee shall use his discretion in the management of the estate and its distribution among the creditors."

9.6 Section 83 of the Bankruptcy Ordinance further provides that:

"If the bankrupt or any of the creditors or any other person is aggrieved by any act or decision of the trustee, he may apply to the court, and the court may confirm, reverse or modify the act of decision complained of, and make such order in the premises as it thinks just."

Discussion

9.7 The Official Receiver generally approves of the provisions on creditors' committees in the Insolvency Act and has made several proposals for amendment of the Bankruptcy Ordinance based on these provisions. The Official Receiver's proposals on committees led us into a more detailed consideration of a trustee's duties in administering an estate and we have made some recommendations on duties later in this chapter.

Creditors' committee

9.8 The Official Receiver proposed that the name of the committee should be changed to "creditors' committee" as this is more easily understood than "committee of inspection". We take the view that it is better to name the committee after its members rather than to name it after its function. We therefore recommend that the term "creditors' committee" should be adopted in place of "committee of inspection".

Meetings only when necessary and agreed

9.9 The Official Receiver proposed that meetings of the committee should only be held as and when necessary and as agreed by the committee, rather than monthly as provided for at present, and that members of the committee should be capable of being represented by any person in possession of an appropriate letter of authority, thereby obviating the need for a proxy or power of attorney.[106]

9.10 The Official Receiver advised that the provision requiring the committee to meet at least once a month is impractical. We find that there is little merit in a provision that requires a committee to meet unless it has something to discuss. We recommend that the first meeting of the committee should be called by the trustee to take place within three months of his appointment or of the committee's establishment, whichever is later. Subsequent meetings should be held when and where determined by the trustee or if

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[106] Bankruptcy Ordinance, section 24(2) and (3).

requested by a member of the committee or on a date specified at the previous meeting of the committee. This recommendation reflects the corresponding provision under the Insolvency Rules.[107]

Representation by letter of authority

9.11 We agree with the Official Receiver's proposal that members of the committee should be capable of being represented by any person in possession of a letter of authority. The Bankruptcy Ordinance provides that a creditor may be represented on the committee by a person holding a general proxy or general power of attorney.[108] We do not believe that any useful function is fulfilled by the requirement for a general proxy or power of attorney. We favour the Insolvency Rules provision that a member of the committee may, in relation to the business of the committee, be represented by any other person duly authorised by him for that purpose but that a representative must hold a letter of authority entitling him to act, signed by the member.[109] We would intend that a corporate creditor should be able to change its representative on a committee by use of a simple form of letter of authority.

9.12 For this purpose, any proxy in relation to a committee should, unless it contains a statement to the contrary, be treated as a letter of authority to act generally, signed by or on behalf of the member. The rule also provides that no member may be represented by a body corporate or by a person who is an undischarged bankrupt or is subject to a composition with his creditors. It is further provided that a person's membership of the committee is automatically terminated if he becomes a bankrupt or compounds or arranges with his creditors.[110] We recommend that these provisions be adopted in the Bankruptcy Ordinance.

Resolutions by post

9.13 We received a submission that it would be practical to allow the trustee to seek to obtain the agreement of members of the creditors' committee to a resolution by sending copies of the proposed resolution to members by post. We agree that this would be a useful provision for both the trustee and members of the committee and recommend its adoption. We note that any member may require the trustee to summon a meeting to discuss the proposed resolution.

Control of the Official Receiver or trustee

9.14 The Official Receiver proposed that a trustee should only be under a duty to keep the committee informed of general progress in the bankruptcy and to inform it in advance of any major action he proposes to take. The Official Receiver also proposed that if a majority of the committee was opposed to the proposed action the trustee should only be able to proceed with the leave of the court. These recommendations reflect the position under the Insolvency Act.[111]

9.15 The Insolvency Act, however, goes further and takes control of the Official Receiver, as trustee, out of the hands of the committee. It provides that there should be no creditors' committee where the Official Receiver is the trustee and vests the functions of the committee in the Secretary of State. This would mean that a committee could only be set up at a meeting of creditors that appointed a person other than the Official Receiver to act as trustee.[112] The adoption of such a provision in Hong Kong, where the Official Receiver acts as trustee in the vast majority of bankruptcies, would effectively mean that creditors' committees would cease to exist. We do not believe that the adoption of these provisions from the

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107 The Insolvency Rules 1986, rule 6.153.

108 Bankruptcy Ordinance, section 24(2).

109 The Insolvency Rules 1986, rule 6.156.

110 The Insolvency Rules 1986, rule 6.158(1)(a).

111 Insolvency Act 1986, sections 301 to 304 and the Insolvency Rules, rules 6.150 to 6.166 apply.

112 Insolvency Act 1986, section 301(2).

Insolvency Act would be appropriate to Hong Kong. In any event we can see no reason for differentiating between the Official Receiver and other trustees.

9.16 The Insolvency Act reflects, in great part, the recommendation of the Cork Report that:

> *"....the rights and duties of the committee should be limited to receiving information from the liquidator, trustee, etc, and to consultation. He should be under a duty, not only to keep his committee informed of the general progress of his administration, but so far as practicable to inform it in advance of any important action which he proposes to take. If the majority of the committee are opposed to the proposed action, then he should be able to proceed only with the leave of the Court. As we have said earlier, the committee should have powers to make representations to the court if they are dissatisfied with the information being received, or if they are of the opinion that the person who is administering the estate is not acting in accordance with his powers and duties."* [113]

9.17 The Cork Report's comments were made in the belief that there was no proper supervision carried out by committees and that its recommendations would result in greater and more constructive involvement by committees.[114]

9.18 The only relevant rules under the Insolvency Rules in terms of the functions of the committee or control of a trustee by the committee relate to the duty imposed on a trustee to report to the committee on all such matters as appear to him to be, or as the committee has indicated to him as being, of concern to the committee with respect to the bankruptcy.[115] A trustee is not required to comply with a request of the committee if he considers that the request is frivolous or unreasonable or if the cost of complying would be excessive or if the estate is without sufficient funds to enable him to comply. The committee can also require a trustee to submit a written report on the position generally as regards the progress of the bankruptcy and matters arising in connection with it.

9.19 The only recourse under the Insolvency Act for a committee dissatisfied with a trustee is to apply to the court. The provision governing the application is much the same as the present provision under the Bankruptcy Ordinance and is of doubtful assistance to a committee.[116]

9.20 Under the Companies Ordinance the committee is appointed "to act with" the liquidator.[117] The Cork Report noted that both "superintending" and "to act with" caused confusion in interpretation and that the position was generally unsatisfactory.[118] The reality of the situation is that the relationship between a trustee and a committee is one that should be loosely defined and we do not believe that it is necessary to change the present position. We recommend, however, that, in order to bring conformity to the provisions of the Bankruptcy Ordinance and the Companies Ordinance the trustee in bankruptcy should have the same relationship with his committee as does a liquidator under the Companies Ordinance and that the Bankruptcy Ordinance should adopt the wording of the Companies Ordinance that the trustee should act with the committee.

Powers of the trustee with or without the sanction of the committee

9.21 Under the Bankruptcy Ordinance a trustee has certain powers to deal with the property of the estate without the need to obtain the sanction of the court or the committee.[119] The Ordinance also sets

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113 Cork Report, paragraphs 956 and 957.

114 Cork Report, paragraph 958.

115 Insolvency Rules 1986, rules 6.152 and 6.163.

116 See the Insolvency Act 1986, section 303(1) and the Bankruptcy Ordinance, section 83.

117 Companies Ordinance, section 206(1).

118 The Cork Report, paragraph 918.

119 Bankruptcy Ordinance, section 60.

down a list of powers exercisable by a trustee with the permission of the committee, or of the court in the absence of a committee.[120]

9.22 In most bankruptcies, a trustee usually only has to obtain permission to compromise debts and to bring, institute or defend proceedings relating to the property of a bankrupt. The effect of the division of powers is that a trustee can usually carry out the administration of an estate within the terms of his own powers. A trustee is obliged, however, to have regard to any directions given by the committee. In its turn any directions given by creditors at a meeting of creditors override any directions given by the committee.[121]

9.23 We found that the treatment of a trustee's powers under the Bankruptcy Ordinance was illogical to some extent. For example, a trustee is obliged to obtain permission to compromise any debts that may be due to the estate yet there is no such obligation relating to the writing-off of debts.[122] The result is that in practice a trustee does not need to seek permission to write-off a large debt but he must obtain permission to compromise a small debt.

9.24 We considered introducing financial limits above which a trustee would be required to seek the sanction of the committee. A financial limit could either be for a fixed amount, for example, $100,000, or a fraction of the overall value of the estate, for example, 5 per cent. We do not believe, however, that financial limits are practical as both the fixed amount and the fraction approach cannot properly take account of the size of an estate. A fixed amount could be the major asset in an estate or it could be insignificant depending on the size of the estate. A fraction common to all estates could oblige a trustee to seek sanction for trifling amounts in small estates. We do not propose making any recommendations at this time for amendment to the Bankruptcy Ordinance in respect of the inconsistencies referred to above. We note, however, that the provisions for sanction under the Companies Ordinance contain the same inconsistencies and we will consider them further in our main report.

9.25 We considered the powers of the liquidator in a winding up and of the trustee in bankruptcy under Schedules 4 and 5 of the Insolvency Act and recommend that the present provisions which oblige a trustee to seek sanction for certain actions should be retained with the addition of the following power:

> *"Power, where any right, option or other power forms part of the bankrupt's estate, to make payments or incur liabilities with a view to obtaining, for the benefit of the creditors, any property which is the subject of the right, option or power."* [123]

9.26 As a consequence of our recommendation on non-business related bankruptcy in Chapter 13, we recommend that the trustee should have the power, subject to the sanction of the creditors' committee, to allow a debtor to restructure a business.[124]

9.27 The Insolvency Act[125] essentially preserves the four general powers of the trustee that already exist under the Bankruptcy Ordinance and we recommend the retention of these powers together with a further power, taken from the corresponding provisions of the powers of a liquidator in a winding up under the Insolvency Act, viz,

> *"Power to do all such other things as may be necessary for (administering) the estate and distributing its assets."*[126]

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120 Bankruptcy Ordinance, sections 61 and 24(10).

121 Bankruptcy Ordinance, section 82(1).

122 Bankruptcy Ordinance, section 61(f).

123 Insolvency Act 1986, Schedule 5, Part I, 5.

124 See paragraph 13.24.

125 Insolvency Act 1986, Schedule 5, Part II, with the exception of power number 13 which relates to tenancy in tail and has no relevance to Hong Kong.

126 Insolvency Act 1986, Schedule 4, Part III, 13.

Disagreements between the committee and the trustee

9.28 The Bankruptcy Ordinance provides that, subject to the provisions of the Ordinance, the trustee shall have regard to any resolution that may be given by the creditors at a general meeting or by the committee.[127] The Bankruptcy Ordinance is not clear as to the position in the event that the trustee and the committee, or creditors, disagree, nor is it clear whether this provision extends to the powers of the trustee which he can exercise without permission.

9.29 If a trustee is uncertain as to how he should proceed he may apply to the court for directions.[128] The position of creditors, and by extension the committee, is less certain. The Bankruptcy Ordinance provides that any bankrupt, creditor or other person who is aggrieved by any act or decision of the trustee may apply to the court.[129] The Cork Report, referring to the corresponding section under the Bankruptcy Act 1914, commented that it was extremely difficult for a bankrupt to take any action against his trustee in respect of loss, damage, or other wrong which he (or his estate) may have suffered at the trustee's hands and that there was no reported case where a bankrupt had successfully invoked the jurisdiction conferred by the section. The Cork Report added that an individual creditor seeking to impeach a trustee's administration under the section must, it seemed, show that the trustee was acting entirely unreasonably.[130] There has been a recent instance of a bankrupt making an unsuccessful application to court in Hong Kong under this provision. The test applied by the court was that the bankrupt had to show exceptional behaviour on the part of the trustee, such as, for example, that he had not exercised his power in good faith or had acted in a way in which no reasonable trustee would have acted.[131]

9.30 The remedy available to a committee opposed to the actions of a trustee who ignores its directions would therefore seem to be very difficult, as unless a trustee was acting in bad faith or entirely unreasonably, a committee would seem to have no recourse against him. The Insolvency Act made some attempt to improve the position of creditors by replacing "aggrieved" with "dissatisfied".[132] It is not known whether the change in wording under the Insolvency Act has had any practical effect on the interpretation of the provision by the court though the inclusion of the word "omission" in section 303(1) of the Insolvency Act might assist creditors in an action against the trustee for inaction.[133] We doubt that the change in wording will have any significant effect as the test applied recently relates to the behaviour of the trustee and not to the state of mind of the applicant. We are of the view that the test for the court should not be the exceptional behaviour of a trustee or his bad faith but whether the trustee has been in breach of his duties.[134]

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127 Bankruptcy Ordinance, section 82(1).

128 Bankruptcy Ordinance, section 82(3).

129 Bankruptcy Ordinance, section 83. See paragraph 9.6 for the text of section 83.

130 The Cork Report, paragraphs 778 and 779.

131 *Pun Siu Fun, Maria -v- The Official Receiver*; Hong Kong Law Digest, January 1991, at A7.

132 Insolvency Act 1986, section 303(1).

133 Annotated Guide to the 1986 Insolvency Legislation; Sealy and Milman, 4th edition, at page 368-369. The 4th edition of the Annotated Guide, which was published after this part of the Report was considered, notes the case of *Port v Auger [1994]1 WLR 862* at p. 823-4, and notes that *"Those lawyers looking for a more liberal use of this control facility will have been disappointed by the comments of Harman J. Although Harman J appeared to accept that the change in terminology from "aggrieved"to "dissatisfied" may have indicated an intention on the part of the legislature to widen access to the court he expressed the view that the applicant must have some substantial interest that has been adversely affected and then went on to suggest that the s. 303 jurisdiction should not be invoked lightly by the court for fear of inflicting unnecessary expense on the insolvent estate."*

134 See paragraphs 9.32 to 9.37.

9.31 The Companies Ordinance provides that the exercise by the liquidator of the powers conferred on him are subject to the control of the court and any creditor may apply to the court with respect to any exercise or proposed exercise of any of the powers.[135] The powers referred to include powers for which a trustee does not require the permission of the committee. We find that the Companies Ordinance would provide an appropriate level of control over a trustee in bankruptcy and we recommend its adoption. This would mean that creditors or the committee would have the power to apply to the court in respect of any power under sections 60 and 61 of the Bankruptcy Ordinance.

The trustee's duties

9.32 Although the Bankruptcy Ordinance provides for some control over the trustee, it does not define his duties.[136] The Cork Report considered that the duties of an insolvency practitioner, including a trustee in bankruptcy, should be expressly defined by statute and recommended that an insolvency practitioner should act in a fiduciary capacity and deal with the property under his control honestly, in good faith, with proper skill and competence and in a reasonable manner.[137] The Cork Report further recommended that creditors should be allowed to bring actions against insolvency practitioners for breach of duty without the leave of the court but that an insolvent should obtain the leave of the court before taking action. The rationale behind requiring insolvents to obtain the leave of the court was that, if the trustee or liquidator failed to realise assets at the estimated value put on them in the statement of affairs, the bankrupt often felt that this provided him with a *prima facie* case for complaint. In such cases there was often to be found a tendency on the part of the bankrupt to believe that there was a conspiracy against him of which he was the innocent victim.[138]

9.33 The Insolvency Act has gone some way towards imposing a statutory duty on trustees in providing that a trustee may be liable for his actions in the event that he behaves improperly in the following circumstances:

> *" Where on an application under this section the court is satisfied -*
>
> *(a) that the trustee of a bankrupt's estate has misapplied or retained, or become accountable for, any money or other property comprised in the bankrupt's estate, or*
>
> *(b) that a bankrupt's estate has suffered any loss in consequence of any misfeasance or breach of fiduciary or other duty by a trustee of the estate in the carrying out of his functions,*
>
> *the court may order the trustee, for the benefit of the estate, to repay, restore or account for money or other property (together with interest at such rate as the court thinks just) or, as the case may require, to pay such sum by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just.*
>
> *This is without prejudice to any liability arising apart from this section."* [139]

9.34 This provision only sets out the liability of the trustee for his actions and in so far as it does this we approve of it and recommend its adoption. We are of the view, however, that the Bankruptcy Ordinance should go further and define the trustee's duties in two key areas.

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135 Companies Ordinance, section 199(3).

136 There are provisions imposing duties on the Official Receiver, such as sections 77 and 78, but these are not relevant to our recommendations.

137 Cork Report, paragraphs 777 to 788.

138 Cork Report, paragraphs 781 to 784.

139 Insolvency Act 1986, section 304(1).

9.35 Firstly, we support the Cork Report's recommendation that the duties of the trustee to the bankrupt, to creditors and to other interested parties should be defined by statute. We agree with the Cork Report that any duty imposed on trustees should not be so onerous as to hinder trustees in exercising their functions and recommend that the definition suggested by the Cork Report, that a trustee should be under a general duty ″to act in a fiduciary capacity and to deal with the property under his control honestly, in good faith, with proper skill and competence and in a reasonable manner", would be an appropriate duty to impose. We would emphasise that the court should have a discretion in relation to any breach of duty by a trustee and that if the court considers it appropriate, it should be able to grant relief to the trustee. We wish to make it clear that the definition recommended should not be taken to be exhaustive. We have no intention to codify the law.

9.36 Secondly, we believe that the duty of the trustee in relation to realisation of the assets of an estate should be defined. We considered whether it would be inappropriate to impose a separate duty on trustees but take the view that the realisation of assets is sufficiently specific and important to merit a special duty. We recommend that it should be the duty of a trustee to take all reasonable care to realise the best price reasonably obtainable in the circumstances. We would emphasise that a trustee's duty with regard to realisations is made without prejudice to the general duty recommended and that the realisations duty is comprehended under the umbrella of the general duty.

9.37 We wish to emphasise that the court should have a discretion in relation to any breach of duty by a trustee and that if the court considers it appropriate, it should be able to grant relief to the trustee. In addition, we recommend that if a frivolous complaint is made to the court in respect of the a trustee's duty the court should have the discretion to order that the costs of the hearing be borne by the complainant.

Recommendations

- **The name of the “committee of inspection” should be changed to “the creditors' committee”.**

- **The first meeting of the creditors' committee should be called by the trustee to take place within three months of his appointment or of the committee's establishment, whichever is later. Subsequent meetings should be held when and where determined by the trustee or if requested by a member of the committee or on a date specified at the previous meeting of the committee; following the Insolvency Rules, rule 6.153.**

- **Members of the creditors' committee should be capable of representation at a meeting by any person in possession of a simple form of letter of authority from the member provided that person is not a body corporate, an undischarged bankrupt or a person who is subject to a composition or arrangement with his creditors. Membership of the committee should be automatically terminated if a member becomes bankrupt or compounds or arranges with his creditors; following the Insolvency Rules, rules 6.156 and 6.158.**

- **The trustee should be able to seek to obtain the agreement of members of the creditors' committee to a resolution by sending copies of the proposed resolution to members by post; following the Insolvency Rules, rule 6.162.**

- **A creditors' committee should be appointed "to act with" rather than to supervise the trustee.**

- **The present provisions which oblige a trustee to seek sanction for certain actions should be retained with the addition of the following power:**

  > **"Power, where any right, option or other power forms part of the bankrupt's estate, to make payments or incur liabilities with a view to obtaining, for the benefit of the creditors, any property which is the subject of the right, option or power."**

- **The trustee should have the power, subject to the sanction of the creditors' committee, to allow a debtor to restructure a business.**

- **The four general powers of the trustee that exist under the present provisions should be retained with the addition of the following power:**

  > **"Power to do all such other things as may be necessary for administering the estate and distributing its assets."**

- **The exercise by the trustee of the powers conferred on him should be subject to the control of the court and any creditor or the creditors' committee should be able to apply to the court with respect to any exercise or proposed exercise of any of the powers by the trustee. The powers referred to include powers for which the trustee does not require the permission of the committee.**

- **Where the court is satisfied that a trustee has misapplied or retained, or become accountable for, any money or other property comprised in a bankrupt's estate, or that a bankrupt's estate has suffered any loss in consequence of any misfeasance or breach of fiduciary or other duty by a trustee of the estate in carrying out his functions, the court may order the trustee, for the benefit of the estate, to repay, restore or account for money or other property (together with interest at such rate as the court thinks just) or, as the case may require, to pay such sum by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just; following the Insolvency Act, section 304(1).**

- **A trustee should be under a duty to act in a fiduciary capacity and to deal with the property under his control honestly, in good faith, with proper skill and competence and in a reasonable manner.**

- **In realising the assets of a bankrupt's estate it should be the duty of a trustee to take all reasonable care to realise the best price reasonably obtainable in the circumstances.**

- **If a frivolous complaint is made to the court in respect of the trustee's duty the court should have the discretion to order that the costs of the hearing be borne by the complainant.**

CHAPTER 10

STATEMENT OF AFFAIRS

The present law

10.1 The making of a receiving order against a debtor sets in motion a series of proceedings consequent to the order. The statement of affairs is one of these, its primary purpose being to establish a debtor's assets and liabilities and their whereabouts.

10.2 Section 18 of the Bankruptcy Ordinance provides that:

> *"(1) Where a receiving order is made against a debtor, he shall, unless the court otherwise orders, make out and submit to the Official Receiver a statement of and in relation to his affairs in the prescribed form, verified by affidavit, and showing the particulars of the debtor's assets, debts and liabilities, wherever situate, the names, addresses and occupations of his creditors, whether in Hong Kong or elsewhere, the securities held by them respectively, the dates when the securities were respectively given, and such further or other information as may be prescribed or as the Official Receiver may require. Such statement shall also give details of all property held by him in a* ***t'ong*** *name or under any alias, or by his wife or any concubine of his, or by any person in trust for him or them, with full particulars as to the manner and date of its being acquired.*
>
> *(2) The statement shall be so submitted within the following times, namely-*
>
> > *(a) if the order is made on the petition of the debtor, within 3 days from the date of the order;*
> >
> > *(b) if the order is made on the petition of a creditor, within 7 days from the date of the order,*
>
> *but the court may, in either case for special reasons, extend the time.*
>
> *(3) If the debtor fails without reasonable excuse to comply with the requirement of this section, he may be punished for a contempt of court and the court may, on the application of the Official Receiver or of any creditor, adjudge him bankrupt.*

(4) Any person stating himself to be a creditor of the bankrupt may, on payment of the prescribed fee, personally or by agent inspect the statement at all reasonable times and take any copy thereof or extract therefrom, but any person untruthfully so stating himself to be a creditor shall be guilty of a contempt of court and shall be punishable accordingly on the application of the trustee or Official Receiver."

10.3 Section 78(1)(h) imposes a duty on the Official Receiver to assist the debtor in preparing his statement of affairs where the debtor has no solicitor acting for him and is unable to prepare it properly himself. For this purpose, the Official Receiver may employ someone to assist in the preparation of the statement of affairs at the expense of the estate.

10.4 Under section 129(1)(f) a debtor is guilty of a bankruptcy offence if he makes any material omission or misstatement in any statement relating to his affairs, unless he proves that he had no intent to defraud.

10.5 Bankruptcy Rule 82 provides that where a debtor requires an extension of time in filing his statement of affairs he can apply to the Official Receiver who may give a written certificate extending the time. The certificate shall be filed in court rendering an application under section 18 unnecessary.

Discussion

10.6 The Official Receiver proposed some changes of a minor, practical, nature to the present law. Our recommendation that receiving and adjudication orders should be combined in a single bankruptcy order would have no effect on provisions relating to the statement of affairs generally.

Time for submission of the statement of affairs

10.7 The Official Receiver proposed that the time in which a statement of affairs should be submitted under section 18(2) should be increased from seven to twenty one days on an order made on a creditor's petition. Where an order is made on a debtor's own petition the statement should accompany the petition instead of being submitted within three days of the date of the order.

10.8 The Official Receiver considered that the seven day time limit for the submission of a statement of affairs in the case of a receiving order made on a creditor's petition was unrealistic and that twenty one days would allow a debtor sufficient time to prepare a statement in most cases. The Official Receiver believed, however, that the situation was different in the case of a debtor's petition and that if a debtor petitioned for his own bankruptcy he should immediately provide the Official Receiver with full knowledge of the debtor's financial position.

10.9 The Official Receiver's proposal follows provisions in the Insolvency Act[140] Other jurisdictions looked at did not reveal any great differences to the present law in Hong Kong. Australia provides that in proceedings for the bankruptcy of a debtor instituted by a creditor the bankrupt must file his statement within fourteen days of the bankruptcy order. A debtor's petition must be accompanied by a statement of affairs.[141]

10.10 In Singapore a debtor is obliged, on the making of a receiving order based on a creditor's petition, to file an affidavit within twenty four hours, setting out details of his business partners, if any, together with a statement of his principal assets and liabilities. The affidavit then forms part of the debtor's statement of affairs which must be produced within twenty one days of the making of the receiving order. A debtor who petitions for his own bankruptcy is obliged to furnish a statement of affairs within seven days of the making of a receiving order.[142]

10.11 We are of the opinion that the Official Receiver's proposals on the time limits for the submission of the statement of affairs are an improvement on the current provisions and recommend their adoption. The present requirement that a debtor, in respect of whom a petition has been presented by a creditor, should prepare a statement within seven days is not practical in anything other than the simplest of estates. Most bankrupt estates are more complex and are often in such disarray that seven days does not provide sufficient time for a debtor to prepare a proper statement.

10.12 A debtor who petitions for his own bankruptcy is in a different position. The fact that he seeks his own bankruptcy indicates that he is well aware of his financial position and we see no reason why he should not share his knowledge with the Official Receiver by filing a statement with his petition. The form of the statement of affairs should be freely available at the Official Receiver's Office to any person who wishes to present his own petition.

Dispensing with the statement of affairs

10.13 The Official Receiver also proposed that he should have the discretion to dispense with the statement of affairs where he considers a statement to be unnecessary without having to apply for an order of the court. Bankruptcy Rule 81A states that the court, in considering an order dispensing with the statement, may receive a report of the Official Receiver in support of the order. In practice, the court responds to the initiative of the Official Receiver as it is the Official Receiver who invariably seeks an order to dispense with the statement and who always files a report setting out his reasons for the application. The Official Receiver may consider that a statement is unnecessary after conducting a preliminary examination of the debtor immediately after the making of the receiving order. The preliminary examination is in questionnaire form and is designed to establish the whereabouts of the debtor's assets and the extent of his liabilities, together with other pertinent details, before the statement of affairs is

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140 Insolvency Act 1986, section 272 (in relation to a debtor's petition) and section 288 (in relation to a creditor's petition).

141 Bankruptcy Act 1966, sections 54 and 55.

142 Bankruptcy Act 1888, sections 8 and 16.

prepared.[143] Provided a bankrupt co-operates with the Official Receiver in the preparation of his preliminary questionnaire the Official Receiver is well placed to gauge whether the statement can be safely dispensed with.

10.14 We understand from the Official Receiver that many debtors fail to submit statements either in time or at all. Most debtors, especially non-business debtors, do not keep books of account. In other cases debtors who may have been required to keep books claim that the books have been lost or destroyed. A surprising number claim that the bailiff seized the accounts when levying execution on a judgment.

10.15 We support the Official Receiver's proposal and recommend that he be empowered to dispense with the statement of affairs without an order of the court in circumstances where he considers it unnecessary.

Extension of time for submission of the statement of affairs

10.16 The Official Receiver's final proposal was that he should be able to give an extension of time for filing the statement of affairs without having to file a certificate in court as provided for under Bankruptcy Rule 82. We see no practical purpose to the filing of a certificate and support the proposal.

10.17 Indeed, this recommendation would bring the Bankruptcy Ordinance into line with the Companies Ordinance which provides the Official Receiver with the power to extend the time for submission of the statement of affairs in companies winding up without reference to the filing of a certificate.[144]

Contempt of court

10.18 In addition to the Official Receiver's proposals we recommend that section 18(3) of the Bankruptcy Ordinance (which provides that it shall be a contempt of court for a debtor, without reasonable excuse, to fail to comply with the requirements of the section) should be replaced by section 288(4) of the Insolvency Act which sets out more clearly the reasons for the debtor being guilty of a contempt of court. Section 288(4) provides that:

> *" A bankrupt who -*
>
> > *(a) without reasonable excuse fails to comply with the obligation [to submit a statement of affairs before the end of the period of 21 days beginning with the commencement of the bankruptcy] imposed by this section, or*

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143 But see paragraphs 11.37 to 11.41.

144 Companies Ordinance, section 190(3).

(b) without reasonable excuse submits a statement of affairs that does not comply with the prescribed requirements,

is guilty of a contempt of court and liable to be punished accordingly (in addition to any other punishment to which he may be subject). "

10.19 Section 288(4)(a) is similar to section 18(3) but specifically refers to the obligation of a bankrupt to complete the statement of affairs.

Form of statement of affairs

10.20 Finally, we recommended in the Consultative Document that the form of the statement of affairs should be on standard size paper, simplified and available in Chinese. We now understand from the Official Receiver's Office that events have overtaken us and that a new form of statement is being introduced which generally conforms with our ideas. The new form of statement will be produced with both English and Chinese in the same document, as opposed to separate forms for each language. We approve of this innovation and find that there is now no need to make any recommendation on the form of the statement of affairs.

Recommendations

- **The time for submission of the statement of affairs should be increased to twenty one days from the date of the bankruptcy order in the case of an order made on a creditor's petition; following the Insolvency Act, section 288.**

- **The statement of affairs should be submitted with the petition where a debtor petitions for his own bankruptcy; following the Insolvency Act, section 6.62. The statement of affairs form should be freely available at the Official Receiver's Office to any person who wishes to present his own petition.**

- **The Official Receiver should have the discretion to dispense with the statement of affairs where he considers it unnecessary, without having to apply for an order of the court to dispense with the statement; following the Insolvency Rules, rule 6.62.**

- **The Official Receiver should have the power to extend the time for submission of the statement of affairs without having to file a certificate in court.**

- **The circumstances under which a debtor may be in contempt of court under section 18(3) of the Bankruptcy Ordinance should be more clearly set out, as in section 288(4) of the Insolvency Act.**

CHAPTER 11

PUBLIC EXAMINATION

The present law

11.1 The public examination of a debtor by the court is one of the proceedings consequent to the making of a receiving order and commences, therefore, before a debtor is made bankrupt. A debtor's public examination may continue after he has been adjudicated bankrupt. If our recommendation for a single bankruptcy order is adopted the public examination would take place after bankruptcy.[145]

11.2 The primary objective of public examination is the disclosure and discovery of the assets of the debtor or bankrupt and the procedure is regarded as an important aspect of the bankruptcy process. In addition to the discovery of assets, public examination serves one of the main purposes of the public policy associated with bankruptcy law, that of the protection of the public by the gathering of information about the debtor or bankrupt and his affairs. The Cork Report said that as a general rule the public examination should be held in all cases of bankruptcy with limited power to dispense with it.[146] In practice, however, relatively few public examinations are held. In the ten years between April 1983 and March 1994 only fifty three public examinations were held in a period when over two thousand six hundred receiving orders were made.[147]

11.3 Section 19 of the Bankruptcy Ordinance provides:

> *"(1) Where the court makes a receiving order, it shall, save as in this Ordinance provided, hold a public sitting, on a day to be appointed by the court, for the examination of the debtor, and the debtor shall attend thereat and shall be examined as to his conduct, dealings and property.*
>
> *(2) The examination shall be held as soon as conveniently may be after the expiration of the time for the submission of the debtor's statement of affairs.*
>
> *(3) The court may adjourn the examination from time to time.*
>
> *(4) Any creditor who has tendered a proof, or his representative authorised in writing, may question the debtor concerning his affairs and the causes of his failure.*
>
> *(5) The Official Receiver shall take part in the examination of the debtor, and for the purpose thereof, if specifically authorised by the court, may employ a solicitor with or without counsel. No solicitor or counsel shall be allowed to take part in the examination on behalf of the debtor.*
>
> *(6) If a trustee is appointed before the conclusion of the examination, he may take part therein.*
>
> *(7) The court may put such questions to the debtor as it may think expedient.*
>
> *(8) The debtor shall be examined upon oath and it shall be his duty to answer all such questions as the court may put or allow to be put to him. Such notes of the examination as the court thinks proper shall be taken down either in shorthand or longhand and they or a transcript thereof shall be read over*

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145 See paragraphs 5.4 to 5.9.

146 The Cork Report, paragraph 599.

147 See Annexures 1 and 2 to this Report.

either to or by the debtor and signed by him and may thereafter, save as in this Ordinance provided, be used in evidence against him; they shall also be open to the inspection of any creditor at all reasonable times upon the payment of the prescribed fee.

(9) When the court is of the opinion that the affairs of the debtor have been sufficiently investigated, it shall by order declare that his examination is concluded, but such order shall not be made until after the day appointed for the first meeting of creditors.

(10) Where the debtor is a lunatic or suffers from any such mental or physical affliction or disability as in the opinion of the court makes him unfit to attend his public examination, or is absent from Hong Kong, the court may make an order dispensing with such examination or directing that the debtor be examined on such terms, in such manner and at such place as to the court seems expedient."

11.4 Section 19A provides that:

"(1) Notwithstanding section 19 the court may, on the application of the Official Receiver, make an order dispensing with the public examination of the debtor.

(2) Before making an application under subsection (1) the Official Receiver shall -

*(a) publish notice of his intention to make the application in the **Gazette**; and*

(b) give notice of his intention to make the application to every creditor who has tendered a proof.

(3) Any creditor who has tendered a proof and wishes to oppose the making of an order under subsection (1) shall, within 21 days after the date of publication of a notice pursuant to subsection (2), give notice in writing to the Official Receiver of his intention to oppose the making of an order and may thereafter appear and oppose the making of an order.

(4) Before making an order under subsection (1) the court shall consider a report of the Official Receiver made in the manner prescribed."

Discussion

Self incrimination

11.5 At his public examination a debtor is required to answer on oath questions as to his conduct, dealings and property put to him by the Official Receiver, his trustee, his creditors, or the court. A debtor must answer all questions which the court allows to be put to him and cannot avoid doing so even though his answers may incriminate him (except that a statement or admission made by a person in any compulsory examination or disposition before the court on the hearing of any matter in bankruptcy shall not be admissible as evidence against that person or against the wife or husband of that person in any proceedings in respect of an offence under the Theft Ordinance[148]). The written record of the examination may be used as evidence in any proceedings against him. The Official Receiver may make use of the information obtained at the public examination in preparing the reports which it is his duty to make, including those in relation to a possible prosecution for any alleged offences under the Bankruptcy Ordinance and also in relation to a bankrupt's eventual discharge.

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148 Bankruptcy Ordinance, section 141.

11.6 The Bill of Rights[149] no longer allows the use of answers to be used against a debtor who has already been charged with or convicted of a criminal offence. Article 11(2)(g) of the Bill of Rights provides that:

> *"(2) In the determination of any criminal charge against him, everyone shall be entitled to the following minimum guarantees, in full equality- .....*
>
> *..... (g) not to be compelled to testify against himself or to confess guilt."*

11.7 It was recently decided in the High Court of Hong Kong that the words in article 11(2)(g) were unequivocal and were restricted to the rights of a person charged with a criminal offence. The protection provided by article 11(2)(g) does not therefore extend to a person who has not been charged with a criminal offence.[150]

11.8 In England and Wales, the Insolvency Rules provide that a bankrupt shall answer all such question as the court may put, or allow to be put, to him in his examination and that any statement made by the bankrupt in his public examination may be used as evidence against him. An English court, however, has a discretion to adjourn the public examination if criminal proceedings have been instituted against the bankrupt and the court is of the opinion that the continuance of the hearing of the public examination would be calculated to prejudice a fair trial of those proceedings.[151]

11.9 The English Court of Appeal has decided, *inter alia*, that the transcript of a public examination was admissible in criminal proceedings.[152] This decision is in line with other decisions made by the English courts, notably in the case of private examination under the provisions in the Insolvency Act relating to examination of company directors, that by the provisions of the Insolvency Act, Parliament had abrogated the right of people to refuse to answer questions.

11.10 The Australian Bankruptcy Act 1986 provides, *inter alia*, that subject to a contrary direction by the court, a bankrupt is not excused from answering a question merely because to do so might tend to incriminate him.[153] The wording of this subsection specifically refers to a bankrupt. As the provision relates to the examination of both a bankrupt (the relevant person) and "other persons" the specific reference to bankrupts implies that the privilege against self incrimination is available to persons other than the bankrupt though it is not specifically stated.[154]

11.11 In Hong Kong, there is other legislation that provides for examination of persons. Under section 143 of the Companies Ordinance, for instance, the Financial Secretary may appoint inspectors to investigate the affairs of a company. Under section 149A any answer, in respect of such an investigation, given by a person to a question put to him may be used in evidence against him. Section 145(3A), however, gives protection to the person under investigation in providing that if a question might tend to incriminate him and the person so claims before answering the question, neither the question nor the answer shall be admissible in evidence against him in criminal proceedings other than proceedings in relation to a charge of perjury in respect of the answer.

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149 Bill of Rights Ordinance 1991 (Cap 383).

150 *Re Tse Chu Fai, unrep*. MP No 3646 of 1992, 20th November 1992, Jones J. Hong Kong Law Digest, November 1992 at K5.

151 Insolvency Rules 1986, rule 6.175(1),(5)and(6).

152 *R v Kansal* [1992] 3 WLR 494, C.A.

153 Bankruptcy Act 1966, section 81(11AA).

154 Note also the new provision under section 20 of the Bankruptcy Amendment Act 1992, now section 77(C) of the Bankruptcy Act 1966, which provides the Official Receiver with power to require the bankrupt or any person to give the Official Receiver such information as he requires and to attend before the Official Receiver to give evidence and to produce all books in his possession. The Official Receiver may require the information or the evidence to be given on oath, either orally or in writing, and for that purpose may administer an oath.

11.12 Section 33(6) of the Securities and Futures Commission Ordinance (Cap 24) provides similar protection to a person under investigation under that Ordinance as that provided under section 145(3A) of the Companies Ordinance, although the exempted proceedings are wider. Section 33(6) adds that the investigator shall, before asking any question under the section, inform the person concerned of the limitation imposed by the subsection in respect of the admissibility in evidence of the question and any answer given.[155]

11.13 Apart from public policy considerations, the main objective of a trustee is to recover the assets of a bankrupt and make a distribution to creditors. To that end, public examination should be one of the more powerful weapons the trustee has at his disposal to force a bankrupt to answer questions relating to his assets. It has been argued that if an answer is likely to incriminate him and the answer can be used as evidence against him in other proceedings a bankrupt will be less likely to disclose assets or information. A counter argument, however, says that if a bankrupt is allowed to decline to answer a question because it might incriminate him he could hide behind the privilege.

11.14 It is frustrating for a trustee when he is unable to prove that a bankrupt is hiding assets. Unless a trustee is able to link a bankrupt to concealed assets, a bankrupt is unlikely to reveal them. Our recommendations in the chapter on private examination should go some way to relieving this situation as regards other witnesses but the position of a bankrupt is different.[156] We do not see how any sanction other than those that presently exist under the Bankruptcy Ordinance and those under our recommendations, such as postponement of discharge, can be imposed.

11.15 We do not believe, however, that the privilege of a right to silence would be of any assistance to the administration of an estate and recovery of assets and recommend that a bankrupt should be obliged to answer all questions put to him in his public examination but that his answers may not be used as evidence against him in criminal proceedings. We consider that a bankrupt should be obliged to answer questions in his public examination that might incriminate him even if he has been charged with a criminal offence. In our view a bankrupt who has been charged with a criminal offence would be specifically protected under the Bankruptcy Ordinance as the evidence could not be used against him in criminal proceedings and an obligation to answer questions in such circumstances would not be in breach of the Bill of Rights.

11.16 This protection against self incrimination should not apply, however, where a bankrupt does not give truthful answers in his examination. When this happens, a bankrupt should be open to prosecution for perjury. There is a parallel for this recommendation under the Organised and Serious Crimes Bill 1992.[157]

Legal representation

11.17 The Bankruptcy Ordinance, section 19(5), provides that a bankrupt or debtor is not entitled to be legally represented at his public examination. The position in England under the Bankruptcy Act 1914 was that a debtor could be represented at his examination[158] and the right to be represented is now contained in the Insolvency Rules, rule 6.175(3), which provides that:

> *"The bankrupt may at his own expense employ a solicitor with or without counsel, who may put to him such questions as the court may allow for the purpose of enabling him to explain or qualify any answers given by him, and may make representations on his behalf."*

11.18 The position in Australia is much the same as in England. Under section 81(7) of the Bankruptcy Act 1966, any person summoned for examination:

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155 See *re Lee Kwok Hung, unrep*. MP No 3039 of 1992, 8th January 1993, *Jones J.*

156 See paragraphs 12.14 to 12.18.

157 Organised and Serious Crimes Bill 1992, clause 3(12).

158 See Halsbury's Laws of England, 4th edition, Vol.3 at paragraph 400.

"...is entitled to be represented, on his examination, by counsel or a solicitor, who may re-examine him after his examination."

11.19 We are of the view that a debtor or bankrupt should be entitled to be legally represented at his public examination and that the right to be represented is particularly important if a debtor or bankrupt is obliged to answer questions that might incriminate him. A debtor or bankrupt should, however, be responsible for the expenses of his representation. We recommend the adoption of the provision under the Insolvency Rules.

Public examination only when necessary
Rights of creditors

11.20 The Official Receiver is obliged to hold a public examination unless he applies to the court to dispense with it under section 19A of the Bankruptcy Ordinance. In practice this does not happen as the preliminary examination[159] and the available records of a debtor usually provide sufficient information to obviate the need for a public examination. In many cases, therefore, the Official Receiver has to apply to the court for an order dispensing with the examination. It is only in cases where there is a need to extract further information from a debtor that a public examination is held. The Official Receiver must also have questions to put to a debtor. There is no point in holding a public examination unless the debtor is known to be holding back assets or information and unless the Official Receiver believes that the estate can gain some advantage from the examination.

11.21 The Official Receiver proposed that a public examination should be held only when he considers one to be necessary, thus removing the need for him to apply to the court for an order dispensing with the public examination. As a consequence of this the Official Receiver also proposed that the right of creditors to request or oblige the Official Receiver to hold an examination should be defined.

11.22 The Official Receiver's proposal reflects the provisions on public examination in the Insolvency Act which provides that the Official Receiver may apply to the court for the public examination of a bankrupt at any time before discharge.[160] The Insolvency Act further provides that the Official Receiver may be required to hold a public examination if notice is given to him by one of the bankrupt's creditors with the concurrence of not less than one half in value of the creditors.

11.23 A creditor's request must be in writing and accompanied by a list of creditors concurring with the request and the amount of their claims, written confirmation of concurrence from each concurring creditor, and a statement of the reasons why the examination is requested.

11.24 Before the Official Receiver, or a trustee where one is appointed, makes an application to the court for a public examination in response to a request, the requesting creditors shall, if ordered by the court, deposit with the Official Receiver such sum as the Official Receiver determines to be appropriate by way of security for the expenses of the hearing of the public examination. If the Official Receiver thinks that the request for public examination is unreasonable he may apply to the court for an order relieving him from the obligation to make the application.[161]

11.25 There are some differences in approach in other jurisdictions. In Scotland, the scope of the public examination is not limited to examination of a debtor. In addition, any relevant person may be examined in relation to the debtor's assets, his dealings with them or his conduct relating to his business or financial affairs. Notwithstanding this, the trustee has a discretion not to request the court for a public

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159 At present, on the making of a receiving order, the Official Receiver makes a preliminary examination of a debtor using a standard form of questionnaire that seeks to obtain a debtor's personal and business details together with details of his assets and liabilities and the reasons for his financial problems. The preliminary examination is carried out by the Official Receiver.

160 Insolvency Act 1986, section 290.

161 Insolvency Rules 1986, rule 6.173.

examination but one quarter in value of creditors may apply to the court for an order that a debtor or any relevant person be publicly examined.[162]

11.26 In Australia, there is no specific provision empowering creditors to oblige the trustee to hold a public examination but creditors have general control of the trustee and may oblige him to act on any resolution they may make at a meeting of creditors.[163]

11.27 We recommend that the Official Receiver should have a discretion whether to apply to the court to hold the public examination of a debtor. In addition, we recommend that the public examination should be held if one quarter in value of creditors request the Official Receiver to do so, thus following the Scottish provision. A submission, however, argued that the court should have the discretion to accept the request of a lesser percentage of creditors if it thought fit in the circumstances of the case. We accept that there is a possibility of minority creditors being prejudiced[164] and agree that it would be unfair to restrict the right to an arbitrary percentage of creditors. We therefore amend our original recommendation to give the court power to make an order for examination at the request of creditors making up less than one quarter in value of creditors.

11.28 The shift in emphasis from the Official Receiver having to follow a set procedure of reporting to court in every case, to initiating a procedure that requires reporting to court only when public examination is considered necessary, should result in savings in time and costs to the Official Receiver and the court.

11.29 In recommending that one quarter in value of creditors should be able to oblige the Official Receiver to hold a public examination, and that the court should have the discretion to make an order for examination at the request of creditors making up less than twenty five percent of creditors, we recognise that public examination is one of the most powerful tools available to the Official Receiver and creditors in their efforts to trace assets or obtain information relevant to the administration of the estate. For this reason we are not in favour of the Insolvency Act requirement that one half in value of creditors should have to give notice to the Official Receiver in order to require him to hold a public examination. We believe it is in the public interest that debtors should be examined when it appears necessary to do so and that the Official Receiver should never shrink from holding a public examination purely on the grounds of cost. We are aware, however, that even the simplest public examination involves expense as, in addition to the usual expenses of a court hearing, a short-hand writer must be available to take notes of the examination.

11.30 It can happen that creditors do not want a debtor to be publicly examined, such as where a debtor is indebted to his relatives, or where the bankruptcy proceedings were taken as a result of a family dispute. In such cases, and they are not unusual, the debts owed to relatives of the debtor could amount to a majority both in value and number and a closing of ranks by the creditors related to a debtor could result in prejudice being caused to other creditors. Our recommendation would protect the rights of minority creditors to pursue enquiries through a public examination which the majority would prefer to leave unanswered.

Confidentiality of the trustee's report

11.31 There is also the question of the confidentiality of the report of the trustee on which an application is based. The Court of Appeal in England has recently considered this point.[165] It had been the practice in England, and is the practice in Hong Kong, that a report of a trustee to the court is a confidential document and is not open to inspection. This practice applies to the report of the trustee in making an

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162 Bankruptcy (Scotland) Act 1985, section 45, and the Scottish Law Commission Report on Bankruptcy and Related Aspects of Insolvency and Liquidation (February 1982) at paragraph 14.1.

163 Bankruptcy Act 1966, section 177 and see also section 69.

164 See paragraph 11.29.

165 *Re British and Commonwealth Holdings plc* (Nos 1 and 2) [1992] 2 AER 801 CA. See also *British and Commonwealth Holdings plc (joint administrators) v Spicer & Oppenheim (a firm)* [1992] 4 AER 876 HL. See also *Perak Pioneer Ltd. v Carrian Holdings Ltd.* [1984] HKLR 349 at 352H.

application for public and private examination.[166] The Court of Appeal has upset the practice in England in holding that a person who seeks to set aside an order for production of documents obtained against him by company administrators on the basis of a statement filed with the court will, at the court's discretion, be permitted to inspect the statement if the court would otherwise be unable fairly and properly to dispose of his application to set aside, and if the administrators fail to show that confidentiality is appropriate.

11.32 We accept that there may be circumstances when it is appropriate for the bankrupt or a respondent in a private examination to inspect the report of the trustee but we do not wish to see a situation develop where the bankrupt or a respondent could inspect the report as of right. We consider that there is a balance to be struck and recommend that, in the case of a report of the trustee to the court in relation to a public or private examination, it should be in the discretion of the court whether to allow inspection of the trustee's report, or part of it, but that the report should remain confidential unless the respondent can show that it would be unfair to him not to allow inspection.

Creditors to supply the Official Receiver with a list of questions

11.33 The Consultative Document recommended that, where creditors wished to put questions to a debtor in public examination, the Official Receiver should be furnished with a list of the questions to be put prior to the examination. We are of the view that the furnishing of a list would provide the Official Receiver with advance knowledge of the questions that are to be put to a debtor and should help him in preparing his own questions. It would also be generally helpful in formulating a line of questioning to be put to a debtor.

11.34 It was suggested in one submission received on the Consultative Document that creditors should only have to supply a list of topics rather than specific questions and that creditors should not be limited to the list of questions or topics furnished in putting further pertinent questions to the debtor. We agree that it would be wrong to try to limit creditors to a formal list of prepared questions or to prevent creditors asking further questions. This was never our intention. We have therefore amended our recommendation to allow for creditors to supply a list of topics rather than specific questions.

Costs

11.35 We recommend that the court should have a discretion to order that the costs of a public examination should be borne by the creditors who have obliged the Official Receiver to hold an examination if the court, either on its own motion or on the application of the Official Receiver, considers that it was frivolous to have held the examination.

Perjury on examination

11.36 If a debtor or bankrupt wilfully makes a statement in the course of his public examination which is material in that proceeding and which he knows to be false or does not believe to be true, he can be charged with perjury and is liable on conviction upon indictment to imprisonment for seven years and to a fine.[167] He would not be protected by our recommendations on self incrimination.[168] It is likely that a bankrupt would be aware or would be warned in the course of his examination that his public examination is a judicial proceeding and that he would be committing perjury if he were to make a false statement. Nonetheless, we believe that it would be useful to give a warning before the examination to ensure that the bankrupt was fully aware of the consequences of making a false statement in his examination. We recommend that a notice should be placed in Form 53 of the Bankruptcy (Forms) Rules, the Order

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166 See paragraph 12.29.

167 Crimes Ordinance (Cap 200), section 31.

168 See paragraph 11.16.

Appointing a Time for the Public Examination of a Debtor, warning that on conviction for perjury a bankrupt would be subject to imprisonment for seven years and a fine.[169]

The Northern Irish procedure

11.37 The Cork Report drew our attention to a procedure under the Northern Irish Bankruptcy Rules 1970 which provides that, if a bankrupt consents, notes taken in his preliminary examination may be adopted by a bankrupt as his initial evidence. Before a public examination, the Official Receiver is required to send a copy of the notes to a bankrupt with a notice in prescribed form informing him that, at the sitting for his public examination, the bankrupt will be invited to adopt the notes as his evidence and that, if he has any doubts about this, the bankrupt is advised to consult a solicitor. If a bankrupt agrees to adopt the notes, the Official Receiver is obliged to read them in open court at the public examination and, when signed by a bankrupt, they are filed in court.

11.38 The procedure is not intended to deal with matters of controversy, such as transactions which the trustee may wish to challenge. Controversial matters should be the subject of cross-examination during the public examination. The Cork Report, which found this procedure attractive, commented that it understood that no bankrupt invited to adopt the notes had refused and that the procedure had resulted in a considerable saving in court time and shorthand writer's fees.[170] The question of shorthand writer's fees is relevant to Hong Kong as these fees are high and can be a considerable influence in a decision whether an estate can afford to bear the costs of a public examination.

11.39 We believe that the Northern Irish provisions could be adopted by the Official Receiver in Hong Kong with little difficulty. We recommend the adoption of the Northern Irish procedure with two changes. The first is that, instead of placing the emphasis on a bankrupt agreeing to adopt his preliminary examination, the preliminary examination should be taken as part of his public examination unless a bankrupt objects, and objections must relate to specific matters in the note of the preliminary examination. This represents a slight change from the recommendation in the Consultative Document which simply stated that the bankrupt could object and made no reference to specific objections. The amendment is made in response to a submission that a bankrupt should not be allowed to object at all, which we feel is too severe, but we take the point that a bankrupt should not be allowed to reject the notes without giving satisfactory reasons. The second change is that the examination should be in questionnaire form rather than in narrative form.

11.40 The Official Receiver has pointed out that the present form of preliminary examination is simply recorded by the Official Receiver as part of his investigation of the estate and is not sworn by a debtor or filed in court and that, if the preliminary examination is to be filed in court, it would be necessary to have it translated into English. We recommend that the preliminary examination should be capable of being conducted in English or Chinese and filed in court in either language.

11.41 The form of statement taken by the Official Assignee for Bankruptcy in Northern Ireland is very detailed, going into a bankrupt's history for many years prior to bankruptcy and taking details of family, previous residences and educational details in addition to a bankrupt's business history. We are of the view that it should be a matter for the Official Receiver to decide in each case how deeply he needs to investigate a bankrupt's prior history. The Official Receiver could formulate his questions accordingly.

Record of the examination

11.42 Section 19(8) of the Bankruptcy Ordinance provides that notes of the examination shall be taken in either shorthand or longhand and subsequently signed by a debtor.[171] We consider that this provision is restrictive and recommend that it should be amended to take account of more modern methods of recording evidence.

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169 See also paragraph 12.47.

170 The Cork Report, paragraphs 600 and 601.

171 See paragraph 11.3.

Minority view

11.43 The recommendations of the sub-committee on insolvency on public examination were not unanimous. A strong objection was made to the adoption of some of the Insolvency Act provisions on the basis that it reduced the rights of creditors and pushed them into the background in the administration of bankruptcy. It was argued that every creditor should have the right to question a debtor and that a creditor's questions would be more subjective than those posed by the Official Receiver and would provide a different angle from which to question a debtor.

11.44 It was also argued that even one creditor should be able to require the holding of a public examination but it was accepted that creditors who required a public examination should be obliged to pay the costs of the examination if the court took the view that the holding of the examination was frivolous or wasteful.

Recommendations

- **A bankrupt should be obliged to answer all questions that are put to him in his public examination but his answers may not be used as evidence against him in criminal proceedings other than in relation to perjury. This protection should not apply where a bankrupt does not give truthful answers in his examination.**
- **The provisions under the Insolvency Rules should be adopted whereby a bankrupt may at his own expense employ a solicitor with or without counsel, who may put to him such questions as the court may allow for the purpose of enabling him to explain or qualify any answers given by him, and may make representations on his behalf.**

- **The public examination should only be held on the application of the Official Receiver or, where no such application is made by the Official Receiver, on the requisition of one quarter in value of the creditors; following, in part, the Insolvency Act, section 290. The court should also have the discretionary power to make an order for examination at the request of creditors making up less than one quarter in value of creditors.**

- **It should be in the discretion of the court whether to allow inspection of the trustee's report to the court, or part of it, but the report should remain confidential unless the bankrupt can show that it would be unfair to him not to allow inspection.**

- **Creditors should furnish the Official Receiver with a list of the topics they intend to put to a bankrupt at a public examination.**

- **The court should have a discretion to order that the costs of a public examination should be borne by creditors who have obliged the Official Receiver to hold an examination if the court considers that it was frivolous to have held the examination.**

- **A warning should be placed in the Order Appointing a Time for the Public Examination of a Debtor warning that on conviction for perjury a debtor or bankrupt would be subject to imprisonment for seven years and a fine.**

- **Provisions similar to the procedure under the Northern Irish Bankruptcy Rules 1970 should be introduced whereby the preliminary examination of the bankrupt would be sworn by the bankrupt and filed in court as part of his public examination unless he objects, and objections must relate to specific matters in the note of the preliminary examination. The preliminary examination should be capable of being conducted in English or Chinese and filed in court in either language.**

- **Section 19(8) of the Bankruptcy Ordinance should be amended to take account of more modern methods of recording evidence.**

CHAPTER 12

PRIVATE EXAMINATION

The present law

12.1 The primary purpose of private examination is the examination of third parties as to the assets, or information relating to the assets, of a debtor or bankrupt. The examination is held by the court in private and is conducted by the trustee. It is also possible to examine a debtor or bankrupt under this provision but this is only likely to happen where it is considered desirable that the examination be held in private. The Bankruptcy Ordinance provides for the inquiry into the debtor's conduct, dealings and property as follows:[172]

> *"(1) The court may, on the application of the Official Receiver or trustee, at any time after a receiving order has been made against a debtor summon before it the debtor or his wife, or any person known or suspected to have in his possession any of the estate or effects belonging to the debtor or supposed to be indebted to the debtor, or any person whom the court may deem capable of giving information respecting the debtor, his dealings or property, and the court may require any such person to produce any documents in his custody or power relating to the debtor, his dealings or property.*
>
> *(2) If any person so summoned, after having been tendered a reasonable sum, refuses to come before the court at the time appointed, or refuses to produce any such document, having no lawful impediment made known to the court at the time of its sitting and allowed by it, the court may, by warrant, cause him to be apprehended and brought up for examination.*
>
> *(3) The court may, by itself or by a commissioner appointed for the purpose, examine on oath, either by word of mouth or by written interrogatories, any person so brought before it concerning the debtor, his dealings or property.*
>
> *(4) If any person on examination before the court admits that he is indebted to the debtor, the court may, on the application of the Official Receiver or trustee, order him to pay to the Official Receiver or trustee, at such time and in such manner as to the court seems expedient, the amount admitted or any part thereof, either in full discharge of the whole amount in question or not, as the court thinks fit, with or without costs of the examination.*
>
> *(5) If any person on examination before the court admits that he has in his possession any property belonging to the debtor, the court may, on the application of the Official Receiver or trustee, order him to deliver to the Official Receiver or trustee such property or any part thereof, at such time and in such manner and on such terms as to the court may seem just.*
>
> *(6) The court may, if it thinks fit, order that any person who if in Hong Kong would be liable to be brought before it under this section shall be examined in any place out of Hong Kong by a commissioner appointed for the purpose.*
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> *(7) In the case of the death of the debtor or his wife or of any other witness whose evidence has been duly taken under this Ordinance, the deposition of the person so deceased purporting to be sealed with the seal of the court, or a copy*

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172 Bankruptcy Ordinance, section 29.

thereof purporting to be so sealed, shall in all legal proceedings be admitted as evidence of the matters therein deposed to, saving all just exceptions."

12.2 The powers contained in the Bankruptcy Ordinance are directed at enabling the court to help a trustee in bankruptcy to establish the circumstances relating to the bankrupt's affairs with as little expense and as expeditiously as possible, with a particular view to the recovery of assets and the ascertainment of the validity of creditors' claims.

12.3 A debtor or bankrupt may be examined if the trustee is dissatisfied with the information given by him but in the case of other persons, referred to as respondents, the trustee may be required to show that some inquiry had already been made of the respondent which was responded to unsatisfactorily.

12.4 Although the Ordinance refers only to an application of the trustee or the Official Receiver it is possible for a creditor or others to make an application but this is unusual.[173]

12.5 Until recently a trustee who had commenced proceedings against a respondent was not allowed to examine him under section 29, the principle being that by applying for the examination the trustee was seeking to obtain the equivalent of interrogatories in the action. A trustee who merely contemplated bringing an action against a respondent also had to be careful as he could compromise the action if he decided to proceed on the basis of facts obtained on examination. An examination made by a trustee in such circumstances could be viewed by the court as a "fishing expedition" against the respondent. A decision in England on the corresponding section of the company provisions of the Insolvency Act casts doubt on whether this would still be the case in Hong Kong[174]. The Court of Appeal held that the test whether the liquidator had reached a firm decision to bring an action against the party against whom the order was sought was not the appropriate test, for the court had an unfettered discretion under the section; that in exercising that discretion the court had to balance the requirements of the liquidator against possible oppression of the party sought to be examined.[175] As the Insolvency Rules apply to both company and individual insolvency in relation to the examination of persons concerned in an insolvency, the judgment applies to bankruptcy in England and Wales.[176]

Discussion

Self incrimination

12.6 Unlike the provisions of section 19 on public examination, section 29 is silent on the duty of a respondent to answer questions put to him in the course of a private examination and on the use of any answers he might give in subsequent proceedings. It appears, however, that:

"A witness, other than the bankrupt, may refuse to answer on the ground that his answer would tend to incriminate him, but the court must be satisfied by some fact outside the question that there is a reasonable ground to apprehend danger to him from his being compelled to answer; when that is made plain, great latitude will be allowed to him in judging the effect of any particular question. The bankrupt, however, being obliged to make full disclosure of his property, will not be entitled to any such protection in relation to a question touching his estate."[177]

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173 See Williams and Muir Hunter on Bankruptcy, 19th edition, pages 113 and 114.

174 Insolvency Act 1986, section 236.

175 *Cloverbay Ltd. (Joint Administrators) v Bank of Credit and Commerce International S.A.,* [1991] Chd 90, (C.A)

176 Insolvency Rules, Part 9. See in particular rules 9.1, 9.2 and 9.5(a) and (b).

177 Williams and Muir Hunter on Bankruptcy, 19th edition, page 115 and 116. See also paragraphs 11.5 to 11.16 of this Report.

12.7 The position has now changed in England and Wales in the light of recent decisions relating to self incrimination and it has now been held that, by the provisions of the Insolvency Act, Parliament had abrogated the right of people to refuse to answer questions.

12.8 We see no reason to treat respondents differently to bankrupts and recommend that a respondent should be obliged to answer all questions put to him in his examination but his answers shall not be used in any criminal proceedings against him.

Extent of the examination

12.9 We recommend that section 29(3) of the Bankruptcy Ordinance should be amended to extend the power of the court to examine a respondent concerning the debtor, his dealings or property "and any other matter the court considers relevant". We believe that this additional wording would prevent a respondent from claiming that a particular line of questioning did not relate to the debtor, his dealings or property. It would remain in the discretion of the court to decide whether a particular line of questioning was appropriate in the examination.

Legal representation

12.10 In practice, a respondent in a private examination is permitted legal representation. This is not specified in the Bankruptcy Ordinance, in contrast to the position for public examination. We recommend that a provision following rule 6.175(3) of the Insolvency Rules should be adopted in the Bankruptcy Ordinance to make it clear that a respondent is entitled to legal representation. [178]

Solicitor - client privilege

12.11 We do not intend that the legal professional privilege between a solicitor and his client witness should be affected by our recommendations.

Examination of the bankrupt or the bankrupt's spouse

12.12 The Bankruptcy Ordinance provides for the summoning before the court of the debtor or his wife for examination. [179] In practice, it is recognised that, if the debtor is a woman, her husband can be summoned but the Official Receiver has said that the assumption that a woman cannot become bankrupt is no longer valid and recommends that the wording should be changed to the bankrupt or the bankrupt's spouse to avoid uncertainty.

12.13 We agree that the use of "wife" to describe a debtor's spouse is obsolete and should be replaced. "Debtor" would in any event be replaced by "bankrupt" under our recommendations. We consider that a provision for the examination of a bankrupt or the bankrupt's spouse would be an appropriate replacement for the present provision. This follows the wording in section 366 of the Insolvency Act.

Admission by the respondent of indebtedness to or possession of property belonging to the debtor

12.14 The Bankruptcy Ordinance provides that any person who, on examination, admits that he is indebted to the debtor or has in his possession property belonging to the debtor, may be ordered by the

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178 See paragraphs 11.17 to 11.19.

179 Bankruptcy Ordinance, section 29(1).

court to pay the debt, or deliver the property or part of the debt or property, to the trustee. [180] The Official Receiver proposed that the emphasis of this provision should be changed by providing that, if it appears to the court that a person is indebted to the debtor or is in possession of property belonging to the debtor, the court may order that the debt be paid, or the property or any part of the debt or property be delivered, to the trustee.

12.15 We agree that the Bankruptcy Ordinance should be amended as proposed by the Official Receiver. At present, the provisions are of limited value to a trustee as they provide that the respondent must admit that a debt is owed to the debtor or that he possesses property of the debtor before the court can make an order for payment of the debt or delivery of the property to the trustee. In the context of private examinations, which by their very nature indicate conflicting interests or disagreement between the trustee and a respondent, such admissions are rare and are ineffective against an uncooperative respondent.

12.16 Our recommendation is well supported by legislation in other jurisdictions. The corresponding provisions under the Singapore Bankruptcy Act are almost identical to Hong Kong except that, in Singapore, the court may order the payment of a debt or the delivery of property, or part of the debt or property, if it appears to the court that the respondent is indebted to the debtor or is in possession of his property.[181]

12.17 The Insolvency Act contains a similar provision to Singapore but it differs to the extent that under the Insolvency Act the court appears to have the power to order any person to pay a debt or deliver property as a result of information obtained in the examination of a third party.[182]

12.18 We believe that it is unreasonable to make an order for delivery or payment of assets against a person on the basis of an examination of a third party. We consider that the Singapore provision strikes a better balance between the need to reinforce the power of the court to make orders for delivery of assets as a result of the examination of a respondent and the right of third parties to an opportunity to defend themselves. We therefore recommend the adoption of the Singapore provisions into the Bankruptcy Ordinance.

Inter partes and ex parte applications for private examination

12.19 We have considered whether an application for private examination should be made ex parte, as has been the practice in Hong Kong.[183] The Chancery Division of the High Court in England recently held that an ex parte order should not be made against a respondent without giving him an opportunity to be heard. The court said that the only exception to this should be when two conditions were satisfied:

> *"First, that giving him such an opportunity appears likely to cause injustice to the applicant, by reason either of the delay involved or the action which it appears likely that the respondent or others would take before the order can be made. Secondly, when the court is satisfied that any damage which the respondent may suffer through having to comply with the order is compensatable under the cross-undertaking or that the risk of uncompensatable loss is clearly outweighed by the risk of injustice to the applicant if the order is not made.*
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> *There is, I think, a tendency among applicants to think that a calculation of the balance of advantage and disadvantage in accordance with the second condition is sufficient to justify an ex parte order. In my view, this attitude should be discouraged. One does not*

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180 Bankruptcy Ordinance, section 29(4) and (5).

181 Bankruptcy Act 1888, section 31(4) and (5).

182 Insolvency Act 1986, section 367(1) and (2).

183 See also Insolvency Rules 1986, rule 9.2(4) which allows for an ex parte application.

reach any balancing of advantage and disadvantage unless the first condition has been satisfied."[184]

12.20 We accept that sometimes it is impossible to safeguard the interests of every party and consider that the interests of the trustee and of respondents must be balanced. Accordingly, we recommend that applications for private examination should be made inter partes except in circumstances where the trustee believes that the application would cause the respondent or others to take actions that would prejudicially affect the estate. In cases where a trustee makes an ex parte application he should make full disclosure of the facts of the case to the court, in whose discretion it should lie to make an order.

Submission of affidavits and delivery of documents by the respondent

12.21 The Official Receiver has proposed that the court should have the power to order a respondent to submit an affidavit to the court containing an account of his dealings with the bankrupt and to produce any documents in his possession or under his control relating to the bankrupt or the bankrupt's dealings, affairs or property.

12.22 This reflects the position under the Insolvency Act which provides that the court may, at any time after a bankruptcy order has been made, on the application of the Official Receiver or of the trustee of the bankrupt's estate, summon to appear before it:

> *"(a) the bankrupt or the bankrupt's spouse or former spouse,*
>
> *(b) any person known or believed to have any property comprised in the bankrupt's estate in his possession or to be indebted to the bankrupt,*
>
> *(c) any person appearing to the court to be able to give information concerning the bankrupt or the bankrupt's dealings, affairs or property.*
>
> *The court may require any such person as is mentioned in paragraph (b) or (c) to submit an affidavit to the court containing an account of his dealings with the bankrupt or to produce any documents in his possession or under his control relating to the bankrupt or the bankrupt's dealings, affairs or property."*[185]

12.23 In providing that the persons referred to in the Insolvency Act can be required to furnish an affidavit, the legislators adopted a recommendation of the Cork Report[186] and effectively reversed a rule, which still applies in Hong Kong, that a person summoned for private examination could not be ordered to furnish an account in writing of transactions between himself and the debtor, or of property received by him.[187]

12.24 We are in favour of allowing the court, in appropriate circumstances, to require a respondent, including a bankrupt's spouse, to furnish an affidavit containing an account of his dealings with the bankrupt. A respondent may also be required to produce documents that relate to his dealings with the bankrupt.

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184 Hoffman J. in *re First Express Ltd* [1991] BCC at 785. We note that *re First Express Ltd* was an application under section 234 of the Insolvency Act 1986, which differs from section 236 of the Insolvency Act 1986 in that, under section 236, the respondent has the opportunity to apply to set the order aside before he is required to do anything, whereas under section 234 the respondent does not have that opportunity and is required to hand over records and money forthwith. We do not believe that the distinction is relevant to our recommendation.

185 Insolvency Act 1986, section 366(1).

186 The Cork Report, paragraph 903.

187 The rule in *Ex parte Reynolds* (1882) 21 ChD 601.

12.25 We are concerned that trustees should not be allowed to abuse this power. The giving of evidence on affidavit is more onerous than giving oral evidence. Respondents may be required to disclose dealings going back several years which may involve a respondent incurring considerable expense to comply with the terms of the order. Orders to produce affidavits could affect third parties who did not have direct dealings with a bankrupt, such as accountants, bankers and solicitors, who, through their duties of confidentiality to their clients, would often be obliged to refuse to volunteer information to a trustee. For these reasons, we believe that an application to produce an affidavit should be made inter partes except where the interests of the trustee would be prejudiced as stated above.

12.26 Affidavits should not be used by a trustee as a weapon to ambush respondents but should only be used when information legitimately requested has been withheld. A trustee should be able to demonstrate to the court that he has requested the information. We do not consider that such a procedure would be oppressive and we recommend therefore that a trustee should be able to apply for an order of the court requiring a respondent to produce an affidavit of his dealings with a bankrupt and to produce any documents in his possession or under his control relating to the bankrupt, the bankrupt's dealings, affairs or property.

12.27 Most objections by respondents to applications to produce affidavits are likely to be heard at the application by the trustee for an order. Where, however, a respondent appeals against an order, the appeal should be heard before the examination. An appeal against an order will necessarily delay the hearing of the examination until after the appeal. In the event of a respondent appealing against an order to produce an affidavit, the respondent should not be obliged to continue with the preparation of the affidavit prior to the hearing of the appeal unless the trustee makes a separate application for an order obliging the respondent to continue with preparation of the affidavit and the court so orders.

Interrogatories

12.28 The Insolvency Rules provide the trustee with the option of applying for a court order to require a respondent to answer interrogatories. We believe that this would be a useful option for a trustee to employ in addition to seeking an order for appearance before the court, the submission of affidavits and the production of documents and we so recommend.[188]

Confidentiality of a trustee's report

12.29 The same comments and recommendation apply to the confidentiality of the trustee's report in private examination as in public examination.[189]

Payment of costs of the examination by a respondent

12.30 A further proposal of the Official Receiver is the adoption of a provision similar to the Insolvency Rules which provide that where the court has ordered an examination of any person and it appears to the court that the examination was made necessary because information had been unjustifiably refused by the respondent, it may order him to pay the costs of the examination. In addition, there is provision that, where the court makes an order for a respondent to deliver up property or to discharge a debt due to the bankrupt, the court may order that the costs of the application be paid by the respondent.[190]

12.31 There is legislation in other jurisdictions that makes provision for the payment of costs by a respondent but the provision under the Insolvency Rules is the most far reaching one we have

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188 Insolvency Rules 1986, rule 9.2(3)(b).

189 See paragraphs 11.31 and 11.32.

190 Insolvency Rules 1986, rule 9.6(1) and (2).

examined.[191] The Bankruptcy Ordinance already provides that a person who admits to being indebted to the debtor or to being in possession of any property of the debtor may be ordered to pay the costs of the examination in addition to paying the debt or delivering the property to the trustee.[192]

12.32 It is our view that the Insolvency Rules provision would be a desirable extension of the present provision and should be adopted in Hong Kong. We believe that it is reasonable to give the court power to order a respondent to pay the costs of an examination if the examination was only held as a result of the respondent not complying with a legitimate request of the trustee for information or documentation or where the court makes an order for a respondent to deliver up property or to discharge a debt due to the bankrupt. We so recommend.

12.33 As a corollary to these recommendations, we also recommend that where, in the view of the court, a respondent has co-operated with the trustee in his examination, whether in oral examination or in the production of affidavits, interrogatories or documents, the costs of the respondent may be ordered by the court to be borne by the estate.

Power of the court to order an Inland Revenue official to produce tax documents of the bankrupt

12.34 The Official Receiver's final proposal is for a provision that the court may order an Inland Revenue official to produce to the court any return, account or accounts submitted by the bankrupt to any Inland Revenue official, any assessment or determination made in relation to the bankrupt by any Inland Revenue official, or any correspondence between the bankrupt and any Inland Revenue official; whether before or after the commencement of the bankruptcy. This reflects the position under the Insolvency Act and Rules.[193]

12.35 The Official Receiver has advised that the Inland Revenue Department at present only hands over documents to the Official Receiver, as trustee, if a debtor gives his consent and that the Inland Revenue Department will not even release information to the Official Receiver on the making of an adjudication order, citing the secrecy provisions contained in the Inland Revenue Ordinance.[194]

12.36 The Insolvency Act and Rules set out conditions by which an Inland Revenue official must act if served with an order to produce documents. An official must take all reasonable steps to produce the documents even if they are in the possession of another Inland Revenue official. In addition, the court may order the disclosure of any of the documents ordered to be produced under the Insolvency Act to the Official Receiver, the trustee or the creditors.

12.37 We received two submissions that expressed reservations about the recommendation in the Consultative Document that the court should have the power to order an Inland Revenue official to produce documents relating to a bankrupt's tax affairs to the trustee.

12.38 The Commissioner of Inland Revenue submitted that the current practice of the Inland Revenue Department is to only hand over documents to the Official Receiver, as trustee, where a debtor has given a written authorization. In the case of a deceased bankrupt, information is supplied to the Official Receiver in his capacity as executor of the deceased bankrupt's estate. Section 4 of the Inland Revenue Ordinance, in the absence of a specific written authority from the taxpayer, precludes the disclosure of any information.

12.39 The Consultative Document recommended that the Insolvency Act and Rules provisions should be adopted in the Bankruptcy Ordinance. We see no reason for the trustee in bankruptcy being

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191 For example see the New Zealand Insolvency Act 1967, section 68(4) and (5) or the Singapore Bankruptcy Act 1888, section 31(4) and (5).

192 Bankruptcy Ordinance, section 29(4) and (5).

193 Insolvency Act 1986, section 369 and Insolvency Rules 1986, rules 6.194 to 6.196.

194 Inland Revenue Ordinance (Cap 112), section 4.

denied access to a bankrupt's tax records without sufficient reason being shown, bearing in mind the role of the trustee on the bankruptcy of a debtor and we endorse the recommendation. In the event that there are grounds for objection, the Insolvency Rules allow the Commissioner of Inland Revenue to object in writing to the making of an order.[195]

12.40 The Commissioner of Inland Revenue also submitted that the recommendation would result in a watering-down of the secrecy provisions. The Commissioner added that confidentiality has long been one of the cornerstones of the taxation system and that the secrecy provisions encourage frankness by taxpayers who can provide the Revenue with information in their returns, secure in the knowledge that it will not be passed on. On the other hand, if the taxpayer fears that the financial information which he supplies to the tax authorities is likely to be communicated to others, he will have nothing but encouragement to delay making his returns or to falsify the figures they contain. He may also seek to evade the authorities altogether.

12.41 The second submission said that the recommendation suggested a breach of the secrecy provision in section 4 of Inland Revenue Ordinance. It noted that the secrecy provision has been in the inland Revenue Ordinance since the beginning and that great emphasis is paid to try and keep it as absolute as possible to ensure full and free disclosure. However, gradual erosion of this provision has occurred. Exemption to the provision has so far been granted in relation to recovery of drug proceeds under the Drug Trafficking (Recovery of Proceeds) Ordinance, complaints to the Commissioner of Administrative Complaints, and in relation to investigation of organised crime by the Independent Commission Against Corruption. However, disclosure by the Inland Revenue Department in these areas is limited. Disclosure to the Commissioner of Administrative Complaints, for instance, is restricted to matters in the complaint.

12.42 The second submission added that there is a body of opinion that the secrecy provisions contained in section 4 of the Inland Revenue Ordinance are an integral part of the tax system in Hong Kong. To allow these to be breached for whatever reason will be to weaken the fabric of the Inland Revenue Ordinance, and is a concern. There is also a bigger concern that breaches of the secrecy rule in relation to bankruptcy would be the thin end of the wedge and further attacks on the secrecy provisions could be expected. Such attacks would lead to loss of confidence in the way individuals dealt with the Inland Revenue Department. The submission suggested that in the long term this would lead to more evasion as individuals would be reluctant to provide information to the Inland Revenue Department when the assurances of secrecy which can now be given with total confidence would no longer be valid.

12.43 The second submission noted, however, that from a logical point of view, the trustee should be able to step in the shoes of the debtor and be entitled to information to which the debtor himself is entitled. Although the Inland Revenue Department, as a policy, does not entertain requests for information even from the taxpayer himself in relation to his own tax affairs, the Inland Revenue Department is not bound by the secrecy provision as far as the taxpayer is concerned. Under the official secrecy provision of section 4 of the Inland Revenue Ordinance, the preservation of secrecy by the Inland Revenue Department with regard to matters relating to a person's affairs is restricted to any person other than the person to whom such matter relates or his executor or the authorized representative of such person or such executor.

12.44 The second submission suggested that the exclusion clause to the preservation of secrecy may be expanded to include the trustee of the bankrupt, but should not extend to creditors or the Official Receiver (except where the Official Receiver acts as the trustee). In addition, the trustee should only be entitled to information in the shoes of the debtor, and not any information in the possession of the Inland Revenue Department in relation to the bankrupt's affairs as suggested. The trustee, in turn, should preserve the secrecy of the information and not disclose the information except in the performance of his duty, or use the information except for the purpose of tracing assets of the bankrupt.

12.45 We have set out these submissions in detail because we, together with the sub-committee on insolvency, share some of the concerns expressed. We do not wish to see the secrecy provisions of the Inland Revenue Ordinance eroded unnecessarily. Nonetheless, we consider that the trustee should have the right to the tax documents of a bankrupt and we stand by the recommendation made in the Consultative

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[195] Insolvency Rules 1986, rule 6.194(6).

Document. It was always the sub-committee's intention that the trustee should, as suggested in the second submission, stand in the shoes of the bankrupt as regards his tax records. We believe that a trustee should be entitled to any documents that a bankrupt supplied to the Inland Revenue Department and to any correspondence back from the Inland Revenue. In this regard we believe that section 369(1)(a),(b) and (c) of the Insolvency Act, which is followed in the recommendation in the Consultative Document, provides a precise definition of the information that an Inland Revenue official should produce to the court, that is, any return, account or accounts submitted by the bankrupt to any Inland Revenue official, any assessment or determination made in relation to the bankrupt by any Inland Revenue official, or any correspondence between the bankrupt and any Inland Revenue official; whether before or after the commencement of the bankruptcy. We do not intend that an Inland Revenue official should be obliged to provide the trustee with other confidential information or memoranda that it may have on the bankrupt.

12.46 There can be no doubt that the tax records of a bankrupt are sensitive. We believe that the trustee should treat them as such and that he should not provide copies of the information or the source of the information to anyone, including the creditors' committee or other creditors. While it would probably be obvious where certain information has come from we take the view that the trustee should be the only person to have sight of the information outside of the public examination of the bankrupt or other court proceedings involving the bankrupt's estate.

Perjury on examination

12.47 In the chapter on public examination we recommend that a warning should be placed in the Order that calls a debtor or bankrupt for examination under section 19 of the Bankruptcy Ordinance. We believe that the same warning should be given to a person being examined under section 29 and recommend that a warning should be placed in the summons under Section 29.[196]

Recommendations

- **A respondent should be obliged to answer all questions that are put to him in his examination but his answers may not be used as evidence against him in criminal proceedings.**

- **Section 29(3) of the Bankruptcy Ordinance should be amended to extend the power of the court to examine a respondent concerning the debtor, his dealings or property "and any other matter the court considers relevant".**

- **The provisions under the Insolvency Rules should be adopted to provide that a respondent may at his own expense employ a solicitor with or without counsel, who may put to him such questions as the court may allow for the purpose of enabling him to explain or qualify any answers given by him, and may make representations on his behalf.**

- **The wording of section 29(1) of the Bankruptcy Ordinance should be amended to replace the words "the debtor or his wife" with the words "the bankrupt or the bankrupt's spouse"; following the Insolvency Act, section 366.**

- **Section 29(4) and (5) of the Bankruptcy Ordinance should be amended to provide that where on examination it appears to the court that the person examined is indebted to the bankrupt or has in his possession property belonging to the bankrupt the court may order that person to pay such sum or deliver such property, or any part of the sum or property, as the court thinks fit, to the trustee.**

- **Applications for private examinations should be made inter partes except where a trustee reports to the court that the application would cause the respondent or others to take actions that would be likely to cause injustice to the applicant or where the risk of uncompensatable loss is clearly**

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[196] Form 112 of the Bankruptcy (Forms) Rules. See also paragraph 11.36.

outweighed by the risk of injustice to the applicant if the order is not made. In cases where a trustee makes an ex parte application he should make full disclosure of the facts of the case to the court, in whose discretion it should lie to make an order.

- **The court should have the power to require a respondent, including a bankrupt's spouse, to submit an affidavit of his dealings with a bankrupt and to produce any documents in his possession or under his control relating to the bankrupt, the bankrupt's dealings, affairs or property. In the event of a respondent appealing against an order to produce an affidavit the respondent should not be obliged to continue with the preparation of the affidavit prior to the hearing of the appeal unless the trustee makes a separate application for an order obliging the respondent to continue with preparation of the affidavit and the court so orders.**

- **The court should have the power to require a respondent to answer interrogatories; following the Insolvency Rules, rule 9.2.**

- **It should be left to the discretion of the court whether to allow inspection of the trustee's report.**

- **The court should have the power to order that the costs of an examination should be paid by a respondent if it appears to the court that the examination was made necessary because information requested by a trustee had been unjustifiably withheld by the respondent.**

- **The court should have the power to order that the costs of an examination should be paid by a respondent if the court makes an order for the respondent to deliver up property or to discharge a debt due to the bankrupt.**

- **Where a respondent has co-operated with the trustee in his examination and/or in the production of documents the court should have the discretion to order that the costs of the respondent be borne by the estate.**

- **The court should be able to order an Inland Revenue official to produce documents relating to the bankrupt's tax affairs; following the Insolvency Act, section 369.**

- **A warning should be placed in the Summons under Section 29 warning that on conviction for perjury a person would be subject to imprisonment for seven years and a fine.**

CHAPTER 13

BANKRUPT'S PROPERTY DIVISIBLE AMONG CREDITORS

The present law

13.1 The title to this chapter refers to the property of the bankrupt that is available for distribution among his creditors. The main concern of the Official Receiver's proposals, however, is with the extent of the property that may be retained by a bankrupt. Section 43 of the Bankruptcy Ordinance provides that:

> *"The property of the bankrupt divisible among his creditors, and in this Ordinance referred to as the property of the bankrupt, shall not comprise the following particulars -*
>
> *(a) property held by the bankrupt on trust for any other person;*
>
> *(b) the tools (if any) of his trade and the necessary wearing apparel and bedding of himself and his family dependent on and residing with him, to a value, inclusive of tools and apparel and bedding, not exceeding $3,000 in the whole;*
>
> *But it shall comprise the following particulars -*
>
> *(i) all such property as may belong to or be vested in the bankrupt at the commencement of the bankruptcy or may be acquired by or devolve on him before his discharge;*
>
> *(ii) the capacity to exercise and to take proceedings for exercising all such powers in or over or in respect of property as might have been exercised by the bankrupt for his own benefit at the commencement of his bankruptcy or before his discharge;*
>
> *(iii) all goods being at the commencement of the bankruptcy in the possession, order or disposition of the bankrupt, in his trade or business, by the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof: Provided that things in action other than debts due or growing due to the bankrupt in the course of his trade or business shall not be deemed goods within the meaning of this section."*

Discussion

13.2 The Official Receiver considers that the provisions relating to the property of the bankrupt divisible among his creditors and, by extension, the property that can be retained by the bankrupt, should be re-evaluated as the present provisions are out-dated and inadequate. We agree.

13.3 The sentiments behind the wording of section 43 date back to the Bankruptcy Act 1914. Historically the provisions relating to the extent of the property that may be retained by a bankrupt have undoubtedly been pro-creditor, illustrated in the present provisions by the extent of the allowances in respect of the tools of a bankrupt's trade and his domestic needs. Our recommendations in this chapter may be considered to favour the bankrupt. We do not believe that to be the case, as the recommendations seek only to strike a balance by recognising that the needs of a bankrupt and his dependents go beyond the present allowances. The Cork Report devoted three chapters to the effects of the equivalent section under the Bankruptcy Act 1914. The Cork Report's recommendations were taken up to a great extent in section 283

of the Insolvency Act.[197] The present Australian provisions are more widely drawn than section 43 of the Bankruptcy Ordinance but the Harmer Report nonetheless has also made recommendations to improve the position of bankrupts.[198]

The $3,000 monetary limit

13.4 The Official Receiver proposed that the monetary limit of $3,000 in value, inclusive of tools and apparel and bedding, that a bankrupt is allowed to retain should be abolished and a discretion should be given to the trustee or to the court to take account of each bankrupt's circumstances.

13.5 We recommend that the monetary limit should be abolished. The present limit has been in place since 1976 and cannot now reflect the intention of the legislation. The Official Receiver and practitioners have advised that, in practice, trustees in bankruptcy take a sympathetic approach to bankrupts and ignore the limit. The practice is for trustees, accepting that second-hand values in Hong Kong tend to be low, to leave a bankrupt and his dependents with adequate domestic furniture and hardware.

13.6 The Insolvency Act has no monetary limit, nor is there an overall monetary limit under the Australian Bankruptcy Act 1966, though there are specific monetary limits in respect of certain items such as tools and equipment.[199]

13.7 We see little point in retaining a provision that is almost completely ignored by trustees on humane grounds and which is out of date in terms of the amount. Even if the amount was to be updated and index-linked we believe that the property a bankrupt should be allowed to retain cannot be measured in pure monetary terms and that each bankrupt's case must be considered separately. This approach is reflected in other recommendations in this chapter.

The tools of a bankrupt's trade or business

13.8 The Official Receiver has proposed that the exemptions in respect of the tools of a bankrupt's trade under section 43(b) should be broadened to take modern day trade and business conditions into account.

13.9 The present provision is stark; a bankrupt may retain the tools, if any, of his trade. The Cork Report recommended that the exemptions should be expanded to include equipment indispensable for all trades, professions and callings of all kinds. The recommendation was made with the intention that creditors should look to a bankrupt's future income for payment rather than to realisation of his assets.[200]

13.10 The Insolvency Act, adopting the Cork Report's recommendations, provides that a bankrupt is entitled to retain:

> *"such tools, books, vehicles, and other items of equipment as are necessary to the bankrupt for use personally by him in his employment, business or vocation."* [201]

13.11 There has also been considerable discussion in Australia where the Harmer Report has recommended changes to the Bankruptcy Act 1966 which is, in any event, more progressive than the Hong Kong provision. It provides that the property divisible among the creditors of the bankrupt does not extend to:

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197 The Cork Report; Chapter 22 on Trust Property, Chapter 23 on Reputed Ownership and Chapter 24 on Exempt Property and Family Assets.

198 The Harmer Report, Chapter 17, Property Available for Distribution.

199 Insolvency Act 1986, section 283 and the Bankruptcy Act 1966, section 116.

200 The Cork Report, Chapter 24, paragraphs 1098 to 1106.

201 Insolvency Act 1986, section 283(2)(a).

"ordinary tools of trade, plant and equipment, professional instruments, and reference books of the bankrupt whose aggregate value does not exceed the prescribed amount, and such other property, if any, being such tools, plant and equipment, professional instruments or reference books, as:

(i) the creditors determine by resolution; or

(ii) the court, on application by the bankrupt, determines;

at any time before the trustee realises that other property." [202]

13.12 The Harmer Report was critical of the provision and said that tools could not be catalogued in the same way as household goods as the range of trades and occupations was too wide. The Harmer Report, though recognising that inflation could reduce its value, favoured the retention of a prescribed amount because it provided the bankrupt with a degree of certainty about the items he could retain and, in any event, the bankrupt could always apply to the court for an order that certain tools could be retained by him. The Harmer Report also noted that creditors were inclined to allow bankrupts to retain property above the prescribed amount if it was likely to help them to earn sufficient income to make contributions to the estate.[203] The Harmer Report recommended that a bankrupt should have the right to choose the equipment he wanted to retain provided that it was equipment used by the bankrupt in his trade, occupation or profession.

13.13 We view the question of the property that can be retained by a bankrupt for use in his trade, occupation or profession to be one of the most important aspects of this report. The present provision is plainly inadequate as it provides only for the retention of the tools of a trade in an age when bankruptcy affects people in all walks of life. The effect of the present provision, if interpreted literally, is to reduce bankrupts to virtual destitution and runs contrary to the principle of rehabilitation. The legislation examined and the Harmer and Cork Reports recognise that bankruptcy is not simply a punishment and that the aims of bankruptcy to pay creditors and to rehabilitate bankrupts are compatible.

13.14 We believe that a bankrupt should retain such tools and equipment as is necessary for him to continue to earn a reasonable living for himself and his dependants. In deciding the extent of the tools and equipment that should be retained, a major consideration should be the benefit that creditors might receive as a bankrupt should pay any excess earnings into the estate for the benefit of his creditors. We note that creditors aggrieved with the actions of a trustee have the right to apply to the court under section 83 of the Bankruptcy Ordinance.

13.15 We share the view of the Harmer Report that it is not possible to categorise all the trades, occupations and professions and the equipment that would be necessary for a particular bankrupt to continue in that capacity. The wide definitions employed in the Insolvency Act tend to support this view.[204]

13.16 We therefore recommend the adoption of a more widely drafted provision that would allow each bankrupt to retain property judged on its merits. There is nothing new in this recommendation as the Bankruptcy Ordinance already makes provision for a bankrupt to superintend the management of his former property or for him to carry on his trade for the benefit of his creditors but it is rarely, if ever, used.[205]

13.17 The difference between our recommendation and the present provision is that we want to see the new provision included as part of the provision on the property available for distribution to creditors. The trustee would bear a heavy responsibility in administering the provision as, in every relevant case, it would be left to his discretion, subject to the right of creditors or the bankrupt to apply to the court, to establish whether a bankrupt should be allowed to continue in his occupation, trade or business.

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202 Bankruptcy Act 1966, section 116(2)(c). The prescribed amount is A$ 2,000.

203 The Harmer Report, paragraph 877.

204 Insolvency Act 1986, section 283.

205 Bankruptcy Ordinance, section 62.

Proposal for a voluntary arrangement

13.18 In the context of this expanded responsibility, the trustee would need to take several matters into account. If a bankrupt had made a proposal for a voluntary arrangement that had been accepted by creditors the terms of the voluntary arrangement would apply to the retention of property. As a voluntary arrangement would have the support of creditors, the exercise of his discretion by the trustee would be unnecessary.

13.19 In cases where there is no voluntary arrangement the trustee would be expected to balance the needs of a bankrupt against those of his creditors. We believe that the first consideration of the trustee ought to be the cause of the bankruptcy. We have identified two broad types of bankruptcy in this context; bankruptcy resulting from the failure of a bankrupt's business and bankruptcy resulting from activities unrelated to a bankrupt's business, such as, for example, the bankruptcy of a dentist due to losses on margin trading. It is our view that these distinctions are important.

Business related bankruptcy

13.20 A business related bankruptcy would involve the trustee in deciding whether a bankrupt should be allowed to restructure a viable business. We consider that this should only happen if continuing the business would enable the bankrupt to earn more than he could earn in another occupation and would allow him to make payments to his estate. We consider that such situations would be comparatively rare and would be more appropriately dealt with in the context of a proposal to creditors by a bankrupt for repayment of his debts. It could happen that the illness of a bankrupt was the cause of not only the bankruptcy but also of the failure of the bankrupt to make a proposal to his creditors. We believe that by providing the trustee with this discretion the chances for some business related bankrupts to be rehabilitated would be increased.

13.21 It may be argued that this approach is inconsistent with the Companies Ordinance which makes it an offence for an undischarged bankrupt to act as a director or take part in the management of a company. We note, however, that the Companies Ordinance makes provision for a bankrupt to so act provided he obtains the leave of the court in which he was adjudged bankrupt.[206]

Non-business related bankruptcy

13.22 The position of a bankrupt business person whose bankruptcy is not business related is entirely different. We consider that every effort should be made to assist this type of bankrupt to continue in business as this provides the best opportunity for such a bankrupt to provide for himself and his dependents and to repay his creditors. Obviously, if the business of a bankrupt is viable the appropriate procedure would be a voluntary arrangement but if a voluntary arrangement cannot be agreed with creditors the trustee should have the discretion to allow a bankrupt to remain in business, subject to such terms and conditions as the trustee may impose.

13.23 In all these cases, we consider that there should be no restriction on the equipment that the trustee can allow a bankrupt to retain and that in appropriate circumstances a bankrupt should be allowed to retain his place of business. This recommendation is particularly relevant to non-business related bankruptcies, where it is more likely that a bankrupt could put forward a voluntary arrangement for repayment of his debts based on his remaining in business. Where a voluntary arrangement is accepted by creditors, we see every reason for a flexible approach being taken to the use by the bankrupt of his business equipment, books, premises, vehicles and any other items that the trustee, creditors or the court may consider appropriate. In such cases the trustee would be required to closely monitor the running of the business.

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206 Companies Ordinance, section 156(1).

13.24 We recommend, however, that where the trustee wishes to exercise his discretion to allow a bankrupt to restructure a business, whether the bankruptcy was business related or not, the trustee should seek the sanction of the creditors' committee, or the court if there is no creditors' committee.[207]

Domestic needs

13.25 The Official Receiver proposed that the provision relating to the retention by a bankrupt of his and his family's basic domestic needs should be widened. We have also considered the question of the availability to the estate of a bankrupt's family home.

13.26 The Bankruptcy Ordinance describes the domestic items a bankrupt is entitled to retain as being "the necessary wearing apparel and bedding of himself and his family dependent on and residing with him", subject to the proviso that domestic items together with tools of a trade should not exceed $3,000 in value.[208] We are of the opinion that this provision is unsatisfactory and needs to be widened.

13.27 Both the Cork and Harmer Reports considered the question of what the basic domestic needs of a bankrupt, and of those dependent on him, are. The Reports have considerably expanded the domestic needs of bankrupts and their dependents and, in the case of the Cork Report, these recommendations have been adopted into the legislation in great part.[209] We have been influenced by the arguments presented in both Reports and refer to them in some detail.

13.28 The Cork Report noted an upward trend in what society in the United Kingdom regarded as the lowest level in which anyone there should be expected to live and we believe that the same comment can be applied to Hong Kong.

13.29 The Insolvency Act allows a bankrupt to retain:

> *"such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family."* [210]

13.30 This provision expands the amount and quality of the goods that can be retained by a bankrupt. It is tempered by section 308 which allows the trustee to claim any part of the bankrupt's property if it appears to the trustee that the realisable value of that property exceeds the cost of a reasonable replacement. This provision is designed to prevent a bankrupt retaining such items as luxury cars, durable goods and antique items. The trustee is only obliged to replace such property when he has sufficient funds to do so but a third party can pay the value of such goods to the trustee in order to allow a bankrupt to retain them.[211]

13.31 The Australian Bankruptcy Act 1966 excludes the following domestic needs of the bankrupt and his family from the property divisible among his creditors:

> *"necessary wearing apparel, necessary household property of the bankrupt (including any sewing machine used for domestic purposes) and such other household property of the bankrupt, if any, as the creditors by resolution determine; at any time before the trustee realises that other household property;"* [212]

13.32 The Harmer Report recommended that the exemption should be for clothes and household effects necessary for satisfying reasonable domestic needs. In addition, the Harmer Report recommended that a list of exempt household items should be published. The list would be non-exclusive and it would be

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207 See paragraph 9.26.

208 Bankruptcy Ordinance, section 43(b).

209 The Cork Report; Chapter 24. The Harmer Report, paragraphs 858 to 874 and 912 to 921.

210 Insolvency Act 1986, section 283(2)(b).

211 Insolvency Rules 1986, rules 6.187 and 6.188.

212 Bankruptcy Act 1966, section 116(2)(b).

open to a bankrupt or creditors to argue whether property should or should not be retained. The Harmer Report favoured retention of the present powers of creditors to permit a bankrupt to retain other household property not included in the list of items specifically exempted. [213]

13.33 We consider that the present provision on the domestic items that the bankrupt can retain is limited and relies too heavily on the decency of the trustee in allowing the bankrupt to retain items that are not within the strict terms of the provision. We believe that the new provisions in the Insolvency Act and the proposals put forward by the Harmer Report are well thought out. We have therefore drawn on both the Insolvency Act and the Harmer Report in making our recommendations.

13.34 We consider that the wording of section 283(2)(b) of the Insolvency Act in relation to the domestic property that the bankrupt can retain is drafted sufficiently widely to allow the trustee to exercise a discretion as to the property that can be retained in each bankruptcy and recommend its adoption. We believe that it is important for the trustee to have a wide discretion in each case as the circumstances of bankrupts and their dependents vary widely.

13.35 We also recommend the adoption of another Insolvency Act provision that complements section 283 of the Act by expanding the discretion of the trustee in relation to those bankrupts who have domestic property that the trustee considers has a realisable value which would exceed the cost of replacement by property of a similar nature.[214] An example of this would be where a bankrupt possesses a valuable dining table. The trustee could claim the table, sell it and replace it when he has sufficient funds with a less valuable table. We have no objection to the inclusion of a provision which would allow a third party to pay a sum of money equivalent to the value of a valuable item to the trustee to allow the item to remain in the possession of the bankrupt. [215]

13.36 We considered the recommendation of the Harmer Report that a list of exempted items should be drawn up but have concluded that it would not be practical to produce such a list to suit all circumstances even though the list would be non-exclusive, with it being open to the trustee, creditors, or the bankrupt to have items included or excluded. We believe that the trustee will use his experience to decide what should be included or excluded, though it should be open to the bankrupt or creditors to apply to the court if they want specific items included or excluded.

The family home

13.37 In addition to expanding the exempt personal items of a bankrupt, the Insolvency Act has made special provision for the family home of a bankrupt.[216] There is no equivalent provision under the Bankruptcy Ordinance. The Insolvency Act provisions are quite complex, reflecting the difficulties the English courts and legislature have had in reconciling the conflicting interests of creditors and of the bankrupt and, more particularly, the interests of the bankrupt's spouse and dependents. The position prior to the Insolvency Act was complicated by the domestic situation of bankrupts as regards the rights, under other legislation, of a spouse or former spouse and children and of a deserted spouse and children to occupation of the family home.

13.38 The Cork Report adopted the idea of postponement of creditors' rights and the Insolvency Act provisions are regarded as being a compromise. The existence of other legislation in England and Wales has necessitated a distinction between cases where a bankrupt is the sole beneficial owner of the family home and where a bankrupt is the joint owner with his spouse. [217] For the purposes of this report we have not concentrated on this distinction and have simply taken the main points of principle from the provisions.

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213 The Harmer Report, paragraph 874.

214 Insolvency Act 1986, section 308.

215 See the Insolvency Rules 1986, rule 6.188.

216 Insolvency Act 1986, sections 336 to 338.

217 Law of Property Act 1925, section 30. Matrimonial Homes Act 1983.

13.39 The Insolvency Act provisions operate under a broad principle that effectively postpones the trustee's right of sale of the family home for a period of one year after bankruptcy. The court has a discretion to make such order as it considers appropriate having regard to the interests of a bankrupt's creditors, the conduct of the spouse or former spouse so far as contributing to a bankruptcy is concerned, the needs and financial resources of the spouse or former spouse, the needs of any children, and all the circumstances of the case other than the needs of a bankrupt.

13.40 The key provision is that the courts shall, where an application is made by the trustee after one year after the bankruptcy, assume that the interests of a bankrupt's creditors outweigh all other considerations. By this means, the legislation seeks to provide a grace period or period of sanctuary for a bankrupt and his dependents.

13.41 The Australian position is more straightforward in that, apparently, there was no other relevant legislation on the family home and the Harmer Committee considered the matter from the same position as we have. The Harmer Report noted that, in practice, trustees take into account the major social policy considerations of the avoidance of unnecessary strain on the family unit coming on top of the stress of financial problems and the preservation of the continued presence in the neighbourhood and convenient access to places of employment and schools. The point was also made that in the case of a bankrupt who had been making mortgage payments for several years it was probable that the mortgage repayments would be less than the rental commitment that a bankrupt would have to undertake if the family home was sold.

13.42 The Harmer Report recommended that, unless special circumstances could be shown, there should be no entitlement to obtain possession and complete a sale of a family home prior to the expiration of 6 months after the commencement of the bankruptcy; that the postponement should operate if the home was occupied by the spouse or de facto spouse of the bankrupt, a child or parent of the bankrupt or of the spouse of the bankrupt; the trustee should be entitled to apply for an order that the statutory period of postponement be reduced; and that a bankrupt should be entitled to apply for an order extending the statutory period of postponement.

13.43 The Harmer Report listed several factors that the court should take into account when exercising its discretion to extend or reduce the period of postponement. These are the welfare of a bankrupt's children, alternative accommodation, the amount likely to be realised from the sale of a bankrupt's interest in the family home, the need for the family to remain in a specific area, hardship caused to an individual creditor by a postponement, and whether the relevant members of a bankrupt's family would be able to remain in occupation of the property despite the realisation of the bankrupt's interest.[218]

13.44 The question of the family home is one which tested both the Cork and Harmer committees and which creates great difficulties in balancing the interests of a bankrupt's dependents with those of creditors. In some cases of bankruptcy, especially in the case of non-business bankruptcy, the most valuable asset of the bankrupt could be the family home. It may be argued that postponing the sale of the family home for a year would be detrimental to the interests of creditors. The Official Receiver's statistics indicate that on average it takes over four years to pay a dividend in a bankruptcy case, which tends to support the argument that postponement of sale would cause little or no loss to creditors.[219] The benefit to the dependents of bankrupts cannot be easily measured but any provision that creates a buffer between the twin blows of being made bankrupt and losing the family home must be welcome.

13.45 In the Consultative Document the sub-committee recommended that a bankrupt and his dependents should have the right to remain in occupation of the family home for one year after the making of a bankruptcy order but at the end of one year after the making of the bankruptcy order the court shall assume, unless the circumstances of the case are exceptional, that the interests of the bankrupt's creditors outweigh all other considerations.[220] The sub-committee believed that this provision would achieve a balance between the interests of creditors and the need to provide a measure of protection to bankrupts and more particularly to their dependants in relation to the family home.

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218 The Harmer Report, paragraphs 912 to 921.

219 See paragraph 6.11.

220 Insolvency Act 1986, section 336(5).

13.46 The sub-committee reconsidered the recommendation in the Consultative Document in the light of submissions which pointed out that, considering the high property values in Hong Kong, the family home could constitute a high proportion of the value of an estate. Two submissions suggested that a valuable family home could be replaced by a more modest rented home for the exemption period. On reflection, the sub-committee recommended that the right to stay in the family home should be six months in a normal case but with the proviso that the court should have the discretion to allow the bankrupt and his dependents to remain in the family home for a second period of up to six months in exceptional circumstances. We support this recommendation.

Reputed ownership

13.47 The Official Receiver proposed that the doctrine of reputed ownership should be abolished. The object of the doctrine, which is contained in section 43(iii) of the Bankruptcy Ordinance, is to prevent a trader obtaining credit on the strength of goods that are in his possession which in fact belong to other people.

13.48 The Cork Report recommended its abolition and it is not a provision of the Insolvency Act.[221] It is not law in Australia or New Zealand. The Harmer Report considered the concept and decided that it should not be introduced. Relation back has been repealed or recommended for repeal in Canada and the Republic of Ireland.

13.49 We recommend that reputed ownership should be abolished as its usefulness has been overtaken by commercial practices that were not contemplated at its inception. We accept arguments that a trader is no longer measured by the value of the goods or stock in his possession. An estimation of value based on this measurement takes no account of stock obtained on credit, title retention clauses or goods that are held on hire purchase or lease.

13.50 The credit worthiness of a trader is now established by his general credit rating both from within his trade or business and from bank and similar references.

Property acquired by a bankrupt after bankruptcy

13.51 The Bankruptcy Ordinance provides that property which is acquired or comes into the possession of a bankrupt after the commencement of the bankruptcy but before his discharge, is part of a bankrupt's estate for distribution in bankruptcy.[222] The Official Receiver proposed that property acquired by a bankrupt after the commencement of bankruptcy should not automatically vest in the trustee unless claimed by the trustee. This would shift the emphasis from the trustee being entitled to everything which a bankrupt accumulated after bankruptcy to one where the trustee could claim property selectively. The Official Receiver acknowledged that the present provision is difficult to enforce as it is hard to establish the extent of a bankrupt's assets several years after the commencement of bankruptcy. The Official Receiver also acknowledged that his proposal would save him from having to disclaim onerous after-acquired property of the bankrupt.[223]

13.52 In the Consultative Document the sub-committee agreed with the Official Receiver and recommended the adoption of the Insolvency Act provision in relation to after acquired property which allows the trustee to claim in writing any of a bankrupt's property which has been acquired by him or which has been devolved on him since the commencement of his bankruptcy. A trustee is obliged to give written notice to the bankrupt of his intention to claim property within 42 days of it having come to his knowledge that the bankrupt has the property. After the expiration of the 42 day period the bankrupt is then entitled to dispose of the property.[224]

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221 The Cork Report; Chapter 23.

222 Bankruptcy Ordinance, section 43 (i).

223 Bankruptcy Ordinance, section 59 and Bankruptcy Rules, rule 97.

224 Insolvency Act 1986, section 307.

13.53 The sub-committee received a submission, however, which argued that under the Consultative Document's recommendation any successful recovery of assets would depend on the cooperation of the bankrupt and on the efficiency of the trustee to be able to claim within 42 days of his discovery of assets. Coupled with automatic discharge after three years, there would be a temptation for a bankrupt not to make full disclosure. The submission suggested that it would be more beneficial to the interests of creditors to retain the original provision and, to better enforce it, to provide for periodical reporting by the bankrupt on his earnings and acquisition of property.

13.54 The sub-committee was persuaded by some of the arguments put forward in the submission and recommended that a bankrupt should be obliged to prepare an annual report of his earnings and acquisitions for the trustee. In addition, the sub-committee recommended that a breach of the duty by the bankrupt should be made a condition for objection to automatic discharge and should also be subject to criminal sanction.[225] The trustee would then have 42 days in which to claim any property which had been acquired by a bankrupt during the reporting period. If the trustee did not claim the property, the bankrupt would then be free to dispose of it. We support this recommendation.

Recommendations

- **The present monetary limit of $3,000 on the total value of tools of trade and domestic goods that a bankrupt can retain should be abolished.**

- **A bankrupt should be allowed to retain such equipment as is necessary for him to continue in his trade, occupation or business in order to earn a reasonable living for himself and his dependants. Excess earnings should continue to be paid into the bankrupt's estate. There should be no restriction on the equipment that a bankrupt is allowed to retain and in appropriate circumstances a bankrupt should even be allowed to retain his place of business.**

- **The trustee should, subject to sanction, have a discretion to allow a bankrupt to restructure a viable business if continuing the business would enable the bankrupt to earn more than he could earn in another occupation and would allow him to make payments to his estate.**

- **A bankrupt should be allowed to retain such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family. In addition, the trustee should have a discretion to sell domestic property which the trustee considers has a realisable value which would exceed the cost of replacement by property of a similar nature. It should be open to the bankrupt or creditors to apply to the trustee or the court if they want specific items of domestic property included or excluded; following Insolvency Act, sections 283 and 308.**

- **A bankrupt and his dependents should have the right to remain in occupation of the family home for six months after the making of a bankruptcy order but at the end of six months after the making of the bankruptcy order the court shall assume, unless the circumstances of the case are exceptional, that the interests of the bankrupt's creditors outweigh all other considerations. In the event that the court finds exceptional circumstances it should have the discretion to allow the bankrupt and his dependents to remain in the family home for a second period of up to six months.**

- **The doctrine of reputed ownership should be abolished.**

- **A bankrupt should be obliged to prepare an annual report of his earnings and acquisitions for the trustee. The trustee would then have 42 days in which to claim any property which had been acquired by a bankrupt during the reporting period. If the trustee does not claim the property, the bankrupt should then be free to dispose of it. Any breach of the duty by the bankrupt should be**

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225 See paragraph 17.40.

made a condition for objection to automatic discharge and should also be subject to criminal sanction.

CHAPTER 14

RELATION BACK OF THE TRUSTEE'S TITLE

The present law

14.1 The Bankruptcy Ordinance provides for the "relation back" of the trustee's title to property of the bankrupt to the time of the act of bankruptcy on which a receiving order is made, or, if there has been more than one act of bankruptcy, the time of the first of these acts within the three months before the presentation of the bankruptcy petition. The Bankruptcy Ordinance, section 42, provides that:

> *"The bankruptcy of a debtor, whether it takes place on the debtor's own petition or upon that of a creditor or creditors, shall be deemed to have relation back to, and to commence at, the time of the act of bankruptcy being committed on which a receiving order is made against him, or, if the bankrupt is proved to have committed more acts of bankruptcy than one, to have relation back to, and to commence at, the time of the first of the acts of bankruptcy proved to have been committed by the bankrupt within 3 months next preceding the date of the presentation of the bankruptcy petition, but no bankruptcy petition, receiving order or adjudication shall be rendered invalid by reason of any act of bankruptcy anterior to the debt of the petitioning creditor."*

14.2 The doctrine of relation back enables the trustee to overturn any transaction entered into by the debtor during the period covered where the trustee considers the debtor acted contrary to the interests of the estate. In practice, the discretion is seldom exercised.

14.3 The Harmer Report recognised that the doctrine of relation back is not well understood. The following illustration is given to show the effect of the provision:

17th May	:	A Bankruptcy Notice is served on a debtor.
24th May	:	The debtor does not comply with the terms of the Bankruptcy Notice and is deemed to have committed an act of bankruptcy under section 3(1) of the Bankruptcy Ordinance.
14th June	:	A Bankruptcy Petition is presented against the debtor.
18th July	:	A Receiving Order is made.
15th August	:	An Adjudication Order is made.

14.4 Under section 42 the trustee's title to the property of the debtor dates, not from the making of the receiving or adjudication orders, but from the date of the act of bankruptcy. In the example, this is the failure to comply with the bankruptcy notice by 24th May. If the trustee discovers that the debtor dealt with property to the detriment of the estate on or after 24th May the doctrine of relation back provides that the trustee can claim title to the property under section 42.

Discussion

14.5 The Official Receiver proposed that the doctrine of relation back should be abolished and replaced by a provision based on section 284 of the Insolvency Act[226]. The Official Receiver pointed out that his proposal to abolish acts of bankruptcy[227] would necessitate a change in the relation back provision as the date of the act of bankruptcy could no longer be used as the date to which the doctrine relates.

14.6 In making this proposal, the Official Receiver followed something of an international trend away from relation back. It has been abolished in England and Wales and replaced by section 284 of the Insolvency Act. In Australia, however, relation back is still law and applies to certain transactions within six months of the act of bankruptcy and, though the Harmer Report recommended that it should be abolished, the Bankruptcy Amendment Act 1991 did not repeal it.[228] Both Singapore and New Zealand have relation back provisions for a period of six months prior to the date of the presentation of the petition but the New Zealand Law Reform Commission has recommended that it should be abolished.[229] Relation back has been effectively abolished in the Republic of Ireland.[230]

14.7 The Harmer Report criticised the doctrine, describing it as a fictitious, abstract and artificial concept that in practice is little used and added that the concept of relation back becomes less significant with the strengthening of antecedent transaction avoidance provisions relating to recovery of property disposed of prior to the actual commencement of bankruptcy.[231]

14.8 We agree that relation back may become less significant with the introduction of more effective antecedent transaction avoidance provisions but two factors have caused us to recommend that relation back ought to be retained, at least for now. First, this report does not address strengthening the anti-avoidance provisions in the Bankruptcy Ordinance. These will be addressed in our final report on insolvency, when anti-avoidance provisions in respect of both the Bankruptcy Ordinance and the Companies Ordinance will be considered. Second, we take the view that, in the absence of strengthened anti-avoidance provisions, there should be a

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226 See paragraph 14.9.

227 See paragraphs 1.03 to 1.12.

228 The Harmer Report, paragraph 697. See also the Bankruptcy Act 1966, sections 115 and 123.

229 Singapore Bankruptcy Act 1888, section 46. New Zealand Insolvency Act 1967, section 42. New Zealand Insolvency Law Reform, Discussion Paper, December 1988.

230 Bankruptcy Act 1988, section 44(2).

231 The Harmer Report, paragraphs 696 to 698.

relation back provision in the Bankruptcy Ordinance. In any event, we are not convinced that relation back should be abolished even after the introduction of strengthened anti-avoidance provisions. Pending our detailed examination of anti-avoidance provisions, we recommend that relation back should have effect for a period of three months preceding the date of the presentation of the bankruptcy petition. This change is necessitated at this stage to take account of our proposed abolition of acts of bankruptcy. We have fixed on the date of presentation of a bankruptcy petition as it is the earliest common date which relates to the four grounds we have recommended for the presentation of a petition.[232]

14.9 The adoption of such a provision would be similar to the corresponding provision under the Insolvency Act except that the latter is more precise in defining the type of payment that the provision refers to, the period covered by the section, and the limits of the effect of the section. The Insolvency Act, section 284, would be adapted to provide that:[233]

> *"(1) Where a person is adjudged bankrupt, any disposition of property made by that person in the period to which this section applies is void except to the extent that it is or was made with the consent of the court, or is or was subsequently ratified by the court.*
>
> *(2) Subsection (1) applies to a payment (whether in cash or otherwise) as it applies to a disposition of property and, accordingly, where any payment is void by virtue of that subsection, the person paid shall hold the sum paid for the bankrupt as part of his estate.*
>
> *(3) This section applies to the period beginning with the* ***relevant day, that is, a date 3 months immediately before the date of the presentation of a petition for a bankruptcy order and*** *ending with the vesting of the bankrupt's estate in a trustee.*
>
> *(4) The preceding provisions of this section do not give a remedy against any person -*
>
> *(a) in respect of any property or payment which he received before the* ***relevant date*** *in good faith, for value and without notice that the petition had been presented, or*
>
> *(b) in respect of any interest in property which derives from an interest in respect of which there is, by virtue of this subsection, no remedy.*
>
> *(5) Where after the* ***relevant date*** *the bankrupt has incurred a debt to a banker or other person by reason of the making of a payment*

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[232] The four grounds recommended in Chapter 1 are (i) Failure to comply with the terms of a statutory demand (ii) the unsatisfied execution of a judgment debt (iii) the absconding debtor ground, and (iv) default under the terms of a voluntary arrangement.

[233] Our amendments to section 284 are in bold print.

which is void under this section, that debt is deemed for the purposes of ***this section*** *to have been incurred before the* ***relevant date*** *unless-*

(a) that banker or person had notice of the bankruptcy before the debt was incurred, or

(b) it is not reasonably practicable for the amount of the payment to be recovered from the person to whom it was made.

(6) A disposition of property is void under this section notwithstanding that the property is not or, as the case may be, would not be comprised in the bankrupt's estate; but nothing in this section affects any disposition made by a person of property held by him on trust for any other person."

14.10 Section 284 is not as far-reaching as relation back as it only has effect from the date of the presentation of the petition but our recommendation contemplates the adaptation of section 284 to provide for a three month relation back provision.

14.11 Section 284 provides that a disposition is void notwithstanding that the property is not, or would not be, comprised in the bankrupt's estate, although this extension does not apply to any disposition made by a person of property he holds on trust for another. Section 284(4) protects bona fide purchasers for value without notice of the petition. Section 284(5) allows people who have had payments made to them which have been voided under the section to claim in the bankruptcy in the same way as a creditor for a debt contracted before the date of the petition unless the person had notice.

14.12 The provisions relating to transactions at an undervalue and preferences under the Insolvency Act are connected to relation back as they are powers that allow a trustee to recover property of the debtor which the debtor has sought to dispose of to the detriment of the general body of creditors.[234] The tests that the trustee must satisfy under these provisions are less stringent than the tests in the provisions they replaced and we appreciate that generally there has been a move towards shifting the onus of proof to the recipient of the preference to show that there was no preference, though we also note that the shifting of the burden of proof is not as extensive under the bankruptcy provisions of the Insolvency Act as may be generally supposed.[235]

14.13 We do not see why there should be specific references to "banker" in the section 284(5) of the Insolvency Act and recommend that the reference should be to "any person".

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234 Insolvency Act 1986, sections 339 and 340.

235 See The Law of Insolvency; Ian F. Fletcher; 1st edition, pages 209 and 210 on the burden of proof.

Recommendation

The doctrine of relation back should be retained in an adapted version of section 284 of the Insolvency Act, with relation back applying for a period of three months from the date of presentation of the bankruptcy petition.

CHAPTER 15

PROOF OF DEBT

The present law

15.1 To be able to participate in the distribution of dividends from the bankrupt's estate a creditor must have proved his debt. To do this, he must have a provable debt which has been admitted by the trustee. The mode of proving a debt is by filing a proof of debt in a statutory form prepared by a creditor or his authorised representative, which contains details of the amount of the debt and whether any satisfaction or security has been received in respect of the debt. The proof of debt may be made by the creditor or by a person authorised by or on behalf of the creditor and having knowledge of the facts.

15.2 The proof of debt can be important for voting purposes at a meeting of creditors, as creditors who have proved can vote on a composition or scheme of arrangement proposed by the debtor or bankrupt.[236] The value of a proof of debt could therefore be significant, as a composition or scheme can be accepted by a majority in number and three-fourths in value of creditors.

15.3 The main provision of the Bankruptcy Ordinance relating to proof of debt and provable debts is section 34 and there are other supporting sections and rules.[237] Section 34 provides that:

> *"(1) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise or breach of trust shall not be provable in bankruptcy.*
>
> *(2) A person having notice of any act of bankruptcy available against the debtor shall not prove in bankruptcy for any debt or liability contracted by the debtor subsequently to the date of his so having notice.*
>
> *(3) Save as aforesaid, all debts and liabilities, present or future, certain or contingent, to which the debtor is subject at the date of the receiving order, or to which he may become subject before his discharge by reason of any obligation incurred before the date of the receiving order, including a liability to pay further damages as provided for in section 56A(2)(b) of the Supreme Court Ordinance (following an award of provisional damages), shall be deemed to be debts provable in bankruptcy.*
>
> *(4) An estimate shall be made by the trustee of the value of any debt or liability provable as aforesaid which by reason of its being subject to any contingency or contingencies, or for any other reason, does not bear a certain value.*
>
> *(5) Any person aggrieved by any estimate made by the trustee as aforesaid may appeal to the court.*
>
> *(6) If in the opinion of the court the value of the debt or liability is incapable of being fairly estimated, the court may make an order to that effect, and thereupon the debt or liability shall, for the purposes of this Ordinance, be deemed to be a debt not provable in bankruptcy.*
>
> *(7) If in the opinion of the court the value of the debt or liability is capable of being fairly estimated, the court may direct the value to be assessed before the court itself without the intervention of a jury and may give all necessary*

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236 Bankruptcy Ordinance, sections 20(2) and 25(1).

237 The Proof of Debt Rules, (Cap 6) E1, and Bankruptcy Rules 109 to 118.

directions for this purpose, and the amount of the value when assessed shall be deemed to be a debt provable in bankruptcy.

(8) For the purposes of this Ordinance, "liability" includes -

(a) any compensation for work or labour done;

(b) any obligation or possibility of an obligation to pay money or money's worth on the breach of any express or implied covenant, contract, agreement or undertaking, whether the breach does or does not occur, or is or is not likely to occur or capable of occurring, before the discharge of the debtor;

(c) *generally, any express or implied engagement, agreement or undertaking to pay or capable of resulting in the payment of money or money's worth, whether the payment is, as respects amount, fixed or unliquidated, as respects time, present or future, certain or dependent on any one contingency or on 2 or more contingencies, or, as to mode of valuation, capable of being ascertained by fixed rules or as a matter of opinion."*

15.4 The Proof of Debt Rules set out the conditions on which proofs of debt can be made, detail how the proof of debt form should be completed and make specific provision for secured creditors and for proofs in respect of certain types of contract. The Proof of Debt Rules also provide for the admission or rejection of proofs.

Discussion

15.5 The Cork Report stated, and we agree, that:

> *"It is a basic principle of the law of insolvency that every debt or liability capable of being expressed in money terms should be eligible for proof in the insolvency proceedings, so that the insolvency administration should deal comprehensively with, and in one way or another discharge, all such debts and liabilities."*

The Cork Report added that:

> *"To the extent that claims are not susceptible of proof in bankruptcy at all or, if provable, are not released upon the discharge of the bankrupt, he continues to be personally liable and any property acquired by him after his discharge is available to meet such claims. Apart from the general uncertainty of this situation, it militates against the complete rehabilitation of the bankrupt."*[238]

15.6 The Official Receiver proposed several changes to the present provisions on proof of debt. The proposals were that conversion of foreign currency debts into Hong Kong dollars should take place either at the date of the presentation of the petition, or at the date of the making of the bankruptcy order, that all claims for damages, whether in contract or in tort, should be admissible to proof in bankruptcy provided only that they should be liquidated by agreement or judgment before they come to be proved, and that no penalty imposed by any court should be admissible to proof nor should it be released by the bankrupt's discharge.

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[238] The Cork Report, Chapter 29, "Provable Debts", paragraphs 1289 and 1291.

Foreign currencies

(i) Date of valuation of foreign currency for the purpose of dividend

15.7 The Bankruptcy Ordinance has no specific provision on conversion of currencies but the practice has been to convert at the date of the receiving order. The Insolvency Rules provide that a foreign currency debt shall be converted on the date of the bankruptcy order.[239]

15.8 The Insolvency Rules followed the Cork Report which recommended that the conversion of foreign currencies should be effected as at the date of the commencement of the relevant insolvency proceedings, that is the date of the bankruptcy order, or the date of the winding up order in companies' liquidation. The Cork Report noted that confusion had been caused by conflicting court decisions. It had initially been decided that the date for conversion should be the date when a claim was admitted by the trustee.[240] This was contradicted by subsequent decisions that the conversion should be effected at the date of the winding up order.[241] The Cork Report noted that the basis for the latter decisions was that it is a primary purpose of the winding up of an insolvent company to ascertain the company's liabilities at a particular date and to distribute its assets pro rata amongst the creditors as at that date.[242]

15.9 The Harmer Report noted the position under the Insolvency Act and the related decisions and recommended that Australia should follow the Insolvency Act by providing that the date for conversion should be the date when the insolvency administration actually commenced, that is, the date of the winding up order or the bankruptcy order.[243]

15.10 The principles involved in the appropriate date of conversion of foreign currencies apply equally to bankruptcy and to companies' winding up. We agree with the Cork Report that, in order to be fair to all creditors, an insolvent's assets and liabilities should be ascertained at a particular date and we recommend that the appropriate date should be the date of the bankruptcy order.

(ii) Discretion in trustee to delay conversion of foreign assets

15.11 The setting of the date of the conversion at the date of the bankruptcy order is the notional date of conversion for the purpose of fixing the rate of exchange. Another aspect to currency conversion, however, is the date when the currency is physically converted into Hong Kong dollars. We recognise that enormous sums of money could be at stake in some insolvencies and consider that there should be some flexibility allowed to the trustee and creditors in dealing with assets in foreign currencies. While we do not consider that it is the function of the trustee to engage in currency speculation, the value of an estate could be increased by converting foreign currency realised by the trustee into Hong Kong dollars at a beneficial exchange rate rather than converting into Hong Kong dollars immediately the foreign asset becomes foreign currency, which would be the safe option for a trustee in the absence of guidelines. It is equally obvious that there is a risk involved in delaying conversion but, on balance, we favour giving the trustee flexibility in the timing of foreign currency conversion.

15.12 The conversion of foreign currency is an area where a trustee should act carefully because if a loss were to be made on conversion, where a trustee acted on his own initiative, he might, under our recommendations, be liable to make recompense to creditors or the bankrupt.[244] We recommend, however, that if a trustee, on taking expert advice, considers that it would be beneficial to the estate to delay the conversion of foreign currency to Hong Kong dollars he should be able to do so but only with the approval of the creditors' committee, or the court in the absence of a creditors' committee.

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239 Insolvency Rules 1986, rule 6.111.

240 *Miliangos v. George Frank (Textiles) Ltd.* [1976] A.C.443.

241 *Re Dynamics Corporation of America* [1976] 1 WLR 757. *Re Lines Bros Ltd.* [1983] 1 Ch 1.

242 The Cork Report, paragraphs 1308 and 1309.

243 The Harmer Report, Chapter 16, Claims in Insolvency, paragraphs 805 to 811.

244 See paragraphs 9.32 to 9.37.

(iii) Discretion in the trustee to pay foreign currency claims in that currency

15.13 The Consultative Document commented that it was possible for an estate to have foreign currency assets and also to have claims against the estate in that foreign currency. The Consultative Document proposed that, provided a trustee was satisfied that the foreign currency claims would be admitted for the purposes of paying a dividend, a trustee should be able, with the approval of the creditors' committee or the court, if appropriate, to retain out of assets already in his possession sufficient foreign currency as was considered appropriate, on deposit, to pay dividends in that currency. It was considered that, in such a situation, it would then be irrelevant whether that currency fluctuated.

15.14 Submissions were received pointing out that this reasoning was flawed in that it tended to contradict the proposal that a foreign currency claim should be converted into Hong Kong dollars at the date of the bankruptcy order and that it could result in foreign currency claims either benefiting or suffering from currency fluctuations.

15.15 We accept that, although the proposal was intended to create greater flexibility for the trustee and to benefit creditors, it actually would have created inequality between foreign currency claimants and Hong Kong dollar claimants. We therefore wish to clarify the position on payment of dividends on foreign currency claims. We recommend that the exchange rate for foreign currency claims should be fixed at the exchange rate on the date of the bankruptcy order. The trustee would then always know the Hong Kong dollar value of the foreign currency claim and would only need to consider whether to pay a dividend in respect of a foreign currency claim in Hong Kong dollars or in the foreign currency equivalent of the Hong Kong dollar dividend.

15.16 We accept that foreign currency claimants would still be affected by currency fluctuations but we do not believe that there is any way around the problem if the principle of *pari passu* distribution of dividends is to be maintained.

Tort claims

15.17 The Official Receiver proposed that all claims for damages, whether in contract or in tort, should be admissible to proof in bankruptcy provided only that they should be liquidated by agreement or judgment before they come to be proved. This proposal reflected the position or the recommended position in several other jurisdictions that have considered this matter. Under the law at present, damages in tort are not provable in bankruptcy unless they are liquidated by agreement made or judgment obtained before the commencement of the bankruptcy. If a debtor is adjudicated bankrupt before a claim is liquidated a claimant's only recourse is to liquidate his claim and then petition for the second bankruptcy of a debtor. The recommendation affects section 34(1) of the Bankruptcy Ordinance, which provides that only unliquidated demands that arise by reason of a contract, promise or breach of trust shall be provable in bankruptcy.

15.18 The Cork Report noted that the rule is anomalous in that it does not apply to claims for unliquidated damages for breach of contract or breach of trust, which are provable whether or not they have been liquidated before the commencement of the bankruptcy. The Cork Report made the analogy that many claims, particularly for negligence, may be formulated either in tort or in contract and gave the example of a patient who, in suing his doctor for negligent treatment could, without affecting the result, claim damages either for the tort of negligence or for the breach of contract to give proper treatment and advice. In such a case, where the claim was unliquidated at the commencement of the bankruptcy, the claimant could prove for his claim by the simple expedient of electing for the contractual remedy and waiving the tort. The Cork Report recommended that all claims for damages, whether in contract or in tort, should be admissible to proof provided only that a claim should be liquidated by agreement or judgment before it came to be proved.[245]

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[245] The Cork Report, paragraphs 1310 to 1318.

15.19 The Insolvency Rules followed the recommendation of the Cork Report and provide that all claims by creditors are provable as debts against a company or a bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages. The only exceptions to this in bankruptcy relate to fines imposed for offences and to orders made in family or domestic proceedings.[246] The main problem in relation to orders in family or domestic proceedings is that the enforcement or variation of these orders lie with the court in which the orders were made.[247]

15.20 The position is different in companies winding up where, subject to limitations, damages in tort are provable whether or not they are liquidated before the commencement of the winding up provided they are liquidated by judgment or agreement before the claim comes to be proved.[248] The exclusion of unliquidated damages in tort from full proof in bankruptcy has been criticised judicially as being difficult to justify.[249]

15.21 Claims for unliquidated damages in tort can also be proved in both New Zealand and the Republic of Ireland.[250] In Australia the position is the same as in Hong Kong but the Harmer Report recommended that claims for unliquidated damages in tort should be admissible.[251] The Harmer Report's recommendation has not been taken up in the Bankruptcy Amendment Act 1991. The position in Singapore is similar to Hong Kong.[252]

15.22 The only objection to the admission of tort claims in bankruptcy is the delay that valuing tort claims can cause in administering the estate, which can act to the detriment of other creditors. The adoption of procedures that lead to a valuation being made of tort claims overcomes this objection and we therefore recommend that tort claims should be provable in bankruptcy.

15.23 We believe, however, that there should be a procedure for valuing tort claims as we foresee delays in the administration of estates and the payment of dividends caused by tort claims being unliquidated. A practical example of how easily delays can be caused is to look at claims made against an estate in personal injury cases. In such cases it can take years for the condition of a victim to stabilise in order to assess the damages the victim is entitled to.

15.24 The Harmer Report recommended that, to the extent that there may be practical problems in estimating the amount of claims for unliquidated damages, the court should be expressly empowered to direct that quantification be determined in such manner as the court specifies.[253] The Harmer Report went on to recommend an amended procedure for estimating the value of unliquidated debts based on a procedure already existing under the Australian Bankruptcy Act 1966[254] which requires that:

> *"The trustee shall make an estimate of the value of a debt or liability provable in the bankruptcy which, by reason of its being subject to a contingency, or for any other reason, does not bear a certain value."*

15.25 The Harmer Report recommended that a trustee should either make an estimate of the value of a debt or liability or refer the claim to the court for valuation. The right of appeal from an estimate made by a trustee would then be treated as if that person had referred the claim to the court. The court would have a power to specify a mode of determining the value rather than being necessarily required to determine the value itself. It would still be open to appeal to the court from a valuation determined in the

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246 Insolvency Rules 1986, rule 12.3(1) and (2).

247 For comment on the exclusion of orders made in family or domestic proceedings see The Law of Insolvency, Ian R. Fletcher, 1990 edition, at page 247. For an explanation of the exclusion of fines see the Cork Report, paragraphs 1328 and 1329. See also paragraphs 15.29 to 15.40 of this Report.

248 *Re Berkeley Securities (Property) Ltd.* [1980] 1 WLR 1589.

249 Vinelott J. in *Berkeley Securities (Property) Ltd.*

250 New Zealand Insolvency Act 1967, section 87. Republic of Ireland, Civil Liability Act, section 61.

251 Bankruptcy Act 1966, section 82(2) and the Harmer Report, paragraph 786.

252 Bankruptcy Act 1888, section 41.

253 The Harmer Report, paragraph 786.

254 Bankruptcy Act 1966, section 82(4).

specified manner.[255] We approve of the Harmer Report's proposal and recommend its adoption in the Bankruptcy Ordinance.

15.26 We also considered the New Zealand provision whereby a trustee may give a value to any contingent debt or liability which does not bear a certain value if he considers that it can be fairly estimated. If he cannot fairly estimate the value he shall reject the proof. A creditor aggrieved by a rejection may appeal to the court. The court may either uphold the rejection or may give a valuation or direct that a valuation be made, in which case the debt becomes provable in the bankruptcy. We agree, however, with the New Zealand Law Reform Commission inquiry which said that the Harmer Report recommendation had the advantage of providing more flexibility than the New Zealand provision.[256]

15.27 We have also considered how to treat estimations of unliquidated claims which are liquidated, as in a judgment for damages awarded by the court, after a first dividend has been paid on an estimated amount but before a second dividend has been paid. We recommend that, in the case of an estimate on which a dividend has been paid that is less than the amount subsequently awarded by the court, there should be no catch up entitlement for the claimant in respect of the first dividend. The claimant should, however, be entitled to amend his proof of debt and prove for the judgment amount in the second dividend.[257]

15.28 In the case of a judgment that is less than an estimate on which a dividend has been paid, we recommend that the first dividend payment should not be reduced but that the claimant should not be allowed to claim for any more in the second dividend than he would be entitled to *pro rata* in the total amount of dividend with other creditors in respect of the judgment amount.

Fines and penalties

15.29 The Official Receiver proposed that no penalty imposed by any court should be admissible to proof nor should it be released by a bankrupt's discharge. The Bankruptcy Ordinance does not provide that fines and penalties are provable in bankruptcy but the practice, which probably stems from an English decision that a fine is a provable debt in bankruptcy, is that they are.[258]

15.30 The question of fines has been considered by both the Cork and Harmer Reports. The Cork Report said that the issues were, firstly, the narrow issue of whether fines ought to be provable at all and if so, whether a debtor should be released from such a debt on his discharge and, secondly, the wider issue of the uncertainty that had arisen over the recovery of fines due to an apparent conflict between the criminal and the insolvency codes. The English system appeared to have been beset with uncertainties and arguments concerning the treatment of fines in bankruptcy that have no relevance to Hong Kong but the Cork Report made the point that fines are frequently imposed with the alternative of imprisonment in default of payment of the fine and that for such a sentence to be appropriate it must afford a real and not illusory alternative. Thus, where a convicted person is already bankrupt before the proceedings there may be no real possibility of his paying the fine.

15.31 The Cork Report added, however, that this was not always the case and that, where the depredations of the convicted person caused loss to creditors, it seemed to add insult to injury to impose a fine which, if paid, went to the Treasury to the possible detriment of creditors, and which, if unpaid, was capable of ranking in a subsequent bankruptcy in competition with the claims of defrauded creditors. From the creditors' point of view the position would be aggravated by the fact that imposition of the fine, with the alternative of imprisonment, would be an encouragement to the debtor to pay the fine as quickly as possible,

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255 The Harmer Report, paragraph 797.

256 New Zealand Law Reform Commission, Discussion Paper on Insolvency Law Reform, December 1988, at pages 116 and 117.

257 See Williams and Muir Hunter on Bankruptcy, 19th edition, pages 154 and 155 on the treatment of contingent liabilities.

258 *Re Pascoe (No 2)* [1944] Ch 310.

before any bankruptcy occurred, and in effect out of funds which would otherwise have been available to the creditors.

15.32 The Cork Report also considered whether fines should be proved for in subsequent bankruptcy proceedings and noted that a disadvantage of this would be that an offender on whom substantial fines had been imposed would be encouraged to apply for his own bankruptcy proceedings as a means of avoiding the court's sanction for non-payment.

15.33 The Cork Report recommended that no fine or penalty imposed by any court should be admissible to proof in any form of insolvency proceedings nor should it be released by the bankrupt's discharge.[259] This recommendation is reflected in the Insolvency Rules which provide that in bankruptcy, any fine imposed for an offence, and any obligation arising under an order made in family or domestic proceedings, is not provable.[260]

15.34 In Australia and in New Zealand, fines or penalties in the nature of a fine cannot generally be claimed in bankruptcy. The Harmer Report took a different approach to the Cork Report in stating that the basic policy underlying the Australian position is that a fine is imposed for a breach of the law and should be paid in full, not simply at the proportionate rate which would apply if it ranked equally with all other debts in an insolvency. The Harmer Report contrasted this proposition with the aim of the bankruptcy procedure of rehabilitating the bankrupt by allowing him to be discharged with a "clean slate".

15.35 The Harmer Report recommended that fines should be admissible as claims in bankruptcy but not automatically released on discharge. It recognised that there may be cases where it would be proper for a discharged bankrupt to be released from the obligation to pay a fine but that this would be a matter which should be dealt with by the original sentencing court. In the case of a maintenance agreement, the Harmer Report recommended that the court should have a discretion to release a liability under a maintenance agreement or order. In the case of debts incurred by fraud, the Harmer Report recommended that such a debt should be released on discharge but that the relevant creditor should have a right before discharge to apply to the court for an order that the debt should not be released on discharge.[261]

15.36 The Official Receiver has indicated that Hong Kong has not experienced the problems pointed out by the Cork Report as existing in England and that he is more concerned to establish whether fines should be admissible to proof and whether they should be released on discharge.

15.37 We recommend that fines and penalties should not be admissible in bankruptcy nor should they be released by a bankrupt's discharge. We believe that, as fines and penalties are a sanction of the criminal courts, it should be left with those courts to deal with them. We are not comfortable with the notion that bankruptcy could be an attractive proposition for an offender who could, in bankruptcy, see a proportion only of his fines paid on dividend and for them to be wiped out entirely on discharge.

15.38 The Inland Revenue Department made a submission on the equivalent proposal in the Consultative Document. The submission commented that the Inland Revenue Ordinance[262] provides that tax, a civil debt due to the Crown under section 75 of the Ordinance, includes any sums under section 71(5) and (5A) by reason of default together with any fines, penalties, fees or costs incurred and any interest payable under section 71(9)(e)(ii) or (10). The submission added that the proposal appeared to be in the context of sanctions by the criminal courts and presumably did not apply to fines and penalties imposed under the Inland Revenue Ordinance.

15.39 We consider that there is a distinction to be made between fines and penalties and interest. Section 71(5) of the Inland Revenue Ordinance provides that where tax is in default, the Commissioner of Inland Revenue has a discretion to order that a sum or sums not exceeding 5% in all of the amount in default shall be added to the tax. Section 71(5A) provides that, when on the expiry of six months from the date when any tax is deemed to be in default there remains unpaid any amount of the aggregate of

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259 The Cork Report, paragraphs 1319 to 1330.

260 The Insolvency Rules 1986, rule 12.3.

261 The Harmer Report, paragraphs 787 to 792.

262 The Inland Revenue Ordinance (Cap 112).

the tax deemed to be in default and any sum added under section 71(5), the Commissioner of Inland Revenue may order that a sum or sums not exceeding 10% in all of the unpaid amount shall be added to the unpaid amount and recovered therewith.

15.40 The terms of section 71(5) and (5A) of the Inland Revenue Ordinance clearly confer on the Commissioner of Inland Revenue the discretion to impose a penalty. We see no reason for making such a penalty an exception to our recommendation. The terms of section 71(9)(e)(ii), however, clearly refer to the payment of interest and would be claimable under our recommendations on interest on debt in Chapter 19.

Confiscation of assets

15.41 The question of the treatment of assets of a bankrupt which may be subject to a confiscation order is one that will have bearing on few bankruptcies but which nonetheless could have great impact on the value of the assets available for distribution to creditors in an affected estate.

15.42 The only relevant legislation in Hong Kong at present is the Drug Trafficking (Recovery of Proceeds) Ordinance ("the Drug Trafficking Ordinance") which was enacted in 1989. This provides the court with powers to order the confiscation of the proceeds of drug trafficking and to make certain assumptions regarding the assets of the trafficker. The assumptions, rebuttable by the trafficker, are:

> *"(a) that any property appearing to the court-*
>
> *(i) to have been held by him at any time since his conviction; or*
>
> *(ii) to have been transferred to him at any time since the beginning of the period of 6 years ending when the proceedings were instituted against him, was received by him, at the earliest time at which he appears to the court to have held it, as a payment or reward in connection with drug trafficking carried on by him or another;*
>
> *(b) that any expenditure of his since the beginning of that period was met out of payments received by him in connection with drug trafficking carried on by him or another; and*
>
> *(c) that, for the purpose of valuing any property received or assumed to have been received by him at any time as such a payment or reward, he received the property free of any other interests in it."* [263]

15.43 The Drug Trafficking Ordinance makes specific provision for the bankruptcy of a trafficker. Where a trafficker is adjudged bankrupt, any property subject to a restraint order made before bankruptcy, or property already realised under the Drug Trafficking Ordinance is excluded from the property of the bankrupt for the purposes of the Bankruptcy Ordinance. Where, however, a trafficker has already been adjudged bankrupt the court shall not enforce a confiscation order against the property comprised in the estate of the bankrupt for the purposes of the Bankruptcy Ordinance.[264]

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[263] Drug Trafficking (Recovery of Proceeds) Ordinance (Cap 405), section 4(3). In *R v Ko Chi Yuen,* Criminal Appeal No. 298 of 1993, 22nd March 1994, (unreported), the Court of Appeal ruled that the discretionary assumptions are not inconsistent with article 11(1) of the Bill of Rights, which provides that everyone charged with a criminal offence shall have the right to be presumed innocent until proved guilty according to law. The court said that article 11(1) does not extend to confiscation proceedings such as those under the Ordinance but even if it did, then the assumptions would be justifiable exceptions to the normal principle that the prosecution must prove the defendant' s guilt beyond reasonable doubt.

[264] Drug Trafficking (Recovery of Proceeds) Ordinance, section 16.

15.44 The concern for creditors of an estate affected by a confiscation under the Drug Trafficking Ordinance is that the value of the estate available to them could be diminished or exhausted by the confiscation. A bankrupt trafficker would have no incentive to rebut the assumption that his assets were the proceeds of drug trafficking and there would be no way for creditors to challenge the assumption.

15.45 The situation will probably arise where creditors of a bankrupt trafficker find that the assets of the trafficker have been confiscated by Government leaving the creditors with little or nothing. The question is whether creditors who were innocently involved with a bankrupt drug trafficker should have to suffer directly from a confiscation which would result in the assets being applied to the fight against drug trafficking for the general benefit of society, as opposed to the assets being applied to the benefit of creditors. The public policy argument would become less potent in circumstances where proceeds of confiscation were not applied directly to the fight against drug trafficking but were diverted into the Government's general revenue.

15.46 We consider that money obtained through the trafficking of drugs should not be considered to be an asset of a bankrupt trafficker and that the assumptions of the Drug Trafficking Ordinance are necessary to support this principle. We therefore recommend that assets subject to confiscation should not be treated as part of a bankrupt's estate where the confiscation was made before the date of the bankruptcy order and that confiscation should not be discharged by bankruptcy.

Minority view

15.47 A minority view was expressed in the sub-committee on insolvency that confiscation is not a debt due from the estate but reflects an adverse proprietary claim to that of the estate. This view contends that the retributive effect of confiscation is that the offender will be deprived of ownership and enjoyment of the affected property and that this purpose is already achieved in bankruptcy by the expropriation of the bankrupt's property by his trustee for the purpose of meeting his creditors' claims.

15.48 The minority view argues that the recommendation would have the effect of penalising creditors, not the bankrupt, and that there is a risk in some cases that bankruptcy may actually be triggered by a confiscation leaving a situation where Government, not the trustee, would administer the bankrupt's property. The minority view considers that confiscation made before bankruptcy should be overridden by the bankruptcy order so that property affected by confiscation may be distributed among creditors.

15.49 Although confiscation orders do not give rise to any claim against a bankrupt estate the minority view has no objection to a provision whereby Government could reserve the right to payment over to it of an equivalent sum from any surplus in the bankruptcy either before or after discharge.

Swearing of proofs of debt and false proofs of debt

15.50 The Official Receiver had proposed that proofs of debt should no longer be required to be sworn and we considered it a sensible proposal. The recommendation reflected the Insolvency Rules and similar provisions which had been successfully introduced in the Insolvency Act 1975 in relation to companies winding up and which were considered cheap and simple.[265] Similar provisions are employed in Australia.[266] Events overtook us, however, as the recommendation has now been introduced under the Proof of Debts (Amendment) Rules 1992.[267]

15.51 Both the current proof of debt general form and the affidavit of debt contain warnings that a person convicted of making a false statement in respect of a proof of debt shall be liable to a fine and

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265 The Cork Report, paragraph 1304.

266 Bankruptcy Act 1966, section 84.

267 L.N.220 of 1992, 10th June 1992. See also the Bankruptcy (Amendment) Rules 1992, L.N.222 of 1992 and the Bankruptcy (Forms) (Amendment) Rules 1992, L.N.223 of 1992.

imprisonment of two years and seven years respectively.[268] The Companies Ordinance, however, provides that any person guilty of making a false statement under the Companies Ordinance knowing it to be false shall be liable to a fine of $50,000 and imprisonment for six months, this being stated on the newly amended companies proof of debt and affidavit. [269] We cannot see why the same offences under the two Ordinances should attract different penalties. We believe that the Bankruptcy and Companies Ordinances should have the same penalties for these offences and recommend that the penalties under the Companies Ordinance should be adopted by the Bankruptcy Ordinance as the Companies Ordinance penalties were reviewed recently.[270] We also recommend that the Bankruptcy Ordinance should contain the provision for penalties for these offences rather than the Crimes Ordinance.

Admission of claims

15.52 It can happen that a trustee does not admit a claim under a proof of debt until years after the proof has been lodged. Where interim dividends are made in an estate it can result in loss to a creditor whose claim has not been admitted as he loses the use of the dividend and the interest that would have been earned had he received the dividend.

15.53 A creditor may have no remedy against the trustee, as under section 83 of the Bankruptcy Ordinance, a creditor can only apply to the court if he is aggrieved by any act or decision of the trustee. In this case it may be argued that the trustee had taken no action or decision against which a creditor can appeal.

15.54 We are of the view that a trustee should be in a position to accept or reject a proof of debt within a reasonable time. The Consultative Document proposed that a trustee should be obliged to make a decision on a proof of debt within six years of its being lodged with him, subject to the right of the trustee to apply to the court for an extension of time, adding that this should safeguard creditors to some extent by providing them with a decision which they can appeal against.

15.55 Submissions were received which considered that six years was an unreasonably long period of time to reach a decision especially in the context of the right of the trustee to apply to the court for an extension. We accept that six years appears to be a long time to wait for adjudication of a proof of debt. We therefore recommend that the trustee should be obliged to make a decision on a proof of debt within four years of its being lodged provided that there is a reasonable prospect of a dividend being paid to the class of creditor to which the proof of debt relates. The right of the trustee to apply to the court for an extension would remain unaffected.

Recommendations

- **For the purposes of valuation for dividend, foreign currency debts should be converted into Hong Kong dollars at the date of the making of the bankruptcy order.**

- **If a trustee, on taking expert advice, considers that it would be beneficial to the estate to delay the conversion of foreign currency to Hong Kong dollars he should be able to do so but only with the approval of the creditors' committee, or the court in the absence of a creditors' committee.**

- **The exchange rate for foreign currency claims should be fixed at the exchange rate on the date of the bankruptcy order. The trustee should have the discretion to pay a dividend in respect of a foreign currency claim in Hong Kong dollars or in the foreign currency equivalent of the amount of the Hong Kong dollar dividend.**

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268 Forms 46A and 46B. Crimes Ordinance (Cap. 200), sections 36 and 32.

269 Companies Ordinance, section 349 and the 12th Schedule. For the new proof of debt form and form of affidavit see the Companies (Winding up) (Amendment) Rules 1992, L.N.225 of 1992.

270 Companies Amendment Ordinance (7 of 1990).

- **Proofs of debt for tort claims should be admitted to proof subject to a trustee either making an estimate of the value of a debt or liability or referring the claim to the court for valuation. The right of appeal from an estimate made by the trustee should then be treated as if that person had referred the claim to the court. The court should have a power to specify a mode of determining the value rather than being necessarily required to determine the value itself. It would still be open to appeal to the court from a valuation determined in the specified manner.**

- **Where an estimate on which a dividend has been paid is less than the amount of damages subsequently awarded by the court the claimant should not be entitled to catch up in respect of the first dividend. The claimant should be entitled to amend his proof of debt to the judgment amount in a second dividend.**

- **Where a judgment is less than an estimate on which a dividend has been paid the first dividend payment should not be reduced but the claimant should not be entitled to claim for any more in further dividends than he would have been entitled to in total in respect of the judgment amount.**

- **Fines and penalties should not be admissible in bankruptcy nor should they be released by the bankrupt's discharge.**

- **Assets subject to confiscation under the Drugs Trafficking (Recovery of Proceeds) Ordinance should not be treated as part of a bankrupt's estate where the confiscation was made before the date of the bankruptcy order. Confiscation should not be discharged by bankruptcy.**

- **Any person guilty of making a false statement in respect of a proof of debt or of an affidavit of debt under the Bankruptcy Ordinance knowing it to be false should be liable to a fine of $50,000 and imprisonment for six months and the offence should be provided for in the Bankruptcy Ordinance.**

- **A trustee should be obliged to make a decision on a proof of debt within four years of it being lodged with him provided that there is a reasonable prospect of a dividend being paid to the class of creditor to which the proof of debt relates, subject to the right of the trustee to apply to the court for an extension of time**.

CHAPTER 16

DECLARATION AND DISTRIBUTION OF DIVIDENDS

The present law

16.1 The Bankruptcy Ordinance provides that the trustee shall declare a dividend payment and distribute the assets, if any, of the debtor among the creditors with all convenient speed and in any event not later than four months after the conclusion of the first meeting of creditors, having first deducted the costs of administration.

16.2 The Bankruptcy Ordinance, section 67, provides that:

> *"(1) Subject to the retention of such sums as may be necessary for the costs of administration, or otherwise, the trustee shall with all convenient speed declare and distribute dividends amongst the creditors who have proved their debts.*
>
> *(2) The first dividend, if any, shall be declared and distributed within 4 months after the conclusion of the first meeting of creditors, unless the trustee satisfies the court that there is sufficient reason for postponing the declaration to a later date.*
>
> *(3) Subsequent dividends shall, in the absence of sufficient reason to the contrary, be declared and distributed at intervals of not more than 6 months.*
>
> *(4) Before declaring a dividend, the trustee shall cause notice of his intention to do so to be gazetted and shall also send reasonable notice thereof to each creditor mentioned in the bankrupt's statement who has not proved his debt.*
>
> *(5) When the trustee has declared a dividend he shall cause to be gazetted and shall send to each creditor who has proved a notice showing the amount of the dividend and when and how it is payable.*"

Discussion

16.3 The Official Receiver has proposed some minor changes to section 67(2) and (3) involving abolition of the requirements that a first dividend shall be declared and distributed within four months of the conclusion of the first meeting of creditors and that subsequent dividends shall be declared and distributed at intervals of not more than six months.

16.4 The Official Receiver has advised that in most bankruptcies it is unrealistic to have to make a first dividend within four months of the conclusion of the first meeting of creditors followed by dividends every six months thereafter. This is mainly due to the nature of bankrupt estates, which often have few, if any, assets to realise. As a consequence, it is impractical to provide for regular distributions in view of the costs involved in declaring and distributing a dividend.

16.5 The Official Receiver considered that the Insolvency Act provided a more suitable provision and proposed that it should replace section 67(1),(2) and (3) of the Bankruptcy Ordinance. Section 324(1) of the Insolvency Act would remove the time limits imposed at present and place a duty on the trustee to make a dividend whenever he has sufficient funds for the purpose subject to the retention of monies in respect of his expenses. We believe that this duty is consistent with the duty imposed on the

trustee under the Bankruptcy Ordinance to make a dividend "with all convenient speed" and that it is a more appropriate provision in the circumstances.[271]

16.6 We consider that the time limits imposed under the Bankruptcy Ordinance do not serve any useful purpose and we favour allowing the trustee flexibility in the declaration and distribution of dividends. We agree with the Official Receiver that the Insolvency Act provision would be an appropriate replacement for the Bankruptcy Ordinance provision and recommend its adoption.

16.7 We also considered corresponding provisions in other jurisdictions and found that for the most part they are similar to the Bankruptcy Ordinance. In Singapore, for example, the provision is identical except that the first dividend should be made within twelve months of adjudication of bankruptcy and subsequent dividends should be made at intervals of not more than twelve months.[272] We considered retaining the present provisions with expanded time limits as in Singapore but, on balance, we take the view that the imposition of time limits only serves to make unnecessary work for the trustee.

16.8 Section 67(4) and (5) of the Bankruptcy Ordinance should remain unchanged.

Recommendation

- **A trustee should have flexibility in the timing of declaration and distribution of dividends. Section 67 (1), (2) and (3) of the Bankruptcy Ordinance should be abolished and replaced by section 324(1) of the Insolvency Act which places a duty on the trustee to make a dividend whenever he has sufficient funds for the purpose subject to the retention of monies in respect of his expenses.**

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271 Bankruptcy Ordinance, section 67(1).

272 Bankruptcy Act 1888, section 62(2) and (3).

CHAPTER 17

DISCHARGE

The present law

17.1 It is indisputable that for the overwhelming majority of bankrupts bankruptcy is a life sentence.[273] At present, the only effective way for a bankrupt to achieve discharge is to make his own application to the court. The present provisions make this virtually impossible. We have no doubt that the law on discharge needs to be changed and endorse the Scottish Law Commission statement that it is apparent that the underlying presumption of the law is that the discharge of a bankrupt is a privilege rather than a right.[274]

17.2 Discharge from bankruptcy is provided for under section 30 of the Bankruptcy Ordinance which states:

> *"(1) A bankrupt may, at any time after being adjudged bankrupt, apply to the court for an order of discharge, and the court shall appoint a day for hearing the application, but the application shall not be heard until the public examination of the bankrupt is concluded, or dispensed with under section 19A. The application shall, except when the court in accordance with rules under this Ordinance otherwise directs, be heard in open court.*
>
> *(2) Where the bankrupt does not of his own accord, within such time as the court may deem reasonable, apply for his discharge, the court may, of its own motion or on the application of the Official Receiver or the trustee or any creditor who has proved, make an order calling upon the bankrupt to come up for his discharge on a day to be fixed by the court, and on due service of the order, if the bankrupt does not appear on the day fixed thereby, the court may make such order as it thinks fit, subject to the provisions of this section, and the debtor shall, in addition to any other punishment to which he may be subject, be guilty of a contempt of court and may be punished accordingly.*
>
> *(3) On the hearing of the application, or on the day on which the bankrupt has been ordered to come up for his discharge or any subsequent day, the court shall take into consideration a report of the Official Receiver as to the bankrupt's conduct and affairs (including a report as to the bankrupt's conduct during the proceedings under his bankruptcy) and may either grant or refuse an absolute order of discharge, or suspend the operation of the order for a specified time, or grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the bankrupt or with respect to his after acquired property:*
>
> *Provided that where the bankrupt has committed any indictable offence under this Ordinance or any other indictable offence connected with his bankruptcy, or where in any case any of the facts hereinafter mentioned are provided the court shall -*
>
> *(a) refuse the discharge; or*
>
> *(b) suspend the discharge for such period as the court thinks proper; or*

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273 See paragraph 17.8.

274 Report on Bankruptcy and related aspects of Insolvency and Liquidation (No. 68), at page 275.

(c) suspend the discharge until a dividend of not less than 50% has been paid to the creditors; or

(d) require the bankrupt as a condition of his discharge to consent to judgment being entered against him by the Official Receiver or trustee for any balance or part of any balance of the debts provable under the bankruptcy which is not satisfied at the date of the discharge, such balance or part of any balance of the debts to be paid out of the future earnings or after acquired property of the bankrupt in such manner and subject to such conditions as the court may direct; but execution shall not be issued on the judgment without leave of the court, which leave may be given on proof that the bankrupt has since his discharge acquired property or income available towards payment of his debts:

Provided that, if at any time after the expiration of 2 years from the date of any order made under this section the bankrupt satisfies the court that there is no reasonable probability of his being in a position to comply with the terms of such order, the court may modify the terms of the order or of any substituted order in such manner and on such conditions as it may think fit.

(4) The facts hereinbefore referred to are -

(a) that the bankrupt's assets are not of a value equal to 50% of his unsecured liabilities, unless he satisfies the court that the fact that the assets are not of a value of 50% of his unsecured liabilities has arisen from circumstances for which he cannot justly be held responsible;

(b) that the bankrupt has omitted to keep such books of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the 3 years immediately preceding his bankruptcy, or in the case of a firm carrying on business under a Chinese firm name, that a partnership book has not been kept, or that such books have not been available for the trustee during the bankruptcy proceedings, unless they have been accidentally lost or destroyed, the onus of proof of such accidental loss or destruction being on the bankrupt;

(c) that the bankrupt has continued to trade after knowing himself to be insolvent;

(d) that the bankrupt has contracted any debt provable in the bankruptcy without having at the time of contracting it any reasonable or probable ground of expectation (proof whereof shall lie on him) of being able to pay it;

(e) that the bankrupt has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet his liabilities;

(f) that the bankrupt has brought on or contributed to his bankruptcy by rash and hazardous speculations, or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs;

(g) that the bankrupt has put any of his creditors to unnecessary expense by a frivolous or vexatious defence to any action properly brought against him;

(h) that the bankrupt has brought on or contributed to his bankruptcy by incurring unjustifiable expense by bringing a frivolous or vexatious action;

(i) that the bankrupt has within 3 months preceding the date of the receiving order, when unable to pay his debts as they become due, given an undue preference to any of his creditors;

(j) that the bankrupt has within 3 months preceding the date of the receiving order incurred liabilities with a view to making his assets equal to 50% of his unsecured liabilities;

(k) that the bankrupt has on any previous occasion, whether in Hong Kong or elsewhere, been adjudged bankrupt or made a composition or arrangement with his creditors;

(l) that the bankrupt has been guilty of any fraud or fraudulent breach of trust.

(5) The court may, on proof to its satisfaction of any of the facts mentioned in subsection 4(b),(c),(d),(f),(g),(h),(i) or (l), summarily sentence the bankrupt to imprisonment for 1 year.

(6) For the purposes of this section, bankrupt's assets shall be deemed of a value equal to 50% of his unsecured liabilities when the court is satisfied that the property of the bankrupt has realised or is likely to realise, or with due care in realisation might have realised, an amount equal to 50% of his unsecured liabilities, and a report by the Official Receiver or the trustee shall be prima facie evidence of the amount of such liabilities.

(7) For the purposes of this section, the report of the Official Receiver shall be prima facie evidence of the statements therein contained.

(8) Notice of the appointment by the court of the day for hearing the application for discharge shall be published as the court may direct or as may be prescribed and shall be sent 14 days at least before the day so appointed to each creditor who has proved, and the court may hear the Official Receiver and the trustee and may also hear any creditor. At the hearing the court may put such questions to the debtor and receive such evidence as it may think fit.

(9) The powers of suspending and of attaching conditions to a bankrupt's discharge may be exercised concurrently.

(10) A discharged bankrupt shall, notwithstanding his discharge, give such assistance as the trustee may require in the realisation and distribution of such of his property as is vested in the trustee, and if he fails to do so he shall be guilty of a contempt of court; and the court may also, if it thinks fit, revoke his discharge, but without prejudice to the validity of any sale, disposition or payment duly made or thing duly done subsequent to the discharge but before its revocation."

17.3 In addition to the Bankruptcy Ordinance, the Bankruptcy Rules contain regulations on discharge, some of which should arguably come under the Bankruptcy Ordinance.[275]

17.4 Bankruptcy Rule 89 gives the Official Receiver or trustee the power to appeal to the Court of Appeal from, *inter alia*, any order of the court made upon an application for discharge.

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275 Bankruptcy Rules, rules 88 to 99.

17.5 Bankruptcy Rule 97 provides that, where a bankrupt is discharged subject to the condition that judgment shall be entered against him, or subject to any other condition as to his future earnings or after-acquired property, it shall be his duty, until such judgment or condition is satisfied, from time to time to give the Official Receiver such information as he may require with respect to his earnings and after-acquired property and income, and not less than once a year to file in the court a statement showing the particulars of any property or income he may have acquired subsequent to his discharge.

Discussion

17.6 The Official Receiver considered the present provisions on discharge to be cumbersome and inflexible and recommended that they be reconsidered. The Official Receiver favoured the introduction of automatic discharge from bankruptcy after a period of time. Provisions for automatic discharge are in place in other jurisdictions and appear to operate successfully.

17.7 The Harmer Report commented that automatic discharge, after three years under the Australian Bankruptcy Act 1966, represented a significant improvement on earlier provisions and recommended that a form of discharge should be introduced that would enable discharge from bankruptcy to occur even earlier than at present.[276] The Cork Report did not support the introduction of automatic discharge and believed that the onus should always be on a bankrupt to apply for his discharge and to prove that it was warranted. The Cork Report's comments should be considered in the context of its proposals for a series of procedures of which bankruptcy would be the last resort. The Cork Report did recommend that there should be an automatic review by the court five years after the making of the bankruptcy order for the purpose of determining whether a bankrupt should be discharged.[277] The Insolvency Act did not take up the Cork Report's proposals on discharge but provided for the automatic discharge of first time bankrupts after two or three years.[278]

17.8 The present provisions place the main responsibility for seeking discharge on a bankrupt. The effect is that bankrupts hardly ever apply to the court for discharge, possibly through ignorance or from an unwillingness to put themselves to further expense and trouble or from fear of the provision. In the ten years from 1983 to 1992 only 25 bankrupts were discharged, in a period when nearly 2400 adjudication orders were made.[279]

17.9 It is worth examining section 30 of the Bankruptcy Ordinance from the view of a bankrupt seeking his own discharge. A bankrupt would do well to establish whether the Official Receiver supported his application as section 30(3) requires a report of the Official Receiver on the bankrupt's conduct and affairs, the report being the best evidence the court has in making an order in the terms set out in section 30(3). The court has several options under section 30(3) depending on whether a bankrupt has been convicted of a felony in connection with his bankruptcy or where any of the twelve "facts" in section 30(4) are proved. Discharge is more difficult for bankrupts who have committed a felony connected with the bankruptcy or where any of the facts set out in subsection 4(a) to (l) are proved. In such cases, and these are the majority, the court can make an order in the terms of the options set out in section 30(3)(a) to (d). At its most extreme, an unfavourable report of the Official Receiver could result in a bankrupt ending up in jail for a year on proof of any of eight of the facts in section 30(4).[280]

17.10 Few bankrupts could resist a challenge under the wide ranging provisions of section 30(4). Section 30(4)(a) alone undoubtedly catches the majority of bankrupts as most estate assets are valued at less than 50 per cent of unsecured liabilities and it would be a rare case where a bankrupt could persuade the court that his assets were less than 50 per cent of his unsecured liabilities because of

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276 The Harmer Report, paragraphs 546 to 554. See also paragraphs 17.51 to 17.62 of this Report.

277 The Cork Report, paragraphs 610 and 611.

278 Insolvency Act 1986, section 279. See also paragraph 17.18.

279 Source : Official Receiver's Office and see the Annexures.

280 Bankruptcy Ordinance, section 30(5).

circumstances for which he could not justly be held responsible.[281] Even if a bankrupt could show that he was not guilty of a felony connected with his bankruptcy, and that he was innocent of any of the facts under section 30(4), the court can still refuse to discharge or can attach conditions to discharge.

17.11 In addition, the Bankruptcy Ordinance provision on composition and schemes of arrangement prevents most bankrupts entering into a composition or scheme by providing:

> *"If any facts are proved on proof of which the court would be required either to refuse, suspend or attach conditions to the debtor's discharge were he adjudged bankrupt, the court shall refuse to approve the proposal unless it provides reasonable security for the payment of not less than 25 per cent on all the unsecured debts provable against the debtor's estate."*[282]

17.12 This provision makes bankruptcy a trap for most bankrupts in that, even if creditors were willing to accept less than 25 per cent of the debts owed to them, a bankrupt would be prevented from entering into a composition or scheme of arrangement by section 30.[283]

17.13 We do not believe that anything is achieved under the present provisions by the attachment of harsh penalties to an application for discharge. In the course of his investigation of an estate, the Official Receiver would establish the existence of any of the facts in section 30(4). It is a strange concept, therefore, to contemplate imposing penalties on discharge that had not been imposed during the administration of the estate when, presumably, all the facts included in the Official Receiver's report under section 30 were known to the Official Receiver.

17.14 In the event that a bankrupt does not seek his own discharge, section 30(2) allows the Official Receiver to apply for discharge. It is clear from the figures above that this is, at best, a rare occurrence. In fairness to the Official Receiver, there is no obligation imposed on him to apply for discharge and very often estates in bankruptcy do not produce sufficient assets to provide for the expenses of the Official Receiver in making an application for discharge.

17.15 We are of the opinion that the present provisions on discharge are totally unsatisfactory. We do not believe that it is a function of bankruptcy to keep a person in a state of bankruptcy indefinitely. The main problem under the present provisions lies in placing the onus on a bankrupt to seek his own discharge. It is unreasonable to expect a bankrupt to find the money, much less the inclination, to initiate his own discharge, especially under the draconian provisions of the Bankruptcy Ordinance.

Automatic discharge

17.16 We recommend the adoption of provisions that allow for the automatic discharge of a bankrupt three years after the date of the bankruptcy order coupled with a system of objections to discharge in the event of a bankrupt not meeting certain criteria. The introduction of automatic discharge should, with the objection system, have a two-fold effect. Firstly, bankrupts would have a greater incentive than at

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281 In 1988/89 it was estimated that the total liabilities in all bankruptcies and liquidations amounted to HK$1.159 billion against total assets of HK$59 million, that is, assets were about 5% of liabilities. In 1991/92 total liabilities were HK$2.646 billion against assets of HK$73 million; assets being less than 3% of liabilities. Source : The Official Receiver's Office.

282 Bankruptcy Ordinance, section 20(10).

283 Some bankrupts may be able to get out of bankruptcy by means of rescission of the receiving order and annulment of the adjudication order under section 33 of the Bankruptcy Ordinance. Section 33 provides that where the court is of the opinion that a debtor ought not have been made bankrupt, or where it is proved to the satisfaction of the court that the debts of a bankrupt are paid in full, the court may rescind the receiving order and annul the adjudication order. The advantage for a bankrupt is that annulment means that there is no record of bankruptcy. The disadvantage is that annulment does not prevent creditors from pursuing the debtor for debts incurred before "bankruptcy".

present to co-operate with the trustee, as failure to co-operate could result in the trustee objecting to a bankrupt's discharge. Secondly, the rehabilitation of a bankrupt from bankruptcy would be assured, subject to rehabilitation being delayed as a consequence of a bankrupt's own failings.

17.17 Our recommendation that discharge should take place three years after the date of the bankruptcy order follows corresponding provisions in Australia, New Zealand, Scotland, and England and Wales.

17.18 The usual period for automatic discharge under the Insolvency Act is three years but there is provision for automatic discharge after two years in cases where a certificate for summary administration of a bankrupt's estate has been issued and has not been revoked before the bankrupt's discharge.[284] A certificate for the summary administration of a bankrupt's estate may be issued where it appears to the court that the aggregate amount of the unsecured bankruptcy debts would be less than the small bankruptcies level, which is currently £20,000, and that within five years before the presentation of the petition the debtor had not been adjudged bankrupt nor made a composition or scheme of arrangement with his creditors in satisfaction of his debts.[285]

17.19 The Official Receiver has advised that in over seventy per cent. of bankruptcies he avails himself of the summary arrangement procedure under the Bankruptcy Ordinance. This allows the Official Receiver to dispense with certain matters under the Ordinance, resulting in savings in the cost of administration, provided the court is satisfied that the property of the debtor is not likely to exceed $200,000.[286]

17.20 We considered adopting a period of bankruptcy of less than three years in cases where either the assets or the liabilities of a bankrupt or both were within certain financial levels but we concluded that the period of bankruptcy should not be reduced for administrative convenience. We take the view that all first time bankrupts should be subject to the same period of bankruptcy of three years irrespective of the amounts of their assets or liabilities, subject to objection.[287]

17.21 We have noted that, in bankruptcies where dividends are paid, it takes over four years, on average, to declare a dividend.[288] The Official Receiver has advised that most bankruptcies do not pay a dividend and that only a relatively small number of bankruptcies would be affected by the administration of the estate not being effectively completed after three years. We recommend that, in the event that the administration of an estate has not been completed when the bankrupt comes to be automatically discharged, and there is no objection to automatic discharge, as a condition of discharge the former bankrupt should be obliged to give the trustee such information as to his affairs, attend on the trustee at such times, and do all such other things as the trustee may require in carrying out the remainder of the administration of the estate. This reflects the position under the Insolvency Act .[289] In order to avoid confusion, we would emphasise that the trustee would continue to administer the estate even though a bankrupt has been discharged, as the estate relates to a bankrupt's assets and discharge relates to a bankrupt personally.

17.22 We appreciate that there appears to be a contradiction in recommending automatic discharge after three years when most active bankruptcies, that is bankruptcies where a dividend is paid, take longer then that to administer. It is worth emphasising that the main concern of the trustee is recovering the assets of a bankrupt, not in keeping him bankrupt and that the trustee would still have a hold on a bankrupt by imposing an obligation on the bankrupt to assist the trustee in the further administration of the estate.

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284 Insolvency Act 1986, section 279(2)(a).

285 Insolvency Act 1986, sections 275 and 273.

286 Bankruptcy Ordinance, section 112A.

287 This comment is limited to the question of discharge only and is not intended to be a criticism of the procedure under section 112A of the Bankruptcy Ordinance.

288 See paragraph 6.11.

289 Insolvency Act 1986, section 333(1) and (3).

17.23 We considered adopting a provision that was introduced in the Australian Bankruptcy Amendment Act 1991 whereby the period for automatic discharge runs from the date of filing the statement of affairs but we are inclined to the view that the appropriate date for time to run is the date of the bankruptcy order. A delay in the filing of the statement of affairs should be considered in the overall terms of a bankrupt's conduct during bankruptcy.

Objection to and suspension of automatic discharge

17.24 The introduction of automatic discharge would shift the emphasis from discharge being a privilege to its being a right. This right, however, must be set alongside a bankrupt's duty to co-operate with the trustee in the administration of the estate. If he fails to co-operate with the trustee after bankruptcy, or if a bankrupt's conduct before bankruptcy was unsatisfactory, he should not be automatically discharged.

17.25 The three year period for automatic discharge is a relatively short period of time and an unscrupulous person may consider it a reasonable proposition to defraud his creditors, suffer bankruptcy, and then emerge from bankruptcy free from liability for debts incurred before he was made bankrupt. Cynical behaviour of this nature and more common failings, such as a bankrupt continuing to trade after knowing himself to be insolvent, should be open to more severe penalties.

17.26 We favour the introduction of a procedure whereby the trustee or creditors who have filed a proof of debt can object to the automatic discharge of a bankrupt and note that Hong Kong would be joining several other jurisdictions in having objection provisions. In Scotland, for example, automatic discharge operates after three years and discharge may be deferred for a further two years in certain circumstances.[290]

17.27 We have concentrated on the provisions of the Insolvency Act, on what we refer to as "the old provisions" under the Australian Bankruptcy Act 1966, and on "the new provisions" which replaced them under the Australian Bankruptcy Amendment Act 1991 and we have compared these with the present provisions under the Bankruptcy Ordinance.

17.28 Under the Insolvency Act the court may, on the application of the Official Receiver that a bankrupt has failed or is failing to comply with any of his obligations, order that the automatic discharge period should cease to run, for such period, or subject to such conditions, as the court may order.[291] The obligations referred to cover a range of bankruptcy offences that may have been committed by a bankrupt before or after bankruptcy such as non-disclosure of assets of the estate, concealment of property or books and papers, false statements, fraud and gambling. The provision also applies to a bankrupt' s behaviour in relation to his statement of affairs, public examination and his duties to the Official Receiver.

17.29 In terms of the approach taken under the Insolvency Act we note two points in particular. First, the suspension of discharge can run for an indefinite period as where, for example, a bankrupt fails to comply with conditions attached by the court. This runs contrary to provisions in other jurisdictions where generally there is a time limit after which an objection lapses. Second, the terms of objection are not specific as the provision covers the entire Part IX of the Act, which relates to bankruptcy. Other jurisdictions favour setting out the objection criteria.

17.30 The old provisions under the Australian Bankruptcy Act 1966 listed the criteria for objection to automatic discharge and set out time limits for objection.[292] The criteria were:

> *"(a) that the bankrupt is able, or is likely within 5 years from the date of the bankruptcy to be able, to make a significant contribution to his estate;*

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290 Bankruptcy (Scotland) Act 1985, section 54.

291 Insolvency Act 1986, section 279(3).

292 Bankruptcy Act 1966, section 149(4).

(b) that the discharge of the bankrupt by force of this section would prejudice the administration of his estate;

(c) that the bankrupt has failed to co-operate in the administration of his estate;

(d) that the conduct of the bankrupt, either in respect of the period before or the period after the date of the bankruptcy, has been unsatisfactory."

17.31 Under the old provisions an objection would lapse no later than five years after the date of the bankruptcy.[293]

17.32 The old Australian criteria have been criticised as being rather vague and uncertain in that they failed to specify with sufficient particularity just what the obligations of a bankrupt was and what conduct was likely to result in an extension of the bankruptcy.[294] The new provisions under the Bankruptcy Amendment Act 1991 are designed to make bankrupts fully aware of their obligations and to encourage them to co-operate with the trustee in the administration of the estate. The new grounds expand the objection criteria and are:

"(a) the bankrupt has, whether before, on or after the date of bankruptcy, left Australia and has not returned to Australia;

(b) after the date of bankruptcy the bankrupt continued to manage a corporation as mentioned in section 91A of the Corporations Law without having been given leave to do so under section 229 of that law;

(c) after the date of bankruptcy the bankrupt engaged in misleading conduct in relation to a person in respect of an amount that, or amounts the total of which, exceeded A$3,000;

(d) the bankrupt, when requested in writing by the trustee to provide written information about the bankrupt's property, income or expected income, failed to comply with the request;

(e) the bankrupt failed to disclose any particulars of income or expected income as required by a provision of this Act referred to in subsection 6A(1) or by section 139U;

(f) the bankrupt failed to pay to the trustee an amount that the bankrupt was liable to pay under section 139ZG;

(g) at any time during the period of 5 years immediately before the commencement of the bankruptcy, or at any time during the bankruptcy, the bankrupt :

(i) spent money but failed to explain adequately to the trustee the purpose for which the money was spent; or

(ii) disposed of property but failed to explain adequately to the trustee why no money was received as a result of the disposal or what the bankrupt did with the money received as a result of the disposal;

(h) while the bankrupt was absent from Australia he or she was requested by the trustee to return to Australia by a particular date or within a particular period but the bankrupt failed to return by that date or within that period;

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293 Bankruptcy Act 1966, section 149(7) to (9).

294 CCH, Australian Insolvency Practice Management, New Developments, 28.2.92, at 98,210.

(i) the bankrupt has failed, whether intentionally or not, to disclose to the trustee a liability of the bankrupt that existed at the date of the bankruptcy;

(j) the bankrupt failed to comply with section 80(1) (a requirement to notify the trustee of any change in his name or

(k) the bankrupt refused or failed to sign a document after being lawfully required by the trustee to sign that document;

(l) the bankrupt failed to attend a meeting of his or her creditors without having first obtained written approval of the trustee not to attend or without having given to the trustee a reasonable explanation for the failure;

(m) the bankrupt failed to attend an interview or examination for the purposes of this Act without having given a reasonable explanation to the trustee for the failure;

(n) the bankrupt failed, whether intentionally or not, to disclose to the trustee the bankrupt's beneficial interest in any property."[295]

17.33 Under the new provisions, if a notice of objection has been filed, then, unless the objection is withdrawn or cancelled, a bankrupt is not discharged until the expiration of eight years in the case of an objection made on any of the grounds in paragraphs (a) to (h); or in any other case five years. If the objection was made on the grounds in (a) or (h), the period of eight years does not begin to run until the date on which the bankrupt returns to Australia. In any other case the period begins to run on the date on which the bankrupt filed his or her statement of affairs.[296]

17.34 The question of which system of objection should be adopted generated a great deal of discussion in the sub-committee on insolvency. The main question was whether the provision should be general, as under the Insolvency Act , or specific, as under the new Australian provisions. We regard the old Australian provisions as coming somewhere between the other two provisions in that they are specifically set out in a section but are of a general nature.

17.35 Consideration must be given to the bankrupt in formulating a system of objections. We take the view that bankrupts should be aware of their obligations in the administration of their estates and, ideally, a specific list of grounds of objection should leave a bankrupt in no doubt as to his obligations. There are, however, problems with a list. It would be difficult to list every objection that a bankrupt should be liable to. Each bankruptcy case is unique and a bankrupt's behaviour should be considered in the overall context of the administration of the estate by the trustee. Also, the pre-bankruptcy behaviour of a bankrupt should be taken into account and in this regard we prefer the general terms of the old provision in Australia.[297]

17.36 We do not favour the Insolvency Act's approach of a blanket inclusion of all the bankruptcy provisions as possible grounds for objection to discharge. We consider that there is a need for a dedicated section on objections but that the objections should be of a general nature as under the old Australian provisions. We take the view that automatic discharge must be achievable by most bankrupts and that an exhaustive list of grounds of objection would be more restrictive than necessary.

17.37 When the Bankruptcy Ordinance, both Australian provisions and the Insolvency Act provisions were compared it came as a surprise to find so many possible grounds for objection. Specifically, under section 30(4) of the Bankruptcy Ordinance there are twelve possible grounds; under section 129(1) there are an additional fourteen broadly worded grounds; and there are also technical objections within the Ordinance to consider, such as failure to prepare a statement of affairs or failure to attend a public examination. In addition, there are further bankruptcy offences under sections 131 to 136 to be considered.

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295 Bankruptcy Amendment Act 1991, section 149D(1).

296 Bankruptcy Act 1966, section 149A.

297 See paragraph 17.30.

The Insolvency Act includes many of the possible objections under the Bankruptcy Ordinance and may be loosely described as having applied the old Bankruptcy Act 1914 provisions to its objection procedure.

17.38 In Australia, the approach has been different in that the objection criteria are clearly set out in both the old and new provisions. In the Consultative Document, the sub-committee on insolvency recommended the introduction of a general criteria of objections similar to those under the old Australian provisions and added two more:

(i) That the bankrupt had continued to trade after knowing himself to be insolvent.[298]

(ii) That the bankrupt has committed any offence under section 129 or sections 131 to 136 of the Bankruptcy Ordinance.

17.39 We received a submission that, given the unique position of Hong Kong and the transient nature of some of its residents, an additional criteria for objection should be that a bankrupt has absconded from Hong Kong and has not, on request, returned. We consider that this further criteria would complement the recommendation on absconding debtors in Chapter 1 and recommend its adoption with the slight amendment that the request should be constructive, in that it should be sufficient that the trustee can show the court that the bankrupt has departed from Hong Kong and has not returned.

17.40 As a consequence of the adoption of a submission that a bankrupt should be obliged to prepare an annual report of his earnings and acquisitions for the trustee we recommend that any breach of the duty by a bankrupt should be made a condition for objection to automatic discharge.[299] We note that this is an additional ground for objection.

17.41 We would also amend the wording of criterion (a) of the old Australian provisions to read as follows:

> *"that the bankrupt is likely within 5 years of the date of the bankruptcy to be able to make a significant contribution to his estate."*

17.42 We believe that these criteria should provide the trustee and the court with the ability to prevent the discharge of a bankrupt if discharge is not deserved. The provision should also be sufficiently succinct for a bankrupt to understand his obligations to the trustee. We recognise, however, that the pre-bankruptcy behaviour of some bankrupts will effectively disqualify them from any chance of automatic discharge after three years.

17.43 We recommend that both creditors and the trustee should be able to object to the discharge of a bankrupt. An objection to discharge from bankruptcy by the trustee should be accompanied by a report, which should be served on the bankrupt, setting out the reasons why it appears to the trustee that an order suspending discharge should be made. An objection to discharge filed in court by a creditor should set out the reasons why it appears to the creditor that an order suspending discharge should be made and should be served on the trustee and the bankrupt. The trustee should then file a report in the court setting out the reasons why he supports or opposes the objection. If a bankrupt disputes any statement in the trustee's report or in a creditor's objection he should have the right to file a reply in the court to which the trustee or the creditor may respond.

17.44 In the Consultative Document the sub-committee on insolvency recommended that three months before the end of the three year period for automatic discharge the Official Receiver should send a notice to all creditors who had filed a proof of debt advising whether the Official Receiver intended to file an objection to the automatic discharge of the bankrupt and, if so, on what grounds.

17.45 The Official Receiver's Office has submitted that the Official Receiver should have the discretion, where there are numerous creditors, and where the expense of giving notice to each creditor is not justified, to give notice by advertisement. We agree that it would be impractical in many cases to have

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[298] See the Bankruptcy Ordinance, section 30(4)(c).

[299] See paragraphs 13.53 and 13.54.

to give individual notice to creditors and recommend the adoption of the submission of the Official Receiver's Office. The notice, whether given individually or by advertisement, should advise creditors that they would be entitled to object to discharge whether the Official Receiver intends to object or not and it should also set out the grounds of objection and the procedure to be followed.

17.46 We recommend that if a bankrupt is making a contribution to his estate from income at the time that he is automatically discharged from bankruptcy, the court should have the power to order the bankrupt to continue making contributions but the contributions should not continue for longer than eight years from the date of the bankruptcy order.

Length of time objections should subsist

17.47 We have considered the length of time for which objections should subsist and found considerable variations in other jurisdictions. In Scotland, the period is two years after the end of the three year automatic period. In South Africa, a bankrupt is deemed to be rehabilitated at the end of ten years after the sequestration of his estate but the court can order earlier rehabilitation. The ten year period can also be extended but there has only been one recorded instance of this.[300] In England and Wales, discharge can be suspended indefinitely if a bankrupt does not comply with conditions attached by the court. In Australia, the new provisions have changed the maximum period from five years to five or eight years.

17.48 We take the view that there should be a maximum period for which an objection can subsist. The experience of other jurisdictions suggests that a period of ten years may be too long in the context of the rehabilitation of a bankrupt. We recommend that it would be appropriate, with one exception, for the period of objection to extend bankruptcy to eight years after the date of the making of the bankruptcy order. A bankrupt whose discharge from bankruptcy has been suspended should have the right to apply to the court at any time for the suspension to be lifted. The procedure for the lifting of suspension of discharge under the Insolvency Rules would be appropriate.[301]

17.49 The exception to an extension of bankruptcy to eight years before discharge relates to absconding debtors. We consider that in cases where the bankrupt has, whether before or after the date of bankruptcy, left Hong Kong and has not returned to Hong Kong or where, while the bankrupt was absent from Hong Kong he was requested by the trustee to return to Hong Kong by a particular date or within a particular period but the bankrupt failed to return by that date or within that period, the running of time of the bankruptcy should not begin, or should be suspended where appropriate, until the date on which the bankrupt returns to Hong Kong. This recommendation reflects provisions under the new Australian provisions.[302] The adoption of these provisions would assist in ensuring that bankrupts could not avoid their obligations under the Bankruptcy Ordinance by staying away from Hong Kong until the end of the bankruptcy period. It is not unusual for bankrupts to leave the jurisdiction to avoid the present provisions and we would not like our recommendations to make absconding an attractive proposition for bankrupts.

Subsequent bankruptcy[303]

17.50 Our recommendations on automatic discharge would provide a bankrupt with an opportunity to return to a normal life in a relatively short period of time. We do not believe that this should be the case with a second or subsequent bankruptcy which should be treated more severely than a first bankruptcy.

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300 South African Law Commission, Working Paper 39, Project 63, Review of the Law of Insolvency (Rehabilitation). October 1991.

301 The Insolvency Rules 1986, rule 6.216.

302 Bankruptcy Amendment Act 1991, section 149D(1)(a) and (h). See also paragraph 17.32.

303 Note our recommendation that bankruptcy may be annulled even after discharge, at paragraph 7.07.

17.51 We recommend that automatic discharge should also apply to a second bankruptcy but only after eight years from the making of the subsequent bankruptcy order. Bankrupts should have a right to apply to the court for discharge after the expiration of three years from the date of a subsequent bankruptcy order.

17.52 Any application for discharge should be made on the initiative of a bankrupt. The Official Receiver should report on matters that specifically relate to the circumstances of the bankruptcy, including previous bankruptcies, the bankrupt's compliance with his obligations and the extent to which, in the present and previous bankruptcies, his assets have exceeded his liabilities. In this regard we approve of and recommend the adoption of the Insolvency Rules.[304] We consider the requirement that the Official Receiver report on the circumstances of the present and previous bankruptcies and on the level of any distribution in the present bankruptcy to be particularly important matters for the court to have knowledge of in deciding whether to grant or refuse discharge or to impose conditions on discharge.

17.53 The reason for this is that bankruptcy can occur for any number of reasons and it would seem unreasonable to refuse to discharge a subsequent bankrupt because, for instance, he had been caught out by economic conditions over which he had no control over. This is graphically demonstrated by the recent problems in the property market in the United Kingdom where mortgagors found themselves with a negative equity in their properties. In such a situation, a mortgagor finds that if he cannot afford to make repayments on the mortgage and has to sell, the value of the property is insufficient to allow him to pay off the mortgage. A person who had been previously bankrupt could be caught in that situation. If the property involved was the family home of the bankrupt it would be harsh to treat him in the same way as, say, a subsequent bankrupt who had continued trading after knowing himself to be insolvent.

Early discharge

17.54 We are of the opinion that there may be circumstances where a bankruptcy order, though properly made, may be discharged within three years of the date of the bankruptcy order, such as in the case of a person who became insolvent as a result of the dishonesty of a business partner. We see no reason to keep such a bankrupt in a state of bankruptcy for longer than necessary. Early discharge should, however, only be available to first time bankrupts.

17.55 At present, a bankrupt has the right to apply for discharge at any time after the making of an order of adjudication of bankruptcy. We believe that this right should be retained but that the criteria should be different to the present criteria which makes it virtually impossible for a bankrupt to comply.[305]

17.56 The Insolvency Act contains no specific provisions for an application for discharge from bankruptcy by a person bankrupt for the first time and appears therefore to consider that the three year period of bankruptcy, or two years in the case of summary administration, is appropriate in all cases.

17.57 In Australia, there was provision for early discharge under the Bankruptcy Act 1966, recently replaced by new provisions under the Bankruptcy Amendment Act 1991, which allowed a bankrupt to apply at any time for discharge. The court considered a report of the trustee that referred to the bankrupt's conduct both before and after bankruptcy. The court could order discharge or suspend an order of discharge either conditionally or unconditionally. The matters upon which the court could exercise its discretion whether to discharge were:

> *"(a) that the bankrupt has omitted to keep and preserve such books, accounts or records as sufficiently disclose his business transactions and financial position within the period of 5 years immediately preceding the date on which he became a bankrupt;*

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304 The Insolvency Rules 6.217 and 6.218.

305 Bankruptcy Ordinance, section 30(1) and (4).

(b) that the bankrupt has, after knowing himself to be insolvent, continued to trade or obtained credit to the amount of A$100 or upwards;

(c) that the bankrupt has contracted a debt provable in the bankruptcy without having at the time of contracting it any reasonable or probable grounds of expectation (proof of which lies on him) of being able to pay it after taking into consideration his other liabilities at the time;

(d) that the bankrupt has failed to account satisfactorily to the trustee for any loss of, or depreciation of, assets or for a deficiency of assets;

(e) that the bankrupt has brought on, or contributed to, his bankruptcy by-

(i) rash or hazardous speculations;

(ii) unjustifiable extravagance in living;

(iii) gambling or wagering; or

(iv) culpable neglect of his business affairs;

(f) that the bankrupt has, within the period of 6 months immediately preceding the presentation of the petition on which, or by virtue of the petition of which, he became a bankrupt -

(i) put any of his creditors to unnecessary expense by a frivolous or vexatious defence to an action brought against him; or

(ii) incurred expense by bringing a frivolous or vexatious action;

(g) that the bankrupt has, within the period of 6 months immediately preceding the presentation of the petition on which, or by virtue of the presentation of which, he became a bankrupt, when unable to pay his debts as they became due, given an undue preference to any of his creditors;

(h) that the bankrupt has been guilty of fraud or fraudulent breach of trust; or

(i) that the bankrupt has been convicted of an offence against this Act or the repealed Act or of any other offence related to his bankruptcy."[306]

17.58 The Australian Bankruptcy Act 1966 provisions were similar in their terms to section 30(4) of the Bankruptcy Ordinance with the exception of section 30(4)(a). It is interesting to note, therefore, that the Bankruptcy Act 1966 provisions were criticised as being expensive, resulting in only a very small proportion of bankrupts availing of the provisions. It has been noted [307] that the system was mainly used by failed businessmen who sought early discharge in order to resume their business activities and that the costs involved in making the application to the court greatly disadvantaged low income earners. It was also noted that the new Australian provisions are intended to restore equity to the operation of the early discharge system and the system is designed to ensure that, where the bankrupt has become bankrupt because of commercial culpability, he is disqualified from early discharge. Under the new Australian provisions a bankrupt is able to apply for early discharge at any time six months after the filing of his statement of affairs. The trustee must evaluate whether the bankrupt is eligible, and is not disqualified, for early discharge.

17.59 Under the new Australian provisions, a bankrupt is eligible to apply for early discharge if, and only if:

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306 Bankruptcy Act 1966, section 150(6).

307 Comments from CCH, Australian Insolvency Management Practice, at 98,208.

"(a) when the bankrupt applies for discharge:

(i) there is no money available to pay, or insufficient money available to pay in full, the remuneration and expenses of the trustee; or

(ii) there is no money available to pay a dividend to the bankrupt's creditors; and

(b) either :

(i) the bankrupt has not, whether before, on or after the date of the bankruptcy, entered into a transaction that is void against the trustee; or

(ii) the bankrupt has entered into such a transaction but, if the trustee were to take action to avoid the transaction, the action would not result in a dividend being paid to the bankrupt's creditors; and

(c) the income that the bankrupt is likely to derive during the period of one year beginning at the time when the application is made will not exceed the actual income threshold amount applicable in relation to the bankrupt at that time." [308]

17.60 We do not favour the adoption of eligibility criteria for applying for early discharge as in Australia. We believe that all bankrupts should have an equal right to apply for early discharge.

17.61 We recommend that early discharge from bankruptcy should be available to first time bankrupts at any time after the adjudication of bankruptcy and any application should be made on the initiative of the bankrupt. The Official Receiver should report to the court on the history of the bankruptcy, stating whether he considers the case a suitable one for early discharge.

17.62 We recommend, however, that a bankrupt should be disqualified from early discharge if, based on the new Australian provisions,[309] he:

(a) has been previously bankrupt or has entered into a composition or arrangement with his creditors; or

(b) has unsecured liabilities that exceed 150 per cent of the income that the trustee determines was derived by the bankrupt during the year immediately before the date of the bankruptcy; or

(c) has failed to disclose a beneficial interest in any property; or

(d) has failed to disclose any liability that existed at the date of the bankruptcy; or

(e) has failed to disclose in his statement of affairs income that he expected in the 12 months following the filing of the statement; or

(f) engaged, after the date of bankruptcy, in misleading conduct in relation to a person in respect of an amount or amounts that exceed $15,000; or

(g) after the date of the bankruptcy continued to act as a director or takes part in the management of an company, except with the leave of the court, contrary to section 156 of the Companies Ordinance; or

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308 Bankruptcy Amendment Act 1991, section 149T.

309 Bankruptcy Amendment Act 1991, sections 149X to 149ZE.

(h) has failed or refused to give his passport or other travel document to the trustee when requested to do so; or

(i) has failed to co-operate with the trustee.

17.63 Under section 77(a)(ii) of the Australian Bankruptcy Act 1966 a bankrupt shall, unless excused by the trustee or prevented by illness, *inter alia*, forthwith after becoming a bankrupt, give to the trustee his passport, if any. There is no equivalent provision under the Bankruptcy Ordinance. Any disqualification from discharge under section 149ZE of the Bankruptcy Amendment Act 1991 would relate to the provision under section 77(a)(ii).

17.64 We have received advice that provisions in the terms of section 77(a)(ii) and section 149ZE would be inconsistent with the terms of the International Covenant on Civil and Political Rights (ICCPR) as applied to Hong Kong unless provision was made allowing the bankrupt to appeal on the merits to a court.[310]

17.65 We were also advised that even if a provision in the terms of section 149ZE was adopted with the Bankruptcy Ordinance remaining silent on a duty on the bankrupt to hand over his passport it was arguable that the provision would have the effect of obliging a bankrupt to give his passport to the trustee. If the provision was interpreted in that way it would probably be safer to provide an appeal channel for a bankrupt to comply with the ICCPR.

Transitional

17.66 If automatic discharge is adopted, we recommend that persons bankrupt under the present provisions should be automatically discharged from bankruptcy twelve months after the introduction of the new provisions if they have been bankrupt for three years or longer, subject to objection. The twelve month period should give the Official Receiver sufficient time to review all cases of bankruptcy and decide which of them warrant objection being made to the court. Any person bankrupt under the present provisions should be able to apply for discharge at any time after the introduction of the new provisions if they fall within the criteria recommended for discharge in their particular circumstances.

17.67 The Official Receiver's Office has submitted that the transitional provisions would result in an avalanche of work and that it is not viable to expect this to be undertaken by the present workforce in the Official Receiver's Office. It is submitted that additional funds should be made available for the transitional work. We endorse this submission.

Recommendations

- **The introduction of automatic discharge from bankruptcy three years after the date of the bankruptcy order subject to objection.**

- **Where the administration of an estate has not been completed when a bankrupt comes to be automatically discharged, and there is no objection to automatic discharge, the former bankrupt should be obliged to give the trustee such information as to his affairs, attend on the trustee at such times, and do all such other things as the trustee may require in carrying out the administration of the estate.**

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310 As the introduction of such a provision would be post Bill of Rights legislation the bench-mark is the ICCPR. See article VII(3) of the Letters Patent. A passport is a means of enabling a person "to leave any country, including his own", as he is entitled to do by article 12(2) of the ICCPR, which is almost identical to article 8 of the Bill of Rights.

- **The Official Receiver or any creditor who has filed a proof of debt should be able to object to the automatic discharge of a bankrupt on the following grounds:**

  (a) that the bankrupt is likely within 5 years of the date of the bankruptcy to be able to make a significant contribution to his estate;

  (b) that the discharge of the bankrupt would prejudice the administration of his estate;

  (c) that the bankrupt has failed to co-operate in the administration of his estate;

  (d) that the conduct of the bankrupt, either in respect of the period before or the period after the date of the bankruptcy, has been unsatisfactory;

  (e) that the bankrupt had continued to trade after knowing himself to be insolvent;

  (f) that the bankrupt has committed any offence under section 129 or sections 131 to 136 of the Bankruptcy Ordinance;

  (g) that the bankrupt has absconded from Hong Kong and has not, on request, returned;

  (h) that the bankrupt has failed to prepare an annual report of his earnings and acquisitions for the trustee.

- **Three months before the end of the three year period for automatic discharge the Official Receiver should give notice to all creditors who have filed a proof of debt advising whether the Official Receiver intends to file an objection to the automatic discharge of the bankrupt and, if so, on what grounds. The notice, which at the discretion of the Official Receiver may be given individually or by advertisement, should advise creditors that they are entitled to object to discharge in any event. It should also set out the grounds of objection and the procedure to be followed.**

- **If a bankrupt is making a contribution to his estate from income at the time that he is automatically discharged from bankruptcy the court should have the power to order the bankrupt to continue making contributions but the contributions should not continue for longer than eight years from the date of the bankruptcy order.**

- **If the trustee or creditors object, the court should be able to suspend the operation of automatic discharge for eight years after the date of the making of the bankruptcy order.**

- **A bankrupt whose discharge from bankruptcy has been suspended should have the right to apply to the court at any time for the suspension to be lifted; following the Insolvency Rules , rule 6.216.**

- **Where a bankrupt has, whether before or after the date of bankruptcy, left Hong Kong and has not returned to Hong Kong or where, while the bankrupt was absent from Hong Kong he was requested by the trustee to return to Hong Kong by a particular date or within a particular period but the bankrupt failed to return by that date or within that period, the running of time of the bankruptcy should not begin, or should be suspended where appropriate, until the date on which the bankrupt returns to Hong Kong.**

- **In the case of subsequent bankruptcy, automatic discharge should not operate until eight years after the date of the subsequent bankruptcy order but a bankrupt should be able to apply to the court for discharge three years after that date. The Official Receiver should file a report with the court on an application for early discharge, as provided for in the Insolvency Rules.**

- **Bankrupts should be entitled to apply to the court for discharge from a first bankruptcy before the expiration of three years from the bankruptcy order. The court should have no discretion to grant a discharge in certain circumstances.**

- **Persons bankrupt under the present provisions should be automatically discharged from bankruptcy twelve months after the introduction of the new provisions if they have been bankrupt for three years or longer, subject to objection. Any person bankrupt under the present provisions should be able to apply for discharge at any time after the introduction of the new provisions.**

CHAPTER 18

STATUTORY UNDERTAKINGS

The present law

18.1 The Official Receiver proposed that once a bankruptcy has commenced certain statutory undertakings or utility companies, such as the Water Authority or electricity and gas utility companies should be required to treat a trustee in bankruptcy as a new customer with a statutory right to receive supplies, separate and distinct from the debtor or customer whose account is in arrear. In addition, the Official Receiver proposed that a trustee should be personally liable for the payment of the new supply but that he should not be required to discharge the old debt. A utility company would therefore be obliged to prove for the old debt as an ordinary creditor.

18.2 There is no provision relating to the supply or withholding of supply by utility companies under the Bankruptcy Ordinance.

18.3 We sought comments from the Hong Kong and China Gas Co. Ltd., the Hong Kong Electric Co. Ltd., the Hong Kong Telephone Co. Ltd., and the Water Authority. The Water Authority is regulated by the Waterworks Ordinance (Cap 102). One of its duties is to require payment of any charge and take such steps as may be necessary to enforce such payment. The Water Authority is the only one of the four suppliers consulted that is a branch of Government.

Discussion

18.4 The Official Receiver acknowledged that in practice utility companies in Hong Kong co-operate with trustees and liquidators in maintaining the supply of services and that the recommendation simply seeks to secure the position of trustees in relation to the provision of essential services.

18.5 All the utility companies consulted replied that is not their practice to demand the payment of outstanding charges before providing a supply to a trustee. Their reaction to the Official Receiver's proposal was either that no new legislation was necessary or that there was no objection to legislation.

18.6 An illustration of the sort of problem the Official Receiver seeks to avoid would be where, for example, a supplier of electricity refused to continue or reconnect supply until payment of arrears accumulated by a debtor prior to bankruptcy had been paid. A trustee trying to sell a business as a going concern or trying to preserve assets, such as frozen goods, could find his position undermined by the electricity supplier's refusal to maintain supply.

18.7 The Cork Report said that it was a common practice for public utility companies, on the insolvency of a customer, to threaten to cut off supplies unless the outstanding account was paid in full. The Cork Report distinguished the position of a private creditor who enjoyed a monopoly in relation to the debtor exploiting the commercial advantages of his position and that of a public utility which enjoyed a monopoly granted by Parliament in return for which it was under a statutory obligation to provide a service. The utilities identified by the Cork Report were those concerned with the supply of electricity, gas, water, and telecommunications.

18.8 The Cork Report recommended, in relation to individual debtors, that statutory undertakings should be required to treat, not only the trustee, but also the debtor, as a new customer with a statutory right to receive supplies, separate and distinct from the customer whose account is in arrears.[311]

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311 The Cork Report, Chapter 33, paragraphs 1451 to 1466.

18.9 The Insolvency Act took up the recommendation of the Cork Report by providing that, where a bankruptcy order is made or an interim receiver of an individual's property is appointed or a voluntary arrangement is approved, the trustee may request the utility companies supplying gas, electricity, water and telecommunications to supply services for the purposes of any business which is or has been carried on by the individual, by a firm or partnership of which the individual is or was a member, or by an agent or manager for the individual or for such a firm or partnership.

18.10 The Insolvency Act also provides that the supplier may make it a condition of the giving of the supply that the trustee personally guarantees the payment of any charges in respect of the supply but shall not make it a condition of the giving of the supply, or do anything which has the effect of making it a condition of the giving of the supply, that any outstanding charges in respect of a supply given to the individual are paid.[312]

18.11 The Harmer Report also recommended that a supplier of gas, electricity, water or telecommunications should not make it a condition of supply that outstanding charges are paid although the supplier should be able to demand personal guarantees for payment of charges for subsequent supply.[313]

18.12 Although the suppliers of utility services in Hong Kong are undoubtedly more reasonable than their counterparts in England and Wales were in maintaining the supply of services where a debtor was in arrears, we take the view that it would be useful to formalise the position. We therefore recommend that a supplier of gas, electricity, water or telecommunications should not make it a condition of supply that outstanding charges shall be paid by a trustee, that a trustee should be liable for payment of all charges incurred after his appointment as trustee and that a supplier should be able to demand guarantees from a trustee for payment of charges for subsequent supply.

Individual Voluntary Arrangements

18.13 Our recommendations in this chapter should extend to situations where a debtor enters into a voluntary arrangement with his creditors.[314]

Recommendations

- **A supplier of gas, electricity, water or telecommunications should not make it a condition of supply that outstanding charges shall be paid by a trustee.**
- **A trustee should be liable for payment of all charges incurred after his appointment as trustee.**
- **A supplier should be able to demand guarantees from the trustee for payment of charges for subsequent supply.**
- **These recommendations should also apply in the case of a debtor making a voluntary arrangement with his creditors.**

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312 Insolvency Act 1986, section 372.

313 The Harmer Report, paragraphs 756 to 758.

314 See Chapter 6.

CHAPTER 19

INTEREST ON DEBTS

The present law

19.1 We had intended to leave the question of interest on debts for consideration in our main report on insolvency but practitioners have submitted that these provisions require amendment urgently. The problem lies not so much with the application of the provision to bankruptcy but with its application in the winding up of companies where the provision has been found to be virtually unworkable in complex liquidations, especially in the winding up of banks and other financial institutions. Section 264 of the Companies Ordinance applies the provisions on interest on debts in the Bankruptcy Ordinance to the winding up of insolvent companies under the Companies Ordinance. As the recommendations made in this chapter have particular relevance to companies winding up, we have made specific recommendations for amending the Companies Ordinance.

19.2 The Bankruptcy Ordinance, section 71, provides that:

> *"(1) Where a debt has been proved and the debt includes interest or any pecuniary consideration in lieu of interest, such interest or consideration shall, for the purposes of dividend, be calculated at a rate not exceeding 8 per cent per annum and be calculated only up to the date of the receiving order, without prejudice to the right of a creditor to receive out of the estate any higher rate of interest to which he may be entitled after all the debts proved in the estate have been paid in full.*
>
> *(2) In dealing with the proof of the debt the following rules shall be observed-*
>
> *(a) any account settled between the debtor and the creditor within 3 years preceding the date of the receiving order may be examined, and if it appears that the settlement of the account forms substantially one transaction with any debt alleged to be due out of the debtor's estate (whether in the form of renewal of a loan or capitalization of interest or ascertainment of loans or otherwise), the account may be reopened and the whole transaction treated as one;*
>
> *(b) any payments made by the debtor to the creditor before the receiving order, whether by way of bonus or otherwise, and any sums received by the creditor before the receiving order from the realization of any security for the debt shall, notwithstanding any agreement to the contrary, be appropriated to principal and interest in the proportion that the principal bears to the sum payable as interest at the agreed rate;*
>
> *(c) where the debt due is secured and the security is realized after the receiving order, or the value thereof is assessed in the proof, the amount realized or assessed shall be appropriated to the satisfaction of principal and interest in the proportion that the principal bears to the sum payable as interest at the agreed rate."*

Discussion

19.3 There is universal agreement among all those who have had to deal with section 71 that when a liquidation becomes complicated in terms of the calculation of the interest entitlements of creditors

and the apportionment of capital and interest the application of the provision, as one submission pointed out, "is frequently difficult, time consuming, and therefore costly". It has been noted that the provision was originally introduced with the intention that it should be used, for example, in the winding up of a corner store but that it is now applied to some of the world's major liquidations involving enormous sums of money and great complexity.

Section 71(1) : the interest limitation rule

19.4 Section 71(1) of the Bankruptcy Ordinance provides that, where interest can be charged on a debt, it can only be charged at the rate of 8% per annum up to the date of the receiving order ("the relevant date"). In the case of a winding up by the court the relevant date to which interest is provable is the date of the commencement of the winding up[315], that is to say, the date of the presentation of the petition. By section 230 of the Companies Ordinance, the commencement of a companies voluntary winding up is the time of the passing of the resolution for the voluntary winding up. Accordingly, the relevant date for the proving of interest in a voluntary winding up is the date of the resolution for the voluntary winding up. After the making of a receiving order or the commencement of the winding up there is no entitlement to interest unless there is a surplus after all the debts proved in the estate have been paid in full.

19.5 There is, however, a difference in the treatment of surplus in bankruptcy and in winding up. Section 38(9) of the Bankruptcy Ordinance provides that if there is any surplus after the payment of all the debts due from the estate, it shall be applied in payment of interest from the date of the receiving order at the rate of 8 per cent per annum on all the debts proved in the bankruptcy. Section 38(9) does not apply in winding up because if there is a surplus after the payment of a company's debts the company is not insolvent and the bankruptcy rules have no application.[316]

19.6 When section 71(1) is applied in practice it causes great difficulties because the imposition of an 8 per cent limit means that all interest that has been charged must be recalculated to a maximum rate of 8 per cent per annum. There is no time limit on how far back this recalculation should go. This means that if a bank were to go into liquidation with several thousand running accounts, many in operation for years, attracting varying interest rates in that time, the liquidator would have to recalculate all those accounts from their inception, presuming that the interest rate charged was above 8 per cent, to the relevant date. The task is not only next to impossible but also very expensive and time consuming.

19.7 We recommend that section 71(1) of the Bankruptcy Ordinance should be abolished and replaced by provisions that would allow any creditor to whom a debtor was obliged to pay interest at a given rate pursuant to a specific obligation or obligations, to recover interest at that rate up to the relevant date, subject to our recommendation on extortionate credit transactions. We will refer to that rate of interest as the contractual rate.

19.8 We received a submission from the Inland Revenue Department which drew our attention to the question of statutory rates of interest, such as the interest payable under section 71(9)(e)(ii) and (10) of the Inland Revenue Ordinance.[317] We consider that all such statutory rates of interest should be claimable up to the relevant date in the same way as contractual rates of interest.

19.9 In making this recommendation our aim is to create a provision that is fair to all creditors. In terms of contractual rates of interest, we see no reason to rewrite that part of a contract governing the interest rate to which the court would always give effect unless the rate was an extortionate rate.

19.10 The change in the relevant date in bankruptcy is made necessary by the abolition of the receiving order which is the relevant date at present. A beneficial consequence of this would be to make the relevant date for proving interest in bankruptcy the same as the date for the ascertainment of the assets and liabilities of the estate. The adoption of the date of the bankruptcy order as the relevant date for interest

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315 See in *re Amalgamated Investment and Property Co Ltd* [1985] 1 Ch 349.

316 *Re Fine Industrial Commodities Ltd* [1956] Ch 256.

317 See paragraphs 15.38 to 15.40.

also conforms with our general policy of making the bankruptcy order the relevant date for other events, such as the conversion of foreign currency debts.[318] In a winding up by the court the date for ascertainment of the assets and liabilities is the date of the winding up order whereas the relevant date for proving interest is the date of the winding up petition. We see no reason why the date of calculation of interest should be different to the date of ascertainment of the principal and recommend that the date of the winding up order should be the relevant date. We are not making any recommendation to change the time of the passing of the resolution in companies voluntary liquidation as the relevant date as the winding up begins on the date the resolution is passed.

19.11 In making these recommendations we generally recommend the adoption of the Insolvency Act 1986; section 189 and supporting rules in respect of winding up and sections 322 and 328 and supporting rules in respect of bankruptcy.[319] We have, however, differed from the Insolvency Act provisions in one significant way.

Creditors who are not entitled to claim interest

19.12 We consider that creditors who are not entitled to charge contractual interest under the terms of their agreement with the bankrupt should be allowed to claim interest in certain circumstances. We considered allowing all creditors who would not otherwise be entitled to claim interest to claim interest at the judgment rate to the relevant date, after which, under our recommendations, they would be entitled to interest in any event.

19.13 It became apparent, however, that this would create difficulties of its own on several levels. The most obvious difficulty would be in ascertaining the date from which interest could be claimed in the absence of agreement between the creditor and the debtor. In a normal commercial transaction, such as in the sale of goods, we felt that to provide for the claiming of interest from the date of supplying the goods would interfere with the competitive trade practice of giving credit for varying periods, for example, thirty or ninety days. We consider that interference to such an extent would be too protective of creditors and could have an undesirable effect on ordinary business practice.

19.14 Notwithstanding these problems, we are convinced that there should be a statutory provision for claiming interest when a creditor would not be otherwise entitled to claim. We consider that this is reasonable in the context of our recommendation to allow creditors to claim contractual interest up to the date of the bankruptcy order as that recommendation is likely to benefit institutional creditors rather than trade or other creditors. We believe that a provision allowing these other creditors to claim interest would be fair to all.

19.15 We consider that the solution lies in the rule 88 of the Companies (Winding-up) Rules which provides that:

> "*On any debt or sum certain, payable at a certain time or otherwise, whereon interest is not reserved or agreed for, and which is overdue at the date of the commencement of the winding up, the creditor may prove for interest at a rate not exceeding 8 per cent per annum to that date from the time when the debt or sum was payable, if the debt or sum is payable by virtue of a written instrument at a certain time, and if payable otherwise, then from the time when a demand in writing has been made, giving notice that interest will be claimed from the date of the demand until the time of payment.*"

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318 See paragraph 15.10.

319 See the Insolvency Rules; rule 4.93 in respect of companies and rule 6.113 in respect of bankruptcy. See section 129 for the definition of commencement of winding up and section 247 for the definitions of insolvency and go into liquidation. See section 278 for the definition of commencement of bankruptcy.

19.16 The adoption of this provision in bankruptcy, in the case of creditors who have no agreement for the payment of interest, would place them in the same position as creditors in winding up, as provided the debt was created by a written instrument, for example a cheque, or if a creditor had served a written demand giving notice that interest would be claimed from the date of the demand, that creditor would be entitled to interest up to the relevant date. Accordingly, we recommend the adoption of rule 88 with two amendments. First, that instead of interest being claimable at 8 per cent per annum it should be claimable at the judgment rate as the judgment rate is variable and therefore more likely than a fixed rate to reflect commercial interest rates at any particular time. This recommendation should apply to both bankruptcy and winding up. Second, we note that the relevant date would be the date of the bankruptcy order under our recommendations. In winding up by the court we recommend that the relevant date should be changed from the commencement of the winding up to the date of the winding up order.

Section 71(2)(a) to (c)

19.17 It follows from our recommendation that a contractual rate of interest should be provable in bankruptcy and winding up but that provisions for the re-examination and reopening of settled accounts, the appropriation of payments made and sums received by the creditor from the debtor before insolvency, and appropriation of proceeds or value of security assessed after the insolvency under section 71 (2)(a) to (c), are unnecessary. We therefore recommend that these provisions be abolished.

Guarantors

19.18 We considered the position of a guarantor of a bankrupt individual or of a company that has gone into liquidation. Most financial institutions require guarantors to sign standard form guarantees which usually contain clauses stating that the guarantor cannot claim in the bankruptcy or winding up unless the principal creditor has been paid the full amount of the debt owed to him by the principal debtor, that is, the insolvent party. The amount claimed by the principal creditor in the insolvency is always at least as much as the amount that the guarantor has guaranteed as otherwise the principal creditor could rely on the guarantee alone.

19.19 While it might appear unfair for a guarantor to be excluded from proof when he has a claim that could be made against the estate of the principal debtor, a guarantee is nonetheless a contract and we see no reason for interfering with contractual arrangements made by parties other than the insolvent party through the bankruptcy provisions. If there is to be any revision of the law relating to guarantee terms this is not the forum for it. We therefore make no recommendation on guarantees.

Third party security

19.20 Another aspect of the provision of security relates to the realisation of security given by a third party. It is possible for a creditor with a third party security to realise his security but, by utilising the terms of a suspense account clause in the security document, the creditor is able to place the realisations in a suspense account with the result that the creditor does not have to reduce his claim in the liquidation by a like amount.[320] Thus, if a creditor has a claim in a winding up for $100 and realises $50 from security given by a third party it is still possible for the creditor to claim in the winding up for the full $100 amount, subject to the rule that a creditor cannot recover more than one hundred cents in the dollar on a debt. The point to be made here is that creditors are unlikely to recover all that they are due in a bankruptcy. Thus, by proving for the full $100 the creditor usually hopes to recover part of the $50 balance.

19.21 Again, we are unwilling to make any recommendation, even though the situation appears to give a creditor with such security an advantage over other creditors, on the principle that the security arrangement is made outside the insolvency, does not involve the insolvent party, and does not affect the

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[320] Unless the mandatory set-off rules in section 35 of the Bankruptcy Act apply; see *M.S. Fashions Ltd. v Bank of Credit and Commerce International SA* (No.2) [1993] BCC 70.

administration of the estate. If the creditor was to be obliged to give credit for the realisations of security and the party providing the security was not allowed to prove for his debt by that creditor, it would increase the percentage of the dividend payable to all creditors in the insolvency but it would have no impact on the total amount available for distribution because the realisations came from outside the liquidation. We therefore make no recommendation.

Extortionate credit transactions

19.22 As a general principle, we do not believe that it is desirable for insolvency legislation to go behind transactions entered into before winding up unless the surrounding circumstances dictate that the transaction was unconscionable. Our recommendation that contractual interest rates should be admitted to proof recognises that interest rates fluctuate so that an interest rate of, say, 50 per cent may be extortionate at a certain time but might be the normal bank lending rate at another time.

19.23 For this reason, there is no point in providing for a fixed rate above which an interest claim would be extortionate, such as under the Money Lenders Ordinance[321] which provides that a rate of 48 per cent is presumed to be extortionate but the court may declare that a transaction with an interest rate in excess of 48 per cent but less than 60 per cent is not extortionate if, having regard to all the circumstances, the court is satisfied that the rate is not unreasonable or unfair.

19.24 The relevant provisions of the Money Lenders Ordinance are based on corresponding provisions in the Consumer Credit Act 1974 in the United Kingdom. The extortionate credit transactions provisions under the Insolvency Act are also modelled on the Consumer Credit Act 1974 and have separate, though similar, provisions in respect of winding up and bankruptcy. For winding up, section 244 of the Insolvency Act provides:

> *"(1) This section applies as does section 238 (transactions at an undervalue), and where the company is, or has been, a party to a transaction for, or involving, the provision of credit to the company.*
>
> *(2) The court may, on the application of the office-holder, make an order with respect to the transaction if the transaction is or was extortionate and was entered into in the period of 3 years ending with the day on which the administration order was made or (as the case may be) the company went into liquidation.*
>
> *(3) For the purposes of this section a transaction is extortionate if, having regard to the risk accepted by the person providing the credit-*
>
> *(a) the terms of it are or were such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of the credit, or*
>
> *(b) it otherwise grossly contravened ordinary principles of fair dealing;*
>
> *and it shall be presumed, unless the contrary is proved, that a transaction with respect to which an application is made under this section is or, as the case may be, was extortionate.*
>
> *(4) An order under this section with respect to any transaction may contain such one or more of the following as the court thinks fit, that is to say-*
>
> *(a) provision setting aside the whole or part of any obligation created by the transaction,*

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321 Money Lenders Ordinance (Cap 163). See sections 24 and 25.

(b) provision otherwise varying the terms of the transaction or varying the terms on which any security for the purposes of the transaction is held,

(c) provision requiring any person who is or was a party to the transaction to pay to the office-holder any sums paid to that person, by virtue of the transaction, by the company,

(d) provision requiring any person to surrender to the office-holder any property held by him as security for the purposes of the transaction,

(e) provision directing accounts to be taken between any persons.

(5) The powers conferred by this section are exercisable in relation to any transaction concurrently with any powers exercisable in relation to that transaction as a transaction at any undervalue or under section 242 (gratuitous alienation in Scotland)."

For bankruptcy, Section 34 of the Insolvency Act provides:

"(1) This section applies where a person is adjudged bankrupt who is or has been a party to a transaction for, or involving, the provision to him of credit.

(2) The court may, on the application of the trustee of the bankrupt's estate, make an order with respect to the transaction if the transaction is or was extortionate and was not entered into more than 3 years before the commencement of the bankruptcy.

(3) For the purposes of this section a transaction is extortionate if, having regard to the risk accepted by the person providing the credit-

(a) the terms of it are or were such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of the credit, or

(b) it otherwise grossly contravened ordinary principles of fair dealing;

and it shall be presumed, unless the contrary is proved, that a transaction with respect to which an application is made under this section is or, as the case may be, was extortionate.

(4) An order under this section with respect to any transaction may contain such one or more of the following as the court thinks fit, that is to say-

(a) provision setting aside the whole or part of any obligation created by the transaction;

(b) provision otherwise varying the terms of the transaction or varying the terms on which any security for the purposes of the transaction is held;

(c) provision requiring any person who is or was party to the transaction to pay to the trustee any sums paid to that person, by virtue of the transaction, by the bankrupt;

(d) provision requiring any person to surrender to the trustee any property held by him as security for the purposes of the transaction;

(e) provision directing accounts to be taken between any persons.

(5) Any sums or property required to be paid or surrendered to the trustee in accordance with an order under this section shall be comprised in the bankrupt's estate.

(6) Neither the trustee of a bankrupt's estate nor an undischarged bankrupt is entitled to make an application under section 139(1)(a) of the Consumer Credit Act 1974 (re-opening of extortionate credit agreements) for any agreement by which credit is or has been provided to the bankrupt to be re-opened.

But the powers conferred by this section are exercisable in relation to any transaction concurrently with any powers exercisable under this Act in relation to that transaction as a transaction at an undervalue."

19.25 We note that the definition of "extortionate" under the Insolvency Act is not as specific as the definition under the Money Lenders Ordinance or the Consumer Credit Act 1974 but that the additional matters specified in those provisions would appear to be matters which a court would not ordinarily ignore when considering whether any particular credit transaction was extortionate.[322] We recommend that the relevant extortionate credit transaction provisions under the Insolvency Act be adopted into the Bankruptcy Ordinance and the Companies Ordinance.

Recommendations

- **Section 71 of the Bankruptcy Ordinance should be abolished and replaced by provisions that allow for contractual and statutory rates of interest to be provable; following section 328 of the Insolvency Act in respect of bankruptcy. Section 189 of the Insolvency Act should be adopted into the Companies Ordinance in respect of winding up.**

- **In a winding up of a company by the court the date of the winding up order should be the relevant date for claiming interest.**

- **Rule 88 of the Companies (Winding-up) Rules should be adopted, with the proviso that instead of interest being claimable at 8 per cent per annum it should be claimable at the judgment rate. This should apply to both bankruptcy and winding up. The relevant date should be the date of the bankruptcy order. In winding up by the court the relevant date should be changed from the commencement of the winding up to the date of the winding up order.**

- **The relevant extortionate credit transaction provisions under the Insolvency Act should be adopted; following section 343 in respect of bankruptcy and section 244 in respect of winding up.**

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322 See Halsbury's Laws of England, 4th edition reissue, Volume 3(2), paragraph 658, footnote 1.

CHAPTER 20

SUMMARY OF RECOMMENDATIONS

20.1 Acts of bankruptcy should be abolished. (para. 1.11)

20.2 A debtor should be deemed to be unable to pay his debts if he fails to comply with the terms of a statutory demand. The statutory demand need not be based on a judgment and should require a debtor to pay a debt or to secure or compound for it within 21 days of service of the demand and the failure to satisfy such demand should be a ground for presenting a bankruptcy petition. (para. 1.15)

20.3 The court should be able to set aside a statutory demand if a debtor appears to have a counterclaim, set-off or cross demand which equals or exceeds the amount of the debt or debts specified in the statutory demand; or the debt is disputed on grounds which appear to the court to be substantial; or it appears that the creditor holds some security in respect of the debt claimed by the demand, and either rule 6.1(5) of the Insolvency Rules is not complied with in respect of it, or the court is satisfied that the value of the security equals or exceeds the full amount of the debt; or the court is satisfied, on other grounds, that the demand ought to be set aside; following the Insolvency Rules, rule 6.5(4). (para. 1.16)

20.4 Rules 6.1 to 6.5 of the Insolvency Rules relating to statutory demand should be adopted generally. (para. 1.17)

20.5 An unsatisfied execution of a judgment against the property of a debtor should be an event on which a bankruptcy petition may be grounded. (para. 1.18)

20.6 A petition may be presented if, at the time the petition was presented, a debtor intends to depart or has departed out of Hong Kong, knowing that a necessary consequence of his departing would be to defeat or delay his creditors, notwithstanding that his absence from Hong Kong had nothing to do with his debts. (para. 1.37)

20.7 The provisions of sections 267 and 268 of the Insolvency Act should be adopted generally. In particular, the grace period of 3 weeks given to a debtor to comply with the terms of a statutory demand should be capable of curtailment if there is a probability that the debtor's assets will be diminished during that time. (para. 1.41)

20.8 In the event of a default by a debtor under the terms of a voluntary arrangement the supervisor of, or any person bound by, a voluntary arrangement may present a petition to the court for a bankruptcy order to be made against the debtor. (para. 1.43)

20.9 The criteria, based on section 265 of the Insolvency Act, by which a debtor, irrespective of nationality, can become subject to the jurisdiction of the court should be:

(a) domicile in Hong Kong; or

(b) personal presence in Hong Kong on the day on which the petition is presented; or

(c) having been ordinarily resident or having had a place of residence in Hong Kong at any time within 3 years of the date of presentation of the petition; or

(d) having carried on business in Hong Kong (as interpreted by section 265(2) of the Insolvency Act) within 3 years of the date of presentation of the petition. (para. 2.11)

20.10 The amount of the minimum debt for a creditor' s petition should be raised to $10,000. (para. 3.12)

20.11 The minimum debt amount should be reviewed annually and should be capable of amendment by subsidiary legislation rather than by amendment of the primary legislation. (para. 3.13)

20.12 There should be no minimum debt amount on a debtor's own petition for bankruptcy. (para. 3.14)

20.13 The statutory deposit should be reduced to $5,000 in respect of both creditors' and debtors' petitions. (para. 4.13)

20.14 The amount of the statutory deposit should be reviewed annually and should be capable of amendment by subsidiary legislation rather than by amendment of the primary legislation. (para. 4.16)

20.15 The two stage system of receiving order and adjudication order should be abolished and replaced with a single bankruptcy order. (para. 5.4)

20.16 A prescribed notice should be served with every statutory demand and bankruptcy petition advising debtors of the consequences of ignoring the proceedings and also advising them of the individual voluntary arrangement procedure. (para. 5.9)

20.17 The rights of secured creditors should remain unchanged and they should retain the power to realise or otherwise deal with a security after the making of the bankruptcy order, except in so far as the rights of dependants of the bankrupt are concerned. (para. 5.12)

20.18 The power of the court to appoint an interim receiver should remain unchanged. (para. 5.13)

20.19 Section 12(1) of the Bankruptcy Ordinance should be amended to provide that on the making of a bankruptcy order no action or proceeding shall be proceeded with or

commenced against the property or person of a bankrupt except by leave of the court and subject to such terms as the court may impose. (para. 5.16)

20.20 An individual voluntary arrangements procedure based on Part VIII of the Insolvency Act and its supporting rules should be introduced whereby a debtor can seek an interim order of the court for a moratorium on proceedings against him while he seeks to reach an arrangement with his creditors as to his debts. (para. 6.14)

20.21 Two alternatives for the administration of individual voluntary arrangements are put forward for consideration:

1. That a special Government office, as a unit of the Official Receiver's Office, be established to carry out the administration of individual voluntary arrangements.

2. That a panel of suitably qualified practitioners willing to act as administrators be established. Practitioners could apply for inclusion in the panel. The Official Receiver would be the approving authority. (para. 6.22)

20.22 All creditors, other than secured creditors, should be bound by a voluntary arrangement. Notice of the meeting of creditors should be advertised in one English and one Chinese language newspaper printed in Hong Kong. (paras. 6.25 and 6.24(m))

20.23 Creditors with unliquidated claims should be bound by a voluntary arrangement. The procedure for establishing a valuation should be the same as the procedure set out in the recommendation on tort claims in Chapter 15. (para. 6.26)

20.24 Landlords should be bound by the moratorium and should not be able to exercise the remedy of distress for arrears of rent. (para. 6.27)

20.25 The individual voluntary arrangement procedure should also be available to undischarged bankrupts. (para. 6.30)

20.26 The words "on any grounds existing at the time the order was made", adopted from the Insolvency Act, section 282, should be inserted into section 33(1) of the Bankruptcy Ordinance. (para. 7.7)

20.27 The court should have the power to annul a bankruptcy order if the bankruptcy debts and expenses have all, since the making of the order, been either paid or secured for to the satisfaction of the court; following the Insolvency Act, section 282. (para. 7.8)

20.28 The court should have the power to annul a bankruptcy order even though the bankrupt has been discharged; following the Insolvency Act, section 282. (para. 7.9)

20.29 Where the court orders the annulment of a bankruptcy order it should have the discretion to make such order as to advertising and gazetting and to the costs thereof as it thinks fit. (para. 7.11)

20.30 On the annulment of a bankruptcy order, a bankrupt should be entitled to request a certificate from the Official Receiver confirming that the bankruptcy order has been annulled. (para. 7.12)

20.31 The discretion as to who should be allowed to make an application for annulment should lie with the court. (para. 7.14)

20.32 The 15 per cent rule under section 33(1A) of the Bankruptcy Ordinance should be abolished. (para. 7.17)

20.33 The court should have the power to annul a bankruptcy order on the approval of an individual voluntary arrangement by creditors and/or give such directions with respect to the conduct of the bankruptcy and the administration of the bankrupt's estate as it thinks appropriate for facilitating the implementation of an approved voluntary arrangement; following the Insolvency Act, section 261. (para. 7.18)

20.34 The Official Receiver should have a discretion whether to hold a first meeting of creditors; following the Insolvency Act, section 293. (para. 8.11)

20.35 Where the Official Receiver has not yet summoned or has decided not to summon a general meeting of creditors any creditor may request the Official Receiver to summon one. If the request is made with the concurrence of not less than one quarter in value of the creditors the Official Receiver should be obliged to summon the meeting; following the Insolvency Act, section 294. (para. 8.12)

20.36 The quorum should be reduced to one creditor present or represented at a meeting; following the Insolvency Rules, rule 12.4A. (para. 8.15)

20.37 All provisions should be consolidated in the Bankruptcy Ordinance and the Bankruptcy Rules and the Rules should have proper margin notes. (para. 8.16)

20.38 The name of the "committee of inspection" should be changed to "the creditors' committee". (para. 9.8)

20.39 The first meeting of the creditors' committee should be called by the trustee to take place within three months of his appointment or of the committee's establishment, whichever is later. Subsequent meetings should be held when and where determined by the trustee or if requested by a member of the committee or on a date specified at the previous meeting of the committee; following the Insolvency Rules, rule 6.153. (para. 9.10)

20.40 Members of the creditors' committee should be capable of representation at a meeting by any person in possession of a simple form of letter of authority from the member provided that person is not a body corporate, an undischarged bankrupt or a person who is subject to a composition or arrangement with his creditors. Membership of the committee should be automatically terminated if a member becomes bankrupt or compounds or arranges with his creditors; following the Insolvency Rules, rules 6.156 and 6.158. (para. 9.12)

20.41 The trustee should be able to seek to obtain the agreement of members of the creditors' committee to a resolution by sending copies of the proposed resolution to members by post; following the Insolvency Rules, rule 6.162. (para. 9.13)

20.42 A creditors' committee should be appointed "to act with" rather than to supervise the trustee. (para. 9.20)

20.43 The present provisions which oblige a trustee to seek sanction for certain actions should be retained with the addition of the following power:

> "Power, where any right, option or other power forms part of the bankrupt's estate, to make payments or incur liabilities with a view to obtaining, for the benefit of the creditors, any property which is the subject of the right, option or power." (para. 9.25)

20.44 The trustee should have the power, subject to the sanction of the creditors' committee, to allow a debtor to restructure a business. (para. 9.26)

20.45 The four general powers of the trustee that exist under the present provisions should be retained with the addition of the following power:

> "Power to do all such other things as may be necessary for administering the estate and distributing its assets." (para. 9.27)

20.46 The exercise by the trustee of the powers conferred on him should be subject to the control of the court and any creditor or the creditors' committee should be able to apply to the court with respect to any exercise or proposed exercise of any of the powers by the trustee. The powers referred to include powers for which the trustee does not require the permission of the committee. (para. 9.31)

20.47 Where the court is satisfied that a trustee has misapplied or retained, or become accountable for, any money or other property comprised in a bankrupt's estate, or that a bankrupt's estate has suffered any loss in consequence of any misfeasance or breach of fiduciary or other duty by a trustee of the estate in carrying out his functions, the court may order the trustee, for the benefit of the estate, to repay, restore or account for money or other property (together with interest at such rate as the court thinks just) or, as the case may require, to pay such sum by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just; following the Insolvency Act, section 304(1). (para. 9.34)

20.48 A trustee should be under a duty to act in a fiduciary capacity and to deal with the property under his control honestly, in good faith, with proper skill and competence and in a reasonable manner. (para. 9.35)

20.49 In realising the assets of a bankrupt's estate it should be the duty of a trustee to take all reasonable care to realise the best price reasonably obtainable in the circumstances. (para. 9.36)

20.50 If a frivolous complaint is made to the court in respect of the trustee's duty the court should have the discretion to order that the costs of the hearing be borne by the complainant. (para. 9.37)

20.51 The time for submission of the statement of affairs should be increased to twenty one days from the date of the bankruptcy order in the case of an order made on a creditor's petition; following the Insolvency Act, section 288. (para. 10.11)

20.52 The statement of affairs should be submitted with the petition where a debtor petitions for his own bankruptcy; following the Insolvency Act, section 6.62. The statement of affairs form should be freely available at the Official Receiver's Office to any person who wishes to present his own petition. (para. 10.12)

20.53 The Official Receiver should have the discretion to dispense with the statement of affairs where he considers it unnecessary, without having to apply for an order of the court to dispense with the statement; following the Insolvency Rules, rule 6.62. (para. 10.15)

20.54 The Official Receiver should have the power to extend the time for submission of the statement of affairs without having to file a certificate in court. (para. 10.16)

20.55 The circumstances under which a debtor may be in contempt of court under section 18(3) of the Bankruptcy Ordinance should be more clearly set out, as in section 288(4) of the Insolvency Act. (para. 10.18)

20.56 A bankrupt should be obliged to answer all questions that are put to him in his public examination but his answers may not be used as evidence against him in criminal proceedings other than in relation to perjury. This protection should not apply where a bankrupt does not give truthful answers in his examination. (para. 11.15)

20.57 The provisions under the Insolvency Rules should be adopted whereby a bankrupt may at his own expense employ a solicitor with or without counsel, who may put to him such questions as the court may allow for the purpose of enabling him to explain or qualify any answers given by him, and may make representations on his behalf. (para. 11.19)

20.58 The public examination should only be held on the application of the Official Receiver or, where no such application is made by the Official Receiver, on the requisition of one quarter in value of the creditors; following, in part, the Insolvency Act, section 290. The court should also have the discretionary power to make an order for examination at the request of creditors making up less than one quarter in value of creditors. (para. 11.27)

20.59 It should be in the discretion of the court whether to allow inspection of the trustee's report to the court, or part of it, but the report should remain confidential unless the bankrupt can show that it would be unfair to him not to allow inspection. (para. 11.32)

20.60 Creditors should furnish the Official Receiver with a list of the topics they intend to put to a bankrupt at a public examination. (para. 11.34)

20.61 The court should have a discretion to order that the costs of a public examination should be borne by creditors who have obliged the Official Receiver to hold an examination if the court considers that it was frivolous to have held the examination. (para. 11.35)

20.62 A warning should be placed in the Order Appointing a Time for the Public Examination of a Debtor warning that on conviction for perjury a debtor or bankrupt would be subject to imprisonment for seven years and a fine. (para. 11.36)

20.63 Provisions similar to the procedure under the Northern Irish Bankruptcy Rules 1970 should be introduced whereby the preliminary examination of the bankrupt would be sworn by the bankrupt and filed in court as part of his public examination unless he objects, and objections must relate to specific matters in the note of the preliminary examination. The preliminary examination should be capable of being conducted in English or Chinese and filed in court in either language. (para. 11.39)

20.64 Section 19(8) of the Bankruptcy Ordinance should be amended to take account of more modern methods of recording evidence. (para. 11.42)

20.65 A respondent should be obliged to answer all questions that are put to him in his examination but his answers may not be used as evidence against him in criminal proceedings. (para. 12.8)

20.66 Section 29(3) of the Bankruptcy Ordinance should be amended to extend the power of the court to examine a respondent concerning the debtor, his dealings or property "and any other matter the court considers relevant". (para. 12.9)

20.67 The provisions under the Insolvency Rules should be adopted to provide that a respondent may at his own expense employ a solicitor with or without counsel, who may put to him such questions as the court may allow for the purpose of enabling him to explain or qualify any answers given by him, and may make representations on his behalf. (para. 12.10)

20.68 The wording of section 29(1) of the Bankruptcy Ordinance should be amended to replace the words "the debtor or his wife" with the words "the bankrupt or the bankrupt's spouse"; following the Insolvency Act, section 366. (para. 12.13)

20.69 Section 29(4) and (5) of the Bankruptcy Ordinance should be amended to provide that where on examination it appears to the court that the person examined is indebted to the bankrupt or has in his possession property belonging to the bankrupt the court may order

that person to pay such sum or deliver such property, or any part of the sum or property, as the court thinks fit, to the trustee. (para. 12.15)

20.70 Applications for private examinations should be made inter partes except where a trustee reports to the court that the application would cause the respondent or others to take actions that would be likely to cause injustice to the applicant or where the risk of uncompensatable loss is clearly outweighed by the risk of injustice to the applicant if the order is not made. In cases where a trustee makes an ex parte application he should make full disclosure of the facts of the case to the court, in whose discretion it should lie to make an order. (para. 12.20)

20.71 The court should have the power to require a respondent, including a bankrupt's spouse, to submit an affidavit of his dealings with a bankrupt and to produce any documents in his possession or under his control relating to the bankrupt, the bankrupt's dealings, affairs or property. In the event of a respondent appealing against an order to produce an affidavit the respondent should not be obliged to continue with the preparation of the affidavit prior to the hearing of the appeal unless the trustee makes a separate application for an order obliging the respondent to continue with preparation of the affidavit and the court so orders. (paras. 12.24 and 12.27)

20.72 The court should have the power to require a respondent to answer interrogatories; following the Insolvency Rules, rule 9.2. (para. 12.28)

20.73 It should be left to the discretion of the court whether to allow inspection of the trustee's report. (para. 12.29)

20.74 The court should have the power to order that the costs of an examination should be paid by a respondent if it appears to the court that the examination was made necessary because information requested by a trustee had been unjustifiably withheld by the respondent. (para. 12.32)

20.75 The court should have the power to order that the costs of an examination should be paid by a respondent if the court makes an order for the respondent to deliver up property or to discharge a debt due to the bankrupt. (para. 12.32)

20.76 Where a respondent has co-operated with the trustee in his examination and/or in the production of documents the court should have the discretion to order that the costs of the respondent be borne by the estate. (para. 12.33)

20.77 The court should be able to order an Inland Revenue official to produce documents relating to the bankrupt's tax affairs; following the Insolvency Act, section 369. (para. 12.45)

20.78 A warning should be placed in the Summons under Section 29 warning that on conviction for perjury a person would be subject to imprisonment for seven years and a fine. (para. 12.47)

20.79 The present monetary limit of $3,000 on the total value of tools of trade and domestic goods that a bankrupt can retain should be abolished. (para. 13.05)

20.80 A bankrupt should be allowed to retain such equipment as is necessary for him to continue in his trade, occupation or business in order to earn a reasonable living for himself and his dependants. Excess earnings should continue to be paid into the bankrupt's estate. There should be no restriction on the equipment that a bankrupt is allowed to retain and in appropriate circumstances a bankrupt should even be allowed to retain his place of business. (paras. 13.14 and 13.23)

20.81 The trustee should, subject to sanction, have a discretion to allow a bankrupt to restructure a viable business if continuing the business would enable the bankrupt to earn more than he could earn in another occupation and would allow him to make payments to his estate. (para. 13.20)

20.82 A bankrupt should be allowed to retain such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family. In addition, the trustee should have a discretion to sell domestic property which the trustee considers has a realisable value which would exceed the cost of replacement by property of a similar nature. It should be open to the bankrupt or creditors to apply to the trustee or the court if they want specific items of domestic property included or excluded; following Insolvency Act, sections 283 and 308. (para. 13.34)

20.83 A bankrupt and his dependents should have the right to remain in occupation of the family home for six months after the making of a bankruptcy order but at the end of six months after the making of the bankruptcy order the court shall assume, unless the circumstances of the case are exceptional, that the interests of the bankrupt's creditors outweigh all other considerations. In the event that the court finds exceptional circumstances it should have the discretion to allow the bankrupt and his dependents to remain in the family home for a second period of up to six months. (para. 13.46)

20.84 The doctrine of reputed ownership should be abolished. (para. 13.49)

20.85 A bankrupt should be obliged to prepare an annual report of his earnings and acquisitions for the trustee. The trustee would then have 42 days in which to claim any property which had been acquired by a bankrupt during the reporting period. If the trustee does not claim the property, the bankrupt should then be free to dispose of it. Any breach of the duty by the bankrupt should be made a condition for objection to automatic discharge and should also be subject to criminal sanction. (para. 13.54)

20.86 The doctrine of relation back should be retained in an adapted version of section 284 of the Insolvency Act, with relation back applying for a period of three months from the date of presentation of the bankruptcy petition. (para. 14.8)

20.87 For the purposes of valuation for dividend, foreign currency debts should be converted into Hong Kong dollars at the date of the making of the bankruptcy order. (para. 15.10)

20.88 If a trustee, on taking expert advice, considers that it would be beneficial to the estate to delay the conversion of foreign currency to Hong Kong dollars he should be able to do so but only with the approval of the creditors' committee, or the court in the absence of a creditors' committee. (para. 15.12)

20.89 The exchange rate for foreign currency claims should be fixed at the exchange rate on the date of the bankruptcy order. The trustee should have the discretion to pay a dividend in respect of a foreign currency claim in Hong Kong dollars or in the foreign currency equivalent of the amount of the Hong Kong dollar dividend. (para. 15.15)

20.90 Proofs of debt for tort claims should be admitted to proof subject to a trustee either making an estimate of the value of a debt or liability or referring the claim to the court for valuation. The right of appeal from an estimate made by the trustee should then be treated as if that person had referred the claim to the court. The court should have a power to specify a mode of determining the value rather than being necessarily required to determine the value itself. It would still be open to appeal to the court from a valuation determined in the specified manner. (paras. 15.22 and 15.25)

20.91 Where an estimate on which a dividend has been paid is less than the amount of damages subsequently awarded by the court the claimant should not be entitled to catch up in respect of the first dividend. The claimant should be entitled to amend his proof of debt to the judgment amount in a second dividend. (para. 15.27)

20.92 Where a judgment is less than an estimate on which a dividend has been paid the first dividend payment should not be reduced but the claimant should not be entitled to claim for any more in further dividends than he would have been entitled to in total in respect of the judgment amount. (para. 15.28)

20.93 Fines and penalties should not be admissible in bankruptcy nor should they be released by the bankrupt's discharge. (para. 15.37)

20.94 Assets subject to confiscation under the Drugs Trafficking (Recovery of Proceeds) Ordinance should not be treated as part of a bankrupt's estate where the confiscation was made before the date of the bankruptcy order. Confiscation should not be discharged by bankruptcy. (para. 15.46)

20.95 Any person guilty of making a false statement in respect of a proof of debt or of an affidavit of debt under the Bankruptcy Ordinance knowing it to be false should be liable to a fine of $50,000 and imprisonment for six months and the offence should be provided for in the Bankruptcy Ordinance. (para. 15.51)

20.96 A trustee should be obliged to make a decision on a proof of debt within four years of it being lodged with him provided that there is a reasonable prospect of a dividend being paid to the class of creditor to which the proof of debt relates, subject to the right of the trustee to apply to the court for an extension of time. (para. 15.55)

20.97 A trustee should have flexibility in the timing of declaration and distribution of dividends. Section 67 (1), (2) and (3) of the Bankruptcy Ordinance should be abolished and replaced by section 324(1) of the Insolvency Act which places a duty on the trustee to make a dividend whenever he has sufficient funds for the purpose subject to the retention of monies in respect of his expenses. (para. 16.6)

20.98 The introduction of automatic discharge from bankruptcy three years after the date of the bankruptcy order subject to objection. (para. 17.16)

20.99 Where the administration of an estate has not been completed when a bankrupt comes to be automatically discharged, and there is no objection to automatic discharge, the former bankrupt should be obliged to give the trustee such information as to his affairs, attend on the trustee at such times, and do all such other things as the trustee may require in carrying out the administration of the estate. (para. 17.21)

20.100 The Official Receiver or any creditor who has filed a proof of debt should be able to object to the automatic discharge of a bankrupt on the following grounds:

(a) that the bankrupt is likely within 5 years of the date of the bankruptcy to be able to make a significant contribution to his estate;

(b) that the discharge of the bankrupt would prejudice the administration of his estate;

(c) that the bankrupt has failed to co-operate in the administration of his estate;

(d) that the conduct of the bankrupt, either in respect of the period before or the period after the date of the bankruptcy, has been unsatisfactory;

(e) that the bankrupt had continued to trade after knowing himself to be insolvent;

(f) that the bankrupt has committed any offence under section 129 or sections 131 to 136 of the Bankruptcy Ordinance;

(g) that the bankrupt has absconded from Hong Kong and has not, on request, returned;

(h) that the bankrupt has failed to prepare an annual report of his earnings and acquisitions for the trustee. (paras. 17.38 - 17.41)

20.101 Three months before the end of the three year period for automatic discharge the Official Receiver should give notice to all creditors who have filed a proof of debt advising whether the Official Receiver intends to file an objection to the automatic discharge of the bankrupt and, if so, on what grounds. The notice, which at the discretion of the Official Receiver may be given individually or by advertisement, should advise creditors that they are entitled to object to discharge in any event. It should also set out the grounds of objection and the procedure to be followed. (para. 17.45)

20.102 If a bankrupt is making a contribution to his estate from income at the time that he is automatically discharged from bankruptcy the court should have the power to order the bankrupt to continue making contributions but the contributions should not continue for longer than eight years from the date of the bankruptcy order. (para. 17.46)

20.103 If the trustee or creditors object, the court should be able to suspend the operation of automatic discharge for eight years after the date of the making of the bankruptcy order. (para. 17.48)

20.104 A bankrupt whose discharge from bankruptcy has been suspended should have the right to apply to the court at any time for the suspension to be lifted; following the Insolvency Rules , rule 6.216. (para. 17.48)

20.105 Where a bankrupt has, whether before or after the date of bankruptcy, left Hong Kong and has not returned to Hong Kong or where, while the bankrupt was absent from Hong Kong he was requested by the trustee to return to Hong Kong by a particular date or within a particular period but the bankrupt failed to return by that date or within that period, the running of time of the bankruptcy should not begin, or should be suspended where appropriate, until the date on which the bankrupt returns to Hong Kong. (para. 17.49)

20.106 In the case of subsequent bankruptcy, automatic discharge should not operate until eight years after the date of the subsequent bankruptcy order but a bankrupt should be able to apply to the court for discharge three years after that date. The Official Receiver should file a report with the court on an application for early discharge, as provided for in the Insolvency Rules. (paras. 17.51 and 17.52)

20.107 Bankrupts should be entitled to apply to the court for discharge from a first bankruptcy before the expiration of three years from the bankruptcy order. The court should have no discretion to grant a discharge in certain circumstances. (para. 17.61)

20.108 Persons bankrupt under the present provisions should be automatically discharged from bankruptcy twelve months after the introduction of the new provisions if they have been bankrupt for three years or longer, subject to objection. Any person bankrupt under the present provisions should be able to apply for discharge at any time after the introduction of the new provisions. (para. 17.66)

20.109 A supplier of gas, electricity, water or telecommunications should not make it a condition of supply that outstanding charges shall be paid by a trustee. (para. 18.12)

20.110 A trustee should be liable for payment of all charges incurred after his appointment as trustee. (para. 18.12)

20.111 A supplier should be able to demand guarantees from the trustee for payment of charges for subsequent supply. (para. 12)

20.112 These recommendations should also apply in the case of a debtor making a voluntary arrangement with his creditors. (para. 18.13)

20.113 Section 71 of the Bankruptcy Ordinance should be abolished and replaced by provisions that allow for contractual and statutory rates of interest to be provable; following section 328 of the Insolvency Act in respect of bankruptcy. Section 189 of the Insolvency Act should be adopted into the Companies Ordinance in respect of winding up. (paras. 19.7 and 19.11)

20.114 In a winding up of a company by the court the date of the winding up order should be the relevant date for claiming interest. (para. 19.10)

20.115 Rule 88 of the Companies (Winding-up) Rules should be adopted, with the proviso that instead of interest being claimable at 8 per cent per annum it should be claimable at the judgment rate. This should apply to both bankruptcy and winding up. The relevant date should be the date of the bankruptcy order. In winding up by the court the relevant date should be changed from the commencement of the winding up to the date of the winding up order. (para. 19.16)

20.116 The relevant extortionate credit transaction provisions under the Insolvency Act should be adopted; following section 343 in respect of bankruptcy and section 244 in respect of winding up. (para. 19.25)

Annexure 1

ADJUDICATIONS AND DIVIDENDS DECLARED

BANKRUPTCY	(APR-MAR) 92/93	(APR-MAR) 91/92	(APR-MAR) 90/91	(APR-MAR) 89/90	(APR-MAR) 88/89	(APR-MAR) 87/88	TOTAL
No. of Proofs Adjudicated	564	627	980	993	1,294	2,102	6,560
Amount of Claims Adjudicated($)	124,097,217	454,372,508	239,417,994	648,482,458	124,714,100	341,857,534	1,932,941,811
Amount of Dividends Declared ($)	18,693,557	15,493,290	13,312,547	30,927,340	18,253,199	22,500,570	119,180,503

NOTE

Amount of Dividends Declared was about 6.2% of Amount of Claims Adjudicated.

Annexure 2

GENERAL BANKRUPTCY STATISTICS

BANKRUPTCY	APR-MAR 92/93	APR-MAR 91/92	APR-MAR 90/91	APR-MAR 89/90	APR-MAR 88/89	APR-MAR 87/88	APR-MAR 86/87	APR-MAR 85/86	APR-MAR 84/85	APR-MAR 83/84	TOTAL
1. Bankruptcy Notices	895	859	963	745	795	887	966	983	769	224	8086
2. Petitions	393	375	318	251	248	334	445	441	380	190	3375
3. Receiving Orders	313	294	226	178	193	288	374	336	273	136	2611
4. Adjudication Orders	286	262	198	154	195	277	375	301	209	137	2394
5. Discharges	4	0	1	5	2	5	2	3	1	2	25
6. Public Examination	4	12	7	9	4	4	4	4	3	2	53
7. Private Examination	11	11	10	12	9	17	24	8	12	13	127
8. Dividends	91	108	123	117	135	100	77	56	46	37	890