THE LAW REFORM COMMISSION OF HONG KONG

SUB-COMMITTEE ON INSOLVENCY

THE WINDING-UP PROVISIONS OF THE COMPANIES ORDINANCE

CONSULTATION PAPER

APRIL 1998

This Consultation Paper has been prepared by the Sub-committee on Insolvency of the Law Reform Commission. It does not represent the final views of either the Sub-committee or the Law Reform Commission, and is circulated for comment and criticism only.

The Sub-committee would be grateful for comments on this Consultation Paper by 31 July 1998. All correspondence should be addressed to :

The Secretary
Sub-committee on Insolvency
The Law Reform Commission
20th Floor, Harcourt House
39 Gloucester Road
Wanchai
Hong Kong

Fax : (852) 2865 2902

It may be helpful for the Commission and the Sub-committee, either in discussion with others or in any subsequent report, to be able to refer to and attribute comments submitted in response to this Consultation Paper. Any request to treat all or part of a response in confidence will, of course, be respected, but if no such request is made, the Commission will assume that the response is not intended to be confidential.

THE LAW REFORM COMMISSION OF HONG KONG

SUB-COMMITTEE ON INSOLVENCY

CONSULTATION PAPER

ON

THE WINDING-UP PROVISIONS OF THE COMPANIES ORDINANCE

CONTENTS

INTRODUCTION

1. The Law Reform Commission of Hong Kong was established by the Governor-in-Council in January 1980. The Commission reports on such matters as the Secretary for Justice or the Chief Justice refers to it.

Terms of reference

2. On 14th September 1990, the then Attorney General and the Chief Justice referred the following topic to the 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, in particular the UK Insolvency Act 1986 and Chapter 11 of the US 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."*

3. A sub-committee was appointed by the then Attorney General to consider the reference and report to the Commission. The sub-committee on insolvency is chaired by Professor Edward L G. Tyler, formerly a Judge of the District Court and Professor and Head of the Department of Professional Legal Education at the University of Hong Kong, and now Acting Dean of the Law Faculty and Acting Head of the Department of Law at the City University of Hong

Kong. Professor Tyler was a member of the Law Reform Commission from 4th July 1987 to 11th August 1993. The other members of the sub-committee are:

Mr Mark Bradley	Solicitor Deacons Graham and James
Mr Graham Cheng JP	Chairman Taching Petroleum Company Ltd
Mr S. K. Cheung (since 7.8.1995)	Senior Executive Corporate & Institutional Banking, Hongkong and Shanghai Banking Corporation Ltd
Mr Nicholas Etches	Accountant KPMG Peat Marwick
Mr Stefan Gannon JP	General Counsel to the Hong Kong Monetary Authority
Mr David Hague	Accountant Price Waterhouse
Mr Robin Hearder JP	The Official Receiver
Mr Nic Johnston (since 7.8.95)	Solicitor, Freshfields
Mr Winston Poon SC	Barrister
Mr Ian Robinson	Accountant, formerly of Ernst & Young, now a director of Robinson Management Limited
Mr Jeremy Glen	Senior Solicitor (Secretary)

4. The terms of reference provided that the Commission could make an interim report on such other aspects of insolvency law or practice which the Commission considered should be introduced in advance of the final report on insolvency. The sub-committee's intention had been to make a single interim report on bankruptcy to the Commission followed by a final report on all other aspects of personal and corporate insolvency. The Commission's Report on Bankruptcy was published in May 1995.

5. Following completion of its report on bankruptcy to the Commission, the sub-committee considered that, as provided for under paragraph 2(b) of the terms of reference, it would be appropriate to make a second interim report to the Commission on the issue of making provision for a procedure to facilitate the rescue of ailing companies and to impose liability on directors and senior management for trading while a company was insolvent. The sub-committee's report to the Commission formed the basis of the Commission's Report on Corporate Rescue and Insolvent Trading which was published in October 1996.

The consultation process

6. The winding-up provisions of the Companies Ordinance, when taken in conjunction with the provisions on receivership and the winding-up of unregistered companies under Part X of the Companies Ordinance, account for about 165 of the 365 sections in the Ordinance. These sections are supported by subsidiary legislation in the form of the Companies (Winding-up) Rules.

7. We considered that in order for the Consultation Paper to be as comprehensive as possible it would be necessary to seek preliminary submissions from interested bodies on the provisions before we published the Paper. The responses that we received have all been considered and have been reflected in the Consultation Paper.

8. The primary purpose of the Consultation Paper is to solicit views on our, that is, the sub-committee's, proposals. We would welcome submissions on aspects of the winding-up provisions that we have not referred to. In this context, we note that we have not referred to every section in the Ordinance which relates to winding-up. Where a section is not mentioned it is because we have no comment to make on it.

9. The Consultation Paper will be sent to about 330 consultees and will also be made available free of charge to other interested parties. There will be a consultation period of three months after which all submissions made will be considered by the sub-committee.

10. The sub-committee will then submit its final report to the Law Reform Commission. The Commission will consider the sub-committee's report before issuing its report.

Confidentiality

11. The Consultation Paper follows the Commission's policy of naming those who make submissions unless confidentiality is requested. None

of those who made submissions requested confidentiality. A list of submissions is annexed.[1] We would like to express our gratitude to all those who made submissions.

Abbreviations

12. For the sake of brevity, references to "he" mean "he or she" unless the context implies otherwise. Abbreviated forms of the following reports and legislation have been used:

"*The Commission*" : This refers to the Law Reform Commission of Hong Kong.

"*The Cork Report*" : The Report of the United Kingdom Committee on Insolvency Law and Practice under the Chairmanship of Sir Kenneth Cork.[2]

"*The Harmer Report*" : General Insolvency Inquiry: a Report of the Law Reform Commission of Australia under the Chairmanship of Mr Ron Harmer.[3]

"*The Insolvency Act*" : This refers to the United Kingdom Insolvency Act 1986.
"*The Insolvency Rules*" : This refers to the United Kingdom Insolvency Rules 1986.

Acknowledgements

13. One of the most important matters under consideration in the Consultation Paper is our proposals on cross-border insolvency, an area of great complexity.[4] We must express our gratitude to Mr Charles Booth, Associate Professor in the Department of Professional Legal Education in the University of Hong Kong and Mr Philip Smart, Associate Professor in the Department of Law in the University of Hong Kong, who addressed us on cross-border insolvency issues and who were of great assistance to us in this regard.

Layout of the Consultation Paper

14. The Consultation Paper is effectively set out in two parts. The first part of the Consultation Paper addresses specific sections and rules and the second part addresses general issues.

---

1 See annex 1.
2 1982. Cmnd 8558.
3 Report No. 45, September 1988.
4 See *Winding-up of Unregistered Companies*, at paragraph 21.1.

Consultation Paper in English and Chinese

15. This Consultation Paper is available in both Chinese and English.

CHAPTER 1

OVERVIEW

1.1 The function of the insolvency provisions of the Companies Ordinance is to provide a means by which companies which fail can be effectively disposed of or restructured. At its crudest, the insolvency provisions might be considered to be the waste disposal system for companies which have failed and while this is undoubtedly the case with the majority of companies which become involved in insolvency processes, it is not the full story.

1.2 There is a need for the insolvency provisions because although the vast majority of companies do not become insolvent those that do leave behind a trail that needs to be tidied up. This is an important function, as it oversees the fair distribution of the remaining assets of the insolvent company among its creditors. This is not to say that the administration of an insolvent company is simple matter. It can be difficult to recover assets, particularly in situations where companies do not have the cash to fund recovery actions, and there are often difficulties in getting the former owners to co-operate with each other and with the liquidator.

1.3 The insolvency provisions are only necessary because the nature of doing business requires that companies operate on credit: companies borrow money in order to trade and develop. This process is not limited to companies; private individuals and countries also go into debt. The types of debt that are now being developed in the financial markets are tending to increase the complexity of some insolvencies, usually those where the insolvent company was a finance company or bank or where a company was dealing in complex debt market contracts. The more usual forms of debt used by companies involve the obtaining of loans from financial institutions or the obtaining of credit terms from companies with which a company is doing business.

1.4 The impact of the failure of a company that was carrying out a genuine business is difficult to understand at first glance. The obvious victims are the employees and the shareholders of the company but the failure also affects unpaid creditors and the holder of loans that might have been made to the company. When, as happens periodically, significant numbers of companies fail at about the same time, the impact on an economy becomes plain and can be seen in the form of increased unemployment, falling prices, poorer results from companies which are still in business and increasing social discontent.

1.5 The law of insolvency cannot prevent economic downturns but it assist in ameliorating the affect of the downturn. The aim of this Paper is to

examine the existing company winding-up provisions and to see how they can be improved or developed to facilitate the more efficient winding-up of companies. The Australian Law Reform Commission's General Insolvency Inquiry, better known as the Harmer Report, identified certain principles that should guide the development of a modern insolvency law.[1] We cannot express those principles in any better way and therefore set them out below. These principles apply equally well to this Paper as it did to the Harmer Report. We would note that the Harmer Report addressed both individual and corporate insolvency. The Commission's Reports on Bankruptcy and Corporate Rescue and Insolvent Trading, when read with this Paper, would cover all the principles identified in the Harmer Report, which are that:

> *"(a) the fundamental purpose of an insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies;*
>
> *(b) insolvency law should provide mechanisms that enable both debtor and creditor to participate with the least possible delay and expense;*
>
> *(c) an insolvency administration should be impartial, efficient and expeditious;*
>
> *(d) the law should provide a convenient means of collecting or recovering property that should be applied toward payment of the debts and liabilities of the insolvent person;*
>
> *(e) the principle of equal sharing between creditors should be retained and in some areas reinforced;*
>
> *(f) the end result of an insolvency administration, particularly as it affects individuals, should, with very limited exceptions, be the effective release or relief from the financial liabilities and obligations of the insolvent;*
>
> *(g) insolvency law should, so far as it is convenient and practical, support the commercial and economic processes of the community;*
>
> *(h) as far as is possible and practical, insolvency law should harmonise with the general law; and*

[1] The Harmer Report, paragraph 33.

(i) an insolvency law should enable ancillary assistance in the administration of an insolvency originating in a foreign country."

1.6 It is when companies, individuals and countries do not manage their debt properly or take on unsustainable amounts of debt, either because of indiscipline, incompetence or dishonesty, or they are struck by situations that could not have reasonably been predicted, that the insolvency provisions are called upon to tidy up the resulting mess.

1.7 The last six to nine months have produced some graphic examples of companies, individuals and countries moving from positions that were perceived as being solvent, secure and solid, to positions of penury. This happened so suddenly that it took nearly everybody, including those whom might have been expected to have known better, by surprise. Bad management and dishonesty have undoubtedly had their place in the current crisis. The bad luck can be found in those cases of companies and individuals who took positions that at the time seemed to be appropriate but falling currencies and failing markets have driven to the wall those who would otherwise be still doing good business.

1.8 While the imposition of good business practice is more the function of the main companies provisions, the insolvency provisions hold scope for creativity in dealing with companies which are heading towards insolvency but which still have potential. The Commission has recommended the adoption of a corporate rescue procedure based on procedures that are already operating successfully in other jurisdictions and the recently amended bankruptcy provisions have introduced a scheme which would assist individuals with debt problems to reorganise them under the protection of the court.

1.9 Outside of the bare insolvency provisions, the nature of insolvency is undergoing changes in that there are now many more significant insolvencies that cannot be dealt with simply on a local basis. These international insolvencies can take on a complexity that is virtually unfathomable, particularly where those who controlled the insolvent entity were not acting in the best interests of company or its creditors. The is no need to name names but over the last several years there are many jurisdictions that have suffered from well known business people being found to have gone on a frolic of their own with company assets.

1.10 The proposals we make in this Paper extend from, frankly, proposals for dull technical amendments, to proposals that would constitute a significant shift in the way the insolvency provisions are administered. The purpose, therefore, of this Paper, is to reposition the insolvency provisions so that they will be better able to deal with changes in the business, legal and social environment.

Review of the Hong Kong Companies Ordinance

1.11 In addition to the Commission's review of the winding-up provisions of the Companies Ordinance, a recent Consultancy Report, the Review of the Hong Kong Companies Ordinance, on the other provisions of the Companies Ordinance, was published in 1997.[2]

1.12 The Review of the Hong Kong Companies Ordinance recommended that the insolvency provisions of the Companies Ordinance should be separated from what it describes as the "*core*" provisions of the Companies Ordinance, which the Review recommends should not have extraterritorial effect.[3] Our proposals under Part X of the Companies Ordinance on cross-border insolvency would give the insolvency provisions extraterritorial effect.

Separate Insolvency Ordinance

1.13 We propose that a new Insolvency Ordinance should contain all provisions relating to insolvent winding-up, receivership, the provisions of Part IVA on the disqualification of directors, provisional supervision when introduced into legislation, and bankruptcy. In addition, we consider that members' voluntary winding-up, or solvent liquidation, should also be contained in the Insolvency Ordinance but we note that the Review of the Hong Kong Companies Ordinance takes a different view on this.[4]

Licensing of insolvency practitioners

1.14 We have made extensive proposals on the expansion of the Official Receiver's scheme for the contracting out of cases of compulsory winding-up by the court. We propose that a comprehensive scheme of licensing of insolvency practitioners, that is, liquidators in all forms of winding-up, receivers, trustees in bankruptcy and, when introduced, provisional supervisors, should be licensed under a scheme to be operated by the Official Receiver.

1.15 The intention is that the licensing scheme would develop into a professional qualification for insolvency practitioners.

The Hong Kong court

---

2 We understand from the Registrar of Companies that the *Review* is out of print.

3 *Review of the Hong Kong Companies Ordinance,* paragraphs 1.01 and 1.05 and see also paragraphs 31.1 to 31.9 of this Paper.

4 *Review of the Hong Kong Companies Ordinance*, Chapter 9, particularly paragraph 9.01.

1.16 References are made throughout the Consultation Paper to the court or the Hong Kong court. All winding-up and bankruptcy cases are heard in the Court of First Instance of the High Court of the Hong Kong Special Administrative Region, which was known as the High Court before July 1997.

Language of the new Insolvency Ordinance

1.17 Assuming that our proposals are ultimately adopted, we note that the language of many of the provisions proposed (for instance, those from the Insolvency Act) would be expressed in different language from many of the current provisions of the Companies Ordinance and Bankruptcy Ordinance.

1.18 It would be desirable for the provisions of the new Insolvency Ordinance to be expressed in the same terms throughout and we therefore propose that, in drafting a new Insolvency Ordinance, the opportunity should be taken to review those provisions on which the Commission makes no comment with a view to expressing the new Ordinance in modern language.

1.19 We propose that the new Ordinance should be set out in such a way as to avoid the long subsections that proliferate in the current provisions. We have noticed that identical provisions in the Insolvency Act have been broken down into smaller subsections that are more readily understandable.

1.20 We **propose** that subsections should be titled, as is the practice in the Insolvency Act. We realise that this is not the convention in the Ordinances of Hong Kong but the practice is an aid to understanding and finding provisions and should be adopted.

Combining of repetitive provisions

1.21 We note that we have proposed that several sections might usefully be combined where they tend to repeat details in respect of, for example, creditors' voluntary winding-up and members' voluntary winding-up. We have made specific proposals for combining provisions[5] and suggest that in drafting new provisions as a consequence of any recommendations that the Commission might make in its report, the Law Draftsman might consider combining other provisions that might be repetitive.

[5] See paragraphs 12.16, 12.26, 12.42, 14.9 and 15.5.

CHAPTER 2

MINORITIES

Section 168A Alternative remedy to winding-up in cases of unfair prejudice

2.1 This section does not form part of the winding-up provisions of the Companies Ordinance but is placed here for convenience. The section comes under Part IV of the Ordinance on management and administration and provides minority members of a company with a remedy in cases of unfair prejudice.

2.2 The section provides that a member of a company who complains that the affairs of the company are being conducted in a manner unfairly prejudicial to the interests of members generally, or of some of the members, including himself, may petition the court for an order under the section.

2.3 The provision is used frequently though in the context of solvent, not insolvent, companies. We do not intend to comment on the section except insofar as it relates to the general body of the winding-up provisions.[1] We note that the Review of the Hong Kong Companies Ordinance has made specific recommendations in relation to the unfair prejudice or oppression remedy.[2]

---

1 See Companies (Winding-up) Rules, rules 22A and 23A.

2 *Review of the Hong Kong Companies Ordinance*, paragraphs 7.08 and 7.09.

CHAPTER 3

CONTRIBUTORIES

Section 170 Liability as contributories of present and past members[1]

3.1 The section makes general provision for the circumstances under which contribution by contributories may be made to the assets of a company which is being wound-up.

Liability of past directors and shareholders

3.2 The Insolvency Act, section 76, provides that where a payment has been made out of the capital of a private company for the redemption or re-purchase of the company's shares, and the company is wound-up as insolvent within a year of the date of the redemption or purchase, the recipient of the payment may be obliged to repay the amount paid in whole or in part. In addition, the directors who made the statutory declaration for the purposes of the redemption or purchase may also be jointly and severally liable to make repayment with the recipient.

3.3 There is no corresponding provision under the Companies Ordinance and, as it would be useful to set out the potential liability of past directors and shareholders, we **propose** that the provision be placed in the Companies Ordinance.

Expanded circumstances where a contributory can present a petition

3.4 The adoption of a provision similar to section 76 of the Insolvency Act would effect a change in the circumstances of contributories. At present, contributories are entitled to petition for the winding-up of the company only in limited circumstances,[2] the policy behind which is to prevent a person from buying shares in order to qualify himself to harass or wreck a company. In addition, there is a common law requirement that a contributory normally has to establish a financial interest in the obtaining of an order and therefore a contributory whose shares are fully paid up needs to establish that the company is probably solvent so that there is a prospect of a return of capital to the members at the conclusion of the winding-up.[3]

---

1 Note section 180. It is not necessary for a contributory to prove that a company has a surplus available for distribution.

2 Companies Ordinance, section 179(1)(a). The Insolvency Act equivalent is section 124(2). Note also section 257 of the Companies Ordinance.

3 *The Law of Insolvency*, Ian F. Fletcher, 2nd edition, page 535. See *Re Rica Gold Washing Co.* (1879) 11 Ch. D. 36 and *infra* at paragraph 7.49.

3.5 The new provision would upset the assumption behind the policy as, in this case, the contributory as petitioner would be faced with the prospect of personal liability and therefore he would have the standing to present a petition. The Insolvency Act has therefore provided[4] that a person who is liable under section 76 to contribute to the assets of the company may petition on the grounds that are set out in section 177(1)(d) and (f) of the Companies Ordinance[5], that of a company being unable to pay its debts or where the court is of the opinion that it is just and equitable that the company should be wound-up. We **propose** that this provision should be adopted.[6]

Section 171 Definition of contributory

3.6 The Insolvency Act, section 79(3), provides that a person who is liable under section 76 of the Insolvency Act is not regarded as a contributory for the purposes of the articles of association of the company.[7] We **propose** that this provision be adopted.

Section 173 Contributories in case of death of member
Section 174 Contributories in case of bankruptcy of member [8]

Provision to apply before or after death or bankruptcy

3.7 It has been suggested that the use of the word "*contributory*" in these provisions assumes that a company has already been wound-up and it would follow that the sections assume a pre-existing winding-up. We are unsure as to what the position would be if a contributory had died before the winding-up. For the sake of clarity, we **propose** that the provisions should state that they apply to a person who died either before or after the date of the winding-up.

Insolvent companies

3.8 No provision is made for the demise of insolvent companies, which are just as likely to be contributories as natural persons. We **propose** that provision should be made for insolvent companies in sections 173 and 174.

---

4 Insolvency Act, section 124(3).
5 The Insolvency Act equivalent being section 122(1)(f) and (g).
6 Note our comments on contributories under section 180.
7 Note, s*upra*, paragraph 3.5.
8 Note *Ng Yat Chi & Another v Max Share Ltd & Another* [1997] HKLRD 663.

CHAPTER 4

CASES IN WHICH COMPANY MAY BE WOUND-UP BY THE COURT

Section 177 Circumstances in which company may be wound-up by court

4.1 In general terms, we feel that the provision works reasonably well. We received no specific submissions to change the circumstances under which a company may be wound-up. The provisions are broadly similar to the provisions under the Insolvency Act, section 122.

Regulatory Authorities

4.2 There are several Ordinances which allow regulatory authorities to wind-up companies. The Securities and Futures Commission, Office of the Commissioner of Insurance, and the Hong Kong Monetary Authority, all have provisions to facilitate the winding-up of companies.[1]

4.3 We **propose** that, while it is not necessary to cross-reference the provisions which provide for regulatory authorities with the power to wind-up companies, it would be useful for a new section 177(1)(g) to be added to record that regulatory authorities have these powers. Such a provision would have the effect of giving notice to anyone checking the winding-up provisions that other relevant provisions exist.

Section 178 Definition of inability to pay debts

4.4 Section 177(1)(d) provides that a company may be wound-up by the court if it is unable to pay its debts. Section 178(1) deems that a company is unable to pay its debts in three circumstances:

- if a creditor owed more than $5,000 serves a written demand for payment on the company and that demand is not satisfied by the company within three weeks of the demand; or

- if an 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; or

[1] See the Securities and Futures Commission Ordinance, section 45, the Insurance Companies Ordinance, Part VI, and the Banking Ordinance, section 122.

- if it is proved to the satisfaction of the court that the company is unable to pay its debts, in which case the court shall take into account the contingent and prospective liabilities of the company.

4.5 We are broadly satisfied that these three circumstances are adequate for the purposes of petitioning to wind-up a company that cannot or will not pay its debts. We note that Hong Kong is not alone in providing for a demand that is not based on a judgment as both the Insolvency Act, section 123(1)(a), and the Australian Corporations Law, section 459F, make similar provision. We consider that to change this approach would add considerably to the costs and time involved in recovering debts and we would not support any change.

4.6 We received no submissions on the section. We have, however, a number of proposals that we consider would assist in making the process easier to understand and operate.

Prescribed form

4.7 Section 178(1)(a) provides that a company shall not be able to pay its debts if the company has failed to comply with a demand in writing requiring payment. There is no prescribed form of statutory demand under the Companies Ordinance, although a statutory demand was recently introduced in the Bankruptcy Ordinance[2]. We **propose** that a statutory form should be adopted.

4.8 The Insolvency Rules[3] provide for a prescribed form of demand which must state or provide for the amount of the debt and consideration, any other charge, including interest, and the grounds for inclusion, a warning of intention to wind-up if payment is not made, the time within which to comply and possible methods of compliance, and how to contact the creditor. The Australian provisions also have a well laid out prescribed form of statutory demand.[4]

4.9 We understand that a prescribed form of statutory demand will shortly be introduced in the Bankruptcy Ordinance. It would be appropriate for the form under these provisions to mirror the bankruptcy form. There should be no need for the form to be in a statutory prescribed required form and it should be capable of variation to suit any circumstances that may arise.[5]

Presumption of insolvency

---

2 Bankruptcy (Amendment) Ordinance 1996 (Ord. No. 76 of 1996), section 6A.

3 Insolvency Act, rules 4.4 to 4.6 and Form 4.1.

4 Australian Corporations Law, section 459E(2)(e), and Form 509H.

5 We anticipate that the Bankruptcy (Amendment) Ordinance 1996 and the supporting rules and forms will have come into effect by the date of publication of this Consultation Paper.

4.10 Recent Australian amendments have shifted the emphasis from a company being deemed to being unable to pay its debts to circumstances where it must be presumed by the court that a company is insolvent. A company is solvent if, and only if, the company is able to pay all its debts as and when they become due and payable.[6] Statutory presumptions also apply in relation to whether a company is insolvent. These include the failure to comply with a statutory demand, and the execution of a judgment or other process, in addition to cases where a receiver has been appointed over the property of a company.[7]

4.11 We find no fault with the Australian provisions, but consider that the current provisions, coupled with our proposals, would be adequate.

Minimum debt amount

4.12 Under sections 177(1)(d) and 178(1)(a), a company is unable to pay its debts if the debt is for a sum exceeding $5,000.

4.13 In the Report on Bankruptcy, the Commission recommended that the amount of the minimum debt under the Bankruptcy Ordinance, section 6, should be increased from $5,000 to $10,000, that 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.[8] This recommendation was adopted in the Bankruptcy (Amendment) Ordinance 1996.[9]

4.14 We **propose** that the amount of the minimum debt under the Companies Ordinance should mirror the minimum debt amount in bankruptcy. Our reasons for the proposal are the same as the reasons given in the Report on Bankruptcy, that a person, or company, should not be exposed to bankruptcy, or winding-up, for an insignificant amount, a point borne out in practice where few petitions are presented for less than $10,000.

Contingent and prospective liabilities

4.15 Subsection (1)(c) allows the court to make a judicial assessment of whether a company is unable to pay its debts. In doing so, the court shall take into account the prospective and contingent liabilities of a company.

4.16 We wonder whether this provision should be in the deeming provisions under subsection (1) as the subsection still requires that an inability to pay debts has to have been proved, and it seems strange to have something that has to be proved as a deeming provision. The reference to contingent and prospective

---

6 Corporations Law, section 95A(1).

7 Corporations Law, section 459C.

8 Law Reform Commission of Hong Kong, *Report on Bankruptcy*, May 1995, Chapter 3.

9 Ordinance No. 76 of 1996, section 6(2)(a) and (5). The Financial Secretary may prescribe a greater amount. The Bankruptcy (Amendment) Ordinance 1996 came into effect on 1 April 1998.

debts has been dropped from the test in the corresponding provision of the Insolvency Act, section 123(2), and now forms a separate test from the other deeming provisions in the Insolvency Act.

4.17 It appears that the present wording is unhelpful, as it runs together two issues; (i) the question whether current debts can be met as they fall due, and (ii) the question whether the company can ultimately prove solvent if its future as well as its present liabilities are taken into account.

Service by e-mail or fax

4.18 We considered the possibility of proposing that certain matters might be capable of being served by fax or other electronic forms of communication. We recognise, however, that though there may be merit in the use of new forms of technology for the purposes of service of documents, it is not appropriate to make specific proposals for insolvency as service relates to many other processes.

CHAPTER 5

PETITION FOR WINDING-UP AND EFFECTS THEREOF AND CONSEQUENCES OF WINDING-UP ORDER

Section 179 Provisions as to applications for winding-up

5.1 The section provides that a petition to the court to wind-up a company may be presented by the company, any creditor or creditors, including contingent and prospective creditors, a contributory or contributories, or any combination of those parties. Certain special conditions apply to petitions by contributories and contingent or prospective creditors.[1] The section also makes provision for the Financial Secretary and the Registrar of Companies to wind-up companies in certain cases[2].

Directors to be able to petition to wind-up

5.2 Directors are not included in the list of those who are able to petition for the winding-up of a company under the section. The situation is different under the Insolvency Act, section 124(1), which specifically provides that directors are able to present a petition to wind-up. This provision was introduced to overcome a court decision to the effect that the former practice of allowing the directors of companies to petition for the winding-up of the company based on a resolution of the directors was wrong.[3]

5.3 Even now, it appears that directors must petition in their own names rather than in the name of the company and that they ought to act unanimously in the absence of a decision of the board of directors.[4] Where there has been a resolution of the board to petition to wind-up, the decision may be carried out by any one of the directors who has authority to carry out the decision on behalf of all the directors.[5]

5.4 It appears that petitions of this kind are rarely used as directors are more likely to favour the voluntary winding-up of a company under sections 228 or 228A of the Ordinance. It has been noted that:

---

1 See subsection (1)(a) and (c) respectively.

2 See subsection (1)(d) and (e), respectively, and sections 147(2)(a) and 177(1)(c) and (2) respectively.

3 *Re Emmadart Ltd* [1979] Ch. 540.

4 *Re Instrumentation Electrical Services Ltd* (1988) 4 BCC 301.

5 *Re Equiticorp International plc* [1989] 4 BCC 310.

> "*The directors would in any case require the authorisation of a general meeting in order to be entitled to present a petition for winding-up, unless such a power is expressly conferred on the directors by the company's articles. The fact that the articles usually delegate the management of the company to the directors has been held*[6] *not to include an authorisation to present a winding-up petition without the sanction of a general meeting, and it is significant that* [article 82] *of Table A does not confer any such authority*".[7]

5.5 It is also likely that the directors of Hong Kong companies would also prefer to use the voluntary winding-up procedures under the Companies Ordinance and we note that, due to the nature of Hong Kong companies, where family interests are probably more prevalent than in other jurisdictions, there could be a danger of family groupings oppressing the interests of minorities.

5.6 Regardless of this, we **propose** that directors should be able to petition to wind-up their company and that the decisions referred to in the cases cited above should be adopted. Situations may arise where directors have to act urgently to have their company wound-up by the court and the danger of oppression of minorities is counterbalanced by our proposal that only recognised insolvency practitioners should be qualified to act as liquidators in a winding-up by the court.

Telephone, fax and e-mail numbers to appear on a petition

5.7 The information to be given in a statutory demand under Insolvency Act, rule 4.6, provides that the address and telephone number of an individual who may be contacted by the debtor with a view to satisfying the debt must be given. Similarly, the notice of appearance on the hearing of a petition under Insolvency Act, rule 4.16, provides that the notice should contain the name and address of any person giving it, together with his phone number.

5.8 We would go further and **propose** that any notice under the insolvency provisions which requires any form of reply, including statutory demands and petitions, should contain full details of how to contact the person giving the notice, or the details of his representative. We **propose** that in addition to the address and telephone number of the contact party, other details such as fax and e-mail numbers may also be included. The guidance notes on all such notices should reflect this.

Advertising the petition in the Hong Kong Government Gazette

---

6 *Re Emmadart Ltd* [1979] Ch. 540, *op cit*, at paragraph 5.2.

7 See *The Law of Insolvency,* Ian F. Fletcher, 2nd edition, page 534.

5.9 We note our general comments on the advertising of notices relating to the winding-up provisions in the Government Gazette.[8]

Section 180 Powers of court on hearing petition

5.10 It has been generally accepted in Hong Kong that it is not necessary, where a contributory petitions under section 180(1A) that it is just and equitable that a company be wound-up, for the contributory to prove that the company has a surplus available for distribution from which the contributory could ultimately benefit.[9]

5.11 That is not the case in the United Kingdom where it has been long established that a petitioning contributory must show that that he had a tangible interest in the company.[10]

5.12 The Hong Kong provision and the equivalent provision under the Insolvency Act, section 125(2), are similarly worded and it is unclear that a different approach has been taken to the petitions of contributories.

5.13 We **propose** that the Hong Kong provisions should be amended to make it clear that a contributory should not have to prove that he had a tangible interest in the company against which the petition has been made.[11] In this regard, it might be useful to follow section 467(5) of the Australian Corporations Law which provides that:

> "*Notwithstanding any rule of law to the contrary, the court shall not refuse to make an order for winding-up on the application of a contributory on the ground that, if the order were made, no property of the company would be available for distribution among the contributories.*"

Section 180A Hearing of unopposed petition by Registrar of Supreme Court[12]

5.14 In the case of an unopposed petition, the jurisdiction of the court may be exercised by the Registrar of the High Court.

---

8 See *infra,* paragraphs 25.1 to 25.10.

9 *Re DJH Consultants Ltd and Others,* (1984) Civil App No. 164, *Re Cirtex Co Ltd*, [1987] 3 HKC 13, *Yick Fung Estates Ltd*. CWU No. 100 of 1984 and *Shui Hing Investment Co. Ltd*. CWU No. 101 of 1984, and *Re Universal Information Ltd* 1995 CWU No. 187 of 1995.

10 *Re Rica Gold Washing Co.* (1879) 11 Ch. D. 36, *supra* at paragraph 3.4.

11 Note our proposal under section 170 on expanded circumstances where a contributory can present a petition, *supra*, at paragraphs 3.4 and 3.5.

12 It is proposed under the Adaptation of Laws (Courts and Tribunals) Bill 1998 to amend the heading of this section by repealing "*Supreme Court*" and substituting "*High Court*".

5.15 It has been suggested that there might be a practical problem with the section in that it is sometimes very difficult to know whether a petition has in fact been opposed or not. Experience suggests that appellate decisions as to what is meant by opposition tend to be lenient in favour of companies being petitioned against.[13]

5.16 This means that the petitioner's solicitors can get caught in a situation where the company petitioned against had done no more than indicate that the company wanted to settle but the Registrar proceeded and made an order for winding-up which was later set aside on appeal on the ground that the Registrar did not have the jurisdiction to wind-up a company where there was opposition to the petition.

5.17 It has been suggested that there might be a problem in that a Registrar could hear unopposed petitions but that, if there was even remote opposition to the petition, the hearing must be adjourned before a judge. It was felt that there was a problem judicially in a Registrar adjourning, for example, a case for two weeks with costs to the Official Receiver, because a Registrar could only deal with unopposed petitions. He has no substantive jurisdiction. We consider that there is an argument for allowing Registrars to have slightly increased powers.

5.18 An example of the point in question occurred in the case of *Hendrarsin and ors v Chong Lai Fee and anor*, when the Court of Appeal considered the question of the jurisdiction of the Registrar of the Supreme Court to wind-up companies on unopposed petitions. In the particular circumstances of the case, it was held that an unequivocal statement of intention to oppose a petition in the notices of intention to appear entered by the contributories, reinforced by what the Registrar was told about an earlier petition, was clear evidence that the petition was opposed. The fact that the petition was opposed went to the Registrar's jurisdiction to make a winding-up order. It followed that failure to file an affidavit in opposition or to take out a summons for a stay or apply for an adjournment could not have conferred jurisdiction on the Registrar. The Registrar thus had no power to make the winding-up order.

5.19 Under the Insolvency Act, a Practice Direction lists all the applications that must be heard by the judge. It states that all other applications shall be made to the Registrar in the first instance, who may give any necessary directions and may, in the exercise of his discretion, either hear and determine it himself or refer it to the judge.[14]

---

[13] Note that under the Companies (Winding-up) Rules, rules 30 and 32 any person who intends to appear on a petition must give notice of his intention and affidavits in opposition to a petition must also be filed.

[14] Practice Direction No. 3 of 1986.

5.20 We **propose** that the Registrar should be able to make a winding-up order in an unopposed case and that a petition should not be regarded as opposed unless an affidavit in opposition had been filed on or on behalf of the company. The Registrar should also be given authority to deal with all matters relating to filing and service of affidavits, including extensions of time.

Section 181 Power to stay or restrain proceedings against company

5.21 The section allows the company, any creditor, or a contributory, to apply to the relevant court to stay or restrain proceedings that are pending against the company. The court may stay or restrain any proceedings on such terms as it thinks fit.

5.22 The provision applies, however, only after the presentation of the petition and before a winding-up order has been made. The Bar Association made a submission on our Consultation Paper on Corporate Rescue and Insolvent Trading to the effect that section 181 might be extended to facilitate a moratorium under section 166, which provides companies with the power to compromise with creditors and members. The difficulty with section 166 is that there is no means by which a company seeking to compromise can be protected from actions of creditors or members to frustrate the compromise, such as a petition to wind-up the company.

5.23 The Bar Association submitted that section 166 may be used both before and after winding-up and that neither the presentation of the petition nor an order made upon it would, as a matter of law, finally end the possibility of a scheme. Given the procedural requirements for advertising, and the practical considerations for fixing dates, there would inevitably be a time lapse between presentation of the petition and a hearing on the merits which, although not a true moratorium, would be an effective period of time in which proposals could be finalised.

5.24 In addition, once a petition was presented, the court would have the power to grant a stay of proceedings or execution where a scheme could be finalised. The submission concluded that if the lack of a moratorium was considered to be a major defect, consideration could be given to extending section 181 to pre-presentation situations.

5.25 The Commission's Report on Corporate Rescue and Insolvent Trading rejected the suggestion for a variety of reasons, including points made that section 166 was an open-ended procedure which was not desirable, that use of section 166 could result in limitless court applications, and that section 166 has no proper procedural structure on which to process a workout. Ultimately,

however, the Commission considered that its recommendations for provisional supervision would render use of section 166 redundant.[15]

5.26 We share the Commission's view and see no reason to extend the application of section 181 to the period before the presentation of the petition.

Section 182 Avoidance of dispositions of property, &c. after commencement of winding-up

5.27 A submission received from Mrs J. C. Olivier, then of the Legal Aid Department, suggested that:

> "*To enable petitions to be registered as lites pendantes: In relation to the existing winding-up provisions, I would like to see the introduction of an explicit statutory provision to enable 'winding-up petitions' to be registered in appropriate land registers as lites pendantes, where land property or interest therein forms part of the assets of a debtor company. Such registration would provide for early protection of assets and be of great assistance to this Department.*
>
> *I would emphasise the word 'statutory'. I am at present of the opinion that such a power can be inferred from the provisions of the Land Registration Ordinance but this opinion is not shared by the Land Registrar who refuses to accept winding-up petitions as lites pendantes on the general premise that as a rule there is no reference to land etc in the body of a petition and accordingly in his opinion there is no compliance with the interpretation of lites pendantes in section 1A of the Land Registration Ordinance.*
>
> *The interpretation of lites pendantes in section 1A is :*
>
> *(a) any action or proceeding in a court or tribunal that relates to land or an interest in or charge on land; and*
>
> *(b) a bankruptcy petition.*
>
> *You will note the anomaly between winding-up and bankruptcy procedure. As a rule a bankruptcy petition also does not refer to land etc therein but same is specifically included in the interpretation of lites pendantes.*

[15] See the Commission's *Report on Corporate Rescue and Insolvent Trading*, October 1996, paragraphs 1.1 to 1.7.

My research on this issue does indicate that in the late 19th & early 20th century, the companies legislation in England provided for such registration of winding-up petitions but the statute law developed since has 'lost' this provision. Indeed it is interesting to note that winding-up petitions are considered lites pendantes in certain states of Australia, with mandatory registration, as it is also in Malaysia and Singapore."

5.28 We do not intend to arbitrate on the dispute between the author of the submission and the Registrar of Lands as to whether a winding-up petition is a *lis pendens* as defined under the Land Registration Ordinance (Cap 128). We are not sure that a winding-up petition should be registrable as winding-up proceedings are not an *in rem* claim, as they do not relate to the title or status of property. Winding-up proceedings only relate to the status of the company being petitioned against.

5.29 We consider that, in any event, there are already adequate facilities for searches against winding-up petitions, as a search against a petition can be made in both the Official Receiver's Office and in the High Court Registry. We understand that the Official Receiver's Office keeps a computer record of all petitions filed and that the High Court Registry will be computerised later in 1998.

Section 183 Avoidance of attachments, &c.[16]

5.30 The section provides apparently strict wording that any attachment, sequestration, distress or execution against the estate of the company after the commencement of the winding-up "*shall be void to all intents*". The actual position is not so strict, however, as sections 181 and 186 provide the court with a discretion to allow proceedings to continue if the court thinks fit. Also, section 269 restricts the rights of creditors in relation to attachment or execution in cases where a company has been wound-up.

5.31 There was a suggestion in the sub-committee that the strict wording of the section should be amended to reflect the actual situation but we note that the same wording is used in the United Kingdom, Australia and Singapore and we consider that it would be best that Hong Kong should remain in step with these jurisdictions.[17]

Section 186 Actions stayed on winding-up order

---

16 Note also paragraphs 9.18 to 9.20.

17 United Kingdom Insolvency Act, section 128(1), the Australian Corporations Law, section 468(4), and the Singapore Companies Act, section 260.

5.32 We refer to the comment on this section under section 290A.[18]

[18] See paragraphs 9.18 to 9.20.

CHAPTER 6

OFFICIAL RECEIVER IN WINDING-UP

Section 190 Statement of company's affairs to be submitted to Official Receiver[1]

6.1 This section makes provision for the preparation and submission to the Official Receiver of a statement of affairs once the court has made a winding-up order or appointed a provisional liquidator. The court may order that no statement of affairs is required. The statement of affairs is in prescribed form[2] and it must contain details of all assets, liabilities, and securities and details of the company's creditors. The Official Receiver may require other information.[3]

6.2 The statement must be verified by affidavit by at least one of the directors or the secretary of the company at the time the company is wound-up or by, among others, former directors or officers or employees of the company.[4]

6.3 The statement should be submitted within 28 days of the relevant date,[5] but the time may be extended by the Official Receiver or the court. The reasonable costs of those who prepare the statement shall be paid out of the assets of the company.[6]

6.4 The statement of affairs may be used in evidence against any person making or concurring in the making of the statement. Any creditor or contributory may, on paying a fee, inspect and copy the statement of affairs.[7]

28 days for submission of the statement of affairs

6.5 In its Report on Bankruptcy, the Commission recommended that the time for the submission of the statement of affairs should be increased from seven to 21 days on creditors' petitions. This recommendation was adopted in the Bankruptcy (Amendment) Ordinance 1996, section 12. The question arises whether the Companies Ordinance provision should be amended to reflect the bankruptcy position.

---

1 Note also the Companies (Winding-up) Rules, rules 39 to 44.

2 See form 23 of the Companies (Winding-up) Rules.

3 Subsection (1).

4 Subsection (2).

5 "*Relevant date*" for the purposes of this section means, in a case where a provisional liquidator has been appointed, the date of his appointment, and where no provisional liquidator has been appointed, the date of the winding-up order, per subsection (8).

6 Subsections (3) and (4).

7 Subsections (5A) and (6).

6.6 We consider that there is a considerable difference between the statement of affairs of a bankrupt and of a company. In general, companies' statements are more complicated and therefore we are content that the current provision should remain at 28 days for submission, subject to the power of the Official Receiver or the court to extend the time in appropriate cases.

Dispensing with the statement of affairs

6.7 Section 190(1) provides that the court may dispense with the statement of affairs and rule 44 provides that any application to dispense with a statement of affairs must be supported by a report of the Official Receiver. It is necessary to have a provision to facilitate dispensing with the statement in a winding-up by the court, because, unlike voluntary winding-up, situations are likely to arise in winding-up by the court, such as the unavailability of the directors or of the books of account, which would prevent the preparation of a statement.

6.8 Although the preparation of a statement of affairs is just as important in a receivership as it is in a liquidation, there is no statutory requirement that the directors produce a statement to a receiver. We suggest that the position can be relaxed in the case of winding-up by the court.

6.9 We consider that the Official Receiver would not report that the statement of affairs should be dispensed with in cases where there clearly should be a statement of affairs prepared. We **propose** that the Official Receiver should have the discretion to dispense with the statement of affairs without having to apply to the court and without having to show specific grounds. This follows a provision under the Insolvency Act, section 131(5)(a).

6.10 In cases where a private sector liquidator has been appointed, we **propose** that the Official Receiver should have the same discretion to dispense with the statement of affairs without the need to apply to the court.

6.11 The adoption of these proposals would have the benefit of reducing costs in some liquidations.

Contempt of court

6.12 Under the Insolvency Act, section 288(4), which provides for a statement of affairs to be submitted in cases of personal bankruptcy, a bankrupt may be guilty of a contempt of court if he, without reasonable excuse, fails to submit a properly completed statement of affairs to the Official Receiver. Adoption of this provision was recommended by the Commission in its Report on Bankruptcy and is now contained in section 12 of the Bankruptcy

(Amendment) Ordinance 1996. This provision has not been applied to the Insolvency Act provisions for statements of affairs in cases of companies.

6.13 The preparation of the statement of affairs is one of the most important aspects of the winding-up of a company as it enables the liquidator not only to establish the assets, liabilities and creditors of the company, it also provides the basis for the liquidator or the Official Receiver to investigate any wrong-doing on the part of the company or its directors.

6.14 To that end, directors, in particular, should be encouraged to prepare a statement of affairs as quickly as is reasonable in a particular case. This, however, does not always happen, and the practice of insolvency indicates that directors often seek to delay the preparation of the statement. It is common for it to take months of encouragement before directors produce a statement and the practitioners on the sub-committee are convinced that in numerous cases directors are not intimidated by the prospect of a fine. The figures show that, although fines are imposed, they are usually small.[8]

6.15 We **propose** that, in addition to the provisions for fines, it should be a contempt of court for a director to fail, without reasonable excuse, to produce a statement of affairs to the Official Receiver within 28 days of the relevant date or such extended period as the Official Receiver may allow.

Fines and imprisonment[9]

6.16 If a person who is required to produce a statement of affairs, without reasonable excuse, makes default in complying with the requirement, he may be subject to a fine on summary conviction of up to $50,000 and a daily default fine of $300.

6.17 There is no provision under the Companies Ordinance for the imprisonment of such persons for failure to produce a statement, though there is precedent for this under the Singapore Companies Act, section 271(5), which provides for a fine and imprisonment for up to 12 months.

6.18 The Official Receiver's Office Annual Report for 1996/97 records that, during that period, 40 cases were brought to hearing before the court and that 25 of the cases resulted in convictions.[10]

Affidavit of concurrence

---

8 See *Fines and imprisonment*, *infra*, at paragraphs 6.16 to 6.18.

9 Subsection (5) and see the Twelfth Schedule of the Companies Ordinance. Note also L. N. 306 of 1996 which increased the levels of fines under the Companies Ordinance.

10 Annex 15 of the Official Receiver' s Annual Report 1996/97. Note that there were 11 disqualifications from acting as a company director in 1996/97 according to annex 16 of the Official Receiver' s Annual Report.

6.19 The Insolvency Act, rule 4.33, provides that the Official Receiver may require any person who may be required to submit a statement of affairs to submit an affidavit of concurrence stating that he concurs in the statement of affairs. The affidavit of concurrence may be qualified in respect of matters dealt with in the statement where the maker of the affidavit is not in agreement with the deponents, or he considers the statement to be erroneous or misleading, or he is without the direct knowledge necessary for concurring in the statement.

6.20 We **propose** the adoption of such a provision as it is unfair to expect a person who disagrees with a statement of affairs, in whole or in part, to be obliged to swear as to its accuracy and truthfulness when he cannot honestly do so. The adoption of this provision might also encourage those who disagree with a statement to say so, as this could assist the liquidator in his investigations.

Section 191 Report by Official Receiver

6.21 The section provides that as soon as practical after a statement of affairs has been submitted, or where the court orders that no statement should be submitted, the Official Receiver shall report to the court on the amount of the company's capital issued, subscribed and paid up, the estimated amount of the assets and liabilities, the causes of failure of the company, and whether the Official Receiver considers any further inquiry is desirable.

6.22 If the Official Receiver considers that any fraud has been committed in relation to the company he should report to that effect, in which case the court has available the powers provided under section 222.

6.23 The Official Receiver's Office has submitted that, in practical terms, the section as it is established serves no useful purpose. It states that the original expectation of the section was that a statement of affairs would be produced at an early stage in a liquidation and the Official Receiver could then make a preliminary report setting out the details mentioned above. In practice, however, the report is made at a much later stage of the liquidation, when its value is questionable.

6.24 The Official Receiver's Office referred us to section 132 of the Insolvency Act, which replaced an original provision similar to the current provision with one which provides that the Official Receiver has a discretion to report on the reasons for the failure of a company and as to generally, the promotion, formation, business, dealings and affairs of the company. The Official Receiver is under a duty, however, to investigate these matters even though he may not make a report.

6.25 The Official Receiver's Office has also submitted that the Official Receiver should only be obliged to investigate companies of which he is the liquidator and that, in cases where private sector liquidators have been appointed, the duty should fall on the private sector liquidator.[11]

6.26 We **propose** that the Official Receiver's Office's submission should be adopted. We see no sense in continuing with a provision that the Official Receiver's Office points out is of little use in practice and which amounts to an unnecessary expense in many liquidations.

6.27 We note, however, comment on the Insolvency Act provision which finds it surprising that the Official Receiver should be under a duty to investigate the general features of promotion, formation, business, dealings and affairs of the company as there are circumstances under section 122(1) of the Insolvency Act where the company has not failed, especially as the grounds on which a winding-up order may be made under these provisions include some which have no necessary connection with irregularity.[12]

6.28 We can see no reason why the Official Receiver should be obliged to investigate these general matters if the company has not failed but has been wound-up on other grounds and we **propose** that any new provision should reflect this.

6.29 We note that section 132(2) of the Insolvency Act provides that the report is, in any proceedings, prima facie evidence of the facts stated in it. We **propose** that this approach should be adopted in any new provision in the Companies Ordinance. We note that the report, if made, could have significance if it points to any wrong-doing by directors and others in cases brought under the provisions on disqualification of directors under Part IVA of the Companies Ordinance or under, for example, the Commission's recommendation for personal liability of directors and senior management for insolvent trading in its Report in Corporate Rescue and Insolvent Trading.

6.30 The liquidator's report could also have significance in other matters such as proceedings in which application is made for setting aside transactions at an undervalue, extortionate credit transactions and the prosecution of criminal offences under the Companies Ordinance.

---

[11] Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.6.

[12] Under section 122(1) of the Insolvency Act or its equivalent under the Companies Ordinance, section 177(1). See *The Annotated Guide to the Insolvency Legislation*, L. S. Sealy and David Milman, 4th Edition, page 177.

CHAPTER 7

LIQUIDATORS

Section 193 Appointment and powers of provisional liquidator[1]

Appointment of provisional liquidator

7.1 The section provides for the appointment by the court of a provisional liquidator at any time after the presentation of the petition and either the Official Receiver or "*any other fit person*" may be appointed. The powers of the provisional liquidator are set out by the court order appointing him, with the provision stating that the court "*may limit and restrict*" his powers by the order appointing him. The purpose of the provisional liquidator is to take control of, or preserve, the assets of the company in the period between his appointment on the hearing of the petition and the making of a winding-up order and the appointment of a liquidator.[2]

7.2 The Singapore Companies Act, section 267, takes a different approach and provides that

> "*the provisional liquidator shall have and may exercise all the functions and powers of a liquidator, subject to such limitations and restrictions as may be prescribed by the Rules or as the Court may specify in the order appointing him*".

7.3 We are attracted by the idea of providing a standard list of powers for provisional liquidators rather than the current provision under which a provisional liquidator's powers are limited and restricted by the court. We make proposals on standard powers below. In terms of appointment, we **propose** adapting the approach of the Singapore provisions to the effect that a provisional liquidator would exercise standard powers subject to the power of the court varying the powers on appointment or on application by the provisional liquidator. We suggest adoption of the following wording:

> "*the provisional liquidator shall have and may exercise all the standard powers set out in the schedule unless the court orders otherwise.*"

7.4 Our proposals on insolvency practitioners would mean that only an insolvency practitioner could be appointed as provisional liquidator.

---

1 Note the proposal under the Companies (Winding-up) Rules, rule 28.

2 Subsections (1), (2) and (3). See also section 197.

Powers of provisional liquidator

7.5 The powers of the provisional liquidator are not set out in the Companies Ordinance, unlike the powers of the liquidator, which are set out under section 199. The practice is for the court appointing a provisional liquidator to set out the powers of the provisional liquidator in the order appointing him. The practice of the court in recent times has been to set out basic powers in the order and, if the provisional liquidator needs more powers, he may apply to the court to add them.

7.6 Section 193 provides that the court "*may*" restrict the powers of a provisional liquidator and the practice now, as stated, is that the court invariably does. We consider that it would be helpful to all concerned for the Ordinance to contain standard powers for provisional liquidators which would be set out in a schedule. This would have the advantage of providing certainty. The court should have the power to vary the powers of a provisional liquidator but we are confident that this would only be done for good reasons. We set out below standard powers that may be given to provisional liquidators and would welcome comment, not only on the proposal, but on the specimen powers.

> *"Specimen powers of provisional liquidator:*
>
> *(1) To take into their possession custody or control any money, property, books, papers or other moveable or immovable property of every nature and kind in Hong Kong to which the Company is or appears to be entitled (collectively 'Assets') but not to distribute or part with the same save for the exercise of the powers hereunder or until further notice.*
>
> *(2) To carry on or close down the business or businesses of the Company as they shall think fit so far as may be necessary for the beneficial winding-up of the Company.*
>
> *(3) For the foregoing purposes :*
>
> *(a) to appoint and engage such agents, clerks, servants and employees upon such terms as to remuneration or otherwise and for such periods as the special managers may deem fit;*
>
> *(b) to incur and defray from the assets such fees, expenses, wages and salaries as may be necessary therefor or incidental thereto.*

(4) To bring or defend any action or other legal proceedings in the name of the Company.

(5) To demand and receive and give a valid receipt for all debts due or which may fall due to the Company.

(6) To exercise the rights to which a registered holder of any shares, unit trust or bonds included in the assets of the Company is entitled to exercise, including, but without prejudice to the generality of the foregoing power, the right to exercise any votes annexed to such shares.

(7) To exercise all rights which the Company may have in relation to any subsidiary companies as may be necessary to obtain control of management of any such subsidiary companies.

(8) To insure the assets of the Company in such sum as he deems fit.

(9) To prove, rank, and claim in the bankruptcy, liquidation or other insolvency procedure of any person, company or entity, for any balance against his or its estate, and to receive dividends in the bankruptcy, liquidation or other insolvency procedure in respect of that balance, as a separate debt due from the bankrupt or insolvent, and rateably with the other creditors.

(10) To represent and act for the Company in all such matters, to vote and take part in the election of trustees, liquidators or other insolvency officer-holders, the making of any composition or scheme, and any other matters arising therein.

(11) To employ such person, including servants, employees, agents, solicitors and counsel as they deem fit for the exercise of their duties hereunder.

(12) To do all such other things as may be necessary for or conducive to the exercise of the powers aforementioned or any of them.

(13) Liberty to apply to the court."

Right of third parties to appear at the hearing of an application for appointment of a provisional liquidator

7.7 The suggestion was made in the sub-committee that it might be appropriate to provide that third parties should have standing to be heard by the court at the hearing for the appointment of a provisional liquidator, provided the third party had a proper maintainable interest. At present, only the petitioner is

entitled to be heard on the petition. The reason for the suggestion was that the appearance of third parties could help the court to get a clearer picture of the circumstances surrounding the application.

7.8 We are unconvinced that allowing third parties such a privilege would be of much help and we are concerned that it would only tend to add to the costs. While we appreciate that the court, in deciding whether it is necessary to appoint a provisional liquidator, must look at the circumstances of the case and decide whether the matter is sufficiently urgent to justify the appointment of a provisional liquidator, the court is unlikely to be much swayed by further arguments in support of an appointment, and is only likely to be confused by arguments against appointment. In practice, moreover, a provisional liquidator is only likely to be appointed in cases where there is little or no doubt that a winding-up order will subsequently be made.

7.9 On balance, therefore, we prefer not to make any proposal but would be interested to hear comments on the issue.

Section 194 Appointment, style, &c. of liquidators

Liquidators[3]

7.10 Our proposals on insolvency practitioners would have an impact on several of the provisions relating to liquidators and provisional liquidators.[4] Reference is made to these proposals where appropriate.

7.11 The Insolvency Act contains over 50 rules relating to liquidators dealing with appointment, resignation and removal, release, remuneration, the death of a liquidator and special provisions for the liquidator in a members' voluntary winding-up.[5] While a number of these rules are duplicated in the Companies Ordinance we consider that, when and if these proposals are brought through to legislation, the Insolvency Rules should be considered in detail.

7.12 Some amendments were recently made to the section in the Companies (Amendment) Ordinance 1997.[6] Subsection (1)(a) was amended and a new subsection (aa) was added to provide that where a person other than the Official Receiver is appointed provisional liquidator of a company, he shall continue to act as provisional liquidator until he or some other person becomes the liquidator. Subsections (1)(b) and (d) were also amended as a consequence with references to "*Official Receiver*" being replaced by "*provisional liquidator*". The amendments bring section 194 into line with the provisions of section 193.

---

3 Note also the Companies (Winding-up) Rules, rules 28, 45 to 48, 146 to 155, and 178 to 182.

4 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

5 Insolvency Act, rules 4.100 to 4.150.

6 Ordinance No. 3 of 1997.

7.13 New subsections (2) to (5) have also been added to provide that where the Official Receiver is liquidator of a company, he may apply to the court for the appointment of another person as liquidator in his place. The purpose of these additions is to facilitate the appointment of a private sector liquidator in cases of unexpected realisations of substantial assets. Where a company has assets in excess of $200,000, the case is considered to be non-summary under the terms of section 227F, and the case is contracted out by the Official Receiver to a panel of private sector liquidators appointed under the scheme for contracting out non-summary court winding-up cases to the private sector.[7]

Liquidator may summon meetings of creditors and contributories
Creditors may require a meeting to be held

7.14 We **propose** that the Official Receiver as liquidator should have a discretion to summon a meeting of creditors within 12 weeks of his appointment but that 25 per cent of the creditors in value should be able to oblige the Official Receiver to call meetings. This would follow provisions under the Insolvency Act, section 136(4) and (5). Currently, section 194(1)(b) provides that a provisional liquidator shall call meetings.

7.15 Where a meeting is requisitioned by creditors, the request should contain a list of creditors, their written concurrence, and a statement of the purposes of the proposed meeting, as provided for under the Insolvency Act, rule 4.57.[8]

Choice of meeting of creditors for liquidator to prevail

7.16 The Official Receiver's Office submitted that where there is a difference of view between meetings of creditors and contributories as to who should be appointed liquidator, the view of the creditors should prevail without the need for an application to the court. The current position under subsection (1)(c) is that, where there is a difference of view, the court shall decide who should act.

7.17 We agree with the Official Receiver' s Office and **propose** that in a winding-up by the court the choice of the creditors should prevail. We would, however, also **propose** that this should be subject to the right of contributories to apply to the court in this regard if they wish to. This proposal equates to Insolvency Act, section 139.

---

7 See *infra* at paragraphs 26.2 and 26.5.

8 Note that the rule has application to meetings requisitioned by 10 per cent in value of creditors or contributories as the case may be under Insolvency Act, section 168(2), the equivalent of which is section 200(2).

Section 195 Provisions where person other than Official Receiver is appointed liquidator

7.18 The section provides that where someone other than the Official Receiver is appointed liquidator, before he is recognised as such, he must file a notice of appointment with the Registrar of Companies and he must also provide security to the satisfaction of the Official Receiver.[9]

7.19 The question of the amount of security and the way in which security is given is a matter that is under review by the Official Receiver and private sector liquidators. We are content to make no comment as this is a matter best resolved by the parties concerned.

7.20 There is one issue on the question of security on which we feel we should comment. The Companies (Winding-up) Rules, rule 47, makes general provision for how security is to be given by private sector liquidators. The thrust of the provision is that the Official Receiver dictates the terms. We note that sub-rule (e) provides that the cost of furnishing the security by a liquidator or special manager, including premiums he may pay, shall be borne by the liquidator or special manager personally, and shall not be charged against the assets of the company as an expense incurred in the winding-up. This provision dates back to 1929 and appears to have been abolished elsewhere.

7.21 We do not see why this should be the case. We would prefer for the cost of the security to be out in the open and not obscured in a liquidator's charge out rate or expenses. We **propose** that the cost of a security bond or guarantee should be considered to be an expense incurred in the winding-up and should be charged against the assets of the company.

Section 196 General provisions as to liquidators

Separate provision for resignation, removal and remuneration

7.22 The section provides for the resignation, removal and remuneration of liquidators. The concepts of resignation, removal and remuneration are different and we **propose** that they should be provided for in different sections.

Resignation of liquidator

7.23 The section simply states that a liquidator may resign. The Companies (Winding-up) Rules, rule 154, provides that a liquidator who wants to resign must summon separate meetings of creditors and contributories to vote on his resignation. If both meetings agree by ordinary resolution that he can resign,

---

[9] Note the Companies (Winding-up) Rules, rules 47 and 48 in this regard.

the liquidator must file a memorandum of his resignation with the Registrar of Companies and must also notify the Official Receiver, at which point the resignation takes effect.

7.24 If the creditors or the contributories do not agree, the liquidator must then report to the Official Receiver and the Official Receiver or the liquidator must then apply to the court for a determination as to whether the resignation should be accepted and on what terms.

7.25 The process is unnecessarily involved. There is no need for a liquidator to go to the expense of calling meetings of creditors and contributories just to discuss his resignation. It is an unnecessary expense for the company.

7.26 We consider that, if our proposals on insolvency practitioners[10] are accepted, there will be few cases of resignation in any event, and that, as the Official Receiver would be overseeing the scheme, it is only sensible that the application to resign should be made directly to the court, with the Official Receiver making a report on his view of the application. We **propose** that a liquidator should be able to resign without the need to hold a meeting of creditors but that the liquidator must obtain the approval of the court.

Removal of liquidator

7.27 We refer to our proposals under sections 252 and 235A.

Section 199 Powers of liquidators

7.28 The powers of a liquidator are divided into those powers which he may only exercise with the sanction of the committee of inspection or the court, and those powers which he may exercise without sanction[11].

Powers which may require sanction

7.29 The Official Receiver's Office has submitted that two of the powers for which a liquidator needs sanction, that is, the power to bring and defend any action or other legal proceeding in the name and on behalf of the company, and the power to appoint a solicitor to assist him in the performance of his duties, should no longer require court sanction.[12] The Official Receiver's Office offered no explanation for the submission but we assume that these are powers which are routinely sanctioned and that there would be a saving of costs.

---

10 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

11 Subsections (1) and (2).

12 Subsection (1)(a) and (c).

7.30 Under the Singapore Companies Act, section 273(2)(a), a liquidator is empowered to bring and defend proceedings without the sanction of the court. The power to appoint a solicitor still requires sanction. Under the Insolvency Act, the power to bring and defend proceedings requires sanction in a winding-up by the court, but does not require sanction in a voluntary winding-up. The appointment of a solicitor is, however, not classified as a power and a liquidator, who is not the Official Receiver, is only obliged to give notice of the appointment to the committee of inspection, if there is one.[13]

7.31 As regards the power to appoint a solicitor, we again look to our proposal for the licensing of insolvency practitioners and we re-emphasise the point that the establishment of such a panel should eradicate the sort of liquidator who would be prepared to abuse his position. In consequence, we **propose** that the power to appoint a solicitor should be amended to broadly follow the position under the Insolvency Act to the effect that a liquidator, whether or not he is the Official Receiver, should only be required to give notice to the committee of inspection.

7.32 As regards the power to bring or defend proceedings, we find that the messages from other jurisdictions are mixed. We prefer to avoid differentiating between voluntary winding-up and winding-up by the court, as is the case under the Insolvency Act, as we would like to see the technical provisions of winding-up being the same insofar as possible in all forms of winding-up.

7.33 We are not sure, however, that a requirement to obtain the sanction of the court is a bad thing as a liquidator who obtains sanction in respect of proceedings could, in the event of criticism of a failed action, point to his having obtained sanction. We consider that a liquidator should still seek sanction of the court or of the committee of inspection to bring or defend any proceedings.

Powers of liquidators to be placed in a schedule

7.34 The powers of liquidators in windings-up by the court under this section are also applied to voluntary windings-up by section 251. The powers of liquidators have been conveniently collected together and tabulated in the fourth schedule to the Insolvency Act.[14] We **propose** that for ease of reference it would be sensible to place the powers of all liquidators, no matter how appointed, in a schedule to the Ordinance.

Foreign currencies

---

13 See, respectively, schedule 4, paragraph 4, and section 167(2).

14 See Insolvency Act, sections 165, 167 and the 4th Schedule to the Act.

7.35 The Report on Bankruptcy recommended that if a trustee, on taking expert advice, considered 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 (committee of inspection). The Report also recommended that a trustee should have the discretion to pay foreign currency claims in the foreign currency.[15]

7.36 The reasoning behind the recommendations was that, as enormous sums of money could be at stake in some insolvencies, it could be of benefit to an estate to allow a trustee some flexibility in dealing with assets in foreign currencies.

7.37 In normal circumstances, a trustee or liquidator should convert a foreign asset into Hong Kong dollars once the asset is realised in a foreign currency. This, of course, is the safe option. Nonetheless, the Commission considered that, while it was not the function of a trustee to engage in currency speculation, the value of an estate could be increased by effecting a conversion at an opportune moment. The Report cautioned that trustees should act carefully because a loss on a delayed conversion could leave a trustee open to claims by creditors.

7.38 The recommendations were adopted in the Bankruptcy (Amendment) Ordinance 1996.

7.39 We consider that the power to delay conversion is even more relevant in the liquidation of companies. This is, perhaps, a matter of some consequence at the present time as there is an economic downturn in the region. In Hong Kong there have been liquidations of companies which had large exposure to foreign markets and hence foreign currencies. We **propose** that the liquidators should be provided with the same powers as have been provided to trustees in bankruptcy.

Section 200 Exercise and control of liquidator's power

7.40 In its Report on Bankruptcy the Commission recommended that a trustee in bankruptcy should be subject to specific statutory duties. These duties were subsequently adopted in the Bankruptcy (Amendment) Ordinance 1996.[16] The duties as set out in the Report on Bankruptcy[17] are that:

---

15 *Report on Bankruptcy*, paragraphs 15.11 to 15.16.

16 Section 46 of the Bankruptcy (Amendment) Ordinance amended section 84 of the Bankruptcy Ordinance by providing for additional duties of liquidators.

17 See the *Report on Bankruptcy*, paragraphs 9.32 to 9.37.

"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."

We **propose** that these duties should be adapted to apply to liquidators.

Section 202 Payments of liquidator into bank or Treasury

7.41 Liquidators other than the Official Receiver must pay money received by them into the Companies Liquidation Account, which is maintained by the Official Receiver.[18] Where the Official Receiver is liquidator, he is similarly obliged. There is a proviso that the Official Receiver may authorise a liquidator to make his payments into any other bank specified by the committee.[19] A liquidator is prohibited from paying sums received by him as liquidator into his private banking account.[20]

7.42 If a liquidator retains a sum exceeding $2,000 for more than 10 days, he may be subject to repaying the amount at an interest rate of 20 per cent per annum, disallowance of all or such part of his remuneration as the court thinks fit, be removed as liquidator by the court, and be liable to pay any expenses occasioned by reason of his default.[21] We understand from the Official Receiver that private sector liquidators can now retain amounts of up to $20,000 for up to 14 days, which may satisfy the Hong Kong Society of Accountants' submission that the amount should be reviewed.

7.43 The provisions appear to be adequate as, while we have received submissions on other matters relating to the Companies Liquidation Account, we have received no submissions on this section from private sector liquidators.[22]

7.44 The Official Receiver's Office, however, has submitted that the proviso to subsection (1) is worded in such a way that there must be a committee of inspection before the Official Receiver can authorise private sector liquidators to have a separate bank account. This result clearly cannot have been intended. We **propose** that, in subsection (1), the words "*on the application of the*

---

18 See also sections 285 and 293 to 295 and the Companies (Winding-up) Rules, rules 156 and 183.

19 Subsection (1) and see the Companies (Winding-up) Rules, rule 157.

20 Subsection (3).

21 Subsection (2).

22 See the submission of the Hong Kong Society of Accountants, *infra*, at section 285, paragraphs 18.37 and 18.46.

committee of inspection" should be deleted and the word "*committee*" should be replaced by the words "*Official Receiver*".

Section 203 Audit of liquidator's accounts

7.45 Private sector liquidators are obliged to send an account of receipts and payments every six months to the Official Receiver.[23] The Official Receiver may at any time audit the accounts even if he has exercised his discretion not to audit them. The accounts are available for inspection by creditors or other interested parties on payment of a fee.[24]

Accounts under section 203 and section 284 distinguished

7.46 The Hong Kong Society of Accountants has submitted that the nature of the forms used in sections 203 and 284 should be standardised. Section 203, however, relates to liquidations by the court, while the provisions on accounts under section 284 have application to voluntary winding-up. Section 203 requires a more detailed form of accounts, for audit purposes, than section 284, which has no audit provision. The main purpose of section 284 is to allow creditors in a voluntary winding-up to check what amounts have been received and paid out.

Summary of accounts

7.47 As regards section 203, the Official Receiver inspects the accounts that are submitted and may audit them. The Official Receiver's Office has confirmed that it sometimes requests further information from liquidators as a result of an audit. As the Official Receiver is looking after the interests of creditors and others we suggest that it is an unnecessary expense to send a summary of the accounts to creditors and contributories every six months.[25] This would accord with a submission made by the Hong Kong Society of Accountants. The accounts at present need to be filed with the Official Receiver and in the court where they are available for inspection.

7.48 We **propose** that the requirement to send a summary of the accounts every six months should be dispensed with and replaced by a provision which would allow creditors and contributories to obtain a summary on request and for other interested parties to obtain a summary for a reasonable fee.

7.49 We understand that, in practice, liquidators have been known to be unwilling to produce a summary on request. We consider that this should not be condoned and **propose** that, if a liquidator fails to produce a summary within a

---

23 Subsection (1) and see the Companies (Winding-up) Rules, rules 162 and 166.

24 Subsection (3A), (4) and (6).

25 Subsections (5) and (6)(b).

reasonable time after a request is made, he should be subject to a fine. In the overall context of our proposals for the regulation of insolvency practitioners, this should be a matter that the Official Receiver, as regulator, would oversee.

Accounts to be filed with the Registrar of Companies

7.50 At present, accounts are filed with both the Official Receiver and the court.[26] Although liquidations that come under this section are under the supervision of the court, we see no reason why accounts should be filed in the court. We **propose** that it would be more sensible for accounts to be filed with the Registrar of Companies and that provision should be made to replace the references to the court by references to the Registrar of Companies. A creditor should be able to inspect the accounts on producing a copy of his proof of debt.

Signing accounts by liquidators on conversion of liquidation [27]

7.51 A practical problem may arise in cases where there has been a conversion in the form of winding-up during the six month accounting period. Normally the accounts are prepared in the name of the new liquidator but it is unsatisfactory that the new liquidator should have to sign off on another liquidator's accounts. Under the current provisions, a liquidator has to declare that the receipts and payments account was complete when he had not been involved in their preparation at all relevant times.[28] We **propose** that liquidators should only sign for accounts during the period that they were liquidator.

Section 204 Control of Official Receiver over liquidators

7.52 The section provides that the Official Receiver shall take cognisance of the conduct of liquidators in a winding-up by the court.[29] If a liquidator does not faithfully perform his duties and observe all the requirements imposed on him, or if any complaint is made to the Official Receiver by any creditor or contributory, the Official Receiver is obliged to inquire into the matter and to take appropriate action. The Official Receiver may also require a liquidator to answer any inquiry in relation to a winding-up in which he is engaged and may apply to the court to examine a liquidator or any other person on oath concerning the winding-up. In addition, the Official Receiver may direct an investigation to be made of the books and vouchers of the liquidator.

---

26 Subsections (4) and (6)(a).

27 This proposal also relates to accounts prepared under section 284.

28 For the purposes of section 203, a liquidator signs a trading account, listing receipts and payments under Companies (Winding-up) Rules, rule 163 and form 88. For the purposes of section 284, a liquidator's statement of account is in the form prescribed in form 92, which must be sworn by a liquidator in the form prescribed in form 93.

29 Note also the Companies (Winding-up) Rules, rule 189.

7.53 The relationship between the Official Receiver and liquidators in both winding-up by the court and in all other forms of insolvency are likely to be affected by our proposals on the licensing of insolvency practitioners, in which the Official Receiver would play a central role.[30]

Section 205 Release of liquidators

7.54 When a liquidator of a company being wound-up by the court has completed the liquidation and made a final dividend, if any, he may apply to the court for his release. Creditors and other interested persons may object to the release. The court may withhold the release and may make an order charging the liquidator with the consequences of any act or default which he may have made or done contrary to his duty.[31]

7.55 An order releasing the liquidator has the effect of discharging him from any liabilities for acts done or defaults made as liquidator but the order may be revoked on proof that it was obtained by fraud or by suppression or concealment of any material fact.[32]

7.56 A liquidator must give notice to all creditors and contributories of the application.[33]

7.57 The Official Receiver's Office submitted that there should be no necessity for a liquidator to make an application to the court for release in the absence of any objection from the creditors or contributories.

7.58 The Insolvency Act, section 174, is the equivalent of section 205. Under section 174, where the Official Receiver is liquidator he can apply to the Secretary of State[34] for his release. There is no equivalent to the Secretary of State in Hong Kong except perhaps the Secretary for Financial Services and we consider that it would not be appropriate for him to delegate such statutory powers to the Official Receiver, the effect of which would be to allow the Official Receiver to release himself where he had been acting as liquidator. In such cases the Official Receiver should continue to apply to the court.

7.59 We also note that Insolvency Act, rules 4.124(1) and (2), which equate to the Companies (Winding-up) Rules, rule 189(1), provide that a liquidator before applying for his release must provide all creditors and

---

30 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

31 Subsection (1).

32 Subsection (3).

33 Companies (Winding-up) Rules, rule 189(1).

34 The Secretary of State has delegated his powers to the headquarters of the Insolvency Service of the Department of Trade and Industry.

contributories with a summary of all receipts and payments. We consider that this practice should continue.

7.60 Section 205 clearly contemplates release only in circumstances where the private sector liquidator has effectively completed the liquidation and, to that extent we see no reason, in the absence of an objection by creditors or contributories, as to why the private sector liquidator should go to the expense of a further court application.

7.61 We **propose** that, in the absence of such an objection, the release of a private sector liquidator should be capable of being dealt with by the Official Receiver. The liquidator would still be obliged to give notice to creditors and contributories.

7.62 We **propose** that, notwithstanding that a liquidator has been released, it should not absolve him from the provisions of section 276, which provides the court with the power to assess damages against a delinquent liquidator.[35]

[35] See Insolvency Act, section 174(6), for an equivalent provision.

CHAPTER 8

COMMITTEE OF INSPECTION[1]

Section 206 Meetings of creditors and contributories to determine whether committee of inspection shall be appointed

8.1 The Hong Kong Association of Banks submitted that:

> "*Greater stress needs to be given to creditors' rights of supervision of a liquidation, including the involvement of creditor committees in key decisions, and also to the length of time for which liquidations should continue. In particular, the role of the committee of inspection should be looked at further, including the possibility of the committee being remunerated in some form so that the tendency of its members to lose interest does not arise.*"

8.2 The Law Society has made a submission that "*reforms should be introduced along the lines already proposed in relation to bankruptcy.*"

Relationship of liquidator and committee
Role of committee

8.3 The Commission's Report on Bankruptcy[2] supported our original view that the provisions of the Bankruptcy Ordinance[3] should be amended to dispense with the supervisory aspect of the committee of inspection over the trustee in bankruptcy and to replace it with the provision that the committee of inspection act with the trustee. This followed the wording under section 206(1) and we continue to approve of it. We do not generally support the Hong Kong Association of Banks' submission, although we appreciate that representatives of banks probably act on committees more than any other type of creditor. The committee of inspection is already involved in key decisions relating to the liquidation.

8.4 We note a trend internationally to limit the role of the committee of inspection. Section 206(1), however, provides that the first meetings of creditors and contributories "*shall*" determine whether or not to appoint a

---

1 Note generally the Companies (Winding-up) Rules, rules 146 to 155, 161, and 198.

2 *Report on Bankruptcy*, paragraphs 9.14 to 9.20.

3 Section 24(1). The Bankruptcy (Amendment) Ordinance 1996, section 15, amended section 24(1) by repealing "*committee of inspection for the purposes of superintending the administration of the bankrupt's property by the trustee*" and substituting "*creditors' committee to act with the trustee*".

liquidator in place of the provisional liquidator and whether or not to appoint a committee of inspection.

8.5 The insolvency regime in the United Kingdom has undergone a considerable change with the introduction of the Insolvency Act. The requirement that all liquidators must be qualified insolvency practitioners is probably part of the justification for now providing that a liquidator may summon a meeting of creditors and contributories to appoint a liquidation committee but there is no obligation to do so unless required to do so by one-tenth in value of the company's creditors.[4]

8.6 In Singapore, the position is much the same as under the Insolvency Act, with a liquidator only being obliged to call meetings if requested to do so by any creditor or contributory.[5] In Australia, a liquidator again shall only call meetings if requested to do so by a creditor or contributory.[6]

8.7 The manner in which liquidators are appointed in Hong Kong has undergone a change with the establishment in 1996 of the Official Receiver's Administrative Panel of Insolvency practitioners for the Court Winding-up. Under this scheme, the Official Receiver has established the panel from which he appoints private sector liquidators whom he has approved to act as liquidator in what are known as non-summary cases.[7] This scheme is regarded by us as the first step towards establishing a requirement that all liquidators and other insolvency functionaries should be recognised insolvency practitioners.[8]

8.8 Under the scheme, a first meeting of creditors and contributories must be called to consider whether an application should be made to the court for the appointment of a liquidator from the panel. If the meetings express no preference, the appointment is made on a roster basis.

8.9 We are concerned that the role of the committee of inspection should not be completely usurped and we have made no proposal that would change the principle that a committee, when appointed, should act with the liquidator.

8.10 There should be no obligation, however, on the first meeting to consider whether to appoint a committee of inspection and we **propose** that section 206(1) should be amended to delete the reference to the obligation to determine whether a committee of inspection should be appointed and an alternative provision should be added, where appropriate, to provide that a

---

4 Insolvency Act, section 141(2).
5 Companies Act, section 277.
6 Corporations Law, section 548(1).
7 See section 227F.
8 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

liquidator may call meetings or request the first meetings to appoint a committee of inspection.

8.11 Provision should also be made to provide that a liquidator be required to call a meeting of creditors at the request of one-fourth in value of the company's creditors. This would mirror the new requirement under section 17B of the Bankruptcy (Amendment) Ordinance 1996.

Remuneration of committee

8.12 We have no enthusiasm for the notion that the members of the committee of inspection should be remunerated. We accept that it is the experience of the sub-committee that members of committees of inspection tend to lose interest. We do not imagine that members could be paid any more than a nominal amount in any event, as other creditors would be opposed to any payment being made, and we doubt anything less than large payments would prevent members losing interest. Nevertheless, we seek views on the point.

Resolutions by post

8.13 We do, however, **propose** that committees should be able to function through written resolutions sent by post. This is provided for in a comprehensive provision under the Insolvency Act.[9] Under the provision, resolutions may be sent out by post by the liquidator. If a member requires a meeting on the resolution, he has seven business days from the date of posting to act. In the absence of such a request, the resolution is deemed to be passed.

Length of time liquidations can continue

8.14 We do not know how it would be possible to limit the length of time that liquidations can run. Every liquidation is different and difficult proceedings can continue for years through no fault of the parties involved, as, for example, where the company is subject to claims for personal injuries. The Bankruptcy (Amendment) Ordinance 1996, which has been gazetted, but which, at the date of the Consultation Paper has not been brought into effect, would provide that section 34 of the Bankruptcy Ordinance would be amended to allow proofs of debt in respect of actions for tort, subject to a procedure which would allow the court to place a value on the claim.[10]

8.15 It is more likely in the corporate context that companies in liquidation would be subject to long term liquidation. We see no means by which a time limit could be imposed on liquidations but we are open to suggestions.

---

[9] Insolvency Act, rule 4.167. This is also a *Report on Bankruptcy* recommendation, paragraph 9.13, which is likely to appear in the new Bankruptcy Rules when presented to the legislature.

[10] See Bankruptcy (Amendment) Ordinance 1996, section 25 and paragraphs 15.17 to 15.28 of the *Report on Bankruptcy*.

We hope that the establishment of the scheme for appointing insolvency practitioners and our proposals that only recognised insolvency practitioners should be able to act in insolvency proceedings will have the effect of bringing a more professional approach to all liquidations.

The Securities and Futures Commission

8.16 The Securities and Futures Commission submitted that:

> "*Section 206 and 207 of the Companies Ordinance provides for the appointment of a committee of inspection, which shall consist of creditors and contributories of the company or persons holding general powers of attorney from them. One of the functions of the Commission is to safeguard the interests of investors in listed companies. It may be appropriate to consider whether the Commission should have an independent, statutory right to be present at a committee of inspection appointed for a troubled listed company, since the Commission can better exercise the above function if it is able to monitor a liquidation in which the interests of investors may be in jeopardy.*"

8.17 We consider that a provision allowing the appointment of a representative of the Securities and Futures Commission to a committee of inspection would alter the composition of a committee, though we note that the Commission is not suggesting that it should have a vote. If a listed company is in liquidation, the role of the Commission would surely have shifted from a role of safeguarding the interests of investors to investigating what went wrong.

8.18 It is likely that in the liquidation of a listed company, the investors would have lost their money and would be ranked behind ordinary creditors for the purposes of receiving a dividend. Once any company is in liquidation, the liquidator takes over with the main purpose of recovering assets. We suggest that the Commission's objectives in such a situation would be more concerned with an investigation of the circumstances that led to the liquidation and that these, perhaps conflicting priorities, could lead to friction within the committee and could divert the liquidator's attention from matters that he would prefer to be pursuing.

8.19 While we do not support the Commission's submission we would be interested in other views on the point.

Section 207 Constitution and proceedings of committee of inspection[11]

[11] Subject to minor differences, these proposals would apply equally to the committee formed in a creditors' voluntary winding-up under section 243, *infra*, at paragraph 13.11.

Committee of inspection to be renamed "Liquidation committee"

8.20 The Law Reform Commission in its Report on Bankruptcy recommended that the committee of inspection should be renamed creditors' committee to reflect its composition rather than to reflect its function. The recommendation was adopted in the Bankruptcy (Amendment) Ordinance 1996, section 15. Although we are keen to standardise provisions insofar as they relate to different forms of insolvency, we find that it would be inappropriate to duplicate the bankruptcy amendment in a winding-up because subsection (1) provides that the committee of inspection shall consist of both creditors and contributories. We therefore **propose** that the name should be amended to "*liquidation committee*" to better reflect the function of the committee to act with a liquidator, rather than to supervise and inspect.

Number of members of the committee

8.21 We note that our proposal in section 243 that the maximum number of members of the committee should be limited to five would apply to the committee in a winding-up by the court. The minimum number of members of the committee should be three.[12]

Quorum

8.22 We **propose** that provisions should be made for a quorum. The Insolvency Act[13] provides that the quorum should be two members present or represented and we **propose** that that provision be followed.

Body corporate to be a member of the committee

8.23 The Official Receiver's Office has submitted that a body corporate should be allowed to be a member of the committee, reflecting a provision under the Insolvency Act.[14] There appears to be no provision in the Companies Ordinance that prohibits a body corporate being a member of a committee. We can see no reason why a body corporate cannot be represented and **propose** the Official Receiver's Office's submission be adopted.

Letters of authority

8.24 The Official Receiver's Office has submitted that subsection (1) should be amended to provide that a member of the committee should be capable of being represented by another person on production of a letter of authority rather than, as provided for at present, a power of attorney. This submission

---

12 Insolvency Act, rule 4.152(1)(a).

13 Insolvency Act, rule 4.158.

14 Insolvency Act, rule 4.152(5).

reflects a recommendation in the Report on Bankruptcy for an amendment to the Bankruptcy Ordinance.[15] We endorse the submission and **propose** its adoption. The Insolvency Act make the same provision and also provides that although a body corporate may be a member of a committee, a member may not be represented by a body corporate. We **propose** that this approach be taken.[16]

Meetings only when necessary and agreed

8.25 Subsection (2) provides that the committee must meet at least once a month. We consider this to be unnecessary as did the Official Receiver's Office in its submission. The Bankruptcy (Amendment) Ordinance 1996 has also provided that meetings should only be held as and when necessary and we **propose** that this be followed.

Voting

8.26 There is no clear provision as to how members of a committee should vote. We **propose** that each member of the committee should have a single vote. This would follow the provisions of the Insolvency Act.[17]

Section 208 Powers of court where no committee of inspection

8.27 Where there is no committee of inspection, the court may, on the application of the liquidator, do any act and give any permission which the committee could have done or given. In addition, rule 198 provides that where there is no committee of inspection in a winding-up by the court, any functions of the committee of inspection which devolve on the court, may, subject to the directions of the court, be exercised by the Official Receiver.

8.28 The effect of the section is to distinguish the provisions of section 199(1) to the effect that the court will only exercise its powers under the section where there is no committee of inspection.

8.29 There are now two types of liquidator operating winding-up by the court: private sector liquidators and the Official Receiver. In looking for ways to reduce the expenses of a liquidation we have consistently looked at ways of reducing the number of applications that need to be made to the court. If our proposals on committees of inspection are adopted, it could mean that there are likely to be fewer committees operating in liquidations in the future and we

---

15 The provision for a power of attorney under section 24(2) has been repealed by section 15 of the Bankruptcy (Amendment) Ordinance 1996. The provision for a letter of authority will be placed in new Bankruptcy Rules which have been drafted but have not been presented to the legislature.

16 Insolvency Act, rule 159(2), (3) and (4).

17 Insolvency Act, rule 4.165.

anticipate that this would result in an increase in the number of applications to the court.

8.30 We **propose** that the Official Receiver should have the authority to sanction actions of private sector liquidators where there is no committee, subject to the right of the liquidator to appeal to the court if the Official Receiver refuses to grant permission. This would effectively make the provisions of rule 198 redundant. We **propose** that where the Official Receiver acts as liquidator, he should seek the sanction of the court in the usual way.

8.31 It is arguable that the proposal would create a conflict of roles for the Official Receiver in that, on one level he would be acting as liquidator, and on another level he would be giving authority to take actions for which he, when acting in the role, would have to seek authority. This happens anyway, in a number of instances. The Official Receiver is liquidator, supervisor and regulator. Nobody, however, objects to this.

8.32 There is some precedent for a distinction being made between the Official Receiver as liquidator and private sector liquidators under the Insolvency Act. In the United Kingdom, where the Official Receiver is liquidator, there is no committee of inspection whatsoever, but there may be a committee where a private sector liquidator is appointed.[18] Where the Official Receiver is liquidator, the functions of the committee are carried out by the Secretary of State, but where there is a private sector liquidator with no committee, the powers of the Secretary of State may be exercised by the Official Receiver.

8.33 The purpose of the proposal is to provide appropriate checks and balances for liquidators, while at the same time saving both time and costs.

[18] Insolvency Act, section 141(4) and (5) and Insolvency Act, rule 4.172.

CHAPTER 9

GENERAL POWERS OF COURT IN CASE OF WINDING-UP BY COURT

Section 209 Power to stay winding-up

9.1 The section provides that the court may at any time after an order for winding-up, on the application of the liquidator, the Official Receiver, or any creditor or contributory, on proof that all proceedings in relation to the winding-up ought to be stayed, make an order staying the proceedings, either altogether or for a limited time, on such terms or conditions as the court thinks fit.

9.2 A stay is usually only granted in circumstances where the applicant can satisfy the court that a stay would act for the benefit of all the parties concerned in the winding-up, such as where a scheme of arrangement has been accepted by all the parties. If a stay is granted on that basis, a liquidation should come to an end and there should be no reason for the winding-up to be stayed for a limited period only.

9.3 As it is unlikely, and probably undesirable, that the court should only stay a winding-up for a limited time, we **propose** that the words "*either altogether or for a limited time*" should be replaced by the word "a*ltogether*" within the intention that the court could only stay a winding-up permanently.

9.4 The Official Receiver's Office submitted that where winding-up proceedings are stayed altogether the liquidator should be released immediately without any further court order. The Official Receiver's Office also submitted that there should be specific provisions for the costs of applications by the Official Receiver for stays to be paid and that rules should set out procedural requirements in detail.

Section 209A Power of court to order winding-up to be conducted as creditors' voluntary winding-up
Section 209B Consequences of an order under section 209A
Section 209C Transitional

9.5 Section 209A provides that the court may, on the application of the liquidator or a creditor, within three months[1] after the date of a resolution of

[1] This period may be extended by the court.

creditors to make an application[2], order that a winding-up of a company by the court shall be conducted as if the winding-up was a creditors' voluntary winding-up. The section also makes provision for matters that the court should have regard to, under subsection (2).

9.6 Section 209A is Hong Kong's own: no other jurisdiction, to the best of our knowledge, has adopted a similar provision. The Official Receiver's Office would like to have it, together with sections 209B and 209C, abolished. Creditors of certain companies which are being wound-up by the court certainly want it retained.

9.7 The section appears to originate in a recommendation in England in 1962,[3] made in what is known as the Jenkin's Report, but when the next amendments to the United Kingdom Companies Act were made in 1967 the provision was not included. The Standing Committee on Company Law Reform in Hong Kong had looked at the Jenkin's Report among other reports and provisions but there were delays in putting together a Companies (Amendment) Bill until 1984 by which time the recommendations of the Cork Report, which was published in 1982, were not considered. As a consequence, section 209A suddenly appeared in legislation, it appears, by default.

9.8 The history of the provision was set out by the court in a recent case.[4] The court commented that at the time of its original introduction it did:

> *"... not seem to have occurred to those responsible that the recommendation which they were implementing needed to be fleshed out if it were to work.... This resulted in a comprehensive code regulating the powers of the court to make such an order and providing for its consequences to be found in new sections 209A and 209B, introduced into the Ordinance[5] in 1990."*

9.9 The main reason that companies use the conversion provision under these sections and the main reason for the opposition to the provision of the Official Receiver's Office relates, we believe, to money. Nobody denies that the major reason that applications under section 209A have happened is because, by converting to a creditors' voluntary winding-up, the company can avoid payment to the Official Receiver of the scale fees set out in paragraph I of Table B of the Companies (Fees and Percentages) Order. Section 7 of the Order provides that the percentages shall be paid by a private sector liquidator on submission of his accounts to the Official Receiver under section 203, or, where the Official

---

2 Provision is also made for companies wound-up in a summary manner under section 227F but such companies have few assets liquidators and creditors are unlikely to use this provision.

3 *Report of the Company Law Committee*, appointed by the Board of Trade on 10 December 1959 (Cmnd. 1749).

4 *Re Conso Electronics (Far East) Ltd (In liquidation)* [1995] 2 HKC 327, at 329.

5 Companies (Amendment) (No. 4) Ordinance (No. 59 of 1990).

Receiver is liquidator, before he is released under section 205. There are other legitimate reasons for converting, however, as there is less court supervision, fewer procedures and generally less expense in a creditors' voluntary winding-up than in a winding-up by the court.

9.10 We are not aware how much the Official Receiver's Office has lost out on in fees by use of the section but the Official Receiver's Office has advised that there have been 19 applications under the section, of which 11 occurred after the amendments in 1990.

9.11 The fees can add up under the Companies (Fees and Percentages) Order. On the first $500,000, the fee is 10 per cent; on the second $500,000, the fee is 7.5 per cent; on the next $4 million the fee is 6.5 per cent; on the next $5 million the fee is 3.75 per cent; on the next $40 million the fee is 2 per cent, and on all further amounts the fee is 1 per cent. The fee on an aggregate amount of assets realised and brought to credit in a $100 million estate would amount to $1,835,000. In an estate of $10 million the fee would be $535,000 or 5.35 per cent of the total amount.

9.12 The Official Receiver's Office does not lose out entirely on fees in the case of companies which use section 209A as it would still have charged other fees as they arose under the Companies (Fees and Percentages) Order. Once a conversion order is made, however, if the assets remain undistributed for more than six months, the liquidator must pay them into the Companies Liquidation Account under section 285 of the Companies Ordinance and such amounts would then become subject to the Official Receiver's fee of 1.5 per cent under section 295.

9.13 If companies can convert to a creditors' voluntary winding-up, it takes the fees away from the Official Receiver and makes them available for the creditors. We would point out that although the majority of members of the sub-committee favour the retention of the provision, this should not be construed as a comment that the Official Receiver's Office is trying to profit unreasonably from creditors' voluntary windings-up. The issue is one of balancing the interests of creditors on the one side against the need for the Official Receiver's Office to be adequately funded on the other side.[6]

Minority view

9.14 The comments made on the section represent the majority view of the sub-committee. A minority view has been expressed that the section, and section 209B, should be abolished on the ground that the provision does not appear in any other jurisdiction and that its sole purpose is to avoid the payment of the ad valorum fee under the Companies (Fees and Percentages) Order and that

---

[6] See our proposals on the funding of the Official Receiver's Office at paragraphs 29.1 to 29.3.

the effect of the provision is to allow the participants in a liquidation the opportunity to second guess the situation at an appropriate time in order to avoid the legitimate fees of the Official Receiver. The effect of the section is to unbalance the administrative side of the winding-up provisions.

9.15 In addition, conversion would take the control of the liquidation out of the hands of the court, but only after the creditors had found that the court was the only recourse where directors refused to go into a creditors' voluntary winding-up, and that it was too complex a provision to have to explain to creditors at the first meeting of creditors.

Majority view

9.16 The majority view of the sub-committee accepts these arguments insofar as they go but considers that the minority view addresses two issues: the funding of the Official Receiver's Office, which the sub-committee views as a matter of major importance in respect of its overall proposals and whether the provision should be retained on its own merits.

9.17 The majority view is that since it is possible under the Ordinance to convert a creditors' voluntary winding-up into a winding-up by the court[7] it is logical that there should be a corresponding provision to allow conversion from winding-up by the court to a creditors' voluntary winding-up. In the case of section 209A, creditors are simply reacting to a form of market situation and, as things stand, if a conversion saves a company costs, it would be prudent to take the opportunity. It is the way that the fees are extracted that is at fault, not the provision.

Application of sections 182, 183 and 186 to voluntary windings-up converted from windings-up by the court

9.18 A submission by the Bar Association to the Standing Committee on Company Law Reform has been brought to our attention. The submission raises questions about the application of sections 182, 183 and 186 in cases of voluntary windings-up converted from a winding-up by the court and comments:

> *"The purpose of a voluntary winding-up, whether members' or creditors", is to divorce its control from the court, including the right to bring proceedings against the company in liquidation. Thus it is difficult to see any basis for the application of sections 182, 183 and 186 in the case of voluntary winding-up converted from a compulsory winding-up when an ordinary members' or creditors' voluntary winding-up is not governed by any of these provisions. Moreover, section 182 does not apply once a company has been ordered to be*

[7] Under section 257 of the Companies Ordinance.

wound-up as all the directors become functus. No liquidator has ever applied to the court for the disposal of an asset under that provision as its powers and duties are governed by the Ordinance. In the circumstances, it is all the more puzzling why section 182 remains applicable to a converted creditors' voluntary winding-up."

9.19 The *Conso Electronics* case considered whether the effect of the provisions of section 209A and 209B were that matters of substance continue to be regulated "*as if*"[8] the company was in compulsory winding-up and that matters of procedure are regulated "*as if*" the company were now in a creditors' voluntary winding-up. The court concluded that, by the section 209A order, the compulsory winding-up is for all purposes converted into a creditors' voluntary winding-up.[9]

9.20 The Official Receiver has confirmed, and we therefore **propose**, that it will be necessary to re-draft the provision to make it clear that these sections would only apply in cases where the sections had been utilised while the company was in compulsory winding-up. In that case, decisions made in respect of these sections would still apply after conversion, but if the sections had not been applied while the company was in compulsory winding-up, they could not be applied after the liquidation was converted to a creditors' voluntary winding-up.

Section 210 Settlement of list of contributories and application of assets[10]

9.21 The section provides that a liquidator in a winding-up by the court,[11] as an officer of the court, shall settle a list of contributories and shall cause the assets of the company to be collected and applied in discharge of its liabilities. The court may, however, dispense with the settlement of contributories.

9.22 In practice, a list of contributories is only made where shares had been partly paid up. We understand from the Official Receiver's Office that it only encounters this situation once or twice a year. When it happens, however, it is a costly and time consuming exercise.

9.23 The Insolvency Act, section 148, is the equivalent of this section and is identical in its terms. Section 160 of the Insolvency Act, which is similar in terms to section 226 of the Companies Ordinance, additionally provides for the delegation of certain of the court's powers to liquidators including the power

---

8 See section 209A(1).

9 *Re Conso Electronics (Far East) Ltd (In liquidation)* [1995] 2 HKC 327, at 333. See, *supra*, at paragraph 9.8.

10 See also the Companies (Winding-up) Rules, rules 66 to 73. Note that a recent addition to the Companies Ordinance, section 264A, would provide for the payment of interest to contributories in the event of the winding-up of a company which was not insolvent.

11 Section 210(1) provides that the court shall settle the list but the Companies (Winding-up) Rules, rule 66, passes the privilege on to the liquidator.

to settle a list of contributories, to rectify the register of members where required, and the collection and application of the assets of the company, to be exercised and performed by the liquidator, subject to the court's control. Insolvency Act, rule 4.195, delegates the power to settle a list of contributories to the liquidator. We **propose** that power to settle a list of contributories under section 226 should be delegated to the liquidator under the Companies (Winding-up) Rules.

9.24 The Companies (Winding-up) Rules, rule 69, provides a procedure for settling the list of contributories. The Insolvency Act, rule 4.198(2)(c), the equivalent of rule 69, additionally provides the notice given to each person on the list shall state that in relation to any shares or interest not fully paid up, his inclusion in the list may result in the unpaid capital being called. We **propose** that this provision should be added to rule 69.

9.25 The Insolvency Act, rule 4.198(3), also provides that the notice shall inform any person on the list that if he objects to an entry in, or omission from, the list, he should inform the liquidator in writing within 21 days from the date of the notice. The Insolvency Act, rule 4.198(4), then provides that the liquidator has 14 days in which to advise the person that he has either amended the list or that the objection is rejected. We **propose** that the Insolvency Rule provisions be adopted.

9.26 The Companies (Winding-up) Rules, rule 70, provides that, on the date appointed for the settlement of the list, the liquidator shall hear any objections and rule 72 allows anyone who objects to the settled list to apply to the court for the list to be varied.

9.27 These rules would need to be changed if the proposals for the adoption of the Insolvency Act, rules 4.198(3) and (4), are adopted. The Insolvency Act, rule 4.199, provides that if a person still objects to the liquidator's decision under rule 4.198(4), he may apply to the court for an order removing the entry to which he objects or for otherwise amending the list. We **propose** that Insolvency Act, rule 4.199, be adopted.

Section 211 Delivery of property to liquidator

9.28 The court may require any contributory, trustee, receiver, banker, agent, or officer of the company to pay, deliver, convey, surrender, or transfer, within a time ordered by the court, to the liquidator any money, property, or books and papers which he has to which the company is prima facie entitled. The Companies (Winding-up) Rules provide that the power shall be exercised by the liquidator.[12]

---

[12] Companies (Winding-up) Rules, rule 67.

9.29 The provision is a series of lists, which, though wide, has the effect of limiting its application to the parties described. The provision does not, for example, apply to employees.

9.30 Additionally, the provision is limited to winding-up by the court, a point noted by the Hong Kong Society of Accountants which submitted that the powers under this section, among others, should be expanded to include the liquidator in a voluntary winding-up.

9.31 We **propose** that the provision be extended to cases of voluntary winding-up and that it be extended to include any other party. This would expand those subject to the provision beyond those persons who either derive their authority from the company or are accountable to it.[13]

9.32 We **propose** the adoption of the equivalent section under the Insolvency Act, section 234, which provides that "*any person*" who possesses or controls assets of the company may be required by the court to hand over the assets.[14] The provision is not limited to winding-up by the court and applies to any liquidator and so to any form of liquidation. It also applies where a provisional liquidator has been appointed.

9.33 We **propose** that the provision should apply to provisional liquidators under the Companies Ordinance and that it should also apply to provisional supervisors in the event that the Commission's recommendations on the introduction of provisional supervision are brought into effect.[15]

Section 212 Payment of debts due by contributory to company and extent to which set-off allowed
Section 213 Power of court to make calls
Section 214 Payment into bank of moneys due to company
Section 215 Order on contributory conclusive evidence

9.34 The corresponding provisions under the Insolvency Act are similar to the current provisions.[16] Under the Companies (Winding-up) Rules, rule 75, the application by the liquidator for leave to make a call has to be by summons to the contributories whereas under the Insolvency Act, rule 4.204, the application is ex-parte. We **propose** that the rule under the Insolvency Act be adopted.

---

13 See *Re Crownhall Investments Ltd (In Liquidation) & anor* [1992] 1 HKC 137 C.A.

14 See our proposal that the court should have the power to order persons examined to deliver property to the liquidator, *infra*, at paragraph 9.69.

15 See the Commission's *Report on Corporate Rescue and Insolvent Trading*.

16 See generally Insolvency Act, sections 149 to 152, and the Insolvency Act, rules 4.195 to 4.202.

Section 216 Appointment of special manager

9.35 The section provides that where the Official Receiver is liquidator or provisional liquidator he may, if satisfied that the nature of the company's business or the interests of the creditors and contributories requires the appointment of a special manager, apply to the court for the appointment of a special manager to act as the court may direct.

9.36 The introduction of the scheme for contracting out of non-summary court winding-up cases by the Official Receiver has put pressures on the section that did not exist previously. The provision is only used now in cases where the Official Receiver is provisional liquidator because, in any cases where there are sufficient assets to justify the appointment of a special manager, the liquidation will be contracted out to private sector liquidators.

9.37 In addition, the Official Receiver's Office does not have the resources to take on cases that would require special management and is obliged to seek to have a special manager appointed.

9.38 The problem for the court lies with marginal companies which have some assets to be managed but whose assets would be eroded by the special manager's charges. It would not be in the interests of the company or the creditors to let the business disappear from neglect but, equally, it would be disadvantageous to the creditors for the assets to be spent on the special manager's fees.

9.39 There is no satisfactory solution to this problem. The Official Receiver's Office is not going to take any actions that are not in the best interests of the creditors or the company generally but the provision requires consideration of issues that sometimes come into conflict.

9.40 We **propose** that the solution is to refine the provision so that the court is only required to consider whether the nature of the estate or the business of the company requires the appointment of a special manager. The Official Receiver would have to apply to the court in any event and we doubt that the court would allow an appointment if it did not consider that the interests of the company, and therefore its creditors and contributories, were not best served. In that context, we **propose** that the words "*or in appropriate cases*" be added to the provision before "*or the interests of creditors or contributories generally*", which words should themselves be removed from the provision.

9.41 The Securities and Futures Commission submitted that:

> *"The professional accounting firms which are appointed as special managers charge their fees on a time-cost basis, which are often substantial in complex cases. While the Commission is not suggesting*

that such fees are unjustifiable, we feel it may be useful to introduce some statutory cost control mechanism and reporting mechanism to provide creditors and contributories with some idea of the progress of the case. You may also wish to consider whether it is appropriate to set a maximum limit of such costs, for example, that it should not exceed a certain percentage of the assets realised."

9.42 We would classify special managers in the same bracket as the appointment of private sector liquidators and other insolvency practitioners. We therefore refer further to this submission in our proposals on insolvency practitioners.[17] The Official Receiver's Office's Annual Report for 1996/97 has commented that the introduction of the administrative panel of insolvency practitioners for windings-up by the court has exercised some control over charging levels with the approval of a standard charge out rate.[18]

Section 217 Exclusion of creditors not proving in time

9.43 In a winding-up by the court, the court may fix a date on or before which creditors are to prove their debts or claims. Any creditor who has not proved before the date fixed shall be excluded from the benefit of the distribution made after that date and from any previous distribution. The provision is supported by a number of rules.[19]

9.44 The Hong Kong Society of Accountants submitted:

"With regard to the notice to creditors to prove their debts, we consider that compared to section 217, winding-up rule 93 might not be as 'watertight' as far as the discharge of the liquidator's duties dealing with 'late' claims is concerned. It is noted that the wording in rule 93 is slightly different from section 217; further, section 217 carries the authority of a court order in a compulsory liquidation whereas rule 93 is relatively unclear in voluntary liquidations as to whether a creditor not proving in time may eventually succeed in challenging the liquidator's decision to exclude the creditor from the next and all previous dividends. It is noted that a liquidator in a compulsory liquidation is afforded the further 'protection' of winding-up rule 142(2).

A typical situation is whether a liquidator in a members' voluntary liquidation can rely solely on the 'protection' of rule 93 to advertise a notice to submit claims immediately upon appointment and then, on

---

17 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

18 Paragraph 1.3. From the Panel's establishment in May 1996 to the end of March 1997 there were 35 appointments of Panel members as liquidator and four as special manager.

19 See generally the Companies (Winding-up) Rules, rules 79 to 105 and rules 142 and 143.

the basis of no claims having been received within 14 days, proceed to distribute all surplus assets to the contributories and then immediately close the liquidation.

We suggest that procedures for fixing a final deadline for lodging claims in any liquidation be reviewed, balancing the interest of maximum early distributions in a liquidation with that of long tailed claims [claims that are likely to take a long time to be quantified]*, for example, in a liquidation involving an insurance company."*

9.45 The court order referred to in the submission does not have to be used by a liquidator in a winding-up by the court on every occasion. The section states that the court "*may*" exercise its power to fix a date on or before which creditors are to prove their debts. The Companies (Winding-up) Rules, rule 93, provides that liquidators in a winding-up by the court, or in any other form of winding-up, should give notice to creditors to prove their debts.

9.46 The Hong Kong Society of Accountants suggested that the procedures should balance the interests of providing early distributions against considerations relating to claims that are likely to take a long time to be quantified. In practical terms, we do not see how the legislation can provide comprehensively for the variety of situations that arise in relation to claims. Recent amendments to the Bankruptcy Ordinance on the valuation of unliquidated claims should be of assistance to liquidators in this regard as it would provide a quantification of a claim in quicker time than could otherwise be achieved.[20]

9.47 A liquidator can never totally rely on rule 93 to the extent that he can advertise a notice to submit claims and, after distribution of all assets, close the liquidation. In practice, a liquidator needs to have a tax clearance certificate before he can complete a liquidation and no prudent liquidator would pay claims 14 days after giving notice under rule 93. He would have to hold over a reserve of money in the event of late claims and for any possible tax exposure.[21]

9.48 We understand that, typically, liquidators write to creditors several times in relation to claims in addition to providing notice under rule 93.

9.49 We accept that the situation is not ideal as it means that there is uncertainty surrounding the closing out of a liquidation and we would welcome specific suggestions as to how the situation can be improved.

Section 219 Inspection of books by creditors and contributories

---

[20] See the amendment to section 34 of the Bankruptcy Ordinance under the Bankruptcy (Amendment) Ordinance 1996 (No. 76 of 1996), section 25. Section 34 of the Bankruptcy Ordinance is applied to the Companies Ordinance by section 264 of the Companies Ordinance.

[21] See our comments in this regard under section 239, *infra*, at paragraph 12.36.

9.50 The Hong Kong Society of Accountants has submitted that this section is an example of a section which could be considered for common applications to all modes of winding-up. We can see no reason why the provision should not apply to all forms of winding-up and **propose** its adoption.

9.51 The Hong Kong Society of Accountants also submitted that:

> *"We note that in a winding-up by the court, creditors and shareholders may apply to the court to inspect the books and papers of the company, or inspect the file of the company in liquidation kept by the Registrar of the court upon the payment of a small fee, under winding-up rule 16. In practice, however, most creditors are not prepared to spend the money and effort to apply to the court or go to the Registrar and normally seek information from the liquidator. Since creditors have more of a beneficial interest than others when a company is in liquidation, it is considered they should have relatively easy access to information as to the general progress of the liquidation, without imposing too much cost to the administration.*
>
> *We suggest that for both winding-up by the court and voluntary windings-up, a new requirement be imposed on the liquidator to provide a copy of the resolutions passed at creditors' meetings to any creditor who so requests, upon the payment of a reasonable fee to the company in liquidation."*

9.52 While we are attracted to the idea of opening access to the books and papers of a company to creditors, we are concerned that this would leave a company in liquidation in danger from creditors involved in proceedings against the company in the course of the liquidation, using the provision to fish for evidence to support their claim. While it is acknowledged that the process of discovery of evidence can result in cases being settled or discontinued before going to court, discovery would equally apply to a company in liquidation.

9.53 A solvent company involved in proceedings with another party would refuse to open its records to inspection by that party and we see no reason for making provision for this in the case of a company in liquidation without the party first having obtained an order of the court. We consider that the section should be left as it is.

Section 221 Power to summon persons suspected of having property of company[22]

[22] In this and the next section we make wide reference to recommendations made in the *Report on Bankruptcy* on the corresponding sections in the Bankruptcy Ordinance, sections 29 and 19

9.54 After the appointment of a provisional liquidator, the court may summon before it, for what is known as private examination, any officer of the company or person known or suspected to have property of the company, or supposed to be indebted to the company, or any person whom the court believes capable of giving information concerning the promotion, formation, trade, dealings, affairs or property of the company.

9.55 We have considered public and private examination under the Bankruptcy Ordinance and the Commission's Report on Bankruptcy reflects these

9.56 views.[23] It is our intention that the winding-up provisions on public and private examination should mirror the Bankruptcy provisions insofar as possible. Many of the recommendations on examination in the Report on Bankruptcy are now contained in the Bankruptcy (Amendment) Ordinance 1996. These recommendations were often based on provisions contained in the Bankruptcy parts of the Insolvency Act.

Receivers should not be able to apply under the provision

9.56 The Insolvency Act, section 236, is the equivalent of section 221. Section 236 applies Insolvency Act, section 234,[24] in terms of which insolvency office-holders may apply under the provision. The Insolvency Act includes administrative receivers, which, though there is no equivalent office under the Hong Kong provisions, is a close relation to receivers under the Hong Kong system. We would not support the idea of section 221 being available to receivers.

Self-incrimination

9.57 The concept of obliging a person to give evidence against himself that could be used in evidence against him in a criminal case has implications in terms of the rights of the individual that go beyond insolvency law. This applies as much elsewhere as in Hong Kong and the quotation below on the corresponding Insolvency Act provisions applies just as much to the Companies Ordinance:

---

respectively. For convenience we have substituted the term "*liquidator*" for the term "*trustee in bankruptcy*".

23 See chapters 11 and 12 of the *Report on Bankruptcy*. For proposals under this section, see generally chapter 12 of the *Report*.

24 The Companies Ordinance equivalent of which is section 211.

"There has been a vigorous exploration of the provisions of section 236 in a series of cases, some of which have been appealed all the way to the House of Lords. ... the courts, in their approach to section 236, have been conscious of the need to balance a variety of different principles and divergent interests, including the consensus of society at large to pursue effective investigations in the face of determined and sophisticated resistance on the part of those whose conduct is under scrutiny. On the other hand, it cannot be denied that the extensive powers conferred by section 236, if applied without some degree of sensitivity, have the capability at times of posing an impossible dilemma for persons under investigation, and thereby put in question the prospect of a 'fair' trial on matters which may be technically distinct from, although practically related to, the actual insolvency process itself.

In Joint Administrators of Cloverbay Ltd v. Bank of Credit and Commerce International S.A.,[25] *the Court of Appeal formulated guidelines for the exercise of the court's discretion to order examinations of persons under section 236(2). These guidelines were re-examined very soon afterwards, and further elaborated, by the Court of Appeal and House of Lords respectively in Re British and Commonwealth Holdings plc (No. 2),*[26] *on the basis of a full review of the case law relating to the current section and its statutory predecessors. Ralph Gibson L.J., whose judgment was later endorsed by the House of Lords, affirmed that seven principles were clearly established by authority:*

> *(1) the discretion conferred on the court by section 236(2) is an unfettered and general one;*
> *(2) that discretion nevertheless involves balancing the requirements of the office-holder against possible oppression to the person from whom information is sought;*
> *(3) the power conferred by the section is an extraordinary one whose existence is due to the fact that the office holder usually comes as a stranger to the relevant events;*
> *(4) the power can be used not merely to obtain general information but to discover facts and documents related to contemplated claims, whether proceedings have been started or not, against the proposed witness or someone connected with him;*

---

25 [1991] Ch. 90 C.A.

26 Decided by a majority of the Court of Appeal [1993] A.C. 426 and unanimously by the House of Lords [1992] Ch. 342.

(5) *the power is directed to enabling the court to help the office-holder to complete his function as effectively and with as much expedition as possible, and to discover with as little expense and as much ease as possible, the facts surrounding any possible claim;*

(6) *great weight is to be given to the views of the office-holder, who will have detailed knowledge of what problems exist and what information he needs;*

(7) *matters relevant to the balancing exercise will include that:*

(a) *the case against a former officer will usually be stronger, since he owes both a fiduciary duty to the company and a duty under section 235 of the Act to assist the office-holder;*

(b) *to ask a third party to expose himself, by giving information, to liability involves an element of oppression;*

(c) *an order for oral examination is more likely to be oppressive than one to produce documents;*

(d) *to require a person suspected of wrongdoing to prove the case against himself on oath prior to proceedings being brought, is oppressive.'*[27]

9.58 A respondent[28] 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, subject to perjury. This Report on Bankruptcy recommendation was adopted in the Bankruptcy (Amendment) Ordinance 1996, section 19. We **propose** its adoption.

9.59 This is not the position under the Insolvency Act. Case law has established that an officer of an insolvent company who is summoned under Insolvency Act, section 236, cannot refuse to answer questions on the ground that to do so might tend to incriminate him.[29] The Report on Bankruptcy considered the matter fully and, commenting that the main objective of the examination provisions is to recover assets and make distributions to creditors, made the above recommendation. The Report took into account article 11(2)(g) of the Bill of Rights which provides that:

> *"(2) In the determining 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."*

---

27 *The Law of Insolvency*, Ian F. Fletcher, 2nd edition, pages 562 and 563.

28 For convenience, we refer in this and the next section to "*respondent*". This term is intended to include any person who is examined under the sections, unless specifically described.

29 *Bishopsgate Investment Management Ltd v Maxwell* [1992] BCC 214.

Examination to be extended to voluntary windings-up

9.60 The private examination of persons under this provision is limited to cases of winding-up by the court, though there may be an examination in a voluntary winding-up if the court is prepared to exercise its powers under section 255. The Insolvency Act equivalent, section 234, applies to any company which is insolvent or in liquidation. We **propose** that the provision be extended to cases of voluntary winding-up, though not to provisional supervision.

Application only by liquidator

9.61 The corresponding provision under the Bankruptcy Ordinance, section 29, provides that the application to the court must be made by the trustee or the Official Receiver. Similarly, under the Insolvency Act, the application must be made by the liquidator. Section 221 is silent as to who may make the application. We **propose** that the application should only be made by the liquidator.

Application inter partes unless circumstances demand ex parte application

9.62 The provision is silent as to whether the application should be made *ex parte* but we understand that, until recently, it had been the practice for applications to be so made. We understand that recently the court has been reluctant to make an order without first hearing the person to be examined.

9.63 This issue was addressed in the Report on Bankruptcy which recommended that applications for private examinations should be *inter partes* except where the liquidator 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 application or where the risk of uncompensatable loss was clearly outweighed by the risk of injustice to the applicant if the order was not made. In cases where a liquidator would make an *ex parte* application, he should first make full disclosure of the facts of the case to the court, in whose discretion it should lie to make an order. We endorse this approach and **propose** that it be adopted.

Examination on matters considered relevant

9.64 The Report on Bankruptcy recommended[30] that the court, in addition to examining a person on matters concerning the debtor, his dealings or property, should also be able to examine him on any other matter the court considered relevant. We **propose** that this additional wording should be added at the end of section 221(1).

---

[30] This was adopted in the Bankruptcy (Amendment) Ordinance 1996, section 19.

Legal representation of person to be examined

9.65 The Report on Bankruptcy recommended, and we **propose**, that a person should be entitled to be legally represented at his examination provided it was at his own expense. The legal representative should be able to put to the respondent such questions as the court would allow for the purpose of enabling him to explain or qualify any answers given by him. The legal representative should also be able to make representations on his behalf.[31]

Inspection of liquidator's report to the court

9.66 The Report on Bankruptcy recommended, and we **propose**, that it should be in the discretion of the court to allow inspection of the liquidator's report to the court.

Costs may be paid by the person examined

9.67 The Report on Bankruptcy recommended, and we **propose**, that the court should have the power to order that the costs of an examination should be paid by the respondent if it appeared that the examination was made necessary because information requested by the liquidator had been unjustifiably withheld by the respondent.[32]

9.68 The Report on Bankruptcy recommended, and we **propose**, that where a respondent has co-operated with the liquidator in his examination and in the production of documents the court should have the discretion to order that the costs of the respondent be borne by the estate.

Court may order payment of money or delivery of property etc.

9.69 The Report on Bankruptcy recommended, and we **propose**, that on examination, where it appears to the court that the person examined, the respondent, is indebted to the company or has in his possession property belonging to the company, the court may order the respondent to deliver such sum or property, or any part of the sum or property, as the court thinks fit, to the liquidator.[33] There is a similar provision under Insolvency Act, section 327.

Perjury

9.70 The Report on Bankruptcy recommended, and we **propose**, that a warning should be placed in the summons under section 221 to the effect that on

---

31 This provision is also reflected in the Insolvency Act, rule 9.4(5).

32 Similar provision is made under the Insolvency Act, rule 9.6.

33 Bankruptcy (Amendment) Ordinance 1996, section 19: note also, *supra*, at paragraph 9.32.

conviction for perjury a person is subject to imprisonment for seven years and a fine.[34]

Affidavit of dealings

9.71 The Report on Bankruptcy recommended, and we **propose**, that the court should have the power to require a respondent to submit an affidavit of his dealings with a company and to produce any documents in his possession or under his control relating to the company, the company'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 liquidator makes a separate application for an order obliging the respondent to continue with preparation of the affidavit, and the court so orders.

Interrogatories

9.72 The Report on Bankruptcy recommended, and we **propose**, that the court should have the power to require a respondent to answer interrogatories.

Production of documents by the Commissioner of Inland Revenue

9.73 We **propose** that the court, on the application of a liquidator, may order the Commissioner of Inland Revenue to produce to the court any returns or accounts submitted by the company to the Commissioner, any assessment or determination made in relation to the company by the Commissioner, or any correspondence between the company or its representatives and the Commissioner, either before or after the commencement of the winding-up.

9.74 The proposal would follow a provision introduced in the Bankruptcy (Amendment) Ordinance 1996, section 21. The provision also allows the Commissioner to apply to the court for discharge or variation of the order. Once the document is produced to the court, the court may disclose all or part of the contents of the document to the trustee in bankruptcy but the trustee shall not disclose the contents of the document unless they are disclosed as part of a private examination. No creditor or member of a creditors' committee is entitled to see the contents of a document disclosed to a trustee under the provision.

9.75 This matter was discussed at length in the Report on Bankruptcy.[35] The Commission took the view that the trustee in bankruptcy should be able to "*stand in the shoes*" of the bankrupt as regards his tax records, the effect of which would be that a liquidator should be able to see such tax records as a company

---

34 Crimes Ordinance (Cap 200), section 31.

35 For a fuller discussion, see paragraphs 12.43 to 12.46 of the *Report on Bankruptcy*.

would have been able to see, which resulted in provision being made for a trustee to be able to have access to information that was sent by a bankrupt to the Commissioner, to assessments that were sent by the Commissioner to a bankrupt, and to any other correspondence between the Commissioner and a bankrupt.

9.76 The Commissioner of Inland Revenue was concerned that the secrecy provisions of the Inland Revenue Ordinance should not be compromised as confidentiality is one of the cornerstones of the taxation system and the secrecy provisions are understood to encourage frankness by taxpayers.

9.77 The Bankruptcy Ordinance provision appears to satisfy the Commissioner's requirements as to confidentiality and to satisfy the requirements of trustees. We consider that the application of corresponding provisions to the winding-up of companies would satisfy the same needs.

Section 222 Power to order public examination of promoters, directors, &c.[36]

9.78 In a winding-up by the court, where the Official Receiver has reported to the court that, in his opinion, a fraud has been committed in relation to the promotion or formation of the company or by any officer of the company in relation to the company since its formation, or in the case of an insolvent company, a prima facie case exists against a person that would render him liable to disqualification under the provisions for disqualification of directors under Part IVA of the Ordinance, the court may order the public examination of the person as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer of the company.

Self-incrimination

9.79 The Report on Bankruptcy recommended, and we **propose**, that a respondent 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. The protection, therefore, should not apply where a respondent does not give truthful answers in his examination.[37]

---

[36] Many of the proposals made in respect of private examination under section 221 also apply to public examination under this section. Note that references under this section to recommendations in the *Report on Bankruptcy* refer to chapter 11 of the *Report*.

[37] Bankruptcy (Amendment) Ordinance 1996, section 13. See generally chapter 11 of *the Report on Bankruptcy*.

Legal representation of person to be examined

9.80 The Report on Bankruptcy recommended, and we **propose**, 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.[38]

Creditors may request and require liquidator to hold an examination

9.81 The Report on Bankruptcy recommended, and we **propose**, that public examination should only be held on the application of the liquidator, or the Official Receiver, on the requisition of one quarter in value of the creditors. 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.[39]

Inspection of liquidator's report to the court

9.82 The Report on Bankruptcy recommended, and we **propose**, that 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, by the respondent but the report should remain confidential unless the respondent can show that it would be unfair to him not to allow inspection.

List of topics

9.83 The Report on Bankruptcy recommended, and we **propose**, that creditors should furnish the liquidator with a list of the topics they intend to put to a respondent at a public examination.

Costs may be paid by the person examined

9.84 The Report on Bankruptcy recommended, and we **propose**, that 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.[40]

---

38 See section 13 of the Bankruptcy (Amendment) Ordinance 1996.

39 See section 13 of the Bankruptcy (Amendment) Ordinance 1996: new section 19(2) of the Bankruptcy Ordinance.

40 See section 13 of the Bankruptcy (Amendment) Ordinance 1996: new section 19(8) of the Bankruptcy Ordinance.

Perjury

9.85 We **propose**, that a warning should be placed in the order directing a public examination[41] that on conviction for perjury a respondent would be subject to imprisonment for seven years and a fine.[42]

Special manager

9.86 The Insolvency Act, section 133(4), provides that a special manager appointed by a liquidator may take part in a public examination. We **propose** that a special manager, appointed either by a private sector liquidator or by the Official Receiver under the panel for contracting out non-summary windings-up, should be able to take part in an examination.

Section 226A Dissolution of company otherwise than by order of court[43]

9.87 The section provides that when the affairs of a company in a winding-up by the court have been completely wound-up and the liquidator has been released under section 205, the Official Receiver will certify to the Registrar of Companies that these conditions have been satisfied. Two years after registration of the certificate the company will be dissolved. The provision is subject to deferral of the date of dissolution on application to the court by the Official Receiver.

9.88 The Official Receiver's Office has submitted that the Official Receiver is not in a position to certify that the affairs of a company which has been liquidated by a private sector liquidator have been completely wound-up and should not be required to do so.

9.89 We agree that the Official Receiver should not be obliged to certify matters over which he had no control or knowledge. We **propose** that liquidators should provide the Registrar of Companies with their own certificate.

9.90 The Official Receiver's Office submitted that Part V(iiA) needs to be reconsidered, pointing out that the procedure does not appear to exist in other jurisdictions. The submission noted that the major advantage is that it obviates the need to hold meetings in liquidations with large numbers of creditors or contributories.

---

41 Companies (Winding-up) Rules, form 29.

42 Crimes Ordinance (Cap 200), section 31.

43 Sections 290 to 292A provide for dissolution in all forms of winding-up. Sections 239 and 248 apply to dissolution in members' voluntary winding-up and creditors' voluntary winding-up respectively. Note the proposals on dissolution in the case of solvent companies, *infra,* under section 239.

Section 227A Court may make a regulating order

9.91 The section provides that the court may, by reason of the large number of creditors or contributories, or if for any other reason the interests of the creditors require it, order that the winding-up of a company be regulated by order of the court.

9.92 Where a regulation order is made, the court may dispense with the first meeting of creditors and appoint the Official Receiver or any other person as liquidator and appoint a committee of inspection.[44]

9.93 The court may vary the procedure for ascertaining the wishes and directions of creditors.[45] There are also special provisions relating to compromises and schemes of arrangements under section 166.[46]

9.94 The provisions, introduced in 1965, are used sparingly. The Official Receiver's Office has advised that in 1992 the provisions were used three times and that in the four years since then they have only been used on four occasions. Perhaps the largest case in recent years was the liquidation of *Bank of Credit and Commerce (Hong Kong) Ltd*[47] in 1992 when it was considered that the large numbers of creditors merited the use of the provision. The provision was originally introduced as a consequence of the liquidation of *Canton Trust and Commercial Bank*[48] when, again, there were large numbers of creditors to be dealt with.

9.95 We are encouraged that the provision is only used on rare occasions as it has the effect of impinging on the rights of creditors to have a meeting of creditors, to appoint a liquidator and to elect a committee of inspection. There has, however, been no submission calling for the provision's abolition and we are satisfied that as the provision is only used when needed, and as the court must make an order, there is no need to make any amendments to the provisions.

Section 227E Proof of debts

9.96 The section provides that in the case of the winding-up of a bank, any creditor who is a depositor shall be deemed to have proved his debt for both voting and dividend purposes. The purpose of the provision is to save labour as banks should already have records of the balances of depositors and all that was

---

44 Section 227B, Appointment of liquidator and committee of inspection.

45 Section 227C, Informing creditors and contributories and ascertaining their wishes and directions.

46 Section 227D, Compromises and arrangements with creditors.

47 *Re Bank of Credit and Commerce (HK) Ltd.* [1992] 2 HKLR 46.

48 *Re Canton Trust and Commercial Bank Ltd No. 1* [1965] HKLR 450.

needed was a notice from the liquidator asking a creditor whether he agreed the amount of the debt.

9.97 The section also provides that the relevant date shall have the meaning assigned to it by section 265(6), which provides that in a winding-up by the court the relevant date means the date of appointment of a provisional liquidator, or if no such appointment is made, the date of the winding-up order, unless in either case the company had commenced to be wound-up voluntarily before that date. In any case to which the above conditions do not apply, then the date of commencement of the winding-up applies.

9.98 The problem is that while the assets and liabilities of a bank in liquidation fall to be determined at the beginning of the winding-up, their actual date of determination under the relevant date provision of section 227E is different.

9.99 The problem has been addressed in the following terms:

> *"Logically, the first question that arises in any discussion of Bank of Credit and Commerce (Hong Kong) Ltd (BCC(HK)) is, what is the insolvency date, i.e. the date at which the various procedures in the liquidation are to take effect. Normally of course this would be the date of the winding-up order except in relation to interest, which ceases to run on debts due from the insolvent as from the date of the commencement of the winding-up.*
>
> *In the BCC(HK) case the position is somewhat different. As already noted, BCC(HK) is subject to a regulating order. Accordingly, section 227E of the Companies Ordinance applies to provide a 'relevant date', namely the date of appointment of the provisional liquidator on 17th July 1991. This date is incorporated by reference from section 265(6). The relevant date applies for voting and dividend purposes. The section refers to 'net balances' and probably matters of set-off etc. are also to be determined with effect from that date. The section only applies, however, 'unless and until the Official Receiver or liquidator by notice in writing requires' the creditor 'to make a formal proof of debt'. The somewhat strange situation therefore arises that if the Official Receiver adopts the deeming provisions of Section 227E then the relevant date is 17th July 1991, but if he requires a proof to be filed, then for many purposes the insolvency date will in fact be 2nd March 1992.*
>
> *This distinction can be of substantial significance where for example the creditor is claiming in a foreign currency and there have been large movements in the exchange rate between 17th July 1991 and 2nd March 1992 - for example Canadian Dollars, Deutsche marks or*

Japanese Yen. I should add that BCC(HK) itself appears to have a marked preference for using the date of 17th July 1991 for all purposes.

For completeness, it should not be forgotten that BCC(HK) was wound-up pursuant to the Banking Ordinance as well as the Companies Ordinance. Section 122(3) of the Banking Ordinance provides that for a number of purposes the winding-up shall be deemed to have commenced at the time the Commissioner of Banking took control of the Bank. Fortunately, these purposes do not, following a timely amendment to the Banking Ordinance in 1991, include Sections 264 or 265 of the Companies Ordinance." [49]

9.100 While there is probably no date that would completely satisfy all circumstances, it is unsatisfactory to have a situation where the relevant date can be altered, not to say manipulated. We are of the view that the relevant date should, insofar as possible, be the same in every instance. Section 184 provides commencement dates in winding-up by the court and in voluntary winding-up.

9.101 We **propose** that section 184 should be the benchmark provision for the relevant date.[50] The relevant date for all issues in relation to winding-up by the court should be the date of commencement of the winding-up, that is, the date of the presentation of the petition for winding-up. In a voluntary winding-up, the relevant date should be the date of the resolution to wind-up the company.

9.102 This would also accord with the recommendations in the Commission's Report on Corporate Rescue and Insolvent Trading which recommended that the votes of unsecured creditors should be calculated according to the amount of the creditor's debt at the commencement of provisional supervision. In a case where a liquidator made the proposal for a voluntary arrangement, the relevant date should be the date of presentation of the winding-up petition.[51] It does not, however, accord with the date recommended in the Report on Bankruptcy which recommended that foreign currency debts should be converted into Hong Kong dollars at the date of the making of the bankruptcy order.

Section 227F Application of Ordinance to small windings-up

9.103 The section provides that if the assets of a company are not likely to exceed $200,000, the court may order that the company should be wound-up

---

49 "*BCC(HK) - a Perspective*" *International Insolvency Review* , Autumn 1994, Volume 3, Issue 2, by Mark Bradley, Solicitor, of Deacons Graham and James.

50 This accords with the position under the Insolvency Act, section 129 and the Singapore Companies Act, section 255.

51 *Report on Corporate Rescue and Insolvent Trading*, paragraph 16.35.

in a summary manner. The effect is that the Official Receiver is appointed liquidator; there is no meeting of creditors and consequently no committee of inspection; the Official Receiver doing all things which may be done by a liquidator with the sanction of the committee of inspection. The court may, at any time before dissolution of the company, rescind the order.

9.104 The Official Receiver's Office reports that the vast majority of insolvency cases are unremunerative and fall into this category.[52] The provision is distinguished from the Official Receiver's contracting out of non-summary court winding-up cases to the private sector.

9.105 In cases where the creditors' meeting appoints the Official Receiver as liquidator, the Official Receiver advises the meeting that his role is to monitor and regulate the performance of liquidators or special managers in non-summary cases and that he will apply to the court to appoint a special manager from the panel.

[52] In 1994, 81 per cent of winding-up cases were administered under the summary procedure. In 1995, the figures was 77 per cent and in 1996, the figure was 93 per cent.

CHAPTER 10

RESOLUTIONS FOR, AND COMMENCEMENT OF VOLUNTARY WINDING-UP

Section 228 Circumstances in which company may be wound-up voluntarily

10.1 The section sets out the four circumstances by which a company may be wound-up voluntarily. They are:

- when the period, if any, fixed for the duration of the company by its articles expires or the event, if any, occurs on the occurrence of which the memorandum or articles provide that the company is to be dissolved, and the company in general meeting had passed a resolution requiring the company to be wound-up voluntarily; or

- if the company resolves by special resolution that the company be wound-up voluntarily; or

- if the company resolves by special resolution that it cannot by reason of its liabilities continue in business, and that it is desirable to wind-up; or

- if the directors of the company or, in the case of a company having more than two directors, the majority of directors, make and deliver to the Registrar a statutory declaration under section 228A(1).

10.2 The Hong Kong Society of Accountants has pointed out that the final condition, under section 228(1)(d), which refers to all or a majority of the directors making a statutory declaration under section 228A(1), should be amended because section 228A(1), which was amended in 1993,[1] actually refers to the statutory declaration being made by only one of the directors. We **propose** that section 228(1)(d) should be amended in the manner of section 228A(1) whether or not section 228A is abolished.

10.3 We have one concern with the swearing and written statements of directors under section 228A(1). Section 228A(2) provides that a director making a declaration under section 228A(1) shall be liable to a fine or imprisonment if he had no reasonable grounds for the opinion expressed in the

[1] Ordinance No. 75 of 1993, section 14.

statutory declaration.[2] We do not see why the director making the declaration should be the only one to be subject to this penalty as the statutory declaration only verifies the written statements of the other directors. We **propose** that all directors who make written statements without having reasonable grounds for making the statements should also be liable to the penalty. This proposal would also apply to other winding-up provisions where one director verified the written statements.[3]

Section 228A Special procedure for voluntary winding-up in case of inability to continue business

10.4 Section 228A has attracted a number of submissions, none of them supportive of the provision and all of which advocate abolition or restrictions. For the reason stated below we **propose** that the section, which was introduced under the Companies (Amendment) Ordinance 1984, should be abolished due, in part, to the weight of the submissions but also because other provisions in the Companies Ordinance are adequate for the purposes of winding-up a company efficiently and in a more appropriate manner.

10.5 The section empowers a majority of directors at a meeting, who have formed the opinion that the company cannot by reason of its liabilities continue in business, to resolve and deliver for filing to the Registrar of Companies a statutory declaration by one of the directors verifying written statements signed by the directors resolving that:

- the company cannot by reason of its liabilities continue in business; and

- they consider that it is necessary that the company be wound-up and that there are good and sufficient reasons for the winding-up to be commenced under this section; and

- meetings of the company and of its creditors will be summoned not later than 28 days after the delivery of the declaration to the Registrar.

10.6 The fear expressed by the submissions is that it gives unscrupulous directors the opportunity to wind-up a company, in the period between the date of the resolution and the meetings of creditors and contributories, without reference to either the creditors or the shareholders and perhaps to use the provision their own advantage. The directors, in effect, as agents of the

---

2 The fine is $50,000.

3 See our proposal under section 233, *infra*, at paragraphs 11.3 to 11.9.

shareholders, could take actions that should properly be taken by the shareholders.

10.7 The provision has been described in committee as "*statutory Centrebinding*" in reference to a case in the United Kingdom, which originated, though not in the actual case, a practice whereby unscrupulous liquidators nominated by equally unscrupulous directors could sell off assets of a company at a bargain price to purchasers close to the directors.[4] The United Kingdom insolvency provisions now act to prevent the practice.[5] A 1993 amendment[6] to the section providing that any provisional liquidator appointed under the section must be a solicitor or a professional accountant should have had the effect of cutting down on any abuse of the section that may still happen, but this is questioned in comment made below on the appointment of solicitors or accountants as liquidators.

10.8 The view of the majority of the sub-committee may be summed up in the comment that the section is peremptory, debtor led, paralyses creditors with an inability to apply to the court, causes disputes over fees and causes disputes over the propriety and conduct of liquidators. Questions are also raised as to why a procedure that on the face of it is more expensive to use than other options would be attractive to responsible directors. There is a perception that the procedure has often been used in cases where a winding-up by the court would have been more appropriate.

Minority view

10.9 A minority view was expressed to the effect that it could be useful in the cases of companies which had ceased trading and where the directors had lost interest. By using the provision, the directors could start the winding-up immediately without having to wait for 28 days before a meeting of creditors could be held.

10.10 The Hong Kong Society of Accountants submitted that:

> *"We note that the equivalent of section 228A is not found in the insolvency laws of (other) Commonwealth jurisdictions. Consideration should be given to allowing the contributories of a company or the court to make the final decision as to whether or not a company should be put into liquidation. In compulsory liquidations, contributories and creditors have the opportunity to object before the winding-up order is granted by the court. However, in a section 228A liquidation, once the director's statutory declaration is filed,*

---

4 *Re Centrebind Ltd* [1967] 1 WLR 377.

5 See the Insolvency Act, sections 98, 114 and 166.

6 Ordinance No. 75 of 1995.

contributories and creditors are presented with a fait accompli - the company is placed in liquidation before they meet.

It is proposed that section 228A be amended so that the effect of the filing of the director's statutory declaration would be to enable the directors to forthwith appoint a person to be provisional liquidator; however, the company is not in liquidation until a contributories' resolution for winding-up the company is passed.

If a contributories' resolution for winding-up is subsequently passed, then the commencement date of winding-up should be the date of filing of the director's statutory declaration, so as not to prejudice creditors.

If, however, the contributories wish to reverse the directors' decision to wind-up the company, they should come up with a rescue package. If this is accepted at the contributories' and creditors' meetings, then the contributories, directors or provisional liquidator should subsequently make a statutory declaration that the company is now solvent.

We further propose that once the provisional supervision procedure recommended in the Report on Corporate Rescue and Insolvent Trading is accepted, section 228A should be repealed." [7]

10.11 We do not need to comment on the amendments suggested because provisional supervision is likely to be introduced into legislation before any amendments following as a consequence of this Consultation Paper. If our proposal for abolition is not accepted, we **propose** that the Society's submission be considered further.

10.12 The Legal Aid Department submitted that if the section cannot be repealed, perhaps the introduction of safeguards could be considered. A further submission from Mr Albert Chin[8] submitted that in order to avoid abuse by the company's directors there should only be one type of creditors' voluntary winding-up, that is by resolution of the creditors under section 241 of the Companies Ordinance. That, most of the sub-committee feels, is the best solution.

10.13 The section was recently considered in the High Court where the court commented that "*From its reference to good and sufficient reasons, section 228A appears to envisage circumstances which make it impractical if not impossible to use one of the other provisions.*"[9] We simply note that no other jurisdiction

---

7 Note also the comments of the Hong Kong Society of Accountants at paragraph 13.8.

8 Assistant Principal Legal Aid Counsel in the Legal Aid Department.

9 *Bozell Asia (Holding) Ltd and CAL International Ltd and Another* [1997] HKLRD, 1 at page 10.

seems to have difficulties with using the other provisions for voluntary winding-up.

The introduction of provisional supervision

10.14 The Hong Kong Society of Accountants submitted above that the provision should definitely be abolished once provisional supervision, Hong Kong's form of corporate rescue procedure, is introduced. Certainly, with the introduction of provisional supervision, directors would be provided with an additional option in the event that a company got into financial difficulties, and, as we anticipate that provisional supervision will be introduced as legislation before these proposals, we can see no reason for preserving section 228A.

10.15 In the event that our proposal for abolition is not accepted, we wish to point to some parts of the provision that would require amendment in any event.

Appointment of solicitors or accountants as liquidators

10.16 A submission has been made by Mr John Lees[10] on the amendment to the section by the insertion of sub-section 228A(3C) which reads:

> *"No person shall be appointed to be a provisional liquidator under subsection (3)(b) unless -*
>
> *(1) he has consented in writing to such appointment; and*
>
> *(2) he is a solicitor, or a professional accountant under the Professional Accountants Ordinance (Cap. 50)."* [11]

10.17 The submission points out that:

> *"…this qualification requirement, presumably inserted to ensure that provisional liquidators are competent and have knowledge of the law in Hong Kong relating to liquidations, was not repeated in section 242 which deals with the appointment of a liquidator in creditors' voluntary windings-up. Thus, although it is necessary for the provisional liquidator in a section 228A liquidation to be either a solicitor or accountant as defined, anyone can be appointed as liquidator. This is now more of a problem due to the insertion of subsection 228A(7A) which precludes provisional liquidators from selling property, leaving this power to the subsequently appointed liquidator."*

---

[10] Mr Lees is a partner with Ferrior Hodgson and Marfan, Certified Public Accountants.

[11] Note also the submission of the Hong Kong Society of Accountants under section 242, *infra*, at paragraph 13.8.

10.18 We agree that the amendment has probably not fulfilled all that was intended of it and that, by not requiring that a liquidator should also be a qualified solicitor or accountant, the amendment has not reduced the potential for abuse as much as it might have. We **propose** that, if the section is not abolished, the provisions of subsection (3C)(b) should be applied to the appointment of a liquidator under the section. We note that we have proposed elsewhere that only appropriately qualified and recognised professionals should be appointed as liquidators.[12] That proposal would apply to appointments under section 228A and under section 242.

Penalties under subsection (2)

10.19 We refer to our proposal on the penalties that should attach to directors who make a written statement under subsection (1) without reasonable ground for forming that opinion.[13]

Section 229 Notice of resolution to wind-up voluntarily

10.20 A company shall, within 14 days of passing a resolution for voluntary winding-up, advertise the resolution in the Gazette. The provision is subject to a fine for failure to comply with the requirement.[14]

10.21 The difficulty lies with the 14 day notice period. Practitioners advise that, as the Gazette is only published once a week, on a Friday, advertisements for insertion in the Gazette typically have to be sent to the Government Printer on the Monday morning before publication. If a resolution was made on Thursday, 1 May, it could not be published earlier than Friday, 9 May. This means that the time period for getting the resolution to the Government Printer is tight, as failure to get the advertisement to the Printer before Monday, 5 May, would see the company leaving itself open to a fine as the next Gazette would not be published until 16 May, 15 days after the date of the resolution.

10.22 Balanced against this is the need for notice of resolutions to be given promptly. We note that section 117 provides that certain resolutions of companies under Part IV of the Companies Ordinance requires they be filed with the Registrar of Companies within 15 days of the resolution. Under section 253, a liquidator is obliged to publish notice of his appointment in the Gazette within 21 days. Under section 228A(4) directors have 14 days to publish notice of

---

12 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

13 See, *supra*, at paragraph 10.3 under section 228. Note that a failure by a director to comply with any obligation imposed on him by or under section 228A is an applicable matter for determining the unfitness of a director under the fifteenth schedule to the Companies Ordinance.

14 $10,000 plus a daily default fine of $300.

appointment in the Gazette of a provisional liquidator and of the resolution to wind-up a company.

10.23 We **propose** that notices under this and section 253 should be given within 15 days of the making of a resolution. There is no magic in the number, it just gives those who have meetings late in the working week some breathing space by allowing them to miss one Monday morning deadline without penalty. We can see no reason why the number of days in this section and in section 253 should be different.

CHAPTER 11

DECLARATION OF SOLVENCY

Section 233 Statutory declaration of solvency in case of proposal to wind-up voluntarily

11.1 In order for a voluntary winding-up to be a members' voluntary winding-up, a declaration of solvency must be made at a meeting of directors within the five weeks preceding the date of, and before, the resolution of the directors for the winding-up of a company. The declaration should be delivered for filing with the Registrar of Companies not later than the date of filing of the resolution to wind-up. If these provisions are not complied with, the winding-up will not be considered to be a members' voluntary winding-up and will be treated by the Registrar of Companies as a creditors' voluntary winding-up.

11.2 For directors to make a declaration of solvency, they should have formed the opinion that the company will be able to pay its debts within not more than 12 months from the commencement of the winding-up.

Swearing of the declaration of solvency

11.3 The Hong Kong Institute of Company Secretaries has submitted that it would be useful to explore the possibility of allowing the signing of the declaration after the directors' meeting, as opposed to during, but before the subsequent general meeting. The Institute also drew attention to the difficulty of securing a statutory declaration in the case of directors who are situated overseas.

11.4 The Institute has raised a problem of significant practical importance in terms of members' voluntary winding-up as, under the provisions, it can be difficult to comply with the provisions and a failure to follow the requirements exactly might result in an intended members' voluntary winding-up ending up as what is prosaically known as a "*technical creditors' voluntary winding-up*".

11.5 The difficulty lies with the requirement under subsection (1) that the statutory declaration must be sworn by directors at the meeting of directors. This creates a situation where the required number of directors must all be present at the same time to make the declaration. In practical terms, this can create tremendous difficulties for directors, particularly when they are resident in different countries.

11.6 The Registrar of Companies has advised that there should be one statutory declaration which clearly and unequivocally states that all the directors are swearing to the same thing but that, in practice, the Registrar might accept for filing more than one statutory declaration provided they are in identical terms and presented at the same time.

11.7 The swearing of different statutory declarations still leaves open the possibility of mistakes being made, the consequences of which are that, because of a technical mistake, an intended members' voluntary winding-up ends up as a creditors' voluntary winding-up.

11.8 We believe that the solution already exists under section 228A(1) of the Ordinance. This provides that one director can make a statutory declaration verifying the written statements of the other directors and we **propose** that this procedure should be adopted for declarations under this section subject to the complementary proposal that directors who make a written statement under this section without reasonable grounds for the opinion stated should also be subject to the penalties imposed by subsection (3).[1]

11.9 We **propose** that there should be no requirement that the statutory declaration should be made at the meeting of directors. We **propose** that the statutory declaration should be set out in standard, though not required, form in the Companies (Winding-up) Rules.

[1] A $50,000 fine and imprisonment.

CHAPTER 12

PROVISIONS APPLICABLE TO A MEMBERS' VOLUNTARY WINDING-UP

Section 235 Power of company to appoint and fix remuneration of liquidators

12.1 The section provides for the appointment and remuneration[1] of the liquidator or liquidators at the general meeting. It also provides that on the appointment of a liquidator, all the powers of the directors shall cease except so far as the company in general meeting, or the liquidator, sanctions the continuation of the powers.[2]

12.2 We note that under the provisions for compulsory winding-up by the court no provision is made for the directors' powers to cease. The position in winding-up by the court is that the powers of directors are automatically terminated by the making of the winding-up order at which time the directors are automatically dismissed.[3]

12.3 This is a sufficiently important matter to be referred to in the Ordinance as a director of a company faced with a petition for winding-up by the court should be able to find the answer to this question in the Companies Ordinance.

12.4 We **propose** that express provision be made in the Ordinance to make it clear that the powers of directors cease on the making of a winding-up order. It would make it clearer if the provisions for the ceasing of directors' powers were placed in a single section in those provisions, which apply to all forms of winding-up, even though the terms are different in each form of winding-up.

Section 235A Power to remove liquidator

12.5 The section provides that, in a members' voluntary winding-up, the company may by special resolution remove a liquidator at a general meeting, provided appropriate notice of the resolution is given. The court, however, on the application of a creditor or contributory, may order that the liquidator whom it is proposed to remove should not be removed.

---

1 See our proposals on liquidators' remuneration under section 244, *infra*, at paragraphs 13.19 to 13.23 which would equally apply to liquidators appointed in a creditors' voluntary winding-up.

2 A similar provision is made in respect of creditors' voluntary winding-up under section 244(2).

3 *Measures Brothers Ltd v Measures* [1910] 2 Ch. 248.

12.6 We note that there is no specific provision made in the Ordinance for removal of a liquidator by a meeting called for that purpose by the creditors. We **propose** that such a provision should be made and that Insolvency Act, section 171, which provides that, in a members' voluntary winding-up, a liquidator can be removed at a general meeting summoned for that purpose, should be adopted. A similar provision is also made under Insolvency Act, section 171, in respect of a meeting of creditors in a creditors' voluntary winding-up.

12.7 Under Insolvency Act, section 171, in a members' or creditors' voluntary winding-up, the liquidator does not need to call a meeting but he may be ordered to do so by the court or by, in a members' voluntary winding-up, members representing not less than one-half of the total voting rights of all the members, or, in a creditors' voluntary winding-up, by not less than half in value of the creditors.

Removal of liquidator

12.8 The removal of liquidators is provided for under this section in the case of members' voluntary winding-up, under section 196(1) in the case of winding-up by the court, and under section 252(2) in both forms of voluntary windings-up. We **propose** that, even though the provisions are not the same for every form of winding-up, they should be set out together in one provision.

Section 237 Power of liquidator to accept shares, &c. as consideration for sale of property of company

12.9 This section, which is under the provisions for members' voluntary winding-up, is applied to creditors' voluntary winding-up by section 246.

12.10 The section provides that where in a voluntary winding-up the company is to be sold or transferred in whole or in part to another company in consideration of cash, shares in the transferee, or any other form of arrangement, the liquidator requires sanction from either the shareholders in the case of a members' voluntary winding-up or the creditors in the case of a creditors' voluntary winding-up.

12.11 In a members' voluntary winding-up, a special resolution of members of the company is required. In a creditors' voluntary winding-up, section 246 provides that the liquidator requires either the sanction of the court or the committee of inspection.

12.12 The provision is not used often and we anticipate that the introduction of the Commission's recommendations for provisional supervision would be likely to reduce the use of the provision even further.

Dissent by member of company

12.13 Subsections (3) to (6) provide that if a member is dissatisfied with the terms of the special resolution, he may require the liquidator to either abstain from carrying the resolution into effect or to purchase the member's interest at a price to be fixed by arbitration under the Companies Clauses Consolidation Act 1845. We understand that the reference to this Act will shortly be deleted under adaptation of laws to be introduced consequent on the change of sovereignty of Hong Kong in July 1997.

12.14 The corresponding sections under the Australian and Singapore legislation provide for the dispute to be decided under the arbitration laws of those countries.[4]

12.15 We **propose** that reference should be made to the Arbitration Ordinance[5] in place of the Companies Clauses Consolidation Act 1845

12.16 We **propose** that the provision should be combined with section 246 and be placed under those provisions which apply to all forms of voluntary winding-up.

Section 237A Duty of liquidator to call creditors' meeting in case of insolvency

12.17 The section provides that if a liquidator in a members' voluntary winding-up forms the opinion that the company will not be able to pay its debts in full within the period stated in the declaration of solvency under section 233, he must summon a meeting of creditors and lay before it a statement of the company's assets and liabilities.

12.18 At the meeting, the creditors may appoint another liquidator if they wish to but, in any event, the winding-up would, from the date of the meeting of creditors, continue as a creditors' voluntary winding-up.

12.19 The provision is adequate insofar as it goes but the rules relating to meetings of creditors in the Companies (Winding-up) Rules have not been applied to meetings called under this section.

12.20 The Insolvency Act equivalent, section 95, provides that a liquidator must summon a meeting not later than 28 days after the day on which

---

4 Singapore Companies Act, section 306, and the Australian Corporations Law, section 507.

5 Arbitration Ordinance (Cap 341). Section 18 provides that unless a contrary intention is expressed therein, every arbitration agreement shall be deemed to be final and binding on the parties. There is, however, provision for judicial review of arbitration awards in certain circumstances under sections 23 and 23A.

he formed the opinion; that notice of the meeting should be sent to creditors not less than seven days before the meeting; that the notice be advertised and gazetted; and that the liquidator should provide creditors with all reasonable information concerning the affairs of the company, free of charge.[6]

12.21 The liquidator is also obliged to prepare a statement of affairs in the prescribed form and to lay the statement before the meeting, at which he shall preside. The statement of affairs should contain particulars of the company's assets and liabilities, the names and addresses of creditors and details of any securities held by creditors.[7]

12.22 We **propose** that the Insolvency Act provisions should be adopted.

Section 238 Duty of liquidator to call general meeting at end of each year

Extension of time

12.23 The section provides that where a liquidation continues for over a year, the liquidator shall summon a general meeting of the company within three months of the end of each year but the Official Receiver may extend the time limit.

12.24 The section provides that in the event that a members' voluntary winding-up continues for more than a year, the liquidator shall summon a general meeting of the company and lay before the meeting an account of his acts and dealings and of the conduct of the winding-up to date. The Official Receiver may extend the time for the holding of the meeting. If the liquidator fails to comply with the section, he is liable to a fine of $10,000. [8]

12.25 The Official Receiver's Office has submitted that the references to the Official Receiver in this section and in section 247 should be replaced by a reference to the Registrar of Companies. The Official Receiver's Office also submitted that the Official Receiver should have no involvement in voluntary winding-up apart from supervising the Companies Liquidation Account.

12.26 While we do not necessarily accept that the role of the Official Receiver should be limited to winding-up by the court and to certain aspects of voluntary winding-up, we **propose** that it would be more appropriate in this particular case for the Registrar of Companies to deal with extensions of time both under this section and under section 247.

---

6 Insolvency Act, section 95(2).

7 Insolvency Act, section 95(3) and (4).

8 Note that the section is subject to section 239A, which provides that a winding-up which is converted from a members' voluntary winding-up to a creditors' voluntary winding-up becomes subject to the provisions governing the latter.

12.27 This section is the equivalent of section 247 in respect of creditors' voluntary winding-up. We **propose** that the sections should be combined under the heading of provisions which apply to every voluntary winding-up.

Section 239 Final meeting and dissolution[9]

12.28 The section provides for the dissolution of a company in a members' voluntary winding-up. We have received a detailed submission from the Hong Kong Institute of Company Secretaries on the dissolution of solvent companies, which we address below.[10]

12.29 The Institute has taken issue with the way dissolution is handed at present, in particular with the cost of dissolution, which, the Institute points out, is used in the vast majority of cases by small private companies. We generally support the Institute's submission as it would serve to reduce the costs involved in liquidation in general.

12.30 The Hong Kong Institute of Company Secretaries submitted that:

> *"The formal means by which a company incorporated under the Companies Ordinance may cease to exist is that of dissolution. Prior to dissolution, the Ordinance requires an orderly winding-up of the company's affairs, realisation of assets, settlement of creditors' claims, return of paid up capital and distribution of any surplus to shareholders. Part V of the Ordinance is concerned with these objectives.*
>
> *It should be remembered that Part V deals with the winding-up of all companies incorporated under the Companies Ordinance, i.e. companies limited by shares, limited by guarantee and unlimited companies. Moreover, it should be remembered that the vast majority of companies wound-up are small private companies which have outlived their usefulness, and not the larger, public companies for which the provisions were undoubtedly first designed. Our comments are given in the context of the small, private company where the only creditors are likely to be the Inland Revenue and the shareholders, where shareholders are rarely more than five in number and where the costs of Gazetting will alone exceed the net available assets and so require continued shareholder support if the company is to avoid the*

---

9 We note our comments on the dissolution of companies, *infra*, under section 248, on creditors' voluntary winding-up.

10 We note that the *Review of the Hong Kong Companies Ordinance* has made recommendations for the dissolution of solvent companies. See paragraphs 9.03 to 9.07 of the *Review*.

even more complicated and expensive situation of a creditors' voluntary liquidation. The Commission will no doubt be aware that many advisers (and some company law academics) openly recommend that in the case of modestly capitalised and barely solvent companies the directors should instead petition the Registrar of Companies to use his discretionary powers under section 290.

Whereas the Ordinance provides an efficient means of incorporation, Part V fails to provide an expedient means of permitting the winding-up and dissolution of solvent companies. We feel that it should. Problems include (a) the difficulty of securing a statutory declaration (as defined) in the case of a majority of directors situated overseas, (b) inadvertently filing a statutory declaration after the notice of general meeting resolutions and creating what the Registrar terms as a 'technical creditors' voluntary winding- up'. Furthermore, there is no clear indication as to a dissolution date, a fact which is in turn sometimes responsible for inadvertent breach of section 158(4) in the case of directors of listed companies. Finally, the required wording of general meeting resolutions is such that the cost of advertising required notices in the Gazette is in many cases a complete waste of money. It should be remembered that the text of resolutions and notices is almost identical in every case, and presented in a manner which is hardly conducive towards helping creditors."

Simplified procedure
Inland Revenue

12.31 The Institute submitted suggestions for a simplified procedure for dissolution in the following terms:

- *"directors to draw up a statement of assets and liabilities, reducing all assets to cash balances;*

- *directors to settle all creditors' claims, reduce the balance sheet total to zero;*

- *directors to secure Inland Revenue clearance;*

- *directors to certify under oath that remaining assets comprise cash alone, that the net assets do not exceed the amount of paid-up capital, stating their intention to recommend to the members that the company be wound-up and dissolved, and to file the same with the Registrar, who shall notify the same in the Gazette by way of reference only, for the protection of creditors generally;*

- *the Gazette to list such notifications in alphabetical order;*

- *creditors to have one month in which to object to the proposed winding-up*

- *directors to resolve to wind-up, return capital to shareholders and file notification with the Registrar who shall, upon receipt, dissolve the company and notify the same in the Gazette, again by way of alphabetical listing."*

12.32 The Institute noted that the only significant obstacle to an efficient usage of a regime such as suggested above is the considerable delay experienced in securing clearance from the Inland Revenue Department.

12.33 We **propose** that the Institute's submission should be adopted on the basis that it would satisfy the requirement that the claims of creditors would be satisfied and for the proper dissolution of the company. A problem might need to be overcome in that the Registrar of Companies might take the view that he should not have to pay costs of Gazetting the dissolution. We **propose** that this problem may be overcome by providing that the costs of Gazetting the dissolution could be included in the dissolution fee that would have to be paid by the directors.

12.34 As regards the point that delays are incurred in obtaining security clearance from the Inland Revenue Department, the Inland Revenue Department advised that section 51C of the Inland Revenue Ordinance requires that a taxpayer should retain business records for seven years after the completion of the transactions to which the records relate. As the law stands, however, there is no requirement for liquidators to seek tax clearance from the Inland Revenue Department before they wind-up the affairs of companies.

12.35 The Department added that in most cases it is not interested in dissolved companies as their tax liabilities have usually been cleared. In rare cases, however, where the liquidator proceeds to dissolve a company with outstanding or potential tax liabilities, the Department has a right to reinstate the dissolved company under section 209 of the Companies Ordinance. Upon reinstatement, the company would be regarded as having not been dissolved and section 51C should then continue to apply to it.

12.36 The Department's comments, however, are likely to be of little comfort to a liquidator as he cannot be sure that the company he is liquidating is not going to attract the attention of the Inland Revenue Department. He must therefore obtain a tax clearance certificate. It is beyond our reference to make proposals on the provisions of the Inland Revenue Ordinance. The Hong Kong Institute of Company Secretaries' proposal for a simplified procedure could

provide a solution to the problem in many liquidations. We would therefore welcome comment on the proposal.[11]

Books to be kept

12.37 The Hong Kong Institute of Company Secretaries made reference to contradictions in legislation in relation to the keeping of books. We have commented on the point in our comments on section 283.

Application for deferral of dissolution

12.38 The Institute submitted that the time period within which any interested party can apply to court for deferring the dissolution date should be set out clearly in Part V. Subsection (4)[12] provides for deferral in a members' voluntary winding-up. We consider that no purpose would be served by imposing a time period within which to apply.

Declaration of solvency

12.39 The Institute refers to the declaration of solvency in its submission. We have addressed the points in our proposals under section 233.

Advertising of notice in the Gazette

12.40 We have made proposals as regards the advertising of notices in the Gazette elsewhere.[13] Our proposals would apply to notices under this provision.

Post dissolution

12.41 The Institute submitted that the position and duties of liquidators after dissolution should be set out clearly and that the common law guidelines should be adopted into the Ordinance to assist liquidators.[14] We do not support this suggestion as we consider that it would be a case of over-legislating.

Affairs of the company fully wound up

12.42 We note our proposal in regard to section 248 that the words "*fully wound up*" should be replaced by the words "*has realised all the property of the company, or so much thereof as can, in his opinion, be realised without needlessly protracting the liquidation.*"

---

11 See our comments, *infra*, under section 217.

12 For creditors' voluntary winding-up, see section 248(4) and section 226A(2) in the case of winding-up by the court.

13 See our proposals on the Hong Kong Government Gazette, *infra*, at paragraphs 25.1 to 25.10.

14 Note section 290.

12.43 Our proposal on this matter under section 248, would equally apply to this section.

Combining of this section with section 248

12.44 This section is the equivalent of section 248, which applies to the final meeting and dissolution in a creditors' voluntary winding-up. We **propose** that the two sections might usefully be combined.

CHAPTER 13

PROVISIONS APPLICABLE TO A CREDITORS' VOLUNTARY WINDING-UP

Section 241 Meeting of creditors

13.1 The section provides that a meeting of creditors shall be held on the day of, or the day after, the meeting of the company to resolve that the company should be wound-up voluntarily. Notice of the meeting of creditors should be sent personally to creditors and notice should also be advertised in the Gazette.[1]

13.2 The directors are obliged to provide a statement of affairs to the meeting of creditors which should contain a list of creditors and the amounts of their claims.[2]

13.3 If the meeting of the company at which the resolution for voluntary winding-up is adjourned, and the resolution is passed at an adjourned meeting, any resolution passed at the meeting of creditors held before the adjourned meeting of the company shall have effect as if it had been passed immediately after the passing of the resolution for winding-up the company.[3] The provisions are subject to penalties being imposed on the company or the directors if the provisions are not complied with.[4]

Consequences of adjourned meeting of company

13.4 The Hong Kong Society of Accountants submitted that, under subsection (5):

> *" ...if the meeting of the company at which the resolution for voluntary winding-up is to be proposed is adjourned and the resolution is passed at an adjourned meeting, any resolution passed at the meeting of the creditors held in pursuance of subsection (1) shall have effect as if it had been passed immediately after the passing of the resolution for winding-up the company. It appears from subsection (5) that it may be in order to hold a meeting of a company's creditors under section 241*

---

1 Subsections (1) and (2).

2 Subsection (3).

3 Subsection (5).

4 Under subsection (6) a fine of $50,000 may be imposed. Note that a failure by a director to comply with any obligation imposed on him by or under section 241 is an applicable matter for determining the unfitness of a director under the fifteenth schedule to the Companies Ordinance.

before a winding-up resolution is passed by the company's members. We consider it inappropriate to hold a section 241 creditors' meeting before the members have passed the winding-up resolution and considered the nomination of a liquidator.

If the members' meeting (at which the winding-up resolution is to be passed) is adjourned, we suggest that the creditors' meeting be adjourned to be held after the adjourned meeting of members, but on the same or next day. It is noted that a company only goes into liquidation when a members' resolution for its voluntary winding-up is passed; it would be incorrect to hold a creditors' meeting and pass resolutions on the assumption that the resolution for winding-up would be passed. Additionally, from our members' experience, there is apparently little or no practical use for section 241(5) and accordingly we suggest that it be repealed."

13.5 The situation envisaged by the Society would be a rare event. It is clear that it would be inappropriate for the meeting of creditors to be held before the meeting of the company. We consider that if that were to happen, the meeting of creditors could not transact any business in such circumstances.

Details of the statement of affairs

13.6 Although subsection (3) provides that the statement of affairs shall contain a list of creditors and the amounts owed to them, we **propose** that the statement should be in the prescribed form under the Companies (Winding-up) Rules, form 23. This would provide creditors with the same comprehensive form of statement that would be prepared by a company in a winding-up by the court.[5]

Section 242 Appointment of liquidator

13.7 The section provides for the appointment of a liquidator at the respective meetings of the creditors and the company. The person nominated by the creditors shall have priority but there is also provision for application to the court by any director, member or creditor of the company if that person wants the person nominated as liquidator by the meeting of the company to be made liquidator.

13.8 The Hong Kong Society of Accountants submitted that:

"Section 228A has been amended by the insertion of subsection 228A(3C) which reads;

[5] Note that the Insolvency Act, section 99, makes similar provision.

'No person should be appointed to be a provisional liquidator under subsection (3)(b) unless he has consented in writing to such appointment, and he is a solicitor, or a professional accountant under the Professional Accountants Ordinance (Cap. 50).'

However, this qualification requirement, presumably inserted to ensure that provisional liquidators are competent and have knowledge of the law in Hong Kong relating to liquidators, was not repeated in section 242 which deals with the appointment of a liquidator in creditors' voluntary windings-up. Thus, although it is necessary for the provisional liquidator in a section 228A liquidation to be either a solicitor or an accountant as defined, anyone can be appointed as liquidator. In addition, the insertion of subsection 228A(7A) now precludes provisional liquidators from selling property, leaving this power to the subsequently appointed liquidator. It is equally important that the liquidator appointed under section 242 be qualified in the same way as the provisional liquidators appointed under section 228A.

Although the majority of creditors by value, present in person or by proxy at the creditors' meeting can nominate the liquidator, it would be possible for some, or all of the creditors to be severely disadvantaged if the liquidators were unqualified people. In cases where there is a substantial overseas creditor, it is likely, and it would be possible for him to appoint persons from his own jurisdiction, who may not have any understanding of Hong Kong insolvency law and practice, and who may either be unaware of their obligations under the Companies Ordinance in respect to the filing of documents at the Companies Registry and of their obligation to place undistributed monies on deposit with the Official Receiver, or not be prepared to fulfil these requirements. We believe it is necessary to remedy these deficiencies as soon as possible, and propose that a professional qualification requirement, similar to section 228A, be imposed for all liquidator's appointments, so that only solicitors, professional accountants, and members of similarly regulated professions shall be eligible for appointment as liquidators."

13.9 The Society's submission tends to support our proposals for a comprehensive system of insolvency practitioners to be instituted.[6] Such a scheme would provide for the points raised by the Society.

Section 243 Appointment of committee of inspection

13.10 The Hong Kong Society of Accountants has submitted that:

[6] Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

> *"The provisions relating to the maximum size of the committee of inspection are ambiguous. It is not clear from section 243 of the Ordinance whether the maximum number of members on a committee should be five or 10 (i.e. a maximum of five from creditors and another five from members) in a voluntary liquidation. Under section 207 of the Ordinance, there is no limit in a court liquidation."*

13.11 While it is likely that the section contemplated as many as ten members of a sub-committee, the Society is correct in asserting that the position is not clear. We have proposed, under section 207, that there should be a maximum of five members on a committee and we **propose** that this should also apply to committees appointed under this section. We note that, under subsection (1), if contributories resolve to appoint five representatives to the committee, the creditors can resolve to reject them, at which point the court may be called upon to resolve the issue. Creditors are therefore adequately protected.

13.12 The Hong Kong Society of Accountants also submitted that:

> *"Any procedures specified should ensure that all appointments by creditors to the committee are not controlled by a creditor or group of creditors with a majority in value of claims. In this regard the extent to which related individuals or group companies can participate in voting for committee members should also be considered."*

13.13 We sympathise with the submission but are concerned that it might be difficult to provide for. The nature of the business environment in Hong Kong, with its proliferation of connected businesses, particularly family connections, means that the potential for a body of creditors, representing a particular interest group, taking control of a committee, is not all that remote and we are aware of situations that have arisen where a committee pursued sectional interests rather than represent the interests of all the creditors.

13.14 We do not make a proposal at this stage but we would be interested for views on suggestions that the Ordinance could contain a statement that the general duty of the members of the committee shall be to act in the best interests of all the creditors. This could be supported by specifically providing in section 255 that liquidators would have the right to apply to the court for directions at any time if it became clear that a committee was not acting in the best interests of all the creditors. Such a provision could also apply to section 207.

Proposals under section 207

13.15 We refer generally to our proposals under section 207, all of which would apply to this section.

Section 244 Fixing of liquidators' remuneration and cesser of directors' powers

13.16 Subsection (1) provides that the committee of inspection, or if there is no committee, the creditors, may fix the remuneration of liquidators. Subsection (2) provides that on the appointment of a liquidator, all the powers of the directors shall cease, except so far as the committee of inspection, or the creditors if there is no committee, sanction the continuance of powers.

13.17 The Companies (Winding-up) Rules, rule 146, provides that, in a winding-up by the court, where the remuneration is determined by the committee of inspection, it may be in the nature of a commission or percentage of which one part shall be payable on the amount realised, after deducting any sums paid to secured creditors, and the other part of the amount distributed in dividend. If there is no committee of inspection, the remuneration shall be fixed by the scale of fees and percentages on realisations and distributions by the Official Receiver as liquidator.[7]

Remuneration and cesser of powers to be separated

13.18 This is another section which unfortunately applies to two different concepts. We **propose** that the issues of remuneration[8] and the ceasing of directors' powers should be contained in separate sections.

13.19 In practical terms, a liquidator should agree his remuneration with the committee of inspection on his appointment. If the committee does not fix remuneration initially, the committee can decide at any time how remuneration should be calculated or how it should be paid. Liquidators are either paid by reference to the assets of the company or by the work done in terms of time and expenses. If the committee agrees how remuneration should be calculated there is no basis for a liquidator to demand later that he should be paid in a certain way.

13.20 An example would be where a liquidation continued for several years and the liquidator recovered a great deal of assets. The liquidator suggests that remuneration should be set at 10 per cent of receipts and five per cent of dividends which would give the liquidator a handsome reward for his efforts but the committee of inspection could insist on paying him for his time which would result in a much reduced level of remuneration.

13.21 The Insolvency Act provides a comprehensive provision on the fixing of remuneration in all forms of liquidation.[9] At present in Hong Kong, the Official Receiver in his scheme for contracting out of non-summary court

---

7 Note also the Companies (Winding-up) Rules, rule 147.

8 See section 196.

9 Insolvency Act, rules 4.127 to 4.131.

winding-up cases to the private sector, lays down a scale of fees but this procedure is limited to compulsory winding-up at present.

13.22 Under our proposals on insolvency practitioners, the Official Receiver would regulate the appointment of appropriately qualified persons to act as liquidators, receivers and provisional supervisors. While it is not the intention at present to comprehensively regulate for such matters as fees of liquidators, we **propose** that the regulations should lay down a scale or scales of fees which may be applied to the various forms of insolvency proceedings.

13.23 In the event that a remuneration was not agreed between the liquidator and the committee of inspection in a creditors' voluntary winding-up, we **propose** that the remuneration should be in accordance with the Official Receiver's scale as laid down in the proposed regulations.[10] A creditor, with the concurrence of 25 per cent of all creditors in value, would be entitled to apply to the court if they believed that the fees were excessive.[11]

13.24 We note that the Insolvency Act, rules 4.127 to 4.131, are comprehensive and would fit in with our proposals. The main provisions of the rules are:

- remuneration would be fixed by either a percentage of the value of the assets realised or distributed or of the one value and the other in combination, or by reference to the time properly given by the insolvency practitioner and his staff on the winding-up;[12]

- the form of remuneration would be determined by the committee;[13]

- the committee should be guided by the complexity to the case, any exceptional responsibility on the insolvency practitioner, and the effectiveness with which the insolvency practitioner is carrying out the liquidation;[14]

- fees would be payable where a liquidator sold property on behalf of a secured creditor;[15]

- a liquidator may request a meeting of creditors to increase his fees or he may apply to the court;[16]

---

10 Insolvency Act, rule 4.127(6).
11 Insolvency Act, rule 4.131(1).
12 Insolvency Act, rule 4.127(2).
13 Insolvency Act, rule 4.127(3)
14 Insolvency Act, rule 4.127(4).
15 Insolvency Act, rule 4.128(1).

- a liquidator who is also a solicitor should not be allowed profit costs if he employs his own firm unless authorised by the committee.[17]

Cesser of directors' powers

13.25 We note our comments on cesser of the powers of directors under section 235.

Section 245 Power to fill vacancy in office of liquidator

13.26 No express provision appears to be made in the Ordinance for the resignation of a liquidator in a creditors' voluntary winding-up. The Companies (Winding-up) Rules, rule 154, provides that a liquidator who wants to resign should call separate meetings of creditors and contributories to decide whether or not his resignation should be accepted. If it is accepted, the liquidator shall give notice of the resignation to the court and a copy of the notice to the Official Receiver at which time the resignation shall take effect.

13.27 If the resignation is not accepted by the meetings, the liquidator may apply to the court for a determination whether or not the resignation should be accepted and to give appropriate directions.

13.28 We **propose** that this rule should be adapted for the purposes of creditors' voluntary winding-up.

Section 246 Application of section 237 to a creditors' voluntary winding-up

13.29 We refer to our proposals under section 237.

Section 247 Duty of liquidator to call meetings of company and of creditors at end of each year

Extension of time for meeting at end of year

13.30 We refer to our proposal on extension of time under section 238.[18]

Discretion to postpone holding of meetings for up to three years

---

16 Insolvency Act, rules 4.129 and 4.130.

17 Insolvency Act, rule 4.128(3).

18 See, *supra*, at paragraphs 12.23 to 12.27.

13.31 The Hong Kong Society of Accountants submitted that:

> *"The section should be amended to allow the Official Receiver to exercise discretion to cancel the meetings of creditors and contributories (or one of them) when it is clear that there will not be any return to contributories or the costs of convening these meetings are commercially not justifiable."*

13.32 We agree with the submission and **propose** that the Official Receiver should have the power to dispense with meetings of creditors and contributories in appropriate circumstances subject to there being a meeting at the end of three years if no meeting had been held in the period.

Section 248 Final meeting and dissolution

13.33 The section provides for the dissolution of a company in a creditors' voluntary winding-up.

Affairs of the company fully wound-up

13.34 We consider that the reference in subsection (1) to the affairs of the company being "*fully wound-up*" does not reflect the fact that in many cases there are loose ends in a liquidation that cannot be reconciled with the idea of a company being fully wound-up. We **propose** that the position in practice would be better reflected by use of wording taken from section 205(1) to the effect that a company may be dissolved once the liquidator "*has realised all the property of the company, or so much thereof as can, in his opinion, be realised without needlessly protracting the liquidation.*" This would also apply to the corresponding provision in respect of members' voluntary winding-up under section 239(1).

CHAPTER 14

PROVISIONS APPLICABLE TO EVERY VOLUNTARY WINDING-UP

Section 250 Distribution of property of company

14.1 The section provides that, apart from the provisions for preferential payment of debts in section 265, the property of a company shall, on winding-up, be applied in satisfaction of its liabilities *pari passu*.[1] Subject to that, unless the articles of the company provide otherwise, the property of the company shall be distributed among the members according to their rights and interests in the company.

14.2 We consider that the intention behind this provision has been lost due to the increasing number of preferences provided for in section 265. We **propose** that the section should be moved to form a new subsection (1) of section 265 so as to make clear that the preferences contained in section 265 are exceptions to the principle of *pari passu* distribution.

Application to all forms of winding-up

14.3 The Hong Kong Society of Accountants submitted that:

> *"Section 250 is applicable to voluntary windings-up only. ...In practice, the pari passu principle is also applicable to a winding-up by the court. We therefore propose that the statutory application of the 'pari passu' principle be extended to compulsory windings-up. This would serve as another example of provisions that could be considered for common application to all modes of liquidation."*

14.4 We agree that the section should apply to all forms of winding-up, and, subject to our proposal that the section should be moved to form a new section 265(1), we **propose** that the provision should be placed with those provisions which are applicable to every mode of winding-up.

---

[1] We have noticed that the Chinese definition of *pari passu* under section 250 means "rank equally and at the same time", which accords with the definition of *pari passu* used in the Bankruptcy Ordinance. All other reference to *pari passu* in Chinese in the Companies Ordinance is defined as "rank equally".

Section 251 Powers and duties of liquidator in voluntary winding-up

Powers of liquidator

14.5 This section sets out the powers of a liquidator in a voluntary winding-up by reference to section 199, which provides for the powers of a liquidator in a winding-up by the court.

14.6 We note that we have proposed that the powers of all liquidators, including the powers of liquidators in voluntary windings-up, should be placed together in a schedule to the Ordinance.[2]

Duties of liquidator

14.7 We refer to our proposals on the duties of liquidators under section 200. The duties would equally apply to liquidators in voluntary windings-up as it would to the duties of a liquidator in a winding-up by the court.

Section 252 Court may appoint and remove liquidator in voluntary winding-up

14.8 Subsection (1) provides that if for any reason whatever there is no liquidator acting, the court may appoint a liquidator. Subsection (2) provides that the court may, on cause shown, remove a liquidator and appoint another one.

14.9 Sections 196(1) provides for the removal of liquidators in a winding-up by the court while section 252(2) makes the same provision in the case of voluntary winding-up. We **propose** that they should be combined into one provision applying to all forms of winding-up.[3]

Section 253 Notice by liquidator of his appointment

14.10 We refer to our proposal, explained in our comments under section 229, that notices under this section and section 229 should be given within 15 days of the making of a resolution.

Section 254 Arrangement, when binding on creditors

14.11 The section provides that any arrangement entered into between its creditors and a company which is being wound-up, or about to be wound-up, shall

---

2 See section 199, *supra*, at paragraph 151.

3 Note also section 235A(1) which provides for the removal of a liquidator in a members' voluntary winding-up.

be binding on the company if sanctioned by a special resolution of the company, and shall be binding on the creditors if acceded to by three-quarters in number and three-quarters in value of the creditors. Any creditor or contributory who objects to the arrangement may appeal to the court within three weeks from completion of the arrangement.

14.12 In its Report on Corporate Rescue and Insolvent Trading, the Commission recommended that for a proposal put to creditors for a voluntary arrangement under the recommended provisional supervision procedure, a majority in number and two-thirds in value of creditors present at the meeting should be required for a vote in favour of the proposal.[4] The Commission considered that, while it did not favour a bare majority of creditors being able to alter the rights of creditors, a requirement for three-quarters in value could discourage those who were trying to put an arrangement in place. The Commission was of the view that a majority in number and two-thirds in value of creditors represented a convincing level of acceptance by creditors. We support this view and **propose** that the section should be amended to the effect that a majority in number and two-thirds in value of creditors present at a meeting a creditors should be required for a proposal to be accepted.

Section 255A Audit of liquidator' s accounts in voluntary winding-up

14.13 Subsection (1) provides that the liquidator shall keep an account of his receipts and payments as liquidator, and, subject to subsection (2), cause the account to be audited. Subsection (2) provides that an audit may not be required if the committee of inspection or, where appropriate, the company by ordinary resolution, so determines.

14.14 The Hong Kong Society of Accountants has submitted that:

> *"Section 255A(2) of the Ordinance states that an audit under this section shall not be required if the committee of inspection or, as the case may be, the company by ordinary resolution so determines. It is not clear who should decide whether or not an audit is required in a creditors' voluntary winding-up where there is no committee of inspection. It would seem logical for a decision on the audit requirement to be made, in the case of a creditors' voluntary winding-up, by the committee of inspection or, if there is no such committee, by a meeting of the creditors, and, in the case of a members' voluntary winding-up, by the company by ordinary resolution. Consideration should be given to expanding section 255A to specify who should perform the audit of the liquidator's account, if one is to be carried out, and who should pay for it."*

---

4 See the *Report in Corporate Rescue and Insolvent Trading*, paragraphs 16.35 to 16.37.

14.15 We understand that, in practice, the resolution to wind-up a company invariably makes provision for an audit. In our view, the cost of the audit would be an expense of the company and should be paid for out of the assets of the company under section 256.

14.16 It would be useful for the sake of clarity, however, to make specific provision for an audit and we **propose** that the Society's submission that in a creditors' voluntary winding-up, the committee of inspection, or a meeting of creditors if there is no committee, and in a members' voluntary winding-up, the company by ordinary resolution, should decide on whether an audit is required.

Section 257 Saving for rights of creditors and contributories

14.17 The section provides that the winding-up of a company shall not bar the right of any creditor or contributory to have it wound-up by the court. In the case of an application by a contributory, the court must be satisfied that the rights of the contributories would be prejudiced by a voluntary winding-up.

14.18 In practice, the section is now used as a means whereby employees in a creditors' voluntary winding-up case can apply to the Director of Legal Aid to petition to wind-up a company by the court. When the petition is filed, the employees then qualify for an ex-gratia payment out of the Protection of Wages on Insolvency Fund and the petition is then stayed by order of the court.[5]

[5] *Re Rena Gabriel H. K. Ltd* [1995] 2 HKC 273.

CHAPTER 15

PROOF AND RANKING OF CLAIMS

Section 263 Debts of all descriptions to be proved
Section 264 Application of bankruptcy rules in winding-up of insolvent companies

15.1 Section 263 provides that subject to the provisions on winding-up by the court under section 264, the section applies to every winding-up. All debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or subject to a claim for damages, shall be admissible to proof against the company. A just estimate shall be made, so far as possible, of the value of such debts or claims as may be subject to any contingency or to a claim for damages, or which for some other reason do not have a quantifiable value.

15.2 Section 264 applies the bankruptcy rules to the winding-up of insolvent companies in relation to the rights of secured and unsecured creditors and to debts provable and to the valuation of annuities and future and contingent liabilities.

15.3 The Hong Kong Society of Accountants submitted that:

> *"... in the context of proofs of debt, section 264 of the Ordinance refers to the Bankruptcy Rules without setting out the corporate equivalent of an act of bankruptcy. (We further note the proposed abolition of "acts of bankruptcy" in Chapter 1 of the Bankruptcy Report). Such cross referencing to another legislation should not be used. Another example is the uncertainty surrounding the corporate equivalent of a receiving order."*

15.4 The Hong Kong Association of Banks submitted that:

> *"It has been suggested that the provisions of the Companies Ordinance which cross-refer to the Bankruptcy Ordinance should be codified into a single enactment dealing with company liquidations, thereby avoiding the need to cross-refer to another Ordinance. On balance we would resist this as unnecessary duplication with the danger of the provisions becoming out of synchronisation."*

15.5 We have proposed that the winding-up provisions of the Companies Ordinance, the provisions on receivership under the Companies Ordinance, the

provisions on provisional supervision when they are introduced, and the Bankruptcy Ordinance should be combined in one Ordinance. [1]

15.6 We consider that, since the Review of the Hong Kong Companies Ordinance has made a recommendation along similar lines, it is likely that the amendments coming out of the Commission's final recommendations following on this Consultation Paper will result in a separate Ordinance, perhaps called the Insolvency Ordinance.

15.7 If that is the case, the opportunity should be taken in the drafting process to review all the rules relating to each insolvency procedure and to apply those rules that are compatible to other procedures where possible. Obviously, the fewer provisions there are the easier the Ordinance will be to understand. We have found, however, that while some rules relating to a particular process, such as the rules relating to the petition, could be applied to more than one procedure, not all the rules in a petition in bankruptcy could apply to a petition to wind-up a company by the court.

Section 265 Preferential payments

15.8 The section accords preferential status to a number of different classes of creditors in the distribution of dividends. The section sets out a list of creditors who benefit before other creditors are paid. In a usual case, the largest body of preferential creditors are the employees of insolvent companies who tend to take the largest number and amount of preferences. Employees are compensated for losses by the Protection of Wages on Insolvency Fund before a dividend is paid in a liquidation, in which case the Fund can claim an employee's dividend by way of subrogation. The Government is also accorded a deferred preference and there are other preferences, including specialised preferences that relate only to the insolvency of insurance companies and banks.

Principle of pari passu distribution to be restated

Exceptions to principle only where considerations of maintenance of public order and the prevention of systemic failure are involved

15.9 We consider that the principle of *pari passu* distribution needs to be re-established as the fundamental point of distribution in a winding-up. While we accept that strict application of the principle must be tempered by certain considerations that outweigh the principle, those considerations should be clearly stated. In our view there are only two grounds that carry sufficient weight to justify exclusion from the principle of *pari passu* distribution, the maintenance of

[1] See, *infra*, at paragraphs 31.1 to 31.9.

public order and the prevention of systemic failure in the areas of banking and insurance.

15.10 A number of submissions on the preferential provisions were received, reflecting the importance, and perhaps depth of feeling, that exists in relation to the whole question of preferences.

15.11 We have attempted to establish the effect that preferential payments have on the amounts ultimately received by ordinary creditors. We should point out that our methods are not particularly scientific and are open to correction but the method we used tends to suggest that, depending on the circumstances of a case, ordinary creditors can lose out significantly to preferential creditors.

15.12 The Official Receiver's Office provided details of dividends paid to ordinary and preferential creditors in 20 cases.[2] The 20 cases detail the amounts claimed by ordinary and preferential creditors together with the amounts and percentages of dividend payments that they actually received. The Official Receiver's Office also provided details of the amounts and percentages of dividends that the preferential and ordinary creditors would have received if all creditors had been treated equally.

15.13 We have concentrated on the difference, in percentage terms, between the amounts actually received by ordinary creditors and the amounts they would have received if all creditors had been treated equally. The differences on a case by case basis are startling. Each case, however, had a different set of circumstances in terms of numbers and types of creditors and the amount of money available to them. We consider that it would be wrong to combine the cases to look for averages that might be misleading.

15.14 What is clear is that in every case, apart from L0241/85, where there was a 100% dividend to all creditors, ordinary creditors received less than they would have done if they had been treated equally.

15.15 There were only three cases where the difference between the amounts that ordinary creditors received and would have received if treated equally were less than one per cent.[3] In L0170/90, for instance, ordinary creditors actually received $225,690 and would have received $227,825 if they had received equal treatment, a difference of 0.9 per cent.

15.16 There were eight cases, including the three cases of less than one per cent, where the difference between the amounts ordinary creditors actually

---

2 See annex 2.

3 L0241/85, L170/90 and L366/92.

received and the amounts they would have received if treated equally amounted to less than 10 per cent.[4]

15.17 In four cases, ordinary creditors would have received over 100 per cent more if they had been treated equally. In L0222/91, for instance, ordinary creditors actually received $79,352 but would have received $168,494, a difference of over 100 per cent. The other three cases involved even larger differences.[5]

15.18 Although there are probably a number of ways of interpreting these figures, they suggest that ordinary creditors lose out considerably under the present conditions.

15.19 In general comment on the section, the Official Receiver's Office submitted that:

> *"Section 265 needs rationalisation and simplification so that its provisions are immediately intelligible to someone who has not had many years' daily experience of the operation of the section."*

15.20 The Hong Kong Association of Banks submitted that:

> *"The whole system of preferential creditors in liquidation has become quite complex and difficult to understand and needs to be reviewed. Furthermore, it is time to review the whole rationale for giving employees and government a preferred position. It is difficult to see the justification for such treatment as in many cases delays in making payment to employees are such that hardship is not avoided in all cases. Perhaps now is the time to revert to the traditional principle of pari passu distribution."*

15.21 Section 250, insofar as it relates to the rights of creditors, provides that, subject to the preferential payments provisions under section 265, the property of a liquidated company shall be applied *pari passu* in satisfaction of its liabilities.

15.22 In practice, the intention of the statement of principle in section 250 has been substantially limited by the numerous exceptions under section 265. The introduction of the various preferences has occurred without any overview of the cumulative effect of the preferences having been taken. It is for this reason that we have proposed that before an exemption to the principle of *pari passu* distribution is accepted, it should be subject to the test of whether the exclusion is necessary to prevent systemic failure or to maintain public order.

---

4 The other five cases were L0300/90, L0215/90, L0195/89, L0012/89, and L0363/92.

5 In L0140/89 the difference was over 150 per cent, in L0206/90 the difference was over 200 per cent, and in L0089/88 creditors received $21,381 but would have received $266,192.

We have applied these tests to the individual proposals on the current exclusions in making our proposals below.

15.23 We **propose** that the provisions of section 250 should be given due prominence, which would be achieved by moving the section to form a new subsection (1) of section 265. [6]

15.24 The proliferation of preferences under section 265, while carefully considered in each case, has occurred in piecemeal fashion over a number of years. Some of the preferences have universal application to all liquidations, such as the preferential entitlements of employees, while other preferences are limited to particular types of business, such as the preference accorded to bank depositors.

15.25 In addition to the criteria for exclusion from the principle of *pari passu* distribution, it is legitimate to ask in every insolvent liquidation why the beneficiaries of any particular preference deserve to receive money that would otherwise have been paid to another creditor. In other words, there must be an overwhelming reason for distributing money to Mr A that would have been paid to Mr B if *pari passu* distribution was applied.

15.26 What better right, in the liquidation of a restaurant, does an employee have to a preferential payment than the creditor who supplied the restaurant with its vegetables? Employees might have worked for the restaurant for many years, it is true, but the vegetable supplier could have supplied the restaurant for many years too. The employees might only have had their income from the restaurant to rely on. Equally, the supplier might have relied on the restaurant for much of his business. The employees, however, are offered considerable protection by the preferential provisions. The supplier must wait at the end of the queue to see what is left over for him, as an ordinary creditor, to pay his employees.

15.27 What better right, in the liquidation of a bank, does a bank depositor have to repayment of his debt than the person who supplied the bank with its stationery? The Hong Kong Monetary Authority has stated its view on the need for a preference for deposits below and makes a powerful argument which we accept as justifying an exclusion on the grounds of both maintenance of public order and prevention of systemic failure. The supplier of stationery to a bank that becomes insolvent might also think that he has a good claim for preferential treatment if the business provided by the bank was important to his business but his claim would not fall within the exclusions.

15.28 The reality for both the supplier of vegetables and the supplier of stationery is that they are invisible. They have no lobby group charged with

---

[6] See paragraphs 14.1 to 14.4.

securing a preference. They, like most ordinary trade creditors, do not stand outside Government offices and demand payment of their debts when a debtor goes into liquidation.

Employees / The Protection of Wages on Insolvency Fund Board

15.29 We expect that initial reaction to the idea of removing the preference of employees, the major preference group in most cases, would be that it cannot be done. We consider, however, that there is no further need for the compensation of employees to be in the winding-up provisions. The machinery exists already for the compensation of employees to be dealt with separately under the provisions of the Protection of Wages on Insolvency Ordinance and the administration of the Fund established under that Ordinance.

15.30 A clear distinction needs to be made between the long established winding-up provisions of the Companies Ordinance and the functions of the Protection of Wages on Insolvency Fund, which was established by the Protection of Wages on Insolvency Ordinance in April 1985. The primary purpose of the Protection of Wages on Insolvency Ordinance is to provide for payment of monies from the Fund to employees whose employers become insolvent and for other connected matters. The winding-up provisions provide generally for the realisation and distribution of assets to all creditors, not just employees.

15.31 The Hong Kong Society of Accountants submitted that:

> *"In general, we are against the principle of proliferation of preferential amounts at the expense of the general body of creditors."*

15.32 The Education and Manpower Bureau, however, submitted that:

> *"Under section 265 of the Companies Ordinance, payments from the Protection of Wages on Insolvency Fund have the priority to all other debts in the winding-up of an insolvent company. The Fund makes ex-gratia payments to employees who are owed wages and other termination compensations by their insolvent employers. The Protection of Wages on Insolvency Fund Board has been formed to administer the Fund while the Labour Department is responsible for its daily operation, including the recovery of the maximum amount of payments by way of subrogation under the Protection of Wages on Insolvency Ordinance.*
>
> *The Fund Board and the Labour Advisory Board have recently been consulted and they have endorsed proposals to increase the maximum amount of ex-gratia payments and to extend the period within which an application to the Fund should be made. Our original plan was to*

amend the Protection of Wages on Insolvency Ordinance in the first half of 1996 to effect the changes. However, at the Legislative Council sitting on 31 January 1996 a resolution moved by the Hon LEE Cheuk-yan was passed to increase the maximum amount of ex-gratia payments to a much higher level as compared with the proposal agreed by the Fund Board and the Labour Advisory Board.

The increase in maximum payments and the extension of application period under the Protection of Wages on Insolvency Ordinance have a connection with the winding-up provisions and we are considering proposing amendments to section 265(1) on the maximum limit of preferential payments.

In order to keep in line with changes in wages level and to provide adequate coverage to employees, the maximum payments in relation to arrears of wages, wages in lieu of notice and severance payment covered by the Fund have been adjusted several times since 1985. The latest increases proposed by the Hon LEE Cheuk-yan came into effect on 1 February 1996 and their current limits are $36,000, $22,500 and $36,000 plus 50 per cent of excess entitlements. However, the limits for preferential payments under the Companies Ordinance have not been revised since 1977, resulting in a big gap between the two sets of payments. A table showing their differences is set out below.

Type of Payment	*Maximum amount under Protection of Wages on Insolvency Ordinance as at 1 February 1996*	*Preferential limits under Companies Ordinance*[7]
Arrears of Wages	*$36,000*	*$8,000*
Wages in lieu of notice	*$22,500*	*$2,000*
Severance payment	*$36,000 + 50 per cent of excess entitlements*	*$8,000*

The Fund suffers substantial loss because the rate of recovery from the insolvent employers' assets has declined from 19.4 per cent in 1991/92 to 15 per cent in 1994/95. As the maximum payments from the Fund have further increased in 1995/96, the rate of recovery would continue to drop. The Fund Board felt that the limits for the preferential payments under the Companies Ordinance should be revised, taking into account the interests of other creditors."

15.33 The Financial Services Bureau, referring to the submission of the Education and Manpower Bureau, submitted that its primary concern was to ask the sub-committee to research the original basis for determining the preferential

[7] See also section 38 of the Bankruptcy Ordinance.

payment limits for employees under the Companies Ordinance and the Bankruptcy Ordinance.

15.34 We have been advised by the Official Receiver that the original 1977 limits were set by reference to the wage ceiling for non-manual employees under the Employment Ordinance, which was $2,000, hence arrears of wages and severance pay were set at $8,000, or four times the wage ceiling of $2,000. No reference has been made to the 1953 and 1970 figures but we assume that the same basis was used. In 1990, the distinction between manual and non-manual employees was abolished under the Employment Ordinance and a new wage limit imposed for all workers. It is currently $22,500 and no longer used as a benchmark for statutory limits under the Protection of Wages on Insolvency Ordinance. What has been used from 1993 onwards is the overall median monthly employment earnings, which was $8,000 in January 1996.

15.35 The Hong Kong Society of Accountants drew our attention to a submission it made to the Standing Committee on Company Law Reform (SCCLR) in 1994:

> *"It was reported in its Tenth Annual Report (pages 31-33) that the SCCLR considered a proposal to bring those amounts in respect of arrears of wages, wages in lieu of notice, and severance payments as set out in section 265 of the Ordinance into line with the amounts laid down in the Protection of Wages on Insolvency Ordinance. We note that this proposal was put up to remove the disparity between the preferential payment limits to employees under the Companies Ordinance and the maximum awards to employees under the Protection of Wages on Insolvency Ordinance. We disagree that the preferential limits should be adjusted in line with the Protection of Wages on Insolvency Ordinance.*
>
> *The Protection of Wages on Insolvency Fund was set up as a social welfare exercise, to enable ex-gratia payments to be made promptly to employees who have not been paid wages by reason of the insolvency of their employer. The Fund has two main sources of income, $250 out of the Business Registration Certificate fee and subrogation of the right of employees to priority payments from insolvent estates.*
>
> *Previously, the amount paid out of the Fund could not exceed the limits of employee entitlement to priority claims in insolvency as specified in the Companies and Bankruptcy Ordinances. As a result of lobbying by employee groups, the maximum awards from the Fund have been increased by two amendments of the Protection of Wages on Insolvency Ordinance from the level equivalent to the preferential limits, to significantly higher amounts. ...*

We note that increasing the preferential limits in line with the award under the Protection of Wages on Insolvency Ordinance will help the Fund to increase its recovery from subrogation of preferential rights. However, we do not believe that this is a strong argument for raising the preferential limits for the following reasons:-

(1) It should be noted that the additional cover under the Protection of Wages on Insolvency Ordinance is provided by the increased levy from the business registration fees from $100 to $250, contributed by the business community. Increasing the preferential limits will, in theory, increase the Fund's recovery from the insolvent estate. However, this is at the expense of reduced assets available to the general creditors, and this is a further cost, additional to the increased levy of business registration fees, to the business community. We consider it inappropriate for the Government, having made the policy decision to increase the pay-out from the Fund to achieve a social objective, to then ask the general creditors to pay for the increased pay-out, especially when the Fund has accumulated a significant reserve.

(2) Most liquidations have small assets. Raising employees' preferences by the extent proposed would significantly erode the assets available for general creditors.

(3) The objective of the Protection of Wages on Insolvency Ordinance was to allow prompt payments to employees to relieve hardship brought about by the failing of a business. It should be noted that the purpose of the Fund is to relieve hardship rather than to compensate. Therefore, the speed of pay-out would appear to be more important than the amount. It would seem inappropriate to confuse the issue by trying to tie this in with the insolvency legislation.

(4) We are also concerned that raising the limit by the extent as proposed will lead to abuse. In the case of many owner-managed businesses, the controlling shareholders may allow themselves or their relatives to pose as employees in a failing business and therefore get a first claim of the estate at the expense of genuine creditors.

In general, we are against the principle of proliferation of preferences at the expense of the general creditors, and therefore do not agree that the preferential limits should be raised to the level of the maximum awards under the Protection of Wages on Insolvency Ordinance which may mean in many cases a reduced dividend to the secured creditors.

The expansion of preferential claims goes against the most fundamental principle of insolvency law that on liquidation of a company, every unsecured creditor should have a pari passu entitlement to the assets. The effect of preferential rights is largely to frustrate a primary objective of the insolvency process and to deprive the general body of creditors of any significant interest in the winding-up process. The trend in many countries is moving the other direction, of eliminating preferences and extending the pari passu principle.

We believe there are valid arguments for abolishing employees' preferences altogether, given that:

(1) the Fund already provides relief to employees who have not been paid wages by reason of the insolvency of their employer, of amounts higher than the preferences; and that

(2) most liquidations have small assets. Abolishing preferences would not have a significant effect on the Fund, but would eliminate the associated administrative burdens."

15.36 We have proposed that preferential payments for employees in terms of the Companies Ordinance should be abolished. We have not proposed that employees should not continue to receive compensation when their employer is liquidated.

15.37 The primary legislation for the protection of employees' interests does not come under the winding-up provisions of the Companies Ordinance, it comes from the Fund managed by the Protection of Wages on Insolvency Fund Board under the Protection of Wages on Insolvency Ordinance. In practice, the Fund pays employees compensation for losses incurred under four main categories[8] up to set monetary limits. Employees may claim in a liquidation as ordinary creditors for any amounts over the allowances that remain unpaid.

15.38 The Protection of Wages on Insolvency Fund then has a right to subrogate under section 265 as a preferential creditor for the amounts paid to employees. At present, the amounts that employees are entitled to under the Protection of Wages on Insolvency Ordinance considerably exceed the amounts that the Fund can subrogate for under section 265. This issue is referred to in the submissions above and is addressed below.

15.39 Since its establishment in 1985, the Fund has accumulated assets amounting to $905 million to the end of March 1997, funded by a $250 levy on each business registration certificate. In the year 1996/97, $177 million was

[8] See the table set out in the Education and Manpower Bureau submission, *supra*, at paragraph 15.32.

derived from this source. The Fund had an excess of income over expenditure of over $47 million in 1996/97, down from over $112 million in 1995/96, and over the six years from 1991/92 to 1996/97, the Fund had an excess of income over expenditure of over $599 million, this from a total income of $1,233 million.

15.40 Over that same six year period, the Fund has made payments to employees of almost $556 million but has subrogated for just under $49 million, an average subrogation yield of just under nine per cent of payments to employees. If the Fund Board's subrogation rights were as ordinary creditors in a regime where all unsecured creditors were ordinary creditors, the figures we produced above suggest that the Fund Board would still receive about two-thirds of that amount through subrogation.

15.41 We do not dispute the right of the Fund to subrogate for amounts paid to employees but we consider that the right should not be preferential. If the Fund was an ordinary creditor, it would probably not lose a significant amount income overall in terms of its own income. The net result would be a more equitable distribution of the assets of liquidated companies and an increase in the average dividend paid to ordinary creditors as demonstrated in our calculations.

15.42 We accept that the performance of the Fund would be affected by the greatly increased amounts of compensation that employees can now claim under the Fund but we consider that the Fund has the assets to meet those payments without the need for a preference. If, at any time, the Fund runs short of assets to pay compensation to employees, that would be the time to consider increasing the levy on business registration certificates or other sources but that issue is outside our terms of reference.

15.43 We would strongly refute any suggestion that there should be a connection between amounts that employees can claim from the Fund and preferential payments under the Companies Ordinance and we support the Hong Kong Society of Accountants' submission.

15.44 We find no merit in any argument which effectively maintains that it is fair and reasonable to take money legitimately due to all unsecured creditors to favour one type of creditor, employees, who are already adequately protected by the well financed Fund established for that purpose. This would appear to be the effect of the submission of the Education and Manpower Bureau, which is naturally concerned that the increase in amounts that can be claimed by employees under the Protection of Wages on Insolvency Ordinance is not in accordance with the amounts for which the Fund Board can subrogate for under the Companies Ordinance.

15.45 As we have said, the two provisions are not as connected as might appear to be the case at first glance. We would also point to the Bureau's comment, in the final paragraph of its submission, that the interests of other

creditors should be taken into account. We suggest that the effect of our proposals is to take the interests of all creditors into account, perhaps for the first time in many years.

15.46 We consider that the Fund is adequately covered. The figures show that the Fund does not need the protection of a preference under section 265, but this is a point that would not have been known when the Fund was established. We would suggest that the Fund is now on such sound financial ground that there is no good argument for keeping the preference.

15.47 In the course of the preparation of this Consultation Paper the economy of Hong Kong has suffered a serious downturn. The impact of the downturn, which we are aware will result in a larger number of claims against the Fund than has been the case in recent years, will be interesting to observe, as it may resolve the argument about whether or not the Fund is adequately funded.

15.48 We should add that we have made our views known in advance to the Protection of Wages on Insolvency Fund Board. The Board has responded that it strongly supports the current policy that protected claims be given preference over unsecured creditors. The Board's maintains that in the insolvency of an enterprise, employees will suffer most as they not only lose their jobs but also their only source of income. The Board also comments that its desire to increase the preferential levels under the Companies Ordinance only seeks to restore the real value of preferential limits which have not been revised for two decades.

Insurance

15.49 The Commissioner of Insurance has explained that the Companies (Amendment) (No.3) Ordinance 1988 accorded preferential status to persons with insurance claims under a contract of general insurance business. The preferential status was given to persons with insurance claims in order to protect and retain the Hong Kong assets for them, particularly in the case of a branch office of an overseas insurance company. It was considered that, under the then winding-up rules, Hong Kong insurance claimants were very exposed in the liquidation of an overseas insurance company having a branch operation in Hong Kong.

15.50 This was because there was no requirement in the winding-up rules that all the liabilities of the insurance company's local branch had to be met before assets were withdrawn from Hong Kong. The provisions enabling the Hong Kong court to wind-up overseas companies with assets in Hong Kong might not therefore provide a sufficient safeguard to meet domestic liabilities. The Hong Kong insurance claimants would receive very little or nothing in the liquidation of an overseas insurance company because the assets withdrawn from Hong Kong would be used to pay off in priority all preferential creditors in its

country of incorporation, including insurance claimants in that place. There was therefore a need to protect local insurance claimants.

15.51 To strengthen the protection to local insurance claimants, an amendment was made to the Insurance Companies Ordinance in 1994 to require all insurance companies carrying on general insurance business to maintain assets in Hong Kong to match these local liabilities. The objective was to ensure that in the event of liquidation of an insurance company, the assets retained in Hong Kong would be sufficient to meet the claims of the Hong Kong insurance claimants. The objective would be entirely defeated if the preferential status of local insurance claimants were to be removed.

15.52 The Commissioner of Insurance maintains that:

> *"Insurance is very important to every walk of life. A contract of insurance is not an ordinary contract for the supply of goods but rather a contract for financial protection against some future mishaps. Insurance is bought by both individuals and business enterprises to cover those financial losses which they cannot afford to suffer.*
>
> *Insurance also offers a very strong support to the development of new business ventures as their owners know they are fully protected against any risks associated with them. It plays a very important role in ensuring that any innocent third parties injured or affected in an accident would be properly indemnified, for example, under the different classes of compulsory insurance business in Hong Kong including motor and employees compensation. The protection to employees offered by the Employees Compensation Assistance Ordinance is also built on the preferential status of insurance claimants. it would be disastrous and extremely socially undesirable not to maintain their preferential status.*
>
> *Insurance is a regulated business and the need for better protection to insurance claimants is recognised in most major overseas countries, such as Singapore, Malaysia, Japan, and the United Kingdom, where they are invariably accorded a preferential status or other similar protection. It is therefore our strong view that the preferential status of insurance claimants should be maintained."*

15.53 We understand that part of the impetus behind the introduction of the insurance preference resulted from a series of liquidations of insurance companies in the mid-1980's.[9] We accept that the insolvency of insurance

[9] The Official Receiver advises that there were 10 insurance companies wound-up between 1980 and 1990, the largest of which were *Singapore Insurance Co Ltd* (Liquidation No. 29 of 1980), *Scotland Insurance Co Ltd* (Liquidation No. 20 of 1983*, China Underwriters Life and General Insurance Co Ltd* (Liquidation No. 240 of 1983), *Bedford Insurance Co Ltd* (Liquidation No. 111

companies poses special difficulties and that our tests of maintenance of public order or prevention of systemic failure dictate that the insurance companies preference should be maintained. We note that retention of the preference would have no impact on the vast majority of windings-up.

Bank depositors

15.54 Certain bank deposits are now afforded preferential status under subsections (1)(db), (5D) and (5E) which were introduced in 1995.[10] The subsections give a preference to amounts held on deposit with an insolvent bank up to a maximum aggregate of $100,000 for each depositor, no matter how many accounts a depositor has with the bank. We understand that the $100,000 amount is an amount that would remove about 95 per cent of creditors from any banking liquidation. Unlike most other companies that are wound-up, amounts owed to bank depositors are simple to ascertain through bank records and in the vast majority of deposits there is no dispute as to the amount.

15.55 The Hong Kong Monetary Authority has submitted that

> *". the scheme for priority claims for small depositors, which is now provided under section 265(1)(db) of the Companies Ordinance, should remain in the winding-up provisions. You may also wish to note that we are now considering the issue of a guideline to banks to ensure the they have sufficient assets in Hong Kong to fulfil the requirement for priority payment to small depositors under section 256(1)(db). We may also require banks to maintain sufficient liquefiable assets in Hong Kong so that they will be able to make interim urgent payments to depositors for emergency needs as in the case of BCC (HK) Ltd."*

15.56 The Hong Kong Monetary Authority has stated that the banks provide the principal means by which corporate and individuals' surplus resources provide the liquidity necessary in the economy. The collapse of a bank can adversely affect not only individual depositors but the economy as a whole and, for these reasons, a comprehensive scheme of supervision exists within Hong Kong and other leading financial centres.

15.57 Most individuals and companies choose to open a deposit account with a bank. Many individuals place a significant part of their surplus funds, if not all of them, with one or perhaps two banks. The consequence to them of a collapse of that bank or those banks and their inability to repay those deposits is therefore potentially disastrous. The knock-on effect on their creditors can lead

---

of 1984), *Armour Insurance Co Ltd* (Liquidation No. 139 of 1990). More recently there have been *Kanse General International Co Ltd* (Liquidation No. 308 of 1995) and *North Atlantic Insurance Co Ltd* (Liquidation No. 139 of 1990).

[10] Companies (Amendment) Ordinance 1995, section 16.

to waves of bankruptcies which can have serious implications for the banking system and the economy.

15.58 Individuals respond differently to this type of loss. At worst, there are public order implications. Most developed banking centres have schemes providing limited protection for depositors in public deposit-taking institutions. For example, the depositor protection scheme in the United Kingdom takes the form of a fund contributed to by banks which can be used to make good the losses of small depositors. The introduction of such a scheme in Hong Kong has been discussed with the banks. However, there was no widespread support for such a scheme. The priority scheme was then introduced as an alternative. Similar arrangements exist in countries such as Switzerland and Australia (the recent Wallis inquiry into the Australian financial system has not only supported the statutory preference for depositors in banks, but has suggested that it be extended to building societies and credit unions).

15.59 The Authority appreciates that the banks' general unsecured trade creditors are arguably the ones to suffer as a result of these priorities but there were two points to be made on this. First, they usually have a choice as to whether or not they enter into a commercial transaction from which they expect to receive a commercial profit. The depositor has to use the banking system. Second, the contraction of the economy attendant on the collapse of a bank may well have repercussions for those commercial creditors that go beyond the immediate reduction in their ability to recover from the stricken bank's liquidator. It is arguably in their interests that large numbers of depositors are not reduced to bankruptcy over night. The advantages to them and the public of the maintenance of public order are obvious.

15.60 We accept that the banking system is an area where there are implications for the economy as a whole which go beyond narrow insolvency considerations and that the tests of the prevention of systemic failure and the maintenance of public order apply to the banking sector as to no other commercial activity in Hong Kong. We therefore **propose** that the banking preference should be retained and note that, as with insurance, the preference would apply in a very small number of cases.

The Government

15.61 Under subsection (1)(d), the Government has a preference for all statutory debts due from a company within 12 months before the company is wound-up.

15.62 The Hong Kong Society of Accountants submitted that:

> *"Consideration could perhaps be given to reducing the current preferential claim time limit of 12 months for all Government debts, in*

the light of a world-wide trend in insolvency law to abolish priority of Government debts. For example, in Australia, tax priority under section 221P of the Income Tax Assessment Act was abolished in July 1993."

15.63 The Commissioner of Inland Revenue has laid out reasons justifying the Government's preferential status. The Commissioner stated that he supported the principle of *pari passu* or equal distribution of assets of insolvent companies and persons to creditors, unless there were compelling reasons to do otherwise. The Commissioner considered that certain debts owed to the Government were compelling enough to attract a preference.

"An immediate exception is the preferential treatment in respect of wages payable to an insolvent company's employees which fully justifies a departure from the principle of pari passu on social or compassionate grounds.

Debts due to the Government can be divided into two categories, the first being ordinary debts due to the Government as an ordinary creditor, and the other being taxes and duties due to the Government by an insolvent as a tax payer or duty payer. A debt under the first category may arise from the supply of goods or services by the Government, for example, an unpaid water charges bill. In such cases, the Government is in no different position from any other creditors of the insolvent and therefore should be treated pari passu in the distribution of assets.

The case of taxes and duties is quite different. A tax or duty represents a civic obligation owed to the country. It has its social or fiscal objectives to play in terms of re-distribution of income and wealth, etc. The public interest requires that what is due to the Government by way of taxes and duties are fully paid. That is precisely why taxes and duties are always treated differently from ordinary debts and the Government is given wide powers of recovery, including the issue of departure prevention directions, in the tax statutes. The successful recovery of taxes by the Government is not just for the benefit of its coffer, but for the benefit of the public at large. As a matter of fact, the collections of the Inland Revenue Department contribute very significantly to the general revenue of the Government each year; more than 60 per cent. Any irrecoverable defaults by a certain group of taxpayers will inevitably and inequitably fall on other fellow taxpayers.

On the philosophical side, a tax debt needs to be protected in the case of insolvency. Unlike an ordinary creditor in business with a company, the Inland Revenue Department usually has no dealings with the

company throughout the year and hence does not know or become aware of its financial position. Also, the Inland Revenue Department cannot take steps to secure the tax debts by means of mortgages, charges, etc. which other creditors may be able to arrange. By the time the company returns its trading results to the Inland Revenue Department, it would be at least several months after the close of its accounts and therefore even if the Inland Revenue Department knew that the company was insolvent, it could do practically nothing to protect the revenue by then. Section 265(1)(d) which accords, and indeed restricts, priority to, among other things, tax debts that are due within 12 months next before the relevant date, is fair and reasonable in the circumstances.

When other tax administrations around the world are looked at, it can be confirmed that Hong Kong is not unique in granting preferential entitlement to tax debts in insolvency cases. Under sections 726 and 507(8) of the United States Bankruptcy Code, taxes of various kinds are ranked preferential just after the claims for employee benefits such as wages and salaries. Similarly, the Insolvency Act 1986 gives preferential treatment to taxes such as 'Pay As You Earn', Value Added Tax, employment regulation payments, etc. Other examples are found in the legislation of Canada, Australia and China.

If it is considered that the words 'all statutory debts' appearing in section 265(1)(d) are too wide, the Department would have no objection to having this section suitably amended so long as it covers at least the taxes and duties chargeable under the various tax Ordinances."

15.64 The Cork Report[11] was strongly opposed to Government debts, having a priority. It appears that many of the Cork Report's specific recommendations for the reduction of the number of Crown preferences was initially accepted but that since the introduction of the Insolvency Act 1986 there has been a proliferation of new Crown preferences. The comments set out below are extracted from the Cork Report:

"We unhesitatingly reject the argument that debts owed to the community ought to be paid in priority to debts owed to private creditors. A bad debt owed to the State is likely to be insignificant in terms of total Government receipts; the loss of a similar sum by a private creditor may cause substantial hardship, and bring further insolvencies in its train.

[11] *The Cork Report*, paragraphs 1410 to 1426.

It is the fact that the Government is an involuntary creditor in respect of unpaid tax. Unlike other creditors, the Revenue cannot choose those with whom it will transact business. The Government is not alone in being an involuntary creditor. Many suppliers of goods and services are constrained to extend credit facilities in accordance with the custom of the trade.

In our view, the ancient prerogative of the Government to priority for unpaid tax cannot be supported by principle or expediency, and cannot stand against the powerful tide calling for fairness and reform.

In certain special cases, however, such as PAYE, National Insurance contributions, value added tax and car tax, different considerations obtain. In these cases, the Government's claim is for moneys collected by the debtor, whether by deduction or charge, and for which the debtor is accountable to the Government; the debtor is to be regarded as a tax collector rather than a taxpayer. We cannot think it right that statutory provisions enacted for the more convenient collection of the revenue should enure to be benefit of private creditors.

The arguments against the retention of any general preference for unpaid tax apply with even greater force to general rates. Rates are payable in advance at intervals of six months, though there is provision for domestic rates in arrear by monthly instalments. There is therefore no reason for large arrears to accumulate. Moreover, rating authorities have statutory rights of distress and other summary remedies available to them for the recovery of unpaid rates."

15.65 We agree with the Cork Report to a great extent. We note, however, the distinction made in both the Cork Report and the submission of the Commissioner of Inland Revenue in relation to debts due to the Government which may be classed as ordinary debts due to the Government and those debts which arise in respect of taxes and duties. The Government does not make as extensive use of companies as tax collectors as is the case in other jurisdictions in respect of, for example, deduction from salaries of tax due from employees (PAYE), but the question does arise in certain cases. Obvious examples are departure taxes collected by airlines on behalf of the Government and the duty collected for Government by road toll operators.

15.66 We consider, however, that a preference accorded to the Government in respect of the collection of such taxes is not justifiable under our public order and systemic failure criteria as the Government is not forced to use companies to collect taxes. The Government presumably finds it convenient and efficient to collect taxes in this way and it is therefore reasonable for the Government to assume a certain level of risk in such operations, similar in many

ways, to the sort of risk assumed by suppliers and other habitual ordinary creditors who supply goods and services to other companies. Accordingly, we **propose** that the Government's preference for all debts due to it, no matter how they arise, should be abolished. The Government could still claim as an ordinary creditor.

15.67 We can see no justification for the Government having a preference over, say, a small business which has also been unable to collect on its debt. In our view, by taking a preference over the small business, the Government is taking money out of the pocket of the ordinary creditor. There is no element of fairness involved in this preference, it is simply a matter that the Government knows that it will be a creditor in a certain number of cases at any given time and it has moved to protect its position.

15.68 We have no doubt that the amounts recovered by the Government as a preference creditor have barely any impact on overall Government revenues. The significant figure is the difference between the amount the Government recovers in all liquidations as a preferential creditor, less the amount it would have received as an ordinary creditor.

15.69 The unfortunate ordinary creditor never knows where misfortune will strike, must do business, must take risks in supplying goods on credit, and must know that, in the event that the risk goes bad, every other creditor with a bit of influence will get paid first. In that sense the ordinary creditor is in much the same position as pointed out by the Commissioner of Inland Revenue: he usually is not aware of a debtor's financial position despite his dealings with the creditor. The difference between an ordinary creditor and the Government is that the ordinary creditor has already paid for the goods or services that constitute the debt; the Government cannot readily make that claim.

Fines

15.70 Fines are also provable debts recoverable as a deferred debt by the Government under section 265(1)(d). The Report on Bankruptcy recommended that fines should not be provable in a bankruptcy and should not be released by a bankrupt's discharge.[12] The intention behind the recommendation was that a bankrupt should not benefit from bankruptcy by only paying a proportion of any fines in the form of a dividend. The same situation does not apply to companies in liquidation, however, as they are unlikely to emerge from liquidation. If fines were not provable in liquidation, the result would be that the fines would be lost to the Government, which we see as being unfair. We therefore **propose** that fines should be provable in winding-up but only as an ordinary debt.

---

12 *Report on Bankruptcy*, paragraphs 15.29 to 15.40.

Companies Registry

15.71 Under subsection (1)(da), when a company is revived within 20 years of being struck off under section 290A(6), the fee payable under the section may be claimed by the Registrar of Companies as a preference.

15.72 This preference was introduced in 1993[13] to recover a particular fee payable to the Registrar of Companies for the revival of companies. We have difficulty understanding why this preference was introduced. From what we can gather, the only way that the debt could arise is if the revival fee was paid for by a cheque which was subsequently dishonoured. The preference is unnecessary as the Registrar of Companies could simply wait for cheques to be cleared before he revived a company and, probably, in practice, it takes longer to complete the revival exercise than it does to clear a cheque. The matter should be dealt with internally.

15.73 In addition, a debt due to the Registrar of Companies can be claimed as a statutory debt due to the Government under subsection (1)(d). By providing for the debt under subsection (1)(da), it appears that the Registrar of Companies has secured a preference lower in priority than he would have had under subsection (1)(d), by virtue of subsection (3A). The preference should be abolished for the same reasons that the preference for other Government debts should be abolished.

Distraint / landlords

15.74 Sub-sections 265(5) and (5A) provide a preference for landlords and others who distrain on the goods or effects of a company. The effect of the subsections is that where goods are distrained against within three months before the date of the winding-up order, subsection (5) creates a charge over the proceeds of the distraint which must be used to pay all debts which are given a preference under the section before the proceeds can be used to pay the creditor who initiated the distraint. The distraining creditor who initiated the distraint then has a preference on any balance of the proceeds remaining in priority to all other creditors. The distraining creditor also has a claim in preference to all other non-preferential creditors for any amount that has been taken from the proceeds of the distraint to pay preferential creditors under the section.

15.75 This has the effect of placing the proceeds of a distraint made within three months of the winding-up order in a sort of "quasi-preferential" position.

15.76 The Hong Kong Association of Banks submitted that:-

---

[13] Ordinance No. 10 of 1993, section 2.

"The position of a landlord distraining for rent should be re-considered. A landlord distraining for rent is not in a different position from a normal judgment creditor enforcing his judgment but in a liquidation he is as a matter of law given a higher priority than a judgment creditor."

15.77 Commenting on the terms of the preference accorded by these provisions only, we **propose** that the preference should be abolished. By that, we mean that any proceeds of a distraint made within three months of a winding-up should be considered to be part of the assets of the estate of the company if it has not been paid out to the distraining creditor by the date of the commencement of the winding-up, as opposed to the date of the winding-up order.

15.78 If our overall proposal for the abolition of all preferences is not followed, we **propose** that the quasi-preference given under these subsections should be abolished with the effect that, if the proceeds of distraint become available to the estate of a company, no preference should be accorded to the distraining creditor for any amount applied to paying other preferential creditors, or in respect of any balance remaining. The distraining creditor should not have any form of preference for proceeds distrained against but available to the estate.

Priorities of debts

15.79 The Hong Kong Society of Accountants submitted that:

"Section 265 is now a very complicated and cumbersome section. We propose that this section be redrafted along some basic underlying principles, such as follows:

(1) the priority of payment of costs, expenses and creditors' claims in a liquidation be dealt with in a linear order of priority of payments;

(2) all references to amounts be excluded from this section and be placed in a separate schedule, to facilitate future revisions to these amounts by subsidiary legislation;

(3) the number of classes of priority creditors should be reduced for specified debts. This would better reflect the principle of pari passu than is presently the case;

(4) debts within each class should 'rank equally among themselves' (pari passu principle);

(5) debts within the class should be paid in full unless the assets are insufficient to meet them, in which case they should be abated in equal proportions among themselves; and

(6) it would be beneficial to merely allow as the preferential amount an amount in total which is outstanding to employees. This amount may be made up of holiday pay, severance pay, wages etc. due as at the date of liquidation. This would further simplify calculation of priorities and ensure that set limits are also easy to understand and amend in the future."

15.80 We simply note the submission for the purposes of the Consultation Paper as our proposal is for abolition of preferences. If that is not accepted, it would be worth considering the Society's proposal as a means of making the preferential provisions understandable.

Bankruptcy Ordinance

15.81 These proposals should also be applied to section 38 of the Bankruptcy Ordinance, which contains the equivalent provisions.

CHAPTER 16

EFFECT OF WINDING-UP ON ANTECEDENT AND OTHER TRANSACTIONS

Section 266 Fraudulent preference
Section 266B Fraudulent preference deemed to be an unfair preference

16.1 This provision was recently amended by replacing the former provisions on fraudulent preference with provisions which relate to unfair preference. The Companies Ordinance provisions came into effect on 10 February 1997 as a consequence of the amendments made by the Companies (Amendment) Ordinance 1997 and the Bankruptcy (Amendment) Ordinance 1996.

16.2 The Bankruptcy (Amendment) Ordinance 1996, section 76, amended the Companies Ordinance by adding a new section 266B which provides that fraudulent preference under section 266 is deemed to be an unfair preference. The effect is that where a company is wound-up and it has, at the relevant time, given an unfair preference to any person, the liquidator may apply to the court for an order that the position should be restored to what it would have been if the company had not given the unfair preference.

16.3 The reference to "fraudulent", and therefore the implication that an improper motive must be shown, has been removed. Under the new provision, a liquidator does not even need to show that the dominant intention was to give one creditor a preference but only that the company was influenced by a desire to bring about a preference.

Disqualification of directors

16.4 The fifteenth schedule to the Companies Ordinance, sets out matters for determining the unfitness of directors. A director may, under section 168H, be disqualified by the court, for between one and 15 years, from acting as a director if he has been responsible for a company, among other things, entering into any transaction or giving a preference, being a transaction or preference liable to be set aside under section 182 or section 266. The Official Receiver's Office Annual Report for 1996/97 reports that one director was disqualified for five years under this provision. This appears to have been the only disqualification for this kind of conduct under section 266 since section 168H was introduced in 1994.

Unfair preference to creditors, sureties or guarantors

16.5 A company gives an unfair preference if the person given the preference is one of the company's creditors or a surety or a guarantor for any of the debts of other liabilities of the company, and the company does something which has the effect of putting that person into a position which, in the event of the company being wound-up, is better than the position he would have been in if that thing had not been done. The new bankruptcy provisions, sections 51A(e) and (f), will give the court power to re-impose obligations on a guarantor or surety if the original obligations had been released or discharged by a transaction which was subsequently overturned, and to reinstate a security with the same priority as a former security or charge.

Company influenced by a desire to give a preference

16.6 The court will only make an order under the section if the company giving the unfair preference was influenced in deciding to give it by a desire to put the person into a better position than he would have been in.[1]

Preference to an associate

16.7 If the person preferred is an associate of the company, otherwise than by reason of being an employee, the desire to put the person into a better position is presumed, unless the contrary is shown.[2]

Relevant time

16.8 The relevant time referred to above is two years before the date of the presentation of the petition to wind-up a company in respect of a person who is an associate of the company, and six months before presentation in respect of anyone else.[3]

16.9 We have received a number of submissions, all of which support the idea of introducing effective provisions to facilitate the recovery of company property that has been misapplied.

16.10 The Hong Kong Association of Banks submitted that:

> *"The law relating to fraudulent preference needs to be re-considered. Consideration should also be given to creating a presumption of preference in relation to transactions with certain connected parties."*

---

1 See section 50(4) of the Bankruptcy Ordinance (section 36 of the Bankruptcy (Amendment) Ordinance 1996).

2 See section 50(5) of the Bankruptcy Ordinance.

3 See section 51 of the Bankruptcy Ordinance.

16.11 The Law Society's insolvency committee submitted that:

> *"Reform of the system of fraudulent preference is long overdue and Hong Kong should move towards the English or Australian system where the onus on the insolvency representative to establish intention is reduced."*

16.12 The Official Receiver's Office submitted that:

> *"It is suggested that section 266 be replaced with a provision along the lines of section 239 of the Insolvency Act 1986."*

16.13 The Hong Kong Society of Accountants submitted that it had previously made an extensive submission on issues relating to fraudulent preference and other issues in relation to the sub-committee's Consultation Paper on Corporate Rescue and Insolvent Trading. The submission effectively supports the views expressed in the other submissions referred to here.

16.14 We support the intentions underlying the changes that have been made recently. The proposals made below would complete the process started by the recent amendments. There is a need to strengthen the Companies Ordinance provisions to allow insolvency practitioners to recover assets which have been the subject of a preference by a company prior to liquidation.

16.15 Fraudulent preference was examined in detail in the Cork Report and commented on in the following terms:[4]

> *"Since ... 1883, it has been irrelevant whether or not the creditor alleged to have been 'fraudulently preferred' knew or suspected that this was the case; so that the element of fraud, if present at all, refers exclusively to the state of mind of the debtor himself or, in the case of an insolvent company, to the state of mind of those of its directors who made the relevant decision to 'prefer' the creditor in question. Even in relation to their state of mind, however, the word 'fraudulent' is inappropriate. ... In many cases, however, transactions designed to prefer particular creditors have been inspired by motives which, according to ordinary notions, would not be thought to be deserving of moral censure.*
>
> *In our view the word 'fraudulent' in this context is inaccurate and misleading, and we are satisfied that its use has unfortunate consequences. We believe that many creditors who have been unfairly preferred, and who would otherwise readily agree to repay moneys paid to them shortly before the bankruptcy, may be reluctant to do so*

[4] See *the Cork Report*, paragraphs, 1241 to 1277.

when they mistakenly suppose to be a charge of fraud against themselves is involved. We recommend that in future the word 'fraudulent' should no longer be used in this context, and that it should be replaced by the word 'voidable'. ...

It should be observed that ...payments made in the ordinary course of business and without pressure on the part of the creditor would continue to be irrecoverable.

The majority of the Committee have therefore reached the conclusion that the requirement of an intention to prefer should be retained, and that genuine pressure by the creditor should continue to afford a defence. Their reasons for reaching this conclusion are as follows:

(1) The law should not lightly permit the recovery of payments made in discharge of lawful debts properly due when the payment was made, particularly since the creditor may well have used the money to pay his own creditors. Such payments should be recoverable only if really improper.

(2) The creditor who is active to obtain payment of his own debt ought in principle to be allowed to retain the fruits of his diligence. He ought not to be made to refund them for the benefit of others who were less diligent.

(3) Creditors who delay taking steps to obtain payment of their own debts, whether by commencing insolvency proceedings or otherwise, take the obvious risk that the debtor will pay other creditors in the ordinary course of business or in response to commercial pressure. But there is no reason why they should expose themselves to the risk that he will put his own family and associates first, or discriminate between his creditors on any but normal commercial principles.

(4) The proposed change would introduce into the law of insolvency a notional 'cessation of payments', and would be inconsistent with our approach to the commencement of insolvency proceedings, and in particular with our proposals to abolish the concept of the act of bankruptcy."

Connected persons

16.16 We **propose** the adoption of section 249 of the Insolvency Act, which provides that a person is connected with a company if he is a director or shadow director of the company or an associate of such a director or shadow director, or he is an associate of the company.

16.17 In this context we note our proposal that the definitions of shadow directors found in sections 168C or section 351(2) should be applied to all the winding-up provisions.[5]

Associate

16.18 It has been commented on that a problem arises with the new definition of "*associate*" contained in section 51B of the Bankruptcy (Amendment) Ordinance 1996. The new definition only includes as an associate an entity of which the debtor company has control. "*Associate*" therefore includes subsidiaries of a debtor company but it has been questioned whether a strict interpretation of the legislation would result in a parent company being classified as an associate because a debtor company which is a subsidiary does not have control over its parent and therefore would not be defined as an associate under section 51B.[6]

16.19 The comment continues that the inconsistency is as a result of the Companies Ordinance incorporating provisions which were drafted with a natural person in mind, who cannot, of course, have a parent entity and that, unless amendments are made, it would appear that unfair preferences given to a parent entity would only be recoverable if they are made within six months prior to the liquidation of the subsidiary.

16.20 The Official Receiver acknowledges that this is the case but that the intention was that the amendment to section 266 should be a temporary measure pending a comprehensive examination of the winding-up provisions by the Commission. The Official Receiver has stated that any reference to "*connected persons*", as provided for under section 249 of the Insolvency Act, was carefully avoided since "*connected persons*" includes "*shadow directors*" who are mentioned or defined only in sections 158 and 168C of the Companies Ordinance, and are not mentioned in the interpretation provisions under section 2.

16.21 The definition of "*associate*" is found under section 435 of the Insolvency Act. The Bankruptcy (Amendment) Ordinance 1996, section 51B, adopted most of the definitions of associate but could not make provision for

---

5 Note that there are similar provisions under section 49BA(9) of the Companies Ordinance, which defines director for the purposes of requirements for a listed company to buy its own shares, section 109(5) in relation to general provisions on annual returns, section 158(1), in relation to the register of directors and secretaries, and section 341, in relation to the interpretation of a Part XI (Companies incorporated outside Hong Kong). Section 2(2) provides a saving in respect of advice given in a professional capacity.

6 See "*Extortion, undervalue and preferences - creditors beware*", David Kennedy, Nelson Wheeler Corporate Reconstruction and Insolvency Limited; article in the *Accounting Post*, March 1997.

companies being associates of other companies. We therefore **propose** that the definition of a company's association with another company, under section 435(6) of the Insolvency Act, should be adopted.

16.22 Under section 435(6), a company is an associate of another company:

> *"(1) if the same person has control of both, or a person had control of one and persons who are his associates, or he and person who are his associates, have control of the other, or*
>
> *(2) if a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person of whom he is an associate."*

16.23 The effect of the two proposals on connected persons and associates would not only bring the person or group of persons who had control of the company under the longer relevant time for associates, it would also bring in the associates of those persons who controlled the company. This would include any person with a close family connection to the person who controlled the company, including spouses, former spouses, siblings, aunts, uncles, nephews, nieces, and other lineal ancestors and descendants.

Transactions at an undervalue

16.24 The Bankruptcy (Amendment) Ordinance 1996, section 36,[7] also introduced provisions on transactions at an undervalue into the Bankruptcy Ordinance. These provisions were not applied to the winding-up provisions because the Government did not want to pre-empt the recommendations of the Commission.

16.25 The Official Receiver has advised us that it was considered that proceedings could still be issued against directors of companies for assignments of property which defrauded creditors, under section 60 of the Conveyancing and Property Ordinance (Cap 219).

16.26 We **propose** that it would be appropriate to introduce transactions at an undervalue into the Companies Ordinance. The effect of the provision would be that, where a company makes a gift to a person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration, or, the company enters into a transaction with that person for a

[7] This is the new section 49 in the Bankruptcy Ordinance. The Insolvency Act equivalent is section 238.

consideration which is significantly less that the actual value of the subject of the transaction, the court may make an order to restore the position to what it would have been if the company had not entered into the transaction.

16.27 In the case of a transactions at an undervalue, the relevant time would be a period of five years before the presentation of a petition to wind-up the company.

Court orders in respect of unfair preferences and transactions at an undervalue

16.28 The Bankruptcy (Amendment) Ordinance 1996, section 36, introduced a new section 51A into the Bankruptcy Ordinance which sets out the various orders that the court may make. Orders made under section 51A apply to both transactions at an undervalue and unfair preferences. The intention of the section, however, is not to limit the power of the court but to make provision for cases where:

> *"a company's obligation is backed by a surety or guarantor. For example, a payment may have been made to a creditor with a view to releasing the surety or guarantor rather than preferring the creditor, and the creditor may have released the guarantee and returned any security given before the payment is struck down as a preference. The creditor would then in all probability have had no remedy against the guarantor."*[8]

Third parties may be affected

16.29 Under the new bankruptcy provisions, section 51A(2), third parties involved in a transaction involving an unfair preference or a transaction at an undervalue may be affected. The equivalent provision under the Insolvency Act is section 241(2), about which the following comment has been made:

> *"This subsection allows third parties to be brought into the proceedings and orders to be made against them or their property instead of, or as well as, against the party with whom the company has dealt in the transaction under challenge. In particular, it will enable an order for repayment to be made directly against a surety or guarantor when the real object of a payment made by the company to a particular creditor was to release the guarantee rather than prefer the creditor. Bona fide third parties acquiring property or benefits for value will, however, be protected. Nevertheless, the concluding words of (section 51A(2)(b)) indicate that the person who was the actual counterparty to a transaction at an undervalue or who himself, as a*

---

[8] *Annotated Guide to the Insolvency Legislation*, L. S. Sealy and David Milman, 4th Edition, page 296.

creditor, received the benefit of a preference will not be protected merely because he acted in good faith and for value. (This is in keeping with the traditional view taken in relation to fraudulent preferences, that it is the intention of the company to give an improper preference which is crucial, and that the state of mind of the creditor himself is immaterial.)'[9]

Insolvent trading

16.30 The Commission, in its Report on Corporate Rescue and Insolvent Trading, recommended that directors and senior management of a company should be made liable for any debts of a company which arose when a company traded while it was insolvent. This recommendation, when introduced into legislation, would complement the unfair preference transactions at an undervalue provisions. We note that it was not the intention of the Commission for a provisional supervisor to get involved in insolvency issues and we **propose** that the unfair preference and transactions at an undervalue proposals should not apply in cases where a company goes into provisional supervision.[10] The matter would be left to the liquidator if the provisional supervision failed and the company was wound-up.

Transactions at an undervalue and the Conveyancing and Property Ordinance

16.31 Section 60 of the Conveyancing and Property Ordinance provides for the voidability of dispositions to defraud creditors. Every disposition of property made with intent to defraud creditors is voidable but the section does not extend to any estate or interest in property disposed of for valuable consideration and in good faith, or upon good consideration and in good faith to any person, not having, at the time of the disposition, notice of the intent to defraud creditors.

16.32 We note this provision and, while we consider that there should be no conflict between the provision and the proposal on transactions at an undervalue, we suggest that, in drafting a provision on transactions at an undervalue, notice should be taken of this provision.

Section 267 Effect of floating charge

16.33 The section provides that, where a company is being wound-up, a charge which, when created, was a floating charge on the undertaking or property of the company and which was also created within 12 months of the commencement of the winding-up shall, unless it is proved that the company

---

9 *Annotated Guide to the Insolvency Legislation*, L.S. Sealy and David Milman, 4th Edition, pages 296 and 297.

10 *Report on Corporate Rescue and Insolvent Trading*, paragraph 19.10 to 19.13.

immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the rate specified in the charge or at the rate of 12 per cent per annum, whichever is less.

16.34 The Hong Kong Association of Banks submitted that:

> *"Section 267 contains an exception for new money advanced to the company at the time of or after the creation of the floating charge. When bankers take security for a running account, payments into the account will discharge prior indebtedness and payments out will constitute new advances secured by the floating charge. This section should be preserved as the lending banker is continuing facilities to the company which might otherwise be withdrawn, resulting in liquidation, when given time, the company may survive."*

16.35 The Official Receiver's Office submitted that:

> *"Section 267 should be replaced by a provision along the lines of section 245 of the Insolvency Act 1986. That section expressly covers benefits conferred on a company otherwise than by the payment of cash. The 12-month period is extended to two years if the chargee is a person connected with the company. The exception where the company is proved at the material time to have been solvent will not be available to such a chargee."*

16.36 We **propose** that the effect of the provision should be extended from 12 months to two years in the case of persons who are connected to the company.[11] The proposal follows a similar provision under section 245(3) of the Insolvency Act.

Super priority lending under the provisional supervision

16.37 In the Report on Corporate Rescue and Insolvent Trading, the Commission made recommendations that would allow provisional supervisors to obtain loans which would be in priority to any other borrowing that the company in provisional supervision might have. We **propose** that the provisions of section 267 should not apply to super priority borrowing in a provisional supervision.

Section 268 Disclaimer of onerous property in case of company wound-up

[11] See, *supra*, at paragraph 16.23 in relation to connected persons / associates.

16.38 The section provides that a liquidator may, with the leave of the court, disclaim onerous property. This involves:

- land burdened with onerous contracts,
- shares or stock in companies,
- unprofitable contracts, or
- any property that is unsaleable, or not readily saleable, by reason of its binding the possessor to the performance of an onerous act, or the payment of a sum of money.

16.39 A liquidator must usually apply to the court to disclaim such property within 12 months of the commencement of winding-up but the court may extend the time period.

16.40 The Official Receiver's Office has submitted that:

> *"Section 268 should be amended by the removal of the obligation to obtain the leave of the court. That would bring it into line with section 59 of the Bankruptcy Ordinance. In the Insolvency Act, sections 178 to 182, the liquidator does not need the leave of the court to disclaim."*

16.41 We support the submission and **propose** that a liquidator should be able to disclaim property without having to apply to the court. In this context, we note that, under subsection (4), a person interested in property may give the liquidator notice that he must within 28 days of the notice elect whether or not he wants to disclaim property, failing which the liquidator is deemed to have elected to have adopted the property.[12]

16.42 The disclaimer notice of a liquidator and the application by an interested party are in prescribed forms under the Insolvency Rules. The liquidator's notice should advise the person interested that he should apply to the court in respect of a disclaimer.[13]

---

12 The Companies (Winding-up) Rules, rules 63 and 64, would need to be amended accordingly.

13 Insolvency Act, rules, 4.188 and 4.191.

CHAPTER 17

OFFENCES ANTECEDENT TO OR IN COURSE OF WINDING-UP

17.1 The Official Receiver's Office has delegated authority from the Secretary for Justice to take prosecutions before a magistrate in relation to offences committed under various sections of the Companies Ordinance.

Section 271 Offences by officers of companies in liquidation

17.2 The section provides that if any past or present officer of a company which is being wound-up:

(a) does not to the best of his knowledge and belief fully and truly discover to the liquidator all the property, real and personal, of the company, and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary way of the business of the company; or

(b) does not deliver up to the liquidator, or as he directs, all such part of the real and personal property of the company as is in his custody or under his control, and which he is required by law to deliver up; or

(c) does not deliver up to the liquidator, or as he directs, all books and papers in his custody or under his control belonging to the company and which he is required by law to deliver up; or

(d) within 12 months next before the commencement of the winding-up or at any time thereafter conceals any part of the property of the company to the value of $100 or upwards, or conceals any debt due to or from the company; or

(e) within 12 months next before the commencement of the winding-up or at any time thereafter fraudulently removes any part of the property of the company to the value of $100 or upwards; or

(f) makes any material omission in any statement relating to the affairs of the company; or

(g) knowing or believing that a false debt has been proved by any person under the winding-up, fails for the period of a month to inform the liquidator thereof; or

(h) after the commencement of the winding-up prevents the production of any book or paper affecting or relating to the property or affairs of the company; or

(i) within 12 months next before the commencement of the winding-up or at any time thereafter, conceals, destroys, mutilates, or falsifies, or is privy to the concealment, destruction, mutilation, or falsification of, any book or paper affecting or relating to the property or affairs of the company; or

(j) within 12 months next before the commencement of the winding-up or at any time thereafter makes or is privy to the making of any false entry in any book or paper affecting or relating to the property or affairs of the company; or

(k) within 12 months next before the commencement of the winding-up or at any time thereafter fraudulently parts with, alters, or makes any omission in, or is privy to the fraudulent parting with, altering, or making any omission in, any document affecting or relating to the property or affairs of the company; or

(l) after the commencement of the winding-up or at any meeting of the creditors of the company within 12 months next before the commencement of the winding-up attempts to account for any part of the property of the company by fictitious losses or expenses; or

(m) within 12 months next before the commencement of the winding-up or at any time thereafter pawns, pledges, or disposes of any property of the company which has been obtained on credit and has not been paid for, unless such pawning, pledging, or disposing is in the ordinary way of the business of the company; or

(n) is guilty of any false representation or other fraud for the purpose of obtaining the consent of the creditors of the

company or any of them to an agreement with reference to the affairs of the company or to the winding-up,

he shall, in the case of the offence mentioned in paragraph (m), be liable to imprisonment, and in the case of any other offence shall be liable to imprisonment and a fine.

17.3 The penalty under the section is a fine of up to $150,000 and imprisonment for up to six months on summary conviction or two years' imprisonment on indictment in respect of any offence under this provision, apart from paragraph (m) under which a person may be imprisoned for two years on summary conviction or five years on indictment but there is no provision for a fine.

17.4 The Official Receiver's Office submitted that:

> *"The offences antecedent to or in course of winding-up are somewhat archaic, particularly in section 271, and require modernising."*

17.5 We note that the equivalent sections under the Insolvency Act, sections 206 and 208, are divided into offences antecedent to winding-up, under section 206, and offences in the course of a winding-up, under section 208. We **propose** that, for clarity, it would be useful to separate the provisions in this way.

Few convictions under the section

17.6 The terms of the section are wide-reaching and yet there have been no convictions under the section over the last several years. The Official Receiver has advised that prosecutions are sometimes taken under this section or section 274 in the alternative. Convictions, however, are inevitably made under section 274.

Burden of proof

17.7 It is a good defence to a charge under any of paragraphs (a), (b), (c), (d), (f) and (m), if the accused proves that he had no intent to defraud, and to a charge under any of paragraphs (h), (i) and (j), if he proves that he had no intent to conceal the state of affairs of the company or to defeat the law.

17.8 The equivalent provision under the Insolvency Act, sections 206 and 208, shifts the burden of proof from the prosecution to the defendant and we **propose** that this provision should be followed.[1] The effect is that a defendant must prove that he had no intent to defraud, or, where appropriate, no intent to conceal the state of affairs of the company or to defeat the law. Where the

[1] See the Insolvency Act, section 206(4) and 208(4).

burden of proof is shifted to a defendant, his level of proof is "*on the balance of probabilities*" and not "*beyond a reasonable doubt*", which would apply to the level of proof required of the prosecution.[2]

17.9 We note that reversing the onus of proof could have Bill of Rights implications. If the shifting of the onus does prove contentious, we suggest that provision might be made to raise presumptions about certain situations, similar to the insolvent trading recommendations in the Report on Corporate Rescue and Insolvent Trading.[3]

Concealing of property

17.10 Section 271(1)(d) provides that if within 12 months before winding-up or at any time after winding-up, an officer conceals property of the company to the value of $100 or more, he is guilty of an offence and may be prosecuted.

17.11 We consider that it is inappropriate to place a monetary value on the property as, for instance, company papers of no monetary value to anyone else might be of considerable value to the company. We **propose** that the reference to a monetary value should be removed.

Section 273 Frauds by officers of companies which have gone into liquidation

17.12 The section provides that if any person, being at the time of the commission of the alleged offence an officer of a company which is subsequently ordered to be wound up by the court or which subsequently passes a resolution for voluntary winding-up, with intent to defraud creditors of the company, has made or caused to be made any gift or transfer of or charge on, or has caused or connived at the levying of any execution against, the property of the company; or with intent to defraud creditors of the company, has concealed or removed any part of the property of the company since, or within two months before, the date of any unsatisfied judgment or order for payment of money obtained against the company, he shall be guilty of an offence and liable to imprisonment and a fine.

17.13 The penalty under the section is a fine of up to $50,000 and imprisonment for up to six months on summary conviction or a fine of $150,000 and up to two years' imprisonment on indictment in respect of an offence under this provision.

---

2 *Morten v Confer* [1963] 1 WLR 763.

3 See paragraphs 19.49 to 19.55 of the *Report* and note our suggestions on the payment of compensation by directors, *infra*, at chapter 24.

17.14 We would again **propose** that the onus of proof[4] should be shifted onto the person charged and that the time within which the offence was committed should be increased from 12 months to five years. This would follow the equivalent provision under the Insolvency Act.[5]

Section 274 Liability where proper accounts not kept

17.15 This section provides that, in a winding-up, where, in most cases, it is shown that proper books of account were not kept by the company throughout the two years before the commencement of the winding-up, every officer in default shall, unless he shows that he acted honestly and that in the circumstances the default was excusable, be guilty of an offence.

17.16 The penalty under the section is a fine of up to $50,000 and imprisonment for up to six months on summary conviction or a fine of $150,000 and up to two years' imprisonment on indictment in respect of an offence under this provision. A conviction under this section constitutes grounds for determining whether or not a director is unfit to be a director under the fifteenth schedule and section 168H. In the year 1996/97, 14 directors were disqualified under sections 121 and 274, for periods of between one and three years.[6]

Prosecution of offences

17.17 The Official Receiver's Office's analysis of prosecutions over the four years from 1993/94 to 1996/97 shows that there were no prosecutions taken in respect of any of the sections 271 to 276 apart from section 274. Section 274, which provides for the liability of officers where proper books of account were not kept in the two years before the commencement of the winding-up, is closely related to section 121, which provides for the keeping of books of account by companies at all times. The Official Receiver's Office's figures for 1993/94 and 1994/95 combine the prosecutions under these two sections. Over those two years, there were a total of 84 summonses issued under the sections, of which 67 resulted in successful prosecutions with an average fine of almost $8,900.[7]

17.18 1995/96 was the first year that sections 121 and 274 were distinguished. Under section 274, there were 25 summary convictions resulting in average fines of $7,300. In 1996/97, the first year when the new penalty

---

4 See our comments on the onus of proof under section 271, *supra*, at paragraphs 17.7 to 17.9.

5 Insolvency Act, section 207.

6 *Official Receiver's Office Annual Report 1996/97*, annex 16.

7 At that time the maximum fine that could be imposed was $25,000 on summary conviction under section 274 and $200,000 under section 121. The new level of fines quoted in the sections below came into effect in July 1996 (See L.N. 306 of 1996). The maximum penalty under section 121 is now $300,000.

amounts had application, there were 13 summary convictions resulting in average fines of nearly $3,600.

17.19 It is interesting to note that even though the amount of the penalty under section 274 has been doubled, the average fine has decreased by half in a year. Several factors need to be taken into account. All cases are different and there is no way of distinguishing the particulars of each case from the statistics. Some of the cases in 1996/97 would have been decided and fines would have been imposed under the old penalty tariff. The conviction rate for prosecutions taken dropped from 74 per cent in 1995/96 to 54 per cent in 1996/97, which may be indicative of a change of attitude towards prosecutions by the court.

17.20 While figures can be misleading, we are concerned that even in 1995/96, fines only reached 29 per cent of the maximum tariff and that figure is lower in 1996/97. While it must be assumed that the level of the fines being imposed by the court reflects the seriousness of the offence, it is open to question whether the level of fines is any deterrent to directors who might be tempted to commit an offence under the provisions in general, in the knowledge that, at worst, they will be subject to a modest fine.

17.21 It is also worth noting that a conviction under section 274 will almost automatically mean that a convicted director will be further prosecuted under section 168H to have him disqualified from acting as a director.

17.22 The Official Receiver's Office advises that prosecutions have not been taken under sections 271 to 273 or 275 and 276 because no cases have been referred to the Official Receiver's Office's Prosecutions & Director Disqualification Section that could be carried through to a prosecution. Cases may be referred to the prosecution section either by the Official Receiver's Office insolvency officers or by private sector liquidators.

17.23 The Official Receiver has advised that prosecutions under section 274 come to the attention of liquidators most easily as directors are obliged to produce a statement of affairs. If there are no accounts available to prepare a statement of affairs the fact is usually brought to the attention of the prosecutions section.

Proper books of account

17.24 Subsection (2) provides that:

> *"For the purposes of the section, proper books of account shall be deemed not to have been kept in the case of any company if there have not been kept such books or accounts as are necessary, to exhibit and explain the transactions and financial position of the trade or business of the company, including books containing entries from day to day in*

sufficient detail of all cash received and cash paid, and, where the trade or business has involved dealings in goods, statements of the annual stocktakings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified."

17.25 The definition of "*proper books of account*" under subsection (2) is clearly intended to comprehensively cover all forms of account and trade practice. We **propose**, however, that the definition might usefully be expanded to make reference to computerised books of account. We hesitate slightly in this regard as we note that a number of successful prosecutions have been brought under this section and section 121 in recent years. We seek comments on whether the present wording might be considered to be out of date or whether it is adequate for present day needs.

Section 275 Responsibility of directors for fraudulent trading

17.26 The section provides that if in the course of the winding-up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or others, the court, on the application of the Official Receiver, the liquidator, any creditor, or contributory of the company, may declare that any persons who were knowingly parties to the carrying on of the business in such a way shall be personally liable, without limitation, for all or any of the debts or other liabilities of the company.

17.27 In addition to an unlimited civil liability, it is also a criminal offence to carry on a business with the intention to defraud any person for which the penalty is a fine of up to $100,000 and imprisonment for up to 12 months on summary conviction or an unlimited fine and up to five years' imprisonment on indictment.

Insolvent trading

17.28 We refer to the Commission's comments on fraudulent trading in the Report on Corporate Rescue and Insolvent Trading.[8] The Commission recommended the introduction of a civil remedy, to be known as insolvent trading, under which the directors and senior management of a company could be held personally liable for the debts incurred by a company during the time when it traded while insolvent.[9]

---

8 *Report on Corporate Rescue and Insolvent Trading*, paragraphs 19.114 to 19.116. Insolvent trading is the equivalent of wrongful trading under section 214 of the Insolvency Act and insolvent trading under section 588G of the Australian Corporations Law.

9 *Report on Corporate Rescue and Insolvent Trading*, chapter 19.

17.29 These recommendations have not yet been brought before the legislature. We believe that, if the insolvent trading recommendations are adopted into legislation, civil cases in respect of fraudulent trading are unlikely to be taken as the standard of proof under insolvent trading would be easier to establish.[10]

17.30 One of the problems with fraudulent trading is that the courts have imposed the criminal standard of proof on the proceedings to the effect that a plaintiff whose principal interest is in recovering assets and not in punishing a defendant with a fine or imprisonment, is still obliged to prove his case beyond a reasonable doubt instead of on a balance of probabilities.

17.31 Although fraudulent trading is a little used remedy in Hong Kong, it was considered in a recent case when the court set out the standard of proof required.[11] The plaintiff must prove that:

(a) The defendant made decisions which were not in the interests of the company; and

(b) that they did so with knowledge that at the time of incurring greater liabilities the company was insolvent and in no position to clear its debts.

(c) If (i) and (ii) are shown by the facts, then fraud or dishonesty could be established by inference, subject to

(d) a subjective test as to the state of mind / motives of the defendants, otherwise what seemed like fraud might only be negligence; and subject to

(e) an objective test as to whether the director fulfilled his duty to preserve the assets of the company, namely: where a director takes a risk in using assets of the company which risk no director could honestly believe to be in the interests of the company and which were prejudicial to the rights of others, then that director was fraudulent.

17.32 For the purposes of the Consultation Paper we prefer not to make any proposals for change to the provisions on fraudulent trading as we believe that the insolvent trading recommendations would displace the civil liability side

---

[10] The insolvent trading recommendations have not yet been brought before the legislature due to the change in sovereignty of Hong Kong. We anticipate that a Bill on Corporate Rescue and Insolvent Trading will be brought before the Legislative Council after the elections for that body on 24th May 1998.

[11] *Aktieselskabet Dansk Skibsfinansierung v Wheelock Marden & Co. Ltd.* [15 December 1989] [Jones J] (unreported) (HKLD 1990 A14).

of fraudulent trading. The only change that might be considered is removing the criminal sanction from the section, making it a civil issue and creating a less onerous standard of proof for a plaintiff.

17.33 The civil remedy in future will, we anticipate, be provided by insolvent trading. We would, therefore, prefer to retain the criminal aspect of fraudulent trading as it is important that those who participate in fraudulent trading should be aware that the penalty for such behaviour might go beyond financial penalty and could result in imprisonment.

17.34 We seek comments on how fraudulent trading should be dealt with in the future on the basis that insolvent trading will be introduced in legislation.

Section 276 Power of court to assess damages against delinquent officer, etc.

17.35 The effect of the provision is that, in a winding-up, the court may examine any person who took part in the formation or promotion of the company, any past or present officer, and any liquidator or receiver of the company, for misfeasance or breach of duty or trust in relation to the company.

17.36 If the court finds that a person examined has been guilty of a misfeasance or breach of duty, it may compel that person to repay or restore the money or property, plus interest, or to contribute such sum to the assets of the company by way of compensation as the court thinks just.

17.37 The Official Receiver has confirmed that no actions have been taken by the Official Receiver in recent years and practitioners have also confirmed that the provision is rarely used.

17.38 This is not the case, however, with the Insolvency Act equivalent, section 212. Section 212, which replaced the Act's equivalent of section 276 of the Companies Ordinance, though similarly worded, refers to "*breach of fiduciary or other duty*" whereas section 276(1) refers to both "*breach of duty*" and "*breach of trust*". While the wording might appear to have the same effect, the United Kingdom courts have held that the equivalent of the present wording of section 276(1) did not include claims based on negligence.[12] More recently, the United Kingdom courts have held that the section now covers breaches of any duty, including a duty of care.[13]

17.39 We approve of this expansion of the effect of the provision and **propose** that it be adopted. This would also have the beneficial effect of clarifying the confusing references to duty and trust under the current provisions.

---

12 *Re B Johnson & Co. (Builders) Ltd* [1955] Ch. 624.

13 *Re D' Jan of London Ltd* [1993] BCC 646.

We note that the provision would complement our proposals on specific duties of care to be imposed on liquidators.[14]

Provisional supervisors

17.40 The section should apply to provisional supervision, for two reasons. First, if a provisional supervisor uncovers matters that would come under section 276, as things stand, no action could be taken until the company was wound-up and then action would be taken by the liquidator. We **propose** that a provisional supervisor should be able to take appropriate action under the section.

17.41 Second, if a company in provisional supervision was subsequently wound-up and the liquidator found that the provisional supervisor had been involved in activities that would come under section 276, it would be appropriate, and we **propose** that, the provisional supervisor should be vulnerable to action being taken against him under the section.

Section 277 Prosecution of delinquent officers and members of company

17.42 The Hong Kong Police has submitted that:

> *"In the present legislation, there is no statutory requirement for a liquidator to inform police of any malpractice or criminality he may find in the affairs of a company being wound up. It is felt that the number of liquidations are limited and the benefits of learning at an early stage of criminality within a company under liquidation substantial."*

17.43 The section provides that if it appears to the court, in the course of a winding-up by the court, that any past or present officer or member of the company has been guilty of any offence in relation to the company for which he is criminally liable, the court may direct the liquidator to refer the matter to the Secretary for Justice.

17.44 In a voluntary winding-up, a liquidator is obliged similarly to report the matter to the Secretary for Justice, and to furnish the Secretary for Justice with all relevant information. In a voluntary winding-up the court may, if a matter that should be reported to the Secretary for Justice is brought to its attention, direct a liquidator to report the matter to the Secretary for Justice.

17.45 The Hong Kong Society of Accountants has advised that, on the issue of crime, it was difficult to generalise given that offences could range from theft of a few minor items to fraud. The Society recognises that for substantial

---

[14] See, *supra*, at paragraph 7.40.

matters there is an overriding obligation under section 277 to bring the matter to the attention of the Secretary for Justice and the Society adds that, in practice, reports would be more likely made to law enforcement agencies, such as the Commercial Crimes Bureau or to a regulator, such as the Official Receiver.

17.46 The Society has issued a Professional Ethics Statement on "*Unlawful acts or defaults by clients of members*" which deals primarily with the auditor and client relationship, which states specifically that an appointment as liquidator does not give rise to a similar professional to client relationship. The Ethics Statement states that in a liquidation, an auditor should make information available to the liquidator, whose decision it should be whether or not to make a report under section 277.

17.47 The Society concluded that members had noted that the whole question of reporting crime could give rise to a conflict of interest, given a liquidator's duty to act in the best interests of the creditors as it would not always be clear that reporting a suspicion that a criminal offence had been committed would be to the benefit of the creditors.

17.48 We have commented elsewhere on the unsatisfactory level of prosecutions of directors and on the need for a general reconsideration of how dishonesty on the part of company directors might be addressed more effectively.[15]

17.49 While we fully accept that liquidators may encounter conflicts between the reporting on crime and acting in the interests of creditors, we consider that the reporting of crime should attract a higher priority than appears to be the case at present.

17.50 We can only speculate as to how many crimes go unreported by liquidators, but we must assume that in the absence of a clear policy of reporting crime whenever it is encountered, liquidators will decide not to get involved in the reporting of a crime if it is likely to cost too much or is likely to get in the way of the primary purpose of pursuing assets.

17.51 Indeed, we accept that, among our proposals on examinations under sections 221 and 222, we **propose** that answers given under examination should not be capable of being used in criminal proceedings against the person being examined. The idea behind the proposal is that a liquidator's primary function is to recover assets for the benefit of creditors. This is a legitimate aim but a liquidator could be forgiven for thinking that if the legislation was to make a provision of this nature, why should he bother to report a crime.

---

[15] See, *supra*, at paragraphs 17.17 to 17.23 and our suggestions on the payment of compensation by directors, *infra*, at paragraphs 24.1 to 24.18.

17.52 The establishment of the Official Receiver's Administrative Scheme for the licensing of insolvency practitioners would provide an opportunity for the Official Receiver, in conjunction with the Hong Kong Society of Accountants, the Law Society and the Hong Kong Institute of Company Secretaries, in discussion with the Hong Kong Police, to consider how insolvency practitioners should approach a suspected crime situation.

17.53 We consider that it would not be appropriate to make provision in the Companies Ordinance for imposing obligations to report crimes on insolvency practitioners. We **propose** that it would be appropriate for the Official Receiver, in conjunction with the licensed bodies, to set down a code of practice for insolvency practitioners on crime. Under the Official Receiver's current scheme for appointing private sector liquidators[16], liquidators are obliged to carry out a minimum standard of statutory investigation into the affairs of a company.

17.54 We **propose** that suspected crimes might be reported initially to the Official Receiver as the regulator of the Administrative Panel so that the Official Receiver's Office's Prosecutions and Director Disqualification Section could consider whether to advise the liquidator to report the matter to the Secretary for Justice or for the Official Receiver to refer the matter to the Secretary for Justice or the Police, as appropriate, directly.

"Has been guilty"

17.55 Under sub-sections (1) and (2), references are made to cases where it appears that an officer or a member of a company "*has been guilty*" of an offence for which he is criminally liable, a form of wording that is also used in section 218 of the Insolvency Act. It has been suggested that the emphasis of the wording is misleading as it gives the impression that the officer or member has already committed an offence for which he has been convicted.

17.56 Clearly the intention of the sub-sections is to provide for cases where an officer or member "*may be guilty*" or "*appears to be guilty*" of an offence. We **propose** that the wording of the section be amended to properly reflect the intention of the provisions.

[16] Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

CHAPTER 18

SUPPLEMENT PROVISIONS AS TO WINDING-UP AND SUPPLEMENT POWERS OF COURT

Section 278 Disqualification for appointment as liquidator

18.1 The section provides that undischarged bankrupts and bodies corporate are disqualified from being a liquidator in a winding-up of a company. If any such appointment is made it shall be void and the bankrupt or body corporate would be subject to a fine of up to $150,000.

18.2 The Hong Kong Society of Accountants submitted that:

> *"The section should be amended to incorporate the provision in section 168D(1)(b) which provides that a person against whom a disqualification order has been made shall not, without leave of the court, be a liquidator of a company for a specified period.*
>
> *In addition to the existing restrictions on who may be appointed as a liquidator, consideration should be given to extending the prohibition to cover persons who would or could find themselves in a conflict of interest, for example, (i) a creditor (ii) a debtor (iii) a director.*
>
> *Consideration could also be given to extending the prohibition on acting as liquidator to cover persons of unsound mind."*

18.3 The submission has relevance to our proposal that only qualified insolvency practitioners should be able to act as a liquidator, receiver or as a provisional supervisor.[1] The Insolvency Act, section 389, provides that a person who acts as an insolvency practitioner in relation to a company or an individual when he is not qualified to do so is liable to imprisonment and a fine. The Official Receiver is specifically excluded from the provision.

18.4 The Insolvency Act, section 390, provides that a person who is not an individual, that is, a body corporate, is not qualified to act as an insolvency practitioner and the disqualification also applies to bankrupts, persons of unsound mind and persons disqualified from acting as a director. We **propose** that these provisions should be adopted in the Companies Ordinance.

---

[1] Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

18.5 As regards the submission that creditors, debtors and directors of a company should also be disqualified, we **propose** that the regulations on insolvency practitioners should provide that a qualified insolvency practitioner should be disqualified from accepting an appointment where he is a creditor, debtor or director of a company as it could constitute a conflict of interest.

18.6 We **propose** that anybody who had been an auditor of a company in the previous three years should be precluded from acting as an insolvency practitioner, as this also could constitute a conflict of interest. We understand that a prohibition from acting is already applied by the Hong Kong Society of Accountants' ethical guidelines.

18.7 We also **propose** that any person with a mental disorder, as defined under the Mental Health Ordinance, should be disqualified from acting as an insolvency practitioner.[2]

18.8 We would note that section 168D, which makes general provision for disqualification of directors orders, might need to be amended to take account of insolvency practitioners.

Section 278A Corrupt inducement affecting appointment as liquidator

18.9 The section provides that anybody who pays or attempts to pay a creditor or member of the company to secure his own or some other person's nomination or appointment as liquidator shall be liable to a fine of $150,000.

18.10 We **propose** that the provision should be expanded to include any form of appointment under the proposals on insolvency practitioners.[3]

Section 283 Disposal of books and papers of company

18.11 The section provides that when a company has been wound-up and is about to be dissolved, the books and papers of the company and of the liquidators may be disposed of as follows:

(a) in the case of a winding-up by the court, in such way as the court directs;

(b) in the case of a members' voluntary winding-up, in such way as the company by special resolution directs; and

---

2 "*Mental disorder*" is defined in the Mental Health Ordinance (Cap 136), section 2, as "*mental illness, arrested or incomplete development of mind, psychopathic disorder or any other disorder or disability of mind*".

3 Note our proposals on the licensing of insolvency practitioners under paragraphs 26.1 to 26.26.

(c) in the case of a creditors' voluntary winding-up, in such way as the committee of inspection or, if there is no such committee, as the creditors of the company, may direct.

18.12 Subsection (2) provides that after five years from the dissolution of the company no responsibility shall rest on the company, the liquidators, or any person to whom the custody of the books and papers has been committed, by reason of any book or paper not being forthcoming to any person claiming to be interested in them.

18.13 Under subsection (3), provision may be made by general rules for enabling the Official Receiver to prevent, for not more than five years from the dissolution of the company, the destruction of the books and papers of a company which has been wound-up, and for enabling any creditor or contributory of the company to make representations to him, and to appeal to the court from any direction which may be given by him in the matter.[4]

18.14 The penalty for contravention of section 283 is a fine of $10,000.

18.15 The Hong Kong Society of Accountants submitted that:

> *"Not all companies that go into receivership can be revived and put back to the control of its directors, or put into liquidation. In these situations, when the receiver ceases to act, the company is effectively abandoned as most, if not all, of the directors will have resigned or become uncontactable by then. Further, the fact that there will be no one to pass the company's books and records to might delay the ceasing to act of the receiver.*
>
> *Provisions should therefore be made to deal with these situations for 'automatic' liquidation or strike off of these companies. Section 283 of the Ordinance dealing with disposal of books and papers of a company which has been wound-up, may need to be amended to deal with the disposal of the company's records in these situations."*

18.16 The Hong Kong Institute of Company Secretaries submitted that:

> *"According to the Inland Revenue Ordinance, a liquidator must keep the books of a company for seven years while Companies Ordinance prescribes five years. However, members of a company can authorise the liquidators to dispose the company's books at any time they appoint by passing a special resolution under s283(1)(a). Consistency would be desirable."*

---

[4] Note that the Companies (Winding-up) Rules, rule 190, is relevant.

18.17 The Official Receiver's Office submitted that:

> *"Under section 283(3), a creditor or contributory may succeed in obtaining a court order preventing the destruction of the books and papers of a company, which is about to be dissolved, for up to five years. If the order requires the Official Receiver to keep the documents, the party obtaining the order should be responsible for the Official Receiver's storage rental, and the order should lapse, that is, the documents may be destroyed, if the rental is in arrears."*

18.18 The issues addressed below all revolve around the expense of storing the books of a company. Practitioners advise that it is or was common for receivers to find that after a receivership is completed there is no one left to hand the books of the company back to. This means that the receiver is obliged to store the books under section 121(3A) and this can be expensive.

18.19 Section 283 only provides for the preservation of the books of a company which is dissolved, subsection (2) providing that the books should be retained for five years. Section 121(3A), however, provides that any books of account which a company is required to keep shall be preserved by it for seven years from the end of the financial year of which the last entry was made.

Commissioner of Inland Revenue

18.20 The concern for liquidators and receivers is that they cannot dispose of the books of a company as they may be obliged to make them available to the Commissioner of Inland Revenue for up to seven years.

18.21 We asked the Commissioner about the relationship between the Companies Ordinance provisions and the Inland Revenue Ordinance, section 51(C) which provides that records should be retained for not less than seven years after the completion of the transactions, acts or operations to which they relate. We noted that subsection (2) provides an exception to subsection (1) where the Commissioner specifies that records need not be preserved or where a corporation has been dissolved.

18.22 The Commissioner advised that although in most cases he is not interested in dissolved corporations as their tax liabilities would have already been cleared, in the rare cases where a liquidator had dissolved a company which had outstanding or potential tax liabilities, the Commissioner has the right to reinstate the dissolved corporation under section 290 of the Companies Ordinance. The effect of this is that the discretion in the Commissioner to specify the records which need not be reserved under section 51C(2) would not give a liquidator or receiver much reassurance and he would still need to preserve the records in case the company was reinstated under section 290 of the

Companies Ordinance. In addition, the Commissioner, as an aggrieved creditor, could move to have a company restored under section 290A(6) or under section 291(7).

18.23 On reinstatement, the company would be regarded as having not been dissolved and section 51C(1) of the Inland Revenue Ordinance would continue to apply to it. The Commissioner considers that it is necessary to preserve the record-keeping provisions, that is, section 283(2) in respect of dissolution, and section 121(3A) in respect of functioning companies, including companies that are in receivership.

18.24 It is the view of the Commissioner that any amendment to section 283 would not absolve an obligation which arose under section 51C of the Inland Revenue Ordinance.

18.25 There is little that we can do on the question of the preservation of the records of a company under section 121 as that section is not part of the winding-up provisions of the Companies Ordinance and is not within our terms of reference. In addition, section 51C of the Inland Revenue Ordinance is not within our terms of reference either. While we have sometimes commented on issues that are not strictly within our terms of reference, we prefer to make no comment on the issue at this point. We would, however, be prepared to reconsider the matter if necessary in our report to the Commission.

18.26 We find, however, that section 283 is a confusing piece of legislation and should be made clearer. As we understand it, the effect of subsection (1) is that a liquidator could dispose of the records of a company after about six months after dissolution in any form of winding-up, the six month period relating to a three months period for the dissolution of a company and a further three months for the final meeting of creditors.

18.27 Subsection (2), however, imposes a five year period under which the liquidator, the company or any person to whom custody of the books has been committed (a warehouseman perhaps) must retain the books on the off chance that someone might be interested in them. The only person, in all probability, who has sufficient authority to oblige liquidators to retaining books under these circumstances would be the Commissioner of Inland Revenue, unless the Official Receiver uses his powers under subsection (3).

18.28 We **propose** that there should be an automatic right in voluntary winding-up cases for the liquidator to destroy books six months after dissolution subject to an objection by the Official Receiver. If that was to happen we believe that subsection (2) could be deleted.

Costs

18.29 We consider it reasonable, and therefore **propose**, that any person who applies to the court or the Official Receiver to have books preserved under subsection (3) should be obliged to pay the costs of storage of the books for the term of the order.

Section 284 Information as to pending liquidations

18.30 This section requires that, in all liquidations, if the winding-up is not completed within a year, the liquidator shall send a statement to the Registrar of Companies with details of the proceedings in and the position of the liquidation.[5] Subsequent statements must be sent to the Registrar every six months.[6] The statement is open to inspection by creditors and contributories.[7] Liquidators who fail to comply with the section are subject to a fine of up to $10,000 plus a daily default fine of $700.[8]

18.31 The section applies only to voluntary windings-up, with section 203 fulfilling the same role for winding-up by the court, and it should not be placed in provisions applicable to every mode of winding-up. We **propose** that it should be moved to the provisions applicable to voluntary winding-up.

18.32 In practice, the Registrar of Companies is responsible for ensuring that liquidators comply with the section.

18.33 We are advised by the Official Receiver's Office that, although statements are not required to be lodged with the Official Receiver, the Official Receiver's Office had noticed that some liquidators were failing to make payments into the Companies Liquidation Account, as required by section 285. The Official Receiver's Office advised that when every Gazette is published, a list is taken of all appointments as liquidator and, if payments are not subsequently made to the Companies Liquidation Account in accordance with the provisions, the Official Receiver will take the matter up with the liquidator. We understand that the system is effective and we see no need to make any proposals.

18.34 The placement of the provision in provisions applicable to every form of winding-up appears to have caused some confusion, not least to us. The Hong Kong Society of Accountants has submitted that the nature of the forms used in section 203 and 284 should be standardised and on principle we would agree but, unfortunately, as we have stated in our comments on section 203, a much more detailed account is required under section 203 for audit purposes. We therefore do not support the submission.

---

5 Subsection (1).
6 Companies (Winding-up) Rules, rules 181 and 182.
7 Subsection (2).
8 Subsections (2) and (3).

Signing accounts by liquidators on conversion of liquidation

18.35 We refer to our proposals on this point under section 203.[9]

Section 285 Unclaimed assets to be paid to Companies Liquidation Account

18.36 The section provides that if it appears that either from any statement sent to the Registrar under section 284 or otherwise that a liquidator has in his hands or under his control any money representing unclaimed or undistributed assets of the company which have remained unclaimed or undistributed for six months after the date of their receipt, or any money held by the company in trust in respect of dividends or other sums due to any person as a member of the company, the liquidator shall forthwith pay the said money to the Companies Liquidation Account.

Public interest

18.37 The Hong Kong Society of Accountants submitted that:

> *"In compulsory windings-up where there is an element of public interest, it is understandable that the funds under the control of the liquidator should be supervised and the requirement for payment of funds into the Companies Liquidation Account serves that purpose. However, in creditors' voluntary winding-up and members' voluntary winding-up in particular, there is probably a much lesser public interest need to supervise funds under control of the liquidator. The requirement for such funds to be paid to the Companies Liquidation Account adds to the administrative costs, for example, liquidator's time in administering the funds and related fees payable to the Official Receiver, but without any apparent benefits to the members and creditors.*
>
> *We do not, however, appreciate fully the purpose of the Companies Liquidation Account and how it actually operates particularly in respect of voluntary winding-up, but would like to suggest that if appropriate, consideration could be given as to whether undistributed and unclaimed funds now required to be paid to the Companies Liquidation Account should be left instead to the supervision of members or, in a creditors' voluntary winding-up, to the committee of inspection or if there is no such committee, the creditors."*

18.38 The Society's submission touches on several issues including that of the funding of the Official Receiver's Office, to which we refer elsewhere.[10]

---

9 See, *supra*, at paragraph 7.46.

10 See, *infra*, at chapter 29.

While there is always an argument for doing away with unnecessary regulation, in this case there are also good arguments for retaining the provisions relating to making payments in to the Companies Liquidation Account, even in the case of voluntary windings-up.

18.39 The only reasons for providing that the assets in a voluntary winding-up might be capable of exclusion from the Companies Liquidation Account are that the estate could earn more by investing the money itself and that the estates would not be subject to payment of the 1.5 per cent fee charged by the Official Receiver, which is a lesser amount than is applied in other jurisdictions.

18.40 It is, however, questionable, that liquidators in a voluntary winding-up could obtain better overall income from assets. The Official Receiver has advised us that under what is known as the "Pool Investment Scheme"[11] the Official Receiver pools funds from various estates for investment collectively. Funds belonging to individual estates therefore lose their unique identity once they join the scheme.

18.41 The Official Receiver invests in fixed deposits, which are arranged so that one 12 months' deposit matures every week and one weekly deposit matures every day to meet possible cash requirements. The Official Receiver can rearrange the schedule as and when required.

18.42 The advantages to the system are that by placing money in long term fixed deposits, the Official Receiver is able to earn high interest rates and cash is always available at short notice to meet payment obligations. It is not necessary to wait for deposits of a particular estate to mature before funds become available for payment, nor is it necessary for each estate to place funds on short term deposit in anticipation of payment. Each estate is able to maximise its interest returns, particularly smaller estates because they attract the higher interbank interest rate which attaches to deposits of over $500,000.

18.43 Estates of less than $100,000 cannot invest in the Pool Investment Scheme. In such estates all the interest earned accrues to the Government under section 294. Estates of $100,000 or more may opt in or out of the scheme. Liquidators and special managers participating in the scheme may request the Official Receiver to specify the amount of investment.

18.44 The scheme has the additional attraction that there is no prospect of estate monies being lost by the negligence or dishonesty of a private sector liquidator. While we accept that our proposals for the introduction of qualified insolvency practitioners[12] would reduce such risks even further, the scheme seems to be a sensible and well run operation.

---

[11] See section 295.

[12] See our proposals on the licensing of insolvency practitioners, *infra,* at paragraphs 26.1 to 26.26.

18.45 The questions of the charge of 1.5 per cent on the interest earned, and other administrative charges when assets are realised, go more to the nature of the funding of the Official Receiver's Office and we address that issue elsewhere.[13]

Inconsistencies between section 285 and rule 183

18.46 The Hong Kong Society of Accountants submitted that:

> *"There are apparent inconsistencies between section 285 and winding-up rule 183 as regards the timing, the amount of and the terminology used for unclaimed and undistributed assets to be paid to the Companies Liquidation Account.*
>
> *Section 285(1) provides that 'If it appears that either from any statement sent to the Registrar under section 284 'or otherwise' that a liquidator has in his hands or under his control any money representing unclaimed or undistributed assets of the company which have remained unclaimed or undistributed for six months after the date of their receipt, or any money held by the company in trust in respect of dividends or other sums due to any person as a member of the company, the liquidator shall 'forthwith' pay the said money to the Companies Liquidation Account, ...'.*
>
> *This could mean that the liquidator is required to keep track of the receipts on a daily basis, and to pay into the Companies Liquidation Account any unclaimed or undistributed monies 'forthwith' on the day 'exactly six months after the day of receipt' of the funds in question. This would be administratively impossible.*
>
> *Rule 183 sets out the rules relating to payment of undistributed and unclaimed money into the Companies Liquidation Account. Rule 183(2), which applies only to a voluntary liquidation, expands on section 285(1) and sets out additional provisions for payment of money representing unclaimed or undistributed assets under the control of the liquidator into the Companies Liquidation Account. This rule states that, among other things, the amount to be paid into the Companies Liquidation Account shall be paid into the Companies Liquidation Account within 14 days from the date to which the 'statement of accounts' is brought down. This is clearly in contradiction with the 'forthwith' rule in section 285(1). In practice, the Official Receiver makes a request for payment under section 285(1) subsequent to the*

[13] See our proposals on the funding of the Official Receiver' s Office, *infra,* at paragraphs 29.1 to 29.3.

filing of a liquidator's return or six months after commencement of a voluntary liquidation.

Further, rule 183(2) sets the amount to be paid to the Companies Liquidation Account, which shall be the minimum balance of such money which the liquidator has had in his hands or under his control during the six months immediately preceding to the date to which the liquidator's statement of account (Form 92) is brought down, less such part (if any) that the Official Receiver may authorise him to retain for the immediate purpose of the liquidation.

In practice, the Official Receiver makes no reference to rule 183(2) when requesting payments to be paid to the Companies Liquidation Account and the amount to be paid in is effectively all undistributed assets unless the liquidator gives good reasons for any proposed retention of funds.

In practice, the Official Receiver asks that all funds, that is, the closing balance, be paid to the Companies Liquidation Account regardless and puts the onus on the liquidator to justify to the satisfaction of the Official Receiver the retention of any funds in the liquidation, before such funds can be retained by the liquidator.

It is suggested that the law be revised to eliminate the apparent discrepancies between section 285 and rule 183. Additionally, it would be useful for the Official Receiver to issue guidance notes on their practice."

18.47 We **propose** that "*forthwith*" in section 285(1) should be replaced by "*within 14 days*". This would remove the discrepancy pointed out by the Hong Kong Society of Accountants.

18.48 The Official Receiver has advised that the Official Receiver's Office is reviewing its practice and guidance notes generally and that the exercise would apply to section 285 and winding-up rule 183.

Tax Clearance Certificates and Estate Duty Clearance Certificates

18.49 We understand that there is sometimes a delay in obtaining tax clearance certificates and estate duty clearance. When delays occur in members' voluntary windings-up, liquidators are obliged to place money in the Companies Liquidation Account. It had been pointed out that this has the effect that the Government benefits from these deposits while it processes the clearance certificates. The Official Receiver had indicated that if the only outstanding matter is the tax clearance certificate or the estate duty clearance then, in a members' voluntary winding-up, the Official Receiver would be prepared to allow

liquidators to retain monies without having to deposit them in the Companies Liquidation Account.

Prescribed period

18.50 The Hong Kong Society of Accountants submitted that:

> *"As regards the five year limit, it is proposed that section 285(5) be amended to say that the prescribed period should be six years, to correspond with the statutory limitation period of contractual debt. We further propose that the period should only begin to run from the date of declaration of final dividend."*

18.51 We have no evidence that the five year period causes any problems in practice. We have no objection to the period being changed from five to six years but do not understand the reasoning behind the submission as it appears that the six year limitation would not relate to contractual debt but to the time limit for fraud.

Section 289 Affidavits, &c. in Hong Kong and Commonwealth

18.52 The section provides for the swearing of affidavits in Hong Kong and elsewhere. Under the recent Adaptation of Laws (Courts and Tribunals) Bill, the reference to "*in Hong Kong and Commonwealth*" in the title to the section is to be repealed and from "*elsewhere within the Commonwealth*" to "*outside the Commonwealth*" is to be substituted by "*in any jurisdiction before any court, judge or person authorised under the law of that jurisdiction to take and receive affidavits in that jurisdiction*".

CHAPTER 19

PROVISIONS AS TO DISSOLUTION

Section 290 Power of court to declare dissolution of company void[1]

19.1 The section provides that where a company has been dissolved,[2] the court may within two years of the dissolution, on the application of the liquidator or any interested party, order that the dissolution has been void. The court may extend the two year time period provided there are exceptional reasons for doing so.

19.2 The provision applies whether a company has been wound-up by the court or by a creditors' voluntary winding-up or a members' voluntary winding-up.

19.3 We considered whether the court needed to be involved in an application to reverse the dissolution of a company. There is, however, a public interest element in reversing the dissolution of a company and, though the costs of reversing a dissolution can be considerable, an application would only be made for good reasons, and the costs are a necessary expense that must be factored in.

19.4 The public interest element is particularly important in the case of a company which has been wound-up as a members' voluntary winding-up, as the members effectively guide the liquidation as opposed to the creditors.

19.5 We considered whether the provision should only apply to members' voluntary winding-up, with the establishment of some other process, perhaps an application to the Registrar of Companies, as an alternative for the other forms of winding-up. We have made no proposal in this regard but would be interested to receive comments.

Section 290A Registrar may strike off company for failure to forward annual returns

19.6 The section provides that the Registrar of Companies may strike a company off the companies register if it fails to file an annual return for two consecutive years.

19.7 We have no comment to make on the section. Subsection (6), however, provides that a company may be revived for up to 20 years after it has

---

1 Note the comment, *supra*, under paragraph 12.41.

2 Dissolved under sections 226A, 227, 239 or 248.

been struck off on payment to the Registrar of Companies of a revival fee of $20,000. We refer to the preference accorded to the revival fee in our proposals under section 265.[3]

Section 290B Bona vacantia

19.8 The section provides that, where a property is dissolved under section 290A, all property of the company immediately before its dissolution, apart from property held by the company on trust for any other person, shall be deemed to be *bona vacantia* and shall accordingly belong to the Government.

19.9 The section is limited to cases where a company has been dissolved. The principle of *bona vacantia* in all other circumstances is dealt with under section 292.

Limitation of four months in respect of claims

19.10 We are concerned about the reference in subsection (2) that a claim under *bona vacantia* should be made within four months after dissolution, as it seemed to us that as many claims under *bona vacantia* are property related and often do not arise for years, it tend to defeat the purpose behind the principle of restitution of property held by the Government to its rightful owner.

19.11 Instead of extending the established right of claimants to apply at any time for restitution of property, the section appears to penalise claimants in the case of companies dissolved under section 290A.

19.12 The Registrar of Companies has advised that sections 290A to E originated from the recommendations made by the Standing Committee on Company Law Reform.[4] The Standing Committee, while noting that details of the procedure would be worked out at a later date, did not refer to any time limit in its report.

19.13 Claims under the section are now made to the Registrar of Companies and his decisions are subject to appeal to the court.

19.14 We do not understand why claimants under *bona vacantia* in cases of companies which have been dissolved under section 290A should be treated differently to claimants in other circumstances. We consider the imposition of a time limit to be unfair and contrary to the principle of restitution by the Government if the real owner steps forward. It should be of no consequence to a claim that the company was dissolved under particular circumstances nor that the

---

3 See, *supra*, paragraphs 514 to 516.

4 *Standing Committee on Company Law Reform, Fifth Annual Report*, paragraph 4.73.

claim might arise many years after the dissolution. We **propose** that section 292 should apply to all claims of *bona vacantia*, regardless of how a company was dissolved.

Section 291 Registrar may strike defunct company off register

Limitation of claims under bona vacantia under section 292

19.15 No provision is made in relation to *bona vacantia* under section 291, which provides that the Registrar of Companies may strike a company off the register if he believes that the company is not carrying on a business.

Claims in respect of bona vacantia

19.16 We refer to our proposal in section 290B that all claims for restitution of property that has gone to the Government under *bona vacantia* should be dealt with under section 292.

19.17 The Registrar of Companies has advised that claimants under section 290B(2) are in a better position than claimants under section 292, which makes no reference to *bona vacantia*. We would have assumed that section 292 would apply to claims under *bona vacantia* made in respect of a company dissolved under section 290A. If that is not the case, we **propose** that our proposal in relation to section 290B should also apply to section 291.

Section 292 Property of dissolved company to be bona vacantia

19.18 The section provides that where a company is dissolved otherwise than under section 290A, all property of the company immediately before its dissolution, apart from property held by the company on trust, shall be deemed to be *bona vacantia* and shall accordingly belong to the Government.

19.19 Although there is no legislation on the point, it is the convention that if property that has vested in the Government under *bona vacantia* is subsequently claimed by its rightful owner, the property will be returned to the owner.

Claims to property which have vested bona vacantia in the Government

19.20 The Hong Kong Association of Banks submitted that:

> *"The law relating to bona vacantia may need review in the context of the change in sovereignty in July 1997. In brief, in certain circumstances property can vest in the Government when it is not*

claimed by any person. At present by convention the Government will on application grant back property vested in it as bona vacantia to the original owner. This is however discretionary and perhaps either this practice should be formalised or the whole concept of bona vacantia abolished so that property remains with its existing owner rather than vesting in the Government."[5]

19.21 There appears to be an argument that the Crown prerogative might have lapsed after the change of sovereignty on 30 June 1997. Whether or not the argument is correct, we **propose** that the opportunity might now be taken, in line with the Hong Kong Association of Banks proposal, that the convention should be formalised into legislation.

19.22 We **propose** that provision should be made for the outstanding or surplus assets of a defunct company to vest in the Government and that the Government should return property to any rightful owner who can establish a claim to the surplus property.

[5] The submission was made before the change of sovereignty on 1 July 1997. All references to "*Crown*" should now be taken as references to "*Government*".

CHAPTER 20

RECEIVERS AND MANAGERS

20.1 The Hong Kong Society of Accountants submitted that:

> *"The Society considers that receiverships, being one particular form of insolvency proceedings, are closely related to the winding-up provisions and should be reviewed at the same time as the winding-up provisions."*

20.2 The Hong Kong Association of Banks submitted that:

> *"The position of receivers needs to be reviewed and in particular whether they should be subject to a greater level of accountability to other creditors and whether they should have particular qualifications."*

Combining Part III (Registration of Charges) and Part VI (Receivers and Managers)

20.3 The Hong Kong Society of Accountants submitted that:

> *"While Part VI of the Ordinance sets out certain provisions for 'Receivers and Managers', it does not cover all provisions relating to 'receiverships' even within the Ordinance. This sometimes creates certain unnecessary confusion. We consider it helpful to combine the current Part VI with Part III 'Registration of Charges' so that, even without any further amendment, the law governing receiverships may be found all in one place within the Ordinance."*

20.4 We agree with the submission and **propose** that Parts III and VI should be combined as the two parts are closely related. The combined provisions should appear before the provisions on the winding-up of companies.

Regulation of insolvency practitioners

20.5 We refer to our proposals for the regulation of receivers and other offices under the insolvency regime under our proposals for the licensing of insolvency practitioners.

Certification of the appointment of a receiver or receiver and manager

20.6 The Hong Kong Society of Accountants submitted that:

> *"As the concept of a receiver or receivership is not found in most non-common law jurisdictions, practitioners have invariably been asked to explain and to prove, when dealing with parties in such jurisdictions as the PRC and Macau, the position, authority and powers of a receiver. All that the receiver is able to produce at the moment is likely to be his appointment papers which are invariably engrossed on plain white paper, bearing the signature of some duly authorised officer of the debenture holder or appointing bank. These papers simply do not appeal to these parties in such jurisdictions. They expect to see some documents from the relevant authority or the court to 'authenticate' the appointment.*
>
> *It would therefore be helpful if provisions can be included in the Ordinance for say, the Registrar of Companies to issue, on an 'as required' basis, 'official' certificate confirming that the appointment of the receiver or receiver and manager has been duly registered with the Companies Registry. The 'certificate' will of course need to be so worded that the Registrar is not confirming the validity of the appointment."*

20.7 We do not wish at this stage to make any proposal in respect of this submission but we would be grateful to receive comments.

Section 297 Disqualification for appointment as receiver
Section 297A Disqualification of undischarged bankrupts

Disqualification of directors

20.8 Reference should be made under these provisions to cases where a person is disqualified from acting as a receiver under the provisions of Part IVA of the Companies Ordinance. Section 168D(1)(c), which disqualifies "unfit directors"[1] from being a receiver, and section 168G(1)(b) which disqualifies a receiver or manager of a company who has been guilty of a fraud or any breach of trust.

Receiver should not be liquidator of the same company

20.9 The Hong Kong Society of Accountants submitted that:

> *"Section 300A(5) of the Ordinance states that 'this section and section 300B, where the company is being wound-up, shall apply*

[1] See the 15th schedule to the Companies Ordinance.

notwithstanding that the receiver or manager and the liquidator are the same person, but with any necessary modifications arising from that fact.' This section seems to suggest that for the same company, the receiver and the liquidator may be the same person. This does not seem to accord with the generally held view that the receiver may not be the liquidator of the same company.

Paragraph 16 of the Supplement to the Society's Professional Ethics Statement 1.203 'Integrity, objectivity and independence in Insolvency' provides that 'Where a partner in or an employee of a practice is, or in the previous two years has been, receiver of any of the assets of a company, no partner in or employee of the practice should accept appointment as liquidator of the company in an insolvent liquidation.' This restriction does not apply where the appointment was sanctioned by the court.

We submit that section 300A(5) be amended to reflect the need for independence in the discharge of the liquidator's duties."

20.10 We agree with the submission and **propose** that there should be a prohibition on a receiver over the assets of a company later acting as liquidator of that company. It would be undesirable for a receiver to subsequently act as a liquidator as it could place the receiver / liquidator in a conflict of interest between his obligations to the person who appointed him as receiver and his obligations and duties as a liquidator.

20.11 A liquidator would be under a general duty to look into the actions of any receiver of assets of a company in liquidation and a receiver / liquidator of the same company would not do this. It would not be in the interests of creditors and contributories generally for a receiver of assets of a company to later wind-up the company.

20.12 We **propose** additionally that the prohibition should extend to partners or members of the same firm who acted as receiver of a company which subsequently went into liquidation.

20.13 We also **propose** that the regulations on insolvency practitioners, when they are drawn up, should contain this prohibition.

Section 300 Power of court to fix remuneration on application of liquidator

20.14 We understand that there is no obligation on a receiver to provide a liquidator with information in order that a liquidator can examine whether a receiver's charges have been reasonable in the circumstances. We are undecided on whether or not receivers should be obliged to reveal such information.

20.15 One view taken is that as banks usually appoint receivers, they are aware of the level of fees that are appropriate for a particular situation and in respect of a particular receiver. Another view is that appointments of receivers are often made by private companies who have no knowledge of what an appropriate level of charging is for receivers. In any event, there is a good argument for more openness, as, if receivers can withhold such information from liquidators, there is always a chance that some receivers will abuse the situation.

20.16 We are considering whether an "*obligation of reasonableness*" should be imposed on receivers and that liquidators' powers to investigate whether a reasonable amount had been charged in the circumstances of a case should be extended. We would be grateful to receive comments.

Section 300A Provisions as to information where receiver or manager appointed
Section 300B Special provisions as to statement submitted to receiver

20.17 Section 300A provides that, on his appointment, a receiver or manager of the whole or substantially the whole of the property of a company shall give the company notice of his appointment. Within 14 days of the appointment of a receiver, the receiver must be provided with a statement of affairs of the company. A receiver is obliged to provide the court with a statement of receipts and payments for every 12 months period after his appointment, with a final statement to be provided within two months, in most cases, after a receiver has ceased to act.

20.18 Section 300B provides that the company's statement of affairs shall be sworn by affidavit and submitted by, in most cases, the officers or employees of the company and shall show the company's assets, debts and liabilities, details of its creditors and any securities held by creditors, as at the date of the receiver's appointment.

Information to be provided by receivers to creditors and other interested parties

20.19 At present, a receiver is only obliged to provide details of receipts and payments to the Registrar of Companies. A receiver owes no obligation to creditors and contributories to provide details of the progress of the receivership. Separately, a receiver will undoubtedly report in much greater detail to the person who appointed him as receiver.

20.20 We **propose** that receivers should provide reports to the creditors and contributories of a company as they have an interest in knowing the financial position of the company.

20.21 In the event that a receiver is appointed but the company is not subsequently wound-up, we **propose** that creditors and contributories should be able to obtain a copy of a receiver's latest report on request on payment of a receiver's reasonable expenses and that a receiver's report should be updated every 12 months if necessary.

20.22 Where a receiver is appointed and the company is subsequently wound-up, we **propose** that a receiver should file a "*Receiver's report*" with the Registrar of Companies within one month of an appointor having given notice of his entering into possession of property the subject of the receivership under section 87(2), that is, in effect, the end of the receivership.

20.23 Provision might be made for the receiver's report in the Official Receiver's administrative scheme for reporting regulations. In the context of reporting by receivers generally, we note some dissatisfaction among practitioners with the amount of information that some receivers are prepared to give to creditors and others. We suggest that the Official Receiver, in preparing the rules for the licensing of insolvency practitioners, should address the issue.

CHAPTER 21

WINDING-UP OF UNREGISTERED COMPANIES (CROSS-BORDER INSOLVENCY)

21.1 The treatment of cross-border insolvency is especially important in Hong Kong because of Hong Kong's status as an international business and financial centre. A large and growing proportion of companies listed in Hong Kong are registered abroad and a large and growing number of private companies are also registered outside Hong Kong. It is therefore imperative that cross-border insolvency provisions be promulgated that are both comprehensible and functional. The present provisions have provided some difficulty in terms of comprehension but have proved to be sufficiently flexible to suggest that, while they need to be clarified, the underlying intentions do not need to be greatly altered.

Section 326 Meaning of unregistered company

21.2 The section provides that for the purposes of Part X, "*unregistered company*" includes any partnership, whether limited or not, any association and any company, with the following exceptions:

(a) a company registered under the Companies Ordinances of 1865 and 1911 or under the present Companies Ordinance;

(b) a partnership, association or company which consists of less than eight members and is not a foreign partnership, association or company;

(c) a partnership registered in Hong Kong under the Limited Partnerships Ordinance.

21.3 A recent amendment has added the provision that for the avoidance of doubt it is declared that "*unregistered company*" includes an oversea company which is certified under section 333(3) as being registered under Part XI.[1]

Section 327 Winding-up of unregistered companies

[1] Ordinance No. 3 of 1997.

21.4 Subject to the provisions of Part X, any unregistered company may be wound-up under the Ordinance, and all provisions of the Ordinance with respect to winding-up shall apply to an unregistered company, with the exceptions and additions mentioned in this section. No unregistered company can be wound-up voluntarily under these provisions.

21.5 An unregistered company may only be wound-up under these provisions:

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

(b) if the company is unable to pay its debts; or

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

Section 327A Oversea companies may be wound-up although dissolved

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

21.7 The Securities and Futures Commission submitted that:

> *"Opportunity should be taken to...examine whether there are ...pitfalls in the winding-up provisions concerning extra-territoriality. This is significant in view of the large number of oversea incorporated companies listed on the Unified Exchange."*

21.8 The Hong Kong Society of Accountants submitted that:

> *"At present, overseas companies are wound-up in Hong Kong pursuant to the rules applicable to companies incorporated in Hong Kong. There are no additional rules specific to overseas companies which address their particular circumstances. It is suggested that there be additional rules applicable to overseas companies to reflect the fact that the Hong Kong liquidation is limited to the branch or the assets in Hong Kong, rather than a winding-up of the world-wide undertaking of the overseas company. In addition, specific rules should address such issues as the pooling of Hong Kong assets with the liquidator in the jurisdiction of incorporation."*

21.9 The Companies Ordinance provisions relevant to the area of cross-border insolvency are undoubtedly thin. Cross-border insolvency is an area that is becoming increasingly important as companies become more internationalised with significant numbers of companies operating in Hong Kong either being registered in other jurisdictions or being owned by or owning foreign companies.

21.10 There is a temptation to suggest legislation that would comprehensively provide for every situation envisaged at present. We do not, however, favour the introduction of comprehensive provisions as the current provisions, when considered together with common law developments, already cover many of the areas that need to be addressed. Where we make proposals for legislation, the proposals relate to weaknesses or gaps in the current provisions that could be usefully resolved through legislation. These are mainly technical matters that would make it easier, for instance, for foreign insolvency proceedings, to have access to the Hong Kong court.

21.11 Comprehensive legislation could also result in an inflexible procedure which is not desirable in an area of law that is constantly developing. We prefer to provide fundamental legislative provisions but leave considerable discretion in the hands of the court in order that the court would have the power to react to any given set of circumstances. An example of just such a situation may be found in the decision of the court in the "*Irish Shipping*" case, where the court allowed a foreign representative to file a petition on behalf of a foreign company.[2]

21.12 The way in which the winding-up of foreign companies is dealt with under the Companies Ordinance is explained as follows:

> *"Section 176 of the Companies Ordinance provides the Hong Kong court with the jurisdiction to wind-up any 'company', which is defined in section 2 as a Hong Kong company.*[3] *Foreign companies are wound-up pursuant to provisions in Part X of the Companies Ordinance. A foreign company in Hong Kong is called an 'unregistered company'; it is also called an 'oversea company' if it has established a place of business in Hong Kong. Although a foreign company is generally not considered to be a 'company' as that term is defined in section 2 of the Ordinance, it may be deemed to be a 'company' to the extent provided by Part X of the Ordinance.*
>
> *... Part X of the Companies Ordinance, entitled 'Winding-up of unregistered companies' contains the relevant sections for winding-up*

---

2 *Re Irish Shipping Ltd.* [1985] HKLR 437.

3 Section 2 defines "*company*" as a "*company formed and registered under this Ordinance or an existing company*". An "*existing company*" , in turn, is defined as a company formed and registered under earlier Hong Kong companies ordinances.

foreign companies. Section 326 defines 'unregistered company' to include any partnership, limited partnership, and company, except for, [among other things] ... a company registered ... under the Companies Ordinance.

Section 327(1), in turn, provides that, subject to the provisions of Part X of the Companies Ordinance, any unregistered company may be wound-up under the Companies Ordinance. Under section 327(3), and unregistered company may be wound-up under the following circumstances:

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

(b) if the company is unable to pay its debts;

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

21.13 The recent amendment to section 326[4] was introduced as a consequence of the decision of the court in the case of *Securities and Futures Commission v MKI Corporation*[5], which held that *an* "*oversea company*" may be wound-up as an "*unregistered company*"; another example of the court exercising its discretion appropriately.

21.14 Most foreign companies in Hong Kong are wound-up under section 327 and, although a foreign company may be wound-up under section 327A, in practice the section is rarely used.

21.15 In making these proposals our objective is to achieve provisions which would have the effect of providing that:

(a) any company which does business in Hong Kong, whether or not it is a company which can be wound-up as defined under section 167 or an "unregistered company" or "oversea company" as defined in sections 326 and 327A respectively, may be wound-up by the Hong Kong court.

(b) foreign insolvency proceedings may be recognised in main proceedings without the need for the foreign insolvency practitioner to initiate main insolvency proceedings under the Companies Ordinance, and

---

4 See, *supra*, paragraph 21.3.

5 [1995] 2 HKC 79.

(c) such recognition would be based on the principle of reciprocity.

21.16 These proposals would involve Hong Kong participating in what has been described as the simplification and unification of transnational insolvency proceedings.[6] The comment continues:

> *"Under this approach, a primary insolvency proceeding, which is intended to resolve all claims against the debtor's estate world-wide, occurs in the jurisdiction in which the debtor is domiciled or where the debtor's principal place of business is located. A trustee is appointed in this primary proceeding. To collect the world-wide assets of the debtor and to seek the turnover of all such assets to the primary proceeding, the trustee travels abroad and commences ancillary proceedings in each country in which assets of the debtor are located.*
>
> *In each of these ancillary proceedings the court recognises and gives effect to the declaration of insolvency in the primary proceeding, provides assistance to the trustee or foreign representative, applies the substantive insolvency law to the country in which the primary proceeding is occurring, and orders the turnover of all local assets to the primary proceeding. Because the final adjudication in the primary proceeding is respected by all jurisdictions, all creditors world-wide must submit claims in the primary proceeding or be forever barred from pursuing their claims."*

21.17 Giving effect to that intention is another matter and, although the international insolvency community is moving in the direction of the universal approach, there is probably no jurisdiction which applies the principle entirely. This does not mean that Hong Kong should not now make efforts to move in that direction as to do so would facilitate the resolution of insolvency cases expeditiously and for the benefit of all concerned. Such provisions should also enhance Hong Kong's reputation as a place to do business.

Jurisdiction of the court

21.18 In order for a company to be wound-up under the provisions of the Companies Ordinance it must be established that Hong Kong is the appropriate jurisdiction in which a particular company should be wound-up.

---

[6] Charles D. Booth, "*The Transnational Aspects of Hong Kong Insolvency Law*", *Southwestern Journal of Law and Trade in the Americas,* Spring 1995, Volume 2, Number 1, page 5.

21.19 While companies which are incorporated in Hong Kong obviously qualify to be wound-up by the court under section 176, the situation is not so clear with regard to companies which are registered in other jurisdictions.

21.20 It was submitted to us that except for section 327A's application to situations where a foreign company "*which has been carrying on business in Hong Kong ceases to carry on business in Hong Kong*" the Companies Ordinance is silent as to the jurisdictional connection that must exist between a foreign company and Hong Kong to enable the foreign company to be wound-up in Hong Kong. The submission suggested that two independent jurisdictional tests, one based on the presence of assets and another based on the carrying on of business either directly or through an agent, should be adopted into legislation.[7]

21.21 The "*assets based*" test referred to in the submission is just one example of "*sufficient connection*", with carrying on business either directly or through an agent being another test.

21.22 We do not accept that it is appropriate to incorporate specific tests into the Companies Ordinance because, as stated above, this could have the effect of limiting the discretion of the court to certain criteria that might not be appropriate to a particular set of circumstances. We **propose** that the Companies Ordinance should not set out the jurisdictional requirements needed to establish a connection as we prefer to leave this to the discretion of the court in any particular case.

21.23 Although we received submissions of a general nature on these provisions, the only substantive comment we received was from Mr Booth and Mr Smart. We consider that it is important to have as much comment as possible on this issue and we therefore seek substantive comments on these proposals.

Recognition of foreign proceedings

21.24 The Companies Ordinance does not make provision for recognition of foreign proceedings and this is an area where we consider that the legislation should provide guidance to the court. Mr Booth has also suggested that this is an area of weakness in the Companies Ordinance provisions.

21.25 The Insolvency Act 1986, section 426, provides that the courts of the United Kingdom will co-operate with courts of certain designated jurisdictions, including Hong Kong. This leads to something of an anomaly as Hong Kong does not reciprocate with the United Kingdom or any other jurisdiction through legislation. We do not, however, favour the concept of a list

---

[7] Submission of Mr Charles Booth and Mr Philip Smart. See, *supra*, paragraph 13 in the Introduction.

of jurisdictions[8] which would automatically receive co-operation as we would prefer to leave it to the courts to decide whether a foreign proceeding should receive co-operation from the court.

21.26 A different approach is taken under section 304 of the United States Bankruptcy Code. Under this approach, the Hong Kong court would need to determine whether to allow a foreign representative to commence a proceeding ancillary to the foreign proceeding in the Hong Kong court. The foreign representative would initiate the application by filing a summary application with the court. In determining whether to grant relief, the court should be guided by what would best assure an economical and expeditious administration of the estate. The court could apply the criteria which is applied under section 304 of the Bankruptcy Code, as follows:

(a) just treatment of all holders of claims against or interests an estate,

(b) protection of claims holders in (Hong Kong) against prejudice and inconvenience in the processing of claims in such foreign proceeding,

(c) prevention of preferential or fraudulent dispositions of property of an estate,

(d) distribution of proceeds of an estate substantially in accordance with the order prescribed by (the Companies Ordinance), and

(e) comity.[9]

21.27 We propose the adoption of a provision along the lines of section 304 of the United States Bankruptcy Code as this would provide the court with guidelines to apply to any particular case while leaving the court to exercise its discretion in each application and satisfy the main requirement, as we see it, that Hong Kong interests receive fair treatment in a foreign proceeding.

"Oversea" companies

21.28 The title to section 327A refers to "*oversea*" companies, which is, we believe, a legacy of legislative drafting that is not only curiously worded, but

---

[8] In this context, Hong Kong is in a unique position. The Hong Kong Special Administrative Region is now part of the Peoples' Republic of China (the PRC) but, under the concept of "*One country, Two systems*", Hong Kong retains a separate legal system. This means that while Hong Kong is part of the PRC, to all intents and purposes the rest of the PRC may be treated as a separate and distinct jurisdiction.

[9] The U.S. Bankruptcy Code provisions are also applied in personal bankruptcy.

is plainly wrong in the physical sense as part of the territory of Hong Kong is on mainland Asia.

21.29 We **propose** that the reference to "*oversea*" should be amended to reflect the fact that the legislation would relate to companies which are not Hong Kong companies, bearing in mind that companies incorporated in the China are not foreign. We suggest that the it might be more appropriate to use wording such as "*non-Hong Kong Special Administrative Region companies*" or "*non-domestic companies*".[10]

Whether Hong Kong courts should apply foreign law in ancillary proceedings

21.30 It had been suggested that Hong Kong courts might be permitted to apply foreign law in ancillary liquidation proceedings. A provision of this nature is found under section 426(5) of the Insolvency Act and we understand that the United Kingdom courts do apply foreign provisions in appropriate cases.

21.31 Although the logic of the suggestion is accepted, we consider that it would be inappropriate to adopt a provision of this nature in Hong Kong. We are concerned that Hong Kong is involved in so many multinational liquidations that the Hong Kong courts could be faced with a large number and variety of applications to apply foreign rules. In addition, Hong Kong insolvency practitioners would not have the practical experience to apply foreign rules. We therefore decline to endorse the suggestion but would welcome comments on the point.

UNCITRAL model law [11]

21.32 We should refer to the United Nations Commission on International Trade Law (UNCITRAL) model law which has been promulgated to assist jurisdictions to formulate a modern, harmonised and fair legislative framework to address more effectively instances of cross-border insolvency. The model provisions are intended to provide jurisdictions with the opportunity to adopt certain internationally accepted practices into their law.[12]

21.33 The model law is in a draft stage at present and is, we understand, being actively considered by Government bodies in the United States and in Australia. While we welcome an initiative that encourages harmonising the laws of insolvency internationally, we consider that it would be premature for Hong Kong to adopt what is still only a draft, as legislation.

---

10 We note that the expression "oversea company" is likely to be amended by the Law Draftsman in the course of the adaptation of laws exercise.

11 "*UNCITRAL model law*": the United Nations Commission on International Trade Law draft guide to enactment of the UNCITRAL Model Provisions on Cross-border insolvency. UNCITRAL thirtieth session, Vienna, 12 to 30 May 1997.

12 See paragraphs 3 and 4 of the UNCITRAL draft guide.

21.34 We **propose**, however, that in re-drafting the Companies Ordinance provisions on cross-border insolvency, the Law Draftsman might consider the extensive definitions that have been developed in the draft guide.

CHAPTER 22

CONVERSION OF A CREDITORS' VOLUNTARY WINDING-UP INTO A COMPULSORY WINDING-UP

22.1 The Hong Kong Society of Accountants also submitted that:

"Currently there is no clearly defined practice for filing accounts (the relevant date of filing as well as the period to be covered) in the event of a conversion from a voluntary winding-up to compulsory winding-up. It is not clear whether the liquidator appointed under a voluntary winding-up should prepare accounts up to the date of his ceasing to act as liquidator in the voluntary liquidation, the court winding-up order or the date of appointment of the liquidator by the court.

In the event of a conversion, the date of the cessation of the term of office of the liquidator in the voluntary winding-up is not clear. sections 236, 245 and 252 set out the circumstances where liquidators in voluntary liquidations may be removed. They do not include situations of conversions to compulsory liquidations. Hence, unless the relevant winding-up order or the order appointing the court-appointed liquidator specifically provides also for termination of office of the 'voluntary' liquidator, it is not clear when the 'voluntary' liquidator's office is terminated. Thus, in practice, there is an ambiguity which can be confusing for insolvency practitioners.

If the court appoints the liquidator in the voluntary winding-up to continue as liquidator after the conversion, it is also unclear whether this change in capacity / appointment would require the person concerned to file accounts in these two different capacities; that is, in his capacity as liquidator under the voluntary winding-up, according to rule 181, and in his subsequent capacity as liquidator in the court-ordered winding-up, in accordance with rule 162(1. In addition, as mentioned above, there is the issue as to when precisely the term of office of the liquidator in the voluntary proceedings formally ends.

In view of the above, we propose that consideration should be given to providing expressly, in the case of a conversion, for:

(i) the point at which the office of the liquidator in the voluntary winding-up terminates; and

(ii) the requirements as to the timing for the filing of accounts and the period to be covered by such accounts, in respect of the two office-holders."

22.2 We agree with the submission that the position needs clarification and **propose** that the power of the liquidator appointed in the creditors' voluntary winding-up should cease on the date of the order converting the creditors' voluntary winding-up into a winding-up by the court. In addition, we **propose** that in relation to the filing of accounts it stands to reason that a liquidator should only be required to swear accounts for which he was responsible. A liquidator in a creditors' voluntary winding-up who hands over accounts to a new liquidator should, therefore, only be obliged to sign off on the accounts up to the date of the conversion of the liquidation.

CHAPTER 23

COMPANIES (WINDING-UP) RULES

Rule 22A Deposit by petitioner

23.1 The Official Receiver's Office submitted that:

> *"A petition under section 168A should be exempted from the requirement to pay a deposit to the Official Receiver, who has no involvement in such petitions."*

23.2 We understand that the question of whether or not a deposit is required depends on whether the proceedings are described as "*Miscellaneous Proceedings*" or "*Winding-up Proceedings*".

23.3 Petitions under section 168A usually attract a miscellaneous proceedings number but if a petition contains a prayer for a winding-up order as an alternative, the case would be allotted a winding-up number and so attract a deposit because it would come under the winding-up jurisdiction. The alternative prayer for a winding-up order would usually be made on the just and equitable ground under section 177(1)(f).

Rule 23A Copies of documents filed in proceedings to be served on Official Receiver

23.4 The Official Receiver' s Office submitted that:

> *"The requirement to serve copies of all documents in connection with any proceedings on the Official Receiver should not apply to section 168A petitions."*

23.5 We agree with the submission and **propose** that there should be no need for documents in connection with petitions under section 168A should not be served on the Official Receiver.

Rule 24 Advertisement of petition

23.6 The Legal Aid Department submitted that:

"Rule 24 should be amended to correspond with the Practice Direction given by the Chief Justice on 27th June 1989 that the reference to at least two Hong Kong newspapers for the advertisement of a winding-up petition should include publication once in English in an English language paper and once in Chinese in a Chinese language paper."

23.7 At present, paragraph (a) of rule 24 makes no provision for publication to be in one English language and one Chinese language newspaper. We **propose** that rule 24 should be amended to reflect the terms of the Practice Direction.

Rule 28 Appointment of provisional liquidator

23.8 The Hong Kong Society of Accountants submitted that:

"After the presentation of a winding-up petition, the court may appoint a provisional liquidator at any time before the making of a winding-up order. Although section 193 and rule 28 cover the appointment and powers of a provisional liquidator, there is no express provision relating to the procedural aspects of a court liquidation involving a provisional liquidator such as notification of appointment and notification that the company is in liquidation, powers, gazetting of notices, etc.

There have been experiences in the past where provisional liquidators encountered practical problems when trying to lodge notices with the Companies Registry or determine whether, and in what form, the provisional liquidator should advertise his appointment. Practically speaking, practitioners try and follow the winding-up provisions. However, these are inadequate.

We propose that the duties, powers and responsibilities of a provisional liquidator of a court liquidation should be defined to ensure consistencies with existing rules and presently unclear areas are specifically provided for by legislation."

23.9 We agree with the submission and **propose** that the appointment of a provisional liquidator should be advertised and gazetted. Notice of appointment should also be filed with the Registrar of Companies. This could be achieved by following the relevant provisions on appointment of a liquidator. The appointment of a liquidator must be gazetted and advertised, with notice of appointment to be given to the Registrar of Companies.[1]

[1] Companies (Winding-up) Rules, rule 45(5) and (6) and rule 46.

Rule 33 Substitution of creditor or contributory for withdrawing petitioner

Withdrawal of petition where it has not been advertised

23.10 The rule provides that where a petitioner (a) fails to advertise the petition within the appropriate time or (b) consents to withdrawal of the petition, or to allow it to be dismissed, or the hearing adjourned, or fails to appear in support of the petition, or (c), if appearing, does not apply for an order in the terms of the petition, the court may substitute as petitioner any willing creditor or contributory who in the opinion of the court would have the right to present a petition.

23.11 Apart from this provision, there is no formal means by which a petitioner can withdraw a petition. We understand that the practice is that where a petition has been advertised it must be dismissed in open court, and we consider that, once advertised, a petition should only be withdrawn or dismissed at a public hearing of the court.

23.12 Where the petition has not been advertised, the practice is that it may be withdrawn with the consent of the parties but there is no authority of which we are aware for this practice.

23.13 The position is clear under the Insolvency Act, which provides that if at least five days before the hearing of a petition, the petitioner on an *ex parte* application, satisfies the court that (a) the petition has not been advertised, and (b) no notices have been received by him with reference to the petition, and (c) the company consents to an order being made, the court may order that the petitioner has leave to withdraw the petition.[2] We **propose** that this provision should be adopted in the Companies (Winding-up) Rules in order to provide certainty as to how to proceed in such a situation.

Rule 47 Security to satisfaction of Official Receiver
Rule 48 Failure to give or keep up security

23.14 We refer to our proposals on security to be given by liquidators under section 195.

---

[2] Insolvency Act, rule 4.15.

Rule 93 Notice to creditors to prove

23.15 We refer to our comment on this rule under section 217.

Rule 123 Quorum

23.16 The rule provides that the quorum at a meeting of creditors should be three creditors entitled to vote or three contributories or all the creditors entitled to vote or all the contributories, if the number of creditors entitled to vote or the contributories, as the case may be, does not exceed three.

23.17 The Commission recommended in its Report on Corporate Rescue and Insolvent Trading that the quorum at a meeting of creditors to consider a proposal for a voluntary arrangement should be one creditor present and entitled to vote.[3]

23.18 We **propose** that one creditor should constitute a quorum even if it is known that there are more than three creditors. This proposal would follow the Insolvency Act.[4] We do not see why the one or two creditors who attend a meeting of creditors should be denied the right to vote because other creditors have not attended.

23.19 We consider that conflicts are more likely to arise between contributories than among creditors. In addition, shares could also be in the name of nominees who refuse to attend meetings because they have no mandate from their principals. In the light of these potential complexities we **propose** that two contributories should be present to form a quorum at a meeting of contributories. This proposal would follow the Insolvency Act.[5]

Rule 157 Special bank account

23.20 The Official Receiver' s Office submitted that

> *"The requirements in rule 157(1) that where a liquidator is authorised to have a special bank account, every cheque should be countersigned by at least one member of the committee of inspection and by any other person appointed by the committee should be removed. Committees of inspection have shown considerable reluctance to be involved in cheque signing."*

---

3 Paragraphs 16.28 and 16.29.

4 Insolvency Act, rule 12.4A(2)(a).

5 Insolvency Act, rule 12.4A(2)(b).

23.21 We take the point made in the submission but we note that the requirement of a second signature on cheques means that a liquidator is not able to act with complete independence where the assets of the company is concerned.

23.22 We consider that if our proposals for the introduction of licensing of insolvency practitioners are introduced, the higher standards that should result among liquidators should justify amending this rule to allow a liquidator to sign cheques without the need for a second signature.

Rule 176 Costs and taxation

23.23 The Hong Society of Accountants submitted that:

> *"Rule 176 requires all costs and disbursements incurred in a winding-up by the court to be taxed by the court. Whilst such a requirement is useful for preventing possible disputes and as a measure of control over costs, it is not considered necessary in cases where the costs have been approved by the committee of inspection or the creditors. This requirement seems to add to costs without any apparent benefit to the creditors.*
>
> *By comparison, the Insolvency Act, rule 7.34, provides that the liquidator may require the costs of any agent to be taxed, which in effect leaves the matter to the liquidator's discretion. The requirement for taxation will only be imposed if the creditors' committee resolves or the court orders that costs be taxed. Accordingly, it is suggested that rule 176 be revised along the same lines as Insolvency Act, rule 7.34."*

23.24 We agree with the submission for the reasons stated and **propose** that it should be adopted.

Rule 179 Costs payable out of the assets

23.25 This rule provides that the assets of a company in a winding-up by the court remaining after payment of fees and expenses properly incurred in preserving, realising or getting in assets, including where the company has previously commenced to be wound-up voluntarily such remuneration, costs, and expenses as the court may allow a liquidator appointed in such voluntary winding-up shall, subject to any order of the court, be liable to certain payments which are set out in order of priority in the rule.

23.26 The Hong Kong Society of Accountants submitted that:

"With respect to a voluntary liquidation which was subsequently converted to a court winding-up, it is not clear as to whether fees already drawn and paid to the liquidator in the voluntary liquidation would need to be approved by the court or otherwise (retrospectively) under rule 179. Consideration should be given to provide expressly as to whether court sanction is required or whether approval by the creditors or the committee of inspection during the course of the voluntary liquidation would suffice."

23.27 We do not know of any particular problems that have arisen under the rule and see no need to amend the rule.

Rule 183 Payment of undistributed and unclaimed money into companies liquidation account

23.28 We refer to our comments on this rule under section 285.

Rule 190 Disposal of books and papers

23.29 We refer to our comments relating to this rule under section 283.

CHAPTER 24

DIRECTORS: PAYMENT OF COMPENSATION

24.1 The Securities and Futures Commission submitted that:

> *"We believe that one should assess whether directors who had managed the company which ended in insolvency were at fault. If so, we believe they should be held liable for mismanagement. Part IVA of the Companies Ordinance provides for directors who are unfit and directors who are in insolvency situations to be disqualified ... The sub-committee may wish to see how the new insolvency procedures can accommodate procedures for application for directors' disqualification. Secondly, we believe there should also be financial penalty and provisions for compensation in serious cases. The possibility of a claim by the company against directors for breach of fiduciary duties can also be emphasised."*

24.2 Since the Securities and Futures Commission made that submission, there have been 75 disqualifications made of directors under Part IVA of the Companies Ordinance up to 1 April 1997.[1] We question, however, whether the imposition of fines and penalties is the most effective means of punishing directors who do not carry out their functions and obligations in a diligent and honest manner.

24.3 We consider that we have addressed the Securities and Futures Commission's concerns in this Consultation Paper with our proposals for the strengthening of the offences provisions of the Companies Ordinance, sections 271 to 277, but we note our comments on the difficulties of establishing a case against officers of companies and on the low penalties that are being imposed by the court.

Shifting of burden of proof onto directors

24.4 One problem with these proposals is that the proposal that the burden of proof should be shifted onto the person charged with an offence could conflict with the Bill of Rights. While we have no desire to dilute peoples' rights, the fact is that company directors soon become aware that their prospects of being held responsible for their actions are not as great as might otherwise be expected.

---

[1] Note, *supra*, at paragraph 20.8 and, *infra*, at paragraph 31.9.

24.5 We have little doubt that some directors consciously exploit this weakness in the provisions. We are concerned that the lack of effective sanctions under the current law may actively operate as an inducement to otherwise law abiding directors to exploit the weakness and, in regard to small companies where the directors are also shareholders, to regard the protection of limited liability as a sanctuary from which they deal with others with an impunity that they could never have as private individuals.

24.6 Even the introduction of the new provisions on unfair preferences[2] are unlikely to frighten those directors with inclinations towards dishonesty. The provisions generally do not strike directly at a director's point of ultimate interest: his own assets.

24.7 The comments that follow are not proposals as they range beyond our terms of reference and address matters that relate to how solvent companies are managed, to how directors should be obliged to act, and to how directors may be made personally liable to compensate victims for their financial wrong-doings. These are issues that are, however, of concern to the insolvency provisions as provisions that assist in the prevention of unnecessary insolvencies, particularly insolvencies that are caused by asset stripping, should go some way towards tempering the worst cases of abuse by company owners.

24.8 Our concern is that insolvency is often the result of bad management and some of this bad management is dishonest in nature. Insolvency practitioners also know that directors very often get away with dishonest actions because creditors are not prepared to invest the time and money in pursuing these directors. The result is that dishonest directors set up again under a new company name and repeat the same scams against different people. The provisions for the disqualification of directors could go some way towards helping to rid the corporate world of these directors but the current provisions need assistance to achieve these goals.

Obligation on directors to sign an annual statement as to the company's affairs

24.9 It is worth considering imposing an obligation on directors to prepare and sign annually a statement as to a company's affairs, the statement being part of the statutory statement of directors which accompanies the audited accounts. We do not intend to set out what should be in the statement but we suggest that bodies such as the Hong Kong Monetary Authority and the Securities and Futures Commission should be able to assist in preparing a form of statement that would not be a bland statement, revealing nothing, but which would address essential matters. Directors, for example, might be obliged to categorically state that they were fully aware of all key dealings of the company, to disclose all information about their personal dealings with the company, and to state that the

---

[2] Companies Ordinance, section 266B.

company has not traded while insolvent. They might also be obliged to provide details of significant claims that are outstanding against a company and to provide reasons as to why, for instance, significant claims are being contested.

Directors may be obliged to obtain compensation insurance

24.10 The Consultancy Report on the Review of the Hong Kong Companies Ordinance has recommended that apart from a breach of fiduciary duty, the company should be able to purchase directors' and officers' insurance for any risks which the market is prepared to issue.[3] We agree with the recommendation.

24.11 We suggest that consideration might be given to providing that all directors of companies should be obliged to take out personal insurance against compensation claims. The level of insurance would relate to the amount of assets managed by directors or to a ratio between the assets of a company set against its liabilities. We note that such a provision would go against section 165 of the Companies Ordinance which provides for the avoidance of provisions in the articles of association or in contracts which would relieve officers of a company from liability in respect of any negligence, default, breach of duty or breach of trust.

24.12 This approach could have several consequences. Insurers would pitch the level of insurance depending on a director's record, with high standards attracting lower premiums. A benefit would be that claimants would know that they were not facing an empty victory and would be assured of recovering compensation for loss in the event of a successful outcome. This would encourage aggrieved creditors to take on companies and directors directly and directors would not be able to hide behind a "*scorched earth*" policy if they ever wanted to do business in Hong Kong again. Without insurance, creditors may be put off making a claim against companies, as directors would have time to disguise their assets through, for example, the use of trusts.

24.13 This problem was referred to in the Report on Corporate Rescue and Insolvent Trading when, in the chapter on insolvent trading, the Commission recognised that some directors might not have sufficient assets to justify a claim against them for compensation for insolvent trading.[4]

24.14 It should be possible to make provision to oblige directors to maintain insurance by making them subject to a fine and/or disqualification and that auditors should be obliged to report annually on the level and adequacy of insurance.

---

3 The *Review of the Hong Kong Companies Ordinance*, paragraph 6.17.

4 *Report on Corporate Rescue and Insolvent Trading*, paragraph 19.76.

24.15 It might also be useful to provide that companies should be obliged to display their certificates of insurance or produce them on request to interested parties.

24.16 We suggest that, initially, an insurance requirement might be placed on directors of publicly listed companies and that consideration might later be given to extending the provision to the directors of all companies operating in Hong Kong.

24.17 Essentially, we suggest that consideration should be given to moving away from the imposition of penalties and imprisonment and to concentrate more on disclosure and the payment of compensation.[5]

24.18 We note that these comments relate to matters that extend beyond the insolvency provisions and offer these comments as suggestions and observations rather than proposals.

[5] The *Review of the Hong Kong Companies Ordinance* has also made reference to the question of offences. See paragraphs 2.05 and 2.06 of the *Review*.

CHAPTER 25

HONG KONG GOVERNMENT GAZETTE - ADVERTISING OF INSOLVENCY RELATED ISSUES

25.1 Strong views have been expressed in the sub-committee that the costs of advertising statutory notices in the Hong Kong Government Gazette are too expensive.

25.2 The Government Printer has advised that fees for advertisements are, as a matter of policy, market related and that they do not relate to the cost of producing them. The Secretary for the Treasury reviews fees annually, taking into account the current levels of rates for advertising in major local newspapers and the rate of inflation.

25.3 We must question the basis on which the Government calculates the costs of advertising insolvency notices in the Gazette. The Gazette is not a privately published newspaper subject to competition from other publications; it is a statutory monopoly. In our view, it is questionable that basing the charges for advertising on the market rate should be the criterion for costing the Gazette. We do not know whether the Gazette makes a profit for the Government but the experience of the costs of advertising insolvency matters, if applied to other advertisements, would suggest that the Government profits from the Gazette.

25.4 We would point out that insolvency notices published in the Gazette are only published to comply with statutory requirements. Insolvency practitioners have advised that when publishing notices in local newspapers it is a common practice to publish in the newspaper that offers the cheapest rates. This option is not available with notices in the Gazette.

25.5 We took the Gazette's Public Notices, Supplement No. 6, for Friday, 25 April 1997, and catalogued the first 50 notices, starting on page PN3570 with notice number 1, in the matter of *Hon Nin Estates Limited* and ending with number 50, on page PN3584, in the matter of *Iris International Limited*. We suggested to the Government Printer that many of the notices related to the same matters and that it should be possible to list these notices under one heading and then simply note the name of the company concerned underneath with the relevant details.

25.6 Of these 50 notices, 10 can be listed as notices to creditors to send particulars of their debts to liquidators, 12 are notices of final meeting under section 239, and 19 are notices of appointment of a liquidator under section 253.

25.7 Taking section 253 as an example, it would appear, from form 28 of the Companies (Winding-up) Rules, that all that needs to be stated in the notice is the name of the company, the names and addresses of the liquidators, and the date of the resolution. This could be done in a few lines, rather than in the nearly one third of a page that is required at present.

25.8 To illustrate the point, we set out the details of the first three references to section 253 as they might appear in the Gazette:

"The Companies Ordinance (Cap 32)[1]

-

Notice of Appointment of Liquidators

-

Members' Voluntary Winding-up
Pursuant to section 253 (rule 46, form 28)

-

Companies Filing Notice under this Heading [2]
(General heading)

- - - - -

Fook Shau Tong Enterprises Limited
Liquidator: Julie Christina Hume
Address: Flat F, 8th Floor, 132, Electric Road, Tin Hau, Hong Kong
Date of Special Resolution of the Company: 27th March, 1997

-

Sekin Transport International Limited
Liquidators: Joseph K.C. Lo and Dermot Agnew
Address: both of 26th Floor, Wing On Centre,
111, Connaught Road, Central, Hong Kong
Date of Special resolution of the Company: 14th April 1997

-

Lagash Company Limited
Liquidator: Lam King Shan
Address: Flat D, 5th Floor, Fu Dat Court,
32, Fortress Hill Road, North Point, Hong Kong
Date of Special resolution of the Company: 24th April 1997"

25.9 We put this example to the Government Printer who advised that the simplified version of notice could reduce the advertising fee by approximately 74 per cent. The Printer pointed out, however, that this figure did not take account of the cost of the standardised heading, but we would view this as a minor matter. We also note that if notices were grouped in sections and,

---

1 The Companies Ordinance heading could appear at the top of every page instead of in every notice.

2 The heading for each type of notice could appear just once, or at the top of every page, such as, "*Notice of Appointment of Liquidators (under section 253) (Continued)*".

within sections, alphabetically, it would make searches in the Gazette against particular companies much easier.

25.10 We do not suggest that our reduction of the size of notices in the sample is perfect or even entirely in compliance with the statutory requirements but we consider that large savings could be made if notices were standardised. We **propose** that the Official Receiver in conjunction with the Law Society, the Hong Kong Society of Accountants and the Hong Kong Institute of Company Secretaries (those bodies which would make up the bulk of practitioners who would be licensed as insolvency practitioners), should form a working group to look into how the advertising of notices in the Gazette could be shortened. A suggestion that might be considered would be the introduction of forms of consolidated advertisements which could be placed in the Companies (Winding-up) Rules.

CHAPTER 26

LICENSING OF INSOLVENCY PRACTITIONERS

26.1 Our proposals for the licensing of insolvency practitioners would constitute a major change to the practice of insolvency in Hong Kong. The numerous references we make to our proposals on licensing in relation to other issues bear out the impact that licensing would have on the winding-up provisions of the Companies Ordinance and on the practice of insolvency in Hong Kong.[1]

26.2 In 1996, the Official Receiver established and now manages an "*Administrative Panel of Insolvency Practitioners for the Court Winding-up.*" The Administrative Panel is based on similar regulatory provisions that have been established in the United Kingdom and Australia and these proposals are based on those provisions.[2]

26.3 The "*Administrative Panel*" originally consisted of member firms of the Hong Kong Society of Accountants which were deemed to possess the necessary expertise and resources to be appointed as special managers or liquidators of company windings-up by the court having estimated realisable assets of more than $200,000 after deduction of the Official Receiver's fees for acting as the provisional liquidator.

26.4 All cases with realisable assets of more than $200,000 are considered to be "*non-summary*" whereas cases which are defined as "*summary*" cases under section 227F were, until recently, wound-up by the Official Receiver as liquidator in a summary manner.[3]

26.5 The Official Receiver has now expanded the contracting out scheme to summary cases by the establishment of a second panel of practitioners to act as special managers in summary cases, with the Official Receiver remaining as liquidator and in overall control of a summary liquidation. The two panels are now known as the "*List A Panel*" and the "*List B Panel*". There are about 13 firms licensed under the contracting out scheme on the List A Panel and about 17 firms on the List B Panel, though all the firms on the List A Panel are also on the List B Panel.

26.6 The Official Receiver makes appointments from the List A Panel on a roster basis if the statutory meeting of creditors does not appoint a

---

1 Note also our comments, *supra*, at paragraph 9.37.

2 See the Insolvency Act, sections 387 to 398, and the Insolvency Practitioners Regulations under Statutory Instruments Numbers 1995 of 1986 and 439 of 1990 in respect of England and Wales.

3 See section 227F, *supra*, at paragraphs 9.103 to 9.105.

liquidator of its choice. Appointments from the List B Panel are also made on a roster basis.

26.7 The main criteria for membership of the List A Panel is that members must have at least four professional accountants who are members of the Hong Kong Society of Accountants, and two of those accountants must be recognised by the Official Receiver as insolvency professionals with a minimum number of 600 chargeable hours in the last three years or 750 chargeable hours in the last five years of relevant insolvency work, which excludes members' voluntary windings-up, in addition to other requirements. The requirements for the List B Panel are a reduced number of qualifying hours in creditors' voluntary windings-up, compulsory windings-up or in receiverships, with some qualifying hours in members' voluntary winding-up work, among other requirements.

26.8 These additional requirements include undertaking to accept any cases allocated by the Official Receiver, unless there are good reasons which preclude a member from taking an appointment, the carrying out of a minimum standard of statutory investigation, and to continue to handle a case until its reasonable conclusion. Remuneration of liquidators and special managers appointed from the Panels is set down in scales of fees which are reviewed annually by the Official Receiver.[4]

26.9 The winding-up of companies and other insolvency related appointments require high standards of liquidators and other insolvency practitioners as it is they who are charged with realising, managing or re-organising assets and with distributing assets to those entitled to them.

26.10 There has been anecdotal evidence of abuse where assets in windings-up have been diverted by unscrupulous liquidators, usually by selling the assets at low prices to persons connected with the directors. This has particularly occurred in voluntary windings-up where directors declare that a company cannot by reason of its liabilities continue in business, under section 228A, but is not so prevalent in ordinary creditors' voluntary winding-up cases because creditors' voluntary winding-up requires the directors to provide notice to creditors of the winding-up and for a meeting of creditors to be called and a committee of inspection appointed within a short space of time after the resolution to wind-up the company.[5] In addition, there is also some evidence over the last several years of receivers and liquidators being appointed who have had only a vague idea of their functions and obligations.

26.11 We consider that although the majority of liquidations and receiverships are properly conducted, there is a need to regulate appointments to act in insolvency or insolvency related matters and we **propose** therefore to

---

4 Note also our comments on remuneration under section 244, *supra*, at paragraphs 13.18 to 13.23.

5 See sections 241 and 243 and section 251(1)(a).

introduce a new two tier system of licensing of insolvency practitioners to be established and operated by the Official Receiver: "Official Liquidators", who would act in all forms of liquidation, receivership, provisional supervision and bankruptcy and "Registered Liquidators" who would act in members' voluntary winding-up, creditors' voluntary winding-up and individual voluntary arrangements in bankruptcy.

"Official Liquidators" to act in all forms of liquidation, receivership, provisional supervision and bankruptcy[6]

"Registered Liquidators" to act in members' voluntary winding-up, creditors' voluntary winding-up and individual voluntary arrangements in bankruptcy

26.12 Appointments to the new Administrative Panels would be made by the Official Receiver, based on the qualifying criteria for appointments under the current Administrative Panels. In addition to the current situation where only accountants can be appointed to the List A Panel, members of the Law Society and any additional categories of persons with the requisite experience would be entitled to apply to the Official Receiver to be licensed to act as Official Liquidators or Registered Liquidators. In addition, members of the Hong Kong Institute of Company Secretaries would be entitled to be appointed as Registered Liquidators once they had fulfilled the qualifying criteria set down for Registered Liquidators.

26.13 In calculating the number of hours for qualification as Official Liquidators and Registered Liquidators, we suggest that the criteria should be broadly based on the criteria applied to the current provisions for licensing under the existing Administrative Panels.

26.14 The ultimate aim, however, would be to introduce professional insolvency practitioner qualifications based on examinations that would be established by the Official Receiver and the relevant bodies at a later date.

26.15 The licensing system should be tiered so that the most difficult forms of insolvency work, that is, work that would be carried out by Official Liquidators, should only be carried out by those best qualified to do it. In saying this, we recognise that some members' voluntary winding-up cases and summary compulsory winding-up cases produce difficulties and challenges for practitioners just as complicated as those that are more often encountered in non-summary compulsory windings-up. There is a need to grade the various kinds of work, however, and we consider that the model we propose should

---

[6] We note that the use in practice of "*Official Liquidator*" might give rise to confusion with the Official Receiver, particularly the expression "*Official Receiver and liquidator*" and suggest that a more appropriate means of distinguishing the two types of liquidator from each other and the Official Receiver might be found.

generally ensure that the most difficult work is carried out by Official liquidators.

26.16 We refer to those persons who may be appointed to the Administrative Panel dealing with all forms of liquidation, receivership, provisional supervision and bankruptcy, as "*Official liquidators*". Under our "*grandfather*" proposal referred to below, other experienced current practitioners could be included in the list of official liquidators when the scheme is established.

26.17 "*Registered liquidators*" would be qualified to act in members' voluntary winding-up, creditors' voluntary winding-up and individual voluntary arrangements in bankruptcy. Registered liquidators would be members of the Hong Kong Society of Accountants, the Law Society or the Hong Kong Institute of Company Secretaries, though members of the Hong Kong Institute of Company Secretaries would be limited to acting as liquidators in members' voluntary winding-up at least for the initial phase of the Administrative Panel. Registered liquidators could not act in compulsory winding-up, receivership, provisional supervision or as trustee in bankruptcy.

26.18 We have included company secretaries following a submission by the Hong Kong Institute of Company Secretaries, which is the official body for company secretaries in Hong Kong. The Institute submitted that its members are adequately qualified to carry out windings-up and we accept the Institute's contention that company secretaries already carry out a large number of liquidations which we assume is a reference to members' voluntary winding-up for the most part. Members of the Institute are trained in a broad range of legal and accountancy management subjects and are also required to address insolvency issues in the Institute's corporate law and company secretarial practice examinations.

26.19 The authority which would sanction inclusion as Official Liquidators would be the Hong Kong Society of Accountants for accountants and the Law Society for solicitors. The authority for inclusion as Registered Liquidators would lie with the Hong Kong Society of Accountants, the Law Society and the Hong Kong Institute of Company Secretaries. The exception would be the current Administrative Panel list which would form the basis of the initial list of Official liquidators. The Administrative Panel should then be expanded to include Registered liquidators.

Provisional supervision

26.20 Only Official Liquidators, and, in exceptional cases, company doctors, that is, persons who can demonstrate that in a particular circumstance they are the most appropriate person to act as provisional supervisor, could act as provisional supervisor. A provision for the appointment of company doctors has

already been recommended in the Commission's Report on Corporate Rescue and Insolvent Trading. In practice, we anticipate that a proposed company doctor who sought to act as a provisional supervisor would look to the Official Receiver for licence approval before going to the court for sanction.

The "Grandfather" exemption

26.21 In addition to those practitioners who are already on the Administrative Panel, we are aware that there are also a number of qualified and experienced practitioners working in Hong Kong at present who might not be in a position to comply with the criteria for qualification set down for inclusion on the Administrative Panel. We **propose** that, in establishing the expanded Administrative Panel, the Official Receiver should have the power, for a limited period, to appoint those experienced practitioners to the Administrative Panel even though they do not conform with the criteria set down for admission.

26.22 We put forward the "*grandfather*" provision with the aim of securing for the Administrative Panel people of proven ability and experience in Hong Kong. The pool of professional insolvency talent in Hong Kong is relatively small and we consider that it would be short-sighted to exclude proven ability. The "*grandfather*" provision would have a precedent in the Insolvency Act which established the insolvency practitioner provisions in the United Kingdom.

Training and continuing education

26.23 We do not make any proposals for training and education. We consider that these proposals are just a start and that ultimately the Law Society, the Hong Kong Society of Accountants and the Hong Kong Institute of Company Secretaries will establish examinations, as has been the case in the United Kingdom and Australia.

Two practitioners per firm

26.24 We considered whether it should be a requirement that two Official Liquidators from each firm should be available for any appointment from the Administrative Panel, that is, in respect of work that would be carried out by Official Liquidators. It has, however, been pointed out that even large firms could have difficulties in this regard. We therefore **propose** that, as a practical solution, one Official Liquidator and one Registered Liquidator may be appointed from a firm in cases where an Official Liquidator must be appointed.

Indemnity / Bonding

26.25 The question of indemnity and bonding is being considered at present by the Official Receiver and other bodies. There are proposals to replace bonding with professional indemnity insurance. The details are not finalised and

we consider that this is a matter that is best left to the Official Receiver and the professional bodies concerned.

Bankruptcy Ordinance

26.26 We note that the Bankruptcy Ordinance would need to be amended to accommodate these proposals.

CHAPTER 27

TRANSFER OF BUSINESS (PROTECTION OF CREDITORS) ORDINANCE

27.1 We have received three substantial submissions on the Transfer of Business (Protection of Creditors) Ordinance. While the general provisions of the Ordinance are not within our terms of reference, certain provisions of the Ordinance do have relevance to insolvency and thus come within the terms of reference.

27.2 Although many of the comments made in the submissions set out in the following paragraphs are not directly relevant to insolvency, the force of the submissions suggests that the Ordinance does not have the intended effect and needs to be re-examined. The experience of members of the sub-committee reflects the comments made in the submissions.

27.3 We consider that the Ordinance, if effectively drafted, would fulfil a useful function as it is not beyond the bounds of possibility that people could still attempt to transfer businesses without disclosing the true position of the business. The Ordinance should have the effect of providing that where there is dishonesty in the transfer of a business the Ordinance facilitates the pursuit of the vendors without the need to prove fraud against them.

27.4 The Hong Kong Society of Accountants submitted:

> *"In Hong Kong, the Transfer of Business (Protection of Creditors) Ordinance provides protection to unsecured creditors of a business on the transfer of that business by creating a liability in the hands of the transferee for all the debts incurred by the transferor in carrying on the business.*
>
> *While we recognise that there needs to be some sort of protection and recourse for the creditors when businesses are transferred, we have found the legislation to be quite unusable due to the lack of clarity in the provisions and absence of case law.*
>
> *We note that there is no similar legislation in Australia or in the United Kingdom, and that the legislation is quite unique to Hong Kong. The legislation also appears to be quite in-operative. We cannot recall the law having ever been tested in court nor can we provide any relevant authoritative cases thereon. We surmise that due to the significant*

uncertainties contained in the legislation, most people would try to avoid using it.

The following are some anomalies that we have identified in the legislation which may affect :-

(a) the liquidator in a voluntary liquidation.

(b) the receiver or charge holder acting pursuant to a charge registered for less than one year.

Section 10 of the Ordinance provides that 'This Ordinance shall not apply to any transferee where the transfer is effected:

(a) by the Official Receiver or a trustee in bankruptcy;

(b) by the liquidator of a company other than voluntary liquidation;

(c) by the Financial Secretary Incorporated;

(d) by the Director of Education Incorporated;

(e) by the Director of Social Welfare Incorporated;

(f) by a person selling under or pursuant to a charge which has been registered for not less than 1 year at the date when the transfer takes place;

(g) pursuant to any other or direction of any court;

(h) by an executor or administrator; or

(i) by operation of law.'

The words 'other than voluntary liquidation' in section 10(b), and 'for not less than 1 year' in section 10(f) should be deleted, as we cannot see why these limitations should be imposed, to create a potential liability for liquidators in voluntary liquidations and receivers."

27.5 The Hong Kong Institute of Company Secretaries noted two areas of concern when it submitted:

> *"Given the uncertainty in the meaning of a transfer of business in the interpretation sections and otherwise, it is difficult to see how the Ordinance can effectively achieve the protection of creditors objective."*

27.6 We refer to the submission of the Hong Kong Society of Accountants that liquidators in voluntary windings-up could be excluded by deletion of the words in section 10(b) of the Ordinance that "*other than voluntary liquidation*" and that the words in section 10(f) "*not less than 1 year at the date when the transfer takes place*" would satisfy the needs of receivers and liquidators by excluding them from the effect of the provisions. We **propose** that these provisions should be deleted from the Ordinance as we agree with the Society that there is no reason why these limitations should be imposed on voluntary liquidators and receivers. We note that the introduction of a regime of licensed insolvency practitioners would provide a further justification for the deletion of the provisions.

CHAPTER 28

NETTING

28.1 One example of a clearing house netting system in operation in Hong Kong is the Central Clearing and Settlement System (CCASS) operated by the Hong Kong Securities and Clearing Company Limited which was established in 1992. Netting arrangements (that is, arrangements under which two parties or any number of parties enclose or ring-fence their dealings to the exclusion of all other parties) are likely to increase in number over the next few years.

28.2 When the CCASS was introduced we were not in favour of it nor of any scheme which would have the effect of isolating some parties from the consequences of the insolvency of one of those parties *vis a vis* the general body of creditors outside the settlement system. We were concerned that it amounted to an exception to the principle of *pari passu* distribution and that the parties who operated in the system would have first bite at the assets of the insolvent party within the system.

28.3 In an actual case of the insolvency of one of the parties to a netting system, the system would operate to settle all the dealings between the insolvent party and all other parties. In the unlikely event that the insolvent party had a surplus within the system, the balance would be released to the estate of the company for the benefit of other creditors. In the event of a deficit after settlement, the other parties to the system would claim on the liquidation as ordinary creditors.

28.4 The CCASS, for instance, was introduced because it created an environment where settlement of accounts in relation to stock dealings could be completed much quicker than previously and it also facilitated the introduction of a "paperless trading system" as opposed to the previous practice of trading by share certificates.

28.5 The clash between the settlement system and insolvency was that, if the principle of *pari passu* distribution was to be applied to the insolvency of one of the parties to the settlement system, it would mean that all the dealings between the parties within the settlement period would have to be unravelled and that, given the number of dealings involved in the CCASS, for instance, where settlement occurs daily, the task would be both monumental and expensive.

28.6 Electronic settlement systems are not limited to dealings in stocks and shares but are also used for foreign exchange dealings, derivative dealings, inter-group and inter-branch netting, global inter-branch netting (that is, the

netting of contracts with different branches of the same counterparty in different countries) cross-product netting, cross-currency netting and special counterparties netting, for example, special rules for banks, insurance companies and statutory public bodies.

28.7 It has been represented to us that there are strong public policy arguments for the introduction of more settlement systems, all of which would provide for netting between the parties without being subject to the regular insolvency provisions in the first instance. It is suggested that it would be in the best interests of Hong Kong's development as a major financial centre for more clearing house systems to be introduced and that this would necessarily involve a system for netting in each case.

28.8 The principal reason for allowing netting is to limit systemic risk in payment systems and financial markets and to improve payment and settlement system efficiency by minimising settlement costs and reducing credit and liquidity exposures. It is also represented that netting enhances the implementation of policy objectives of central banks. The disadvantages of netting are that it could increase systemic risk as netting may obscure the level of exposure and it would concentrate risk exposure of the central counterparty for multilateral netting systems.

28.9 In insolvency terms netting may operate against unsecured creditors in an insolvency situation, but lowering settlement risks may minimise insolvency risks in the first place.

28.10 It is therefore pragmatic and sensible to consider how the insolvency provisions might need to be adapted to accommodate netting systems when insolvencies occur in those systems.

28.11 We understand that special netting statutes already exist in at least 12 jurisdictions, including the United Kingdom, Canada, Cayman Islands, Germany, Japan, Sweden and the United States. In the United Kingdom, Part VII of the Companies Act 1989 provides for insolvency in the financial markets by aiming to reduce the possibility of domino insolvencies by enhancing the effect of the practice used by the market of netting out exposures to defaulting counterparties and by protecting margins and security given to support the obligations of participants.

28.12 Part VII is applied to "market contracts" connected with "investment exchanges" and "clearing houses" provided that these institutions have "default rules". Under section 156 of the Companies Act 1989, the default rules provide for the steps to be taken by the exchange or clearing house to close out a defaulting participant's position in relation to all unsettled market contracts on the event of the participant appearing to be unable to meet its obligations.

28.13 The effect of Part VII is to establish the principle that all the losses and gains on a defaulting party's contracts are netted out to be reduced to a net sum which is either provable in its insolvency or payable to it. Part VII affects the insolvency provisions:

(a) to the extent of a liquidator's power to disclaim contracts and the ability of the court to rescind contracts, under section 164 of the Companies Act 1989;

(b) in relation to the rules avoiding post-petition disposals, also section 164;

(c) in relation to the rules avoiding preferences, transactions at an undervalue, and transactions defrauding creditors, under section 165; and

(d) in relation to the statutory freeze on proceedings after an insolvency, under section 161(4) of the Companies Act 1989.

28.14 The Securities and Futures (Clearing Houses) Ordinance, (Cap 420), contains provisions similar to those in part VII of the Companies Act 1989. In particular, section 2 of the Ordinance defines "market contract" to mean the resultant contract between a "recognised clearing house" and a participant pursuant to a novation in accordance with its rules and for the purposes of clearing and settlement of securities or future contracts made on the Hong Kong Stock Exchange or the Hong Kong Futures Exchange. Section 5 of the Ordinance provides that the rules of a "recognised clearing house" and any proceedings taken thereunder take precedence over the law of insolvency. This provision would take clearing and settlement of "market contracts" out of the ambit of insolvency law.[1]

28.15 There are no provisions in the Companies Ordinance which take account of the development of netting systems. While we are not entirely at ease with creating exceptions to the established insolvency regime, we consider that it would be pragmatic to take notice of these developments. Accordingly, we **propose** that the insolvency provisions should take account of recognised netting systems and make provision for the effects of netting on a liquidation and, in particular, how the insolvency provisions would deal with the aftermath of a netting event.

[1] Note also sections 8, 9, 11 and 14 of the Securities and Futures (Clearing Houses) Ordinance, which contain further provisions on insolvency issues.

CHAPTER 29

OFFICIAL RECEIVER'S OFFICE - FUNDING

29.1 We understand that the Official Receiver's Office traditionally operates at a deficit, with the annual shortfall being met out of Government revenues. There is evidence to suggest that with the increase in the contracting out of remunerative, non-summary, cases to private sector liquidators, the Official Receiver's Office annual deficit is liable to increase to some extent. We consider that it is important in the overall context of regulation and practice of the winding-up of companies that the Official Receiver's Office should be well funded.

29.2 We note that the Protection of Wages on Insolvency Fund Board is funded by a $250 levy on the business registration fee.[1]. We **propose** that the Government should consider allocating a fixed proportion of the business registration levy in order to assist in the funding of the Official Receiver's Office. In the medium term this should mean that the Government would not have to intervene annually to make up the losses of the Official Receiver's Office, nor would the business registration fee have to be increased.

29.3 We wish to emphasise the amounts required to fund the Official Receiver's Office would not amount to a severe diminution of the income of the Protection of Wages on Insolvency Fund. We are also aware that the Fund has experienced a significant increase in claims over recent months and that this increase could well be maintained for some time. It will be interesting to see how the Fund is affected by these increased claims, at which point it might be possible to assess how to combine the funding of the Official Receiver's Office and the Protection of Wages on Insolvency Fund out of the business registration levy.

[1] Note our comments, *supra*, at paragraphs 15.38 to 15.48.

CHAPTER 30

RELATED COMPANIES

30.1 The Hong Kong Society of Accountants submitted that:

> *"The basic legal position when winding-up separate companies in a group is that each company is a separate legal entity and it is not possible to sacrifice the interest of any one company for the interest of the group.*
>
> *In practice, however, a group is often run as one business by a single management. Transactions within the group are not necessarily on a commercial basis. Effectively one subsidiary may be sacrificed for the good of the group. In such a situation, creditors of that subsidiary may be left without recourse to adequate assets to meet their claims.*
>
> *In such situations it may be equitable to consider consolidating group assets and liabilities so that there is a more equitable distribution. Such a pooling scheme would benefit creditors in that it would cut the costs of liquidating a large group of companies. Further, the problems associated with inter company accounts are eliminated.*
>
> *Safeguards would need to be put in place to ensure such provisions were only invoked if it were just and equitable to do so by the court.*
>
> *For reference to overseas practice, we understand that the New Zealand Companies Act 1955 (as amended) and the US Bankruptcy Law already allow such consolidation."*

30.2 We consider that the points made in the submission have merit but we are concerned that the ramifications go far beyond the winding-up provisions of the Companies Ordinance and, as a consequence, our terms of reference. We suggest that this is an issue that would be more appropriately addressed to the Standing Committee on Company Law Reform.

CHAPTER 31

A SEPARATE INSOLVENCY ORDINANCE TO INCLUDE ALL FORMS OF WINDING-UP, RECEIVERSHIP, PROVISIONAL SUPERVISION AND BANKRUPTCY[1]

31.1 The Hong Kong Society of Accountants submitted that:

> *"The existing provisions relating to the winding-up of a company are not contained in one piece of legislation. We consider that it would be clearer to have a self-contained corporate insolvency regime governing liquidations and other aspects of the corporate insolvency administration. This may mean repeating rules found in other legislation, but it would help centralise and unify different areas of the corporate insolvency law.*
>
> *In particular, bankruptcy rules applicable to corporate insolvencies should be written into the corporate insolvency law. As an illustration, in the context of proofs of debt, section 264 of the Ordinance refers to the Bankruptcy Rules without setting out the corporate equivalent of an act of bankruptcy. (We further note the proposed abolition of 'acts of bankruptcy' in Chapter 1 of the Bankruptcy Report). Such cross referencing to another legislation should not be used. Another example is the uncertainty surrounding the corporate equivalent of a receiving order.*
>
> *During the course of our deliberation, we considered the desirability of having a separate insolvency law like the UK Insolvency Act, but concluded that this matter relates closely to resource availability and is a policy decision for the Insolvency subcommittee to consider. However, we consider that the law on formation, operation and winding-up of companies, reviewed by different bodies at the moment, should be developed together rather than separately, to avoid inconsistencies and incompatibility."*

31.2 We note that the Review of the Hong Kong Companies Ordinance has recommended that a new Companies Ordinance should only contain what is described as "*core*" company matters.[2] This does not include the insolvency provisions, which the Review recommends should be left to a comprehensive Insolvency Ordinance.[3] The Review further recommends that only solvent

---

1 See, *supra*, at paragraph 1.13.

2 Paragraph 1.01 of the *Review*.

3 Paragraph 1.05 of the *Review*.

dissolution and liquidation should be dealt with in the new Companies Ordinance.[4] In effect, this would mean that a new Insolvency Ordinance would not provide for members' voluntary winding-up.

31.3 We are broadly in agreement with the Review's approach though we have some reservations as to whether it might not be better to include members' voluntary winding-up, or solvent liquidation, in an Insolvency Ordinance. There are good arguments for doing this. Many of the winding-up rules in the Companies Ordinance have application to members' voluntary winding-up, creditors' voluntary winding-up and winding-up by the court.[5]

31.4 In addition, our proposals on the licensing of insolvency practitioners would provide for the licensing of liquidators in members' voluntary winding-up together with the licensing of insolvency practitioners in other forms of insolvency or insolvency related procedures. There would therefore be a certain symmetry in including members' voluntary winding-up in a new Insolvency Ordinance.

31.5 In the broader, companies, context of a new Insolvency Ordinance, we **propose** that the current provisions of the Companies Ordinance on receivership, and the proposed provisions on provisional supervision should be included in any new Insolvency Ordinance.

31.6 We **propose**, that the provisions of the Bankruptcy Ordinance should be placed in a new Insolvency Ordinance. Our main reason for this proposal is that, as bankruptcy is an insolvency procedure, it is logical to place it with other insolvency procedures. This proposal would follow the precedent of the Insolvency Act, which places bankruptcy, winding-up, receivership, and the equivalent of provisional supervision, in the same Act.

31.7 The proliferation of procedures in the Insolvency Act does not create the anticipated fusion of provisions, the reason being that it only takes one detail in a provision to require a provision to be duplicated in, say, both bankruptcy and creditors' voluntary winding-up provisions. This happens frequently with the consequence that the Insolvency Act is not as "*user friendly*" as might be wished for.

31.8 We consider that amalgamation of all the provisions would be desirable and we are inclined to include members' voluntary winding-up in this proposal.

31.9 We **propose** that, as the provisions of Part IVA of the Companies Ordinance on disqualification of directors are closely related to the insolvency

---

4 Part 9.00 of the *Review*. See, in particular, paragraph 9.01.

5 See sections 249 to 257 which are common to members' voluntary winding-up and creditors' voluntary winding-up and sections 263 to 296 which are common to all forms of winding-up.

regime, it should be included in any new Insolvency Ordinance. The Review of the Hong Kong Companies Ordinance recommended that the disqualification provisions should be eliminated from the core Companies Ordinance provisions.[6]

[6] *Review of the Hong Kong Companies Ordinance*, paragraph 6.18.

CHAPTER 32

SUBORDINATION OF DEBT

32.1 The Hong Kong Association of Banks submitted that:

> *"At common law debt subordination is not possible because it has been held to infringe the principle of pari passu distribution among creditors. When parties wish to achieve a valid subordination under Hong Kong law this is achieved by a complex trust structure. Subordination of debt and the creation of debts of different levels of seniority is part of many modern security packages and this should not be inhibited by law. We suggest that the law be changed to allow for contractual subordination."*

32.2 We **propose** that the subordination of debt should be allowed so long as the subordination of debt agreement does not affect the rights of third parties.

Annex 1

List of Submissions Received

1. Inland Revenue Department
2. Mr John Lees of Ferrior Hodgson and Marfan
3. The Official Receiver' s Office[1]
4. The Education and Manpower Bureau
5. The Hong Kong Association of Banks
6. The Hong Kong Institute of Company Secretaries
7. The Hong Kong Police
8. The Hong Kong Society of Accountants
9. The Law Society' s insolvency committee
10. The Registrar of Companies
11. The Securities and Futures Commission
12. The Bar Association
13. The Commissioner of Insurance
14. The Hong Kong Monetary Authority
15. The Legal Aid Department
16. Mr Albert Chin, Legal Aid Department
17. Mrs J. C. Olivier, Legal Aid Department
18. Mr Charles Booth, Department of Professional Legal Education, University of Hong Kong
19. Mr Philip Smart, Department of Law, University of Hong Kong

[1] We note that the Consultation Paper contains a number of submissions from the Official Receiver's Office. As the Official Receiver is a member of the sub-committee, he took no part in formulation of these submissions.

Annex 2

Liquidation - Comparison of the payment percentage and amount under the present provisions and if all creditors were treated equally

Case No./ Creditors / Date of Payment	Under present provisions				Total Amount For Distribution	If all creditors were Treated equally	
	Amount admitted as		Payment % and Amount			Admitted	Payment %
	Pref.	Ord.	Pref.	Ord.		Debts	And Amount
L0300/90			100.00%	60.16%			65.84%
Pref. Creditors	60,114.13	28,330.80	60,114.10	17,043.80	77,157.90	88,444.93	58,234.80
Ord. Creditors		332,911.00		200,279.20	200,279.20	332,911.00	219,198.50
7/7/92	60,114.13	361,241.80	60,114.10	217,323.00	277,437.10	421,355.93	277,433.30
L0095/91			100.00%	1.79%			2.33%
Pref. Creditors	19,867.00	23,910.50	19,867.00	428.70	20,295.70	43,777.50	1,021.30
Ord. Creditors		3,566,065.37		63,939.50	63,939.50	3,566,065.37	83,196.30
12/4/92	19,867.00	3,589,975.87	19,867.00	64,368.20	84,235.20	3,609,842.87	84,217.60
L0215/90			100.00%	29.86%			31.10%
Pref. Creditors	10,078.00	124,400.00	10,078.00	37,145.80	47,223.80	134,478.00	41,824.00
Ord. Creditors		434,778.45		129,824.80	129,824.80	434,778.45	135,220.40
12/15/92	10,078.00	559,178.45	10,078.00	166,970.60	177,048.60	569,256.45	177,044.40
L0241/85			100.00%	100.00%			100.00%
Pref. Creditors	21,888.91	85,082.74	21,888.90	85,082.70	107,621.60	107,621.65	107,621.60
Ord. Creditors		2,100.00		2,100.00	2,100.00	2,100.00	2,100.00
2/8/93	21,888.91	87,182.74	21,888.90	87,182.70	109,721.60	109,721.65	109,721.60
L0018/83			100.00%	5.54%			6.96%
Pref. Creditors	37,832.12	7,116.35	37,832.10	394.20	38,226.30	44,948.47	3,129.70
Ord. Creditors		2,464,995.81		136,560.70	136,560.70	2,464,995.81	171,736.60
3/9/93	37,832.12	2,472,112.16	37,832.10	136,954.90	174,787.00	2,509,944.28	174,767.30
L0197/91			100.00%	31.49%			53.13%
Pref. Creditors	1,132,833.58	2,364,713.19	1,132,833.50	744,648.10	1,877,531.60	349,596.77	1,858,587.90
Ord. Creditors		87,351.03		27,506.80	27,506.80	87,351.03	46,417.40
4/2/93	1,132,833.58	2,452,064.22	1,132,833.50	772,154.90	1,905,038.40	3,584,947.80	1,905,005.30
L0195/89			100.00%	56.38%			59.20%
Pref. Creditors	8,632.33	2,321.82	8,632.30	1,309.00	11,444.30	12,457.21	7,374.70
Ord. Creditors		144,252.27		81,329.40	81,329.40	144,252.27	85,398.70
4/6/93	8,632.33	146,574.09	8,632.30	82,638.40	92,773.70	156,709.48	92,773.40
L0140/89			100.00%	0.05%			0.13%
Pref. Creditors	7,933.33	1,760.00	7,933.30	0.80	7,934.10	9,693.33	12.60
Ord. Creditors		9,916,820.75		5,057.50	5,057.50	9,916,820.75	12,891.80
10/18/93	7,933.33	9,918,580.75	7,933.30	5,058.30	12,991.60	9,926,514.08	12,904.40
L0170/90			100.00%	96.00%			96.91%
Pref. Creditors	72,982.93	13,255.30	72,982.90	12,725.00	85,707.90	86,238.23	83,571.70
Ord. Creditors		235,094.56		225,690.70	255,690.70	235,094.56	227,825.40
11/1/93	72,982.93	248,349.86	72,982.90	238,415.70	311,398.60	321,332.79	311,397.10
L0089/88			100.00%	0.22%			2.71%
Pref. Creditors	255,161.57	169,422.54	255,161.50	369.30	256,360.80	425,414.11	11,545.70
Ord. Creditors		9,808,128.31		21,381.70	21,381.70	9,808,128.31	266,192.60
12/21/93	255,161.57	9,977,550.85	255,161.50	21,751.00	277,742.50	10,233,542.42	277,738.30
L0366/92			100.00%	57.72%			58.01%
Pref. Creditors	3,703.41	53,347.79	3,703.40	30,792.30	35,695.70	58,251.20	33,789.10
Ord. Creditors		665,601.65		384,185.20	384,185.20	665,601.65	386,088.80
4/25/94	3,703.41	718,949.44	3,703.40	414,977.50	419,880.90	723,852.85	419,877.90
L0163/91			100.00%	3.23%			5.89%
Pref. Creditors	258,899.44	189,265.47	258,899.40	6,113.20	268,937.80	452,090.13	26,641.60
Ord. Creditors		9,097,901.85		293,862.20	293,862.20	9,097,901.85	536,139.30

5/24/94	258,899.44	9,287,167.32	258,899.40	299,975.40	562,800.00	9,549,991.98	562,780.90

Case No./ Creditors / Date of Payment	Under present provisions				Total Amount For Distribution	If all creditors were Treated equally	
	Amount admitted as		Payment % and Amount			Admitted	Payment %
	Pref.	Ord.	Pref.	Ord.		Debts	And Amount
L0206/90			100.00%	10.88%			34.48%
Pref. Creditors	101,846.71	194,510.11	101,846.70	21,164.60	123,011.30	296,356.82	102,169.00
Ord. Creditors		88,329.92		9,611.10	9,611.10	88,330.92	30,451.70
8/19/94	101,846.71	282,840.03	101,846.70	30,775.70	132,622.40	384,687.74	132,620.70
L0012/89			100.00%	34.70%			36.29%
Pref. Creditors	44,245.67	260,633.33	44,245.60	90,439.70	134,685.30	304,879.00	110,625.30
Ord. Creditors		1,517,697.71		526,641.10	526,641.10	1,517,697.71	550,696.60
10/11/94	44,245.67	1,778,331.04	44,245.60	617,080.80	661,326.40	1,822,576.71	661,321.90
L0222/91			100.00%	14.77%			31.36%
Pref. Creditors	177,246.83	200,380.96	177,246.80	29,592.20	207,889.00	378,677.79	118,745.70
Ord. Creditors		537,326.65		79,352.30	79,352.30	537,326.65	168,494.80
11/18/94	177,246.83	737,707.61	177,246.80	108,944.50	287,241.30	916,004.44	287,240.50
L0080/91			100.00%	8.10%			11.91%
Pref. Creditors	278,179.86	236,683.07	278,179.80	19,183.10	279,362.90	514,862.93	61,304.70
Ord. Creditors		6,207,404.94		503,110.00	503,110.00	6,207,403.94	739,115.50
5/15/95	278,179.86	6,444,087.01	278,179.80	522,293.10	800,472.90	6,722,266.87	800,420.20
L0385/92			100.00%	46.05%			47.86%
Pref. Creditors	57,808.33	189,747.96	57,808.30	87,378.90	145,187.20	247,556.29	118,490.30
Ord. Creditors		1,471,270.84		677,520.20	677,520.20	1,471,270.84	704,209.00
6/20/95	57,808.33	1,661,018.80	57,808.30	764,899.10	822,707.40	1,718,827.13	822,699.30
L0041/91			100.00%	22.05%			39.38%
Pref. Creditors	826,584.94	594,891.97	826,584.90	131,197.40	957,782.30	1,421,477.91	559,734.90
Ord. Creditors		2,297,733.17		506,742.00	506,742.00	2,297,733.17	904,778.30
8/7/95	826,584.94	2,892,625.14	826,584.90	637,939.40	1,464,524.30	3,719,210.08	1,464,513.20
L0082/94			100.00%	15.70%			24.14%
Pref. Creditors	190,797.37	49,495.56	190,797.30	7,770.80	198,568.10	240,293.93	57,997.10
Ord. Creditors		1,666,130.51		261,582.40	261,582.40	1,666,130.51	402,137.20
10/16/95	190,797.37	1,715,626.07	190,797.30	269,353.20	460,150.50	1,906,423.44	460,134.30
L0363/92			100.00%	15.01%			17.98%
Pref. Creditors	177,757.70	313,061.00	177,757.70	46,990.40	224,748.10	490,818.70	88,244.20
Ord. Creditors		4,596,272.51		689,900.50	689,900.50	4,596,272.51	826,363.80
2/5/96	177,757.70	4,909,333.51	177,757.70	736,890.90	914,648.60	5,087,091.21	914,608.00