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柯伍陳律師事務所

Advising Companies in Financial Difficulties

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2. Modes of winding up
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PART 1 - PERSONAL LIABILITIES OF DIRECTORS / MANAGERS

1A Criminal

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1A Criminal

Most commonly prosecuted offence: s.274, Cap 32

(1) If where a company is wound up it is shown that the company has not kept accounting records that comply with section 373(2) and (3) of the Companies Ordinance (Cap. 622) for any part of the shorter of the period of 2 years immediately preceding the commencement of the winding up, or the period between the incorporation of the company and the commencement of the winding up, every officer of the company who is in default is, unless the officer shows that the officer acted honestly and that in the circumstances in which the business of the company was carried on the default was excusable, guilty of an offence and liable to imprisonment and a fine.

1A Criminal (cont'd)

From 1 April 2018 to 31 March 2020

- Total summonses issued: 215
- Total convicted: 101

- Average fine: HK$2,370

1A Criminal (cont'd)

Convictions under Employment Ordinance

- Over 100 per month from Oct 2019 to Jan 2020

- Highest fine: $10,000
- Lowest fine: $500

Payment of wages: Employment Ordinance (Cap. 57)

- Wages shall become due on the expiry of the last day of the wage period and shall be paid as soon as is practicable but in any case not later than 7 days thereafter. (s. 23 EO)

- Any employer who willfully and without reasonable excuse contravenes s. 23 of EO commits an offence and is liable to a fine of $350,000 and to imprisonment for 3 years. (s. 63C EO)

- Any director, manager, secretary or other similar officer of the company is guilty of the same offence under s. 64B of the EO if he consents to, connives in or is negligent as to the non-payment of wages.

HKSAR v Li Fung Ching Catherine [2012] HKEC 807

- The director was responsible for the company's daily operation, personnel and finances of a company which faced serious financial difficulties, did not pay wages to 5 employees for 2 months and was subsequently wound up.

- The director was convicted and fined a sum of HK$110,000.

HKSAR v Li Fung Ching Catherine [2012] HKEC 807

- The Court of Final Appeal held:

5. On appeal to the Judge it was argued that the company had a reasonable excuse for its non-payment of the wages, namely its parlous financial condition and genuine attempt to salvage its business. That was a hopeless argument and was rightly rejected. A company which chooses to use its resources to meet other expenses instead of paying the wages owed to its employees is making a calculated decision to break the law designed to protect those employees

6. It was also submitted before the Judge that the Magistrate had been wrong to find consent or connivance on the applicant's part. The Magistrate had noted her testimony that she had disagreed with her two fellow directors and voted against withholding the wages. However, as the Judge pointed out, it does not follow that he accepted her evidence. There was no formal board meeting or vote; her disagreement was not minuted and the Magistrate found that it "was obvious that she agreed to such a decision at the end of the day."

7. The Judge found that in any event the convictions were amply justified on the footing that she had "connived" at the company's non-payment of wages, adopting the Shorter Oxford's definition of "connivance" as "assistance in wrongdoing by conscious failure to prevent or condemn; tacit permission".

Other possible criminal liabilities

Section 275, Cap 32 Fraudulent Trading

(1) 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 creditors of any other person or for any fraudulent purpose, the court, on the application of the Official Receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct.

Other possible criminal liabilities (cont'd)

(3) Where any business of a company is carried on with such intent or for such purpose as is mentioned in subsection (1), every person who was knowingly a party to the carrying on of the business in manner aforesaid shall, whether or not the company has been or is in course of being wound up, be guilty of an offence and liable to imprisonment and a fine.

Cases:

ADS v. Wheelock Marden & Co. Ltd. FACV 26/1998

Morris v Bank of India [2005] EWCA Civ 693

Semi-criminal: Disqualification

- Section 168D, Cap 32
- Section 168M – offence for contravening disqualification order

- 2019: 31 cases
- Average period: 2.96 years

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Semi-criminal: Disqualification

Under s 168K directors could be disqualified for many reasons. In relation to insolvent companies, these are factors to be taken into account (non-exhaustive):-

Schedule 15, Cap 32, Part 2

Matters Applicable where Company has become Insolvent

1. The extent of the director's responsibility for the causes of the company becoming insolvent.
2. The extent of the director's responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part).

Semi-criminal: Disqualification

3. The extent of the director's responsibility for the company entering into any transaction or giving any unfair preference, being a transaction or unfair preference liable to be set aside under section 182, 265D or 266.
4. The extent of the director's responsibility for any failure by the directors of the company to comply with section 241.

THE OFFICIAL RECEIVER v. JAMES CONRAD LOUEY AND ANOTHER [HCMP 2770/2003]

- Director made an unfair preference to himself whilst failing to pay wages.
- At liquidation, the company had debts of HK$5.67m from director, HK$88k from employees, and HK$97k from PWIF.
- Director repaid HK$350,000 to himself when a receivable was collected, claiming that the employees' claims were exaggerated.
- Disqualified for 2.5 years.

Note the position of listed companies directors under the Securities and Futures Ordinance

Section 214(1) of the SFO allows the SFC to apply to the Court for a disqualification order if the business or affairs of a listed corporation have been conducted in a manner:-

(a) oppressive to its members or any part of its members;

(b) involving defalcation, fraud, misfeasance or other misconduct towards it or its members or any part of its members;

(c) resulting in its members or any part of its members not having been given all the information with respect to its business or affairs that they might reasonably expect; or

(d) unfairly prejudicial to its members or any part of its members.

1B. Civil Liabilities

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Duty to Exercise Reasonable Care, Skill and Diligence

section 465 of the Companies Ordinance (Cap 622)

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with —

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and

(b) the general knowledge, skill and experience that the director has.

(3) The duty specified in subsection (1) is owed by a director of a company to the company.

Negligence

Examples of action **against directors** for negligence:

- ***Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors* [1992] 2 HKC 637**
  - Director failed to monitor credit risk of a futures trading account. Customer defaulted causing substantial loss to the company.

- ***Re D'Jan of London Ltd [1994] 1 BCLC 561***
  - Director negligently filled in insurance proposal form resulting in insurance policy being avoided, company failed to get compensation for a factory destroyed by fire.

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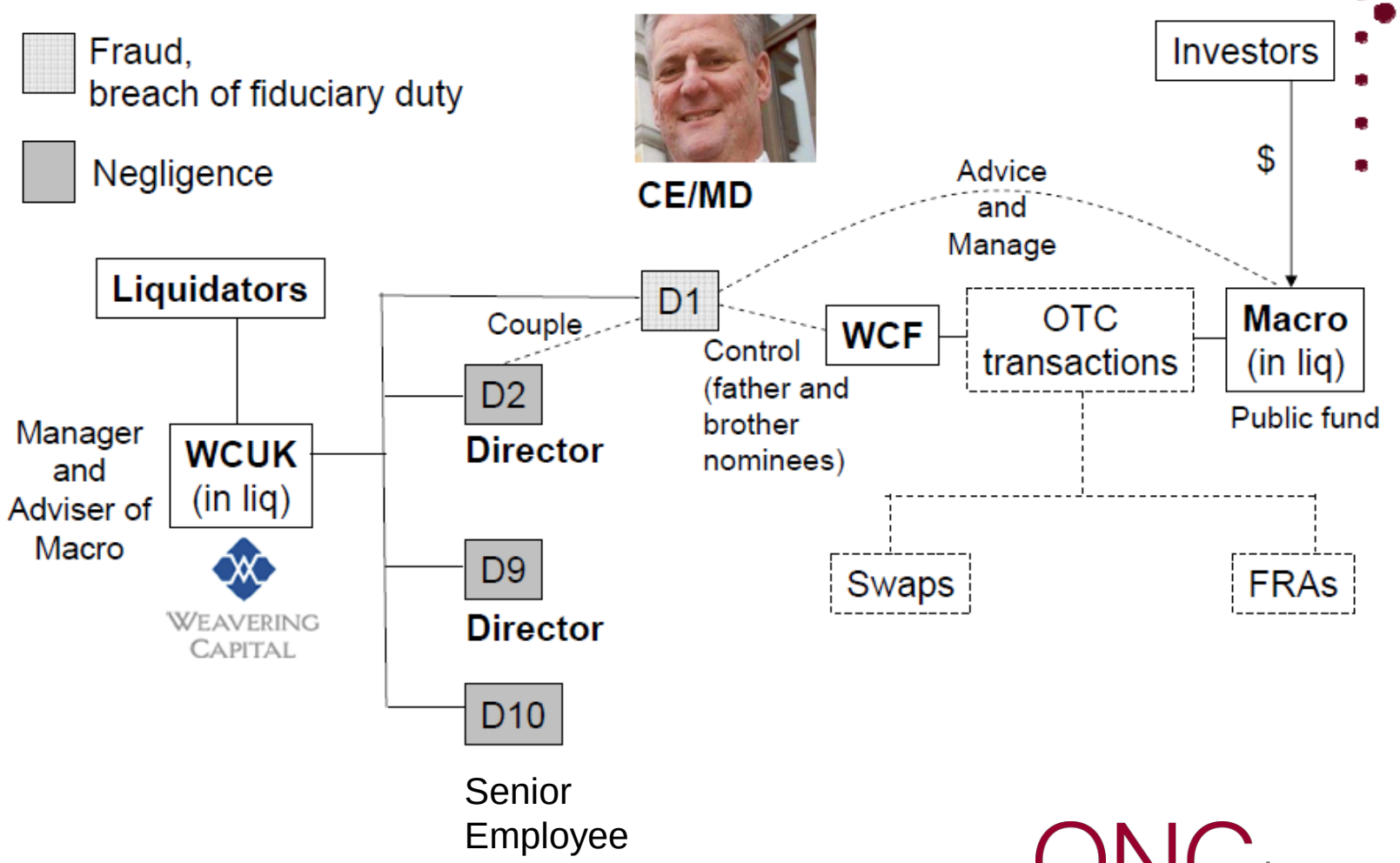
Weavering Capital (UK) Ltd v Peterson [2012] EWHC 1480 (Ch)



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China Resources Power Holdings Company Limited (stock code 836) (HCMP 1655/2013)

- 6 Minority shareholders applied for leave (under section 168BC of the Old Cap 32, now section 732 of the CO) to enable them to commence action in the name of the company against its 20 former and current directors for negligence

- All directors at the material time, including all INEDs (famous people like Elsie Leung, Raymond Chien) and the chairman Song Lin

- The main allegation is that the directors caused the company to commit to over RMB 6 billion to purchase several coal mines in Shanxi without doing sufficient due diligence and when it was later found that the coal mines were worthless, didn't enforce the company's rights against the sellers

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China Resources Power Holdings (cont'd)

- In view of the fact that the Applicants have named, among others, all the current directors of the Company as potential defendants, the Company has appointed a special advisor to the Company, who is independent of the Company, its controlling shareholders or their other subsidiaries, the directors and the staff of the Company, to deal with the further conduct of the Proceedings on behalf of the Company, with the intention and objective of ensuring that the proceedings will be conducted in the best interests of the Company with its special advisor acting independently – see Company's announcement dated 5 August 2013

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SFC's wide enforcement powers

- SFC has wide enforcement powers under the SFO to ensure that directors and senior executives are held accountable for their actions:-
- **Section 213**: SFC may seek injunctive and other orders for restitution or damages against anyone, including a director or senior officer, who has contravened, or aided, abetted, induced or been involved in a contravention of, any provision of the SFO
- **Section 214**: SFC may take action and obtain court orders for breaches by current and former directors and executives which resulted in losses to listed companies. For example, SFC may seek disqualification orders for up to 15 years as well as orders that the relevant directors pay compensation or that the listed company bring legal proceedings against anyone responsible for carrying out the affairs of the company in an unfair, fraudulent or other matter specified in section 214.

SFC's wide enforcement powers (cont'd)

- **Section 279:** Every officer of a corporation shall take all reasonable measures from time to time to ensure that proper safeguards exist to prevent the corporation from acting in a way which would result in the corporation perpetrating any conduct which constitutes market misconduct.

- **Sections 258 and 307N:** SFC may seek civil sanctions directly against any officer who failed to take reasonable measures to establish proper safeguards to prevent market misconduct, even if the officer did not personally engage in the misconduct.

- **Section 390:** Where a company has been found guilty of an offence under the SFO, the SFC may seek to extend criminal liability to any of its officers where the offence was committed with their consent, involvement or otherwise attributable to their recklessness.

Hanergy Thin Film Power Group Limited

- On 23 Jan 2017, SFC commenced legal proceedings under section 214 of SFO seeking disqualification orders against the former chairman, Mr Li Hejun ("**Li**"), and four INEDs of Hanergy Thin Film Power Group Limited ("**Hanergy**")

- The SFC alleged that the five directors :

  - failed to question the viability of Hanergy's business model which relied on the sales of solar panel production systems to its parent company, Hanergy Holding Group Limited ("Hanergy Holding") and its affiliates ("connected parties"), as its main source of revenue;

  - failed to properly assess the financial positions of the connected parties and hence the recoverability of the receivables due from them as a result of these connected transactions.

  - failed to take proper steps to recover these receivables by putting the interests of the connected parties before that of Hanergy, and so did not act in Hanergy's best interest.

Hanergy (Con't)

- On 4 Sep 2017, SFC obtained disqualification orders against Li and the 4 INEDs:-

- Order against Li:
  - disqualified from being a director or being involved in the management of any listed or unlisted corporation in Hong Kong for eight years.
  - ordered to procure Hanergy Holding and/or its affiliates to pay all outstanding receivables due to Hanergy under various sales contracts

- Reasoning: Li's breaches were serious having regard to:
  - his position as the chairman and executive director of Hanergy and the ultimate controller of both Hanergy and Hanergy Holding
  - substantial amounts involved; and
  - long period of time

Hanergy (cont'd)

- Order against 4 INEDs:
  - 2 be disqualified for four years and 2 for three years

- Reasoning: the 4 INEDs were incompetent and indifferent to their responsibilities as directors:
  - failed to make appropriate disclosure about the viability of Hanergy's business model;
  - failed to properly assess the financial positions of the connected parties and hence the recoverability of the receivables due from them as a result of these connected transactions; and
  - failed to take proper steps to recover these receivables, and so did not act in Hanergy's best interest

Liabilities of directors and officers for failure to disclose (cont'd)

- **Section 307G** of the SFO imposes duties on officers of listed corporations in relation to the disclosure of inside information.

- If a listed corporation has breached the disclosure requirement, an **officer** will also be in breach:-

  - if the corporation's breach is a result of his intentional, reckless or negligent conduct; or

  - he has not taken all **reasonable measures** to ensure that proper safeguards exist to prevent the breach.

Liabilities of directors and officers for failure to disclose (cont'd)

Definition of "Officer"

- Part 1 Schedule 1 of the SFO
- An "officer" in relation to a corporation means "a **director**, manager or secretary of, or any other person involved in the management of, the corporation"

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Liabilities of directors and officers for failure to disclose (cont'd)

Reasonable measures:

- Creation and maintenance of appropriate internal control and reporting systems
- Ensure any material information which comes to the knowledge of one or more of its officers be promptly identified, assessed and escalated for the attention of the Board of directors to decide about the need for disclosure
- Ensure a timely and structured flow of relevant financial and operational data

Civil Sanctions

S.307N SFO – The Market Misconduct Tribunal may, at the conclusion of any disclosure proceedings:-

- impose a regulatory fine up to $8 million on the listed corporation and/or the director (s.307N(1)(d))
- disqualify the person in breach of the disclosure requirement from being a director or otherwise involved in the management of a listed corporation for up to 5 years (s.307N(1)(a)(i), (ii))
- make a “cold shoulder” order against the director or officer (i.e. the person is deprived of access to market facilities) for up to 5 years (s.307N(1)(b))

Civil Sanctions (cont'd)

- a "cease and desist" order on the listed corporation, director or officer (i.e. an order not to breach the statutory disclosure requirements again) (s.307N(1)(c))

- an order that any body of which the director or officer is a member be recommended to take disciplinary action against him (s.307N(1)(g))

- payment of costs of the civil inquiry and/or the SFC's costs (s.307N(1)(e),(f))

- an order that a corporation to appoint an independent professional advisor to review its compliance procedure (s.307N(1)(h))

- an order that the officer undergo training (s.307N(1)(i))

Regulatory fine up to $8m

- **NOT** an aggregate amount
- The listed corporation and each of its directors could be fined up to $8 million separately

- **S.307N(3) SFO**
  - Principle of proportionality and reasonableness
    - The fine must be proportionate and reasonable in relation to the breach of the disclosure requirement
  - Relevant factors
    - Seriousness of the conduct
    - Whether the conduct was intentional, reckless or negligent
    - Whether the conduct may have damaged the integrity of the securities and futures market

AcrossAsia Limited

- AcrossAsia Limited (AAL) is an investment holding company listed in Hong Kong. Mr Cheok is its Chairman and Mr Ang is its CEO.

- A winding-up petition was presented against AAL by PT First Media Tbk (First Media) in Indonesia on 20 December 2012. The petition sought a temporary freezing order on AAL's debts in order for a composition plan to be drawn up, and for an Indonesian judge and administrators to be appointed to manage AAL's assets.

- Mr Cheok and Mr Ang and other officers of AAL received the English translation of the court documents on 4 Jan 2013. Petition was granted on 15 Jan 2013. However, no announcement was made until 17 Jan 2013.

- The SFC alleges that the information in relation to the Petition was inside information.

AcrossAsia Limited (cont'd)

- On 22 July 2015, the SFC commenced proceedings in the MMT against AAL, its chairman and its CEO for non-disclosure of inside information under the SFO.

- The MMT found that:-
  - AAL failed to disclose inside information as soon as reasonably practicable as required under section 307B(1) of the SFO
  - Mr. Cheok and Mr. Ang breached the disclosure requirement under section 307G of the SFO

- The MMT fined AAL $600,000, Mr Cheok $800,000, and Mr Ang $600,000

Rontex International Holdings

- The SFC commenced action against the three executive directors of the company, alleging that they:-
  - failed to ensure Rontex fully complied with disclosure requirements under the Listing Rules; and
  - failed to exercise reasonable skill, care and diligence in entering into a number of transactions, overpaying and failing to do DD, etc, resulting in Rontex suffering losses and damages of about $19 million.
  - There's no allegation of fraud or self-dealings. But the directors were found to be grossly negligent and have departed from the investment policies disclosed in prospectus.
- The SFC sought disqualification orders and orders for Rontex to commence actions for recovery of compensation against the three directors.

Rontex International Holdings (cont'd)

Findings:-

- The directors were in breach of duty and had failed to exercise reasonable care in, *inter alia*, causing the company to make investments in particular businesses without carrying out adequate due diligence or proper appraisal of the worth of the investments

- The directors breached the disclosure obligation under the Listing Rules, resulting in its members not having been given all the information with respect to its business or affairs that they might reasonably expect.

  - Note: this is based on section 214(1)(c) of the SFO

Rontex International Holdings (cont'd)

Order:-

1. Disqualification order against R1 (5 years), R2 (5 years) and R3 (4 years). On appeal, R2's length of disqualification was reduced to 4 years.

2. Direct Rontex to bring legal proceedings against the three former directors for compensation
   - this is the first time the SFC has obtained an order in the High Court directing a listed company to commence civil proceedings to seek recovery of compensation for the loss and damage suffered by the company as a result of director's misconduct (section 214(2)(b) of SFO)

PME Group Limited

- In August 2013, the SFC prosecuted PME Group Limited, a Hong Kong-listed company, in relation to the allegations that PME had made false or misleading stock exchange announcements, in contravention of section 384 of the SFO.
- It was alleged that:-
  - in 2008, PME made three announcements respectively in response to the inquiries made by the SEHK in the light of the substantial movement of the share price of PME.
  - In each announcement, PME stated that it knew of no negotiations or agreements which were disclosable to the market nor were its directors aware of any price sensitive matter.
  - However, it was later uncovered that PME was at that time taking steps to acquire 50% of another Hong Kong-listed company, with a market value of about $145 million.
  - The SFC argued that PME ought to have disclosed the transaction in the announcements, and its failure to do so constituted a breach of section 384.

PME Group Limited (cont'd)

- SFC also prosecuted PME's **director**, Ms. Ivy Chan Shui Sheung, for her alleged involvement in the offences by PME, pursuant to section 390 of the SFO

- Section 390(1) of the SFO provides that where a corporation is guilty of an SFO offence, any officer of the corporation, or any person who purports to act in any such capacity, is accordingly liable if that officer aided, abetted, counselled, procured or induced the commission of the offence by the corporation, or the offence was committed by the corporation with the consent or connivance of the officer, or the commission of the offence by the corporation was attributable to any recklessness of the officer

PME Group Limited (cont'd)

- PME pleaded guilty to three counts of making false or misleading announcements → fined $60,000 and ordered to pay investigation costs to the SFC

- Ms. Chan was acquitted:-
  - she had relied on the company secretary to decide whether the acquisition was disclosable or not and therefore did not possess the required *mens rea*.
  - Acquittal upheld on appeal

Trading while insolvent

- Although there is not yet any legislation on insolvent trading in Hong Kong (unlike in the UK), directors should be aware of the financial status of the company, especially if there are signs that the company has become insolvent.
- Where the directors failed to have regard to the company's financial status and caused the company to enter into certain transactions in breach of their fiduciary duties with losses incurred,
  - The directors can be liable for such losses! *Moulin Global Eyecare Holdings Limited (In Liquidation) & Ors v Olivia Lee Sin Mei* (HCA 167/2008).

Moulin Global Eyecare Holdings Ltd (in liquidation) & Ors v Olivia Lee Sin Mei

Facts:-

- The liquidator of Moulin Global Eyecare Holdings Limited brought action against the Defendant, Ms. Lee, a former director and legal adviser to the company, for breach of contractual, common law and fiduciary duties.

- Four years after the writ was issued, the liquidators sought to add three new causes of action:
  - The **Convertible Notes Loss** claim: - where amounts totalling US$15 million and more than HK$98 million were paid out to HSBC for early redemption of convertible notes
  - The **Share Repurchases Loss** claim:- where more than HK$37 million was paid for share repurchases out of capital when Moulin was not in a position to make such repurchase; and
  - The **IND Loss** claim:- for increase in net deficiency of Moulin in the period between the time when the company should have been placed into liquidation and the time when it actually went into liquidation

Moulin (cont'd)

The IND Loss claim

- "Further and in the alternative … the [Company] suffered loss of at least HK$1.23 billion constituting the increase in the net deficiency of the [Company] from at least 31 March 2001 until the date of appointment of the Provisional Liquidators on 23 June 2005, an increase from a net deficiency of HK$745 million had Provisional Liquidators been appointed as at 31 March 2001 to the actual net deficiency in winding up of the [Company] of HK$1.98 billion."

- i.e. HK$1.98 billion – 745 million = HK$1.23 billion

The IND claim is premised upon the following:-

1. By 31 March 2001 the latest, Ms. Lee knew or ought to have known, that the Company was insolvent and there is no hope to trade out of insolvency;
2. She should have procured the appointment of PL or otherwise blown the whistle;
3. Instead she let the Company trade on and as a result there was an IND of HK$1.23 billion by the time the Company was wound-up.

Ms. Lee sought to **strike out** the three new causes of action

Moulin (cont'd)

Barma J (at first instance):-

- The **Share Repurchases Loss** claim: struck out
  - Time-barred
- The **Convertible Notes Loss** claim: struck out
  - the payment discharged genuine liabilities and as such the plaintiff had not suffered any loss
  - Time-barred
- The **IND Loss** claim: allowed

Moulin (cont'd)

Court of Appeal:-

- The **Share Repurchases Loss** claim: upheld (struck out)
- The **Convertible Notes Loss** claim: upheld (struck out)
  - Directors owed a duty to consider the creditors' interests when the company is insolvent
  - The duty, however, is not owed to the creditors but to the company
  - The early redemption was the payment of a genuine liability of the company, as such Moulin suffered no loss. Loss was suffered by the general creditors → appropriate cause is unfair preference
- The **IND Loss** claim: allowed appeal → struck out
  - The amendment did not arise out of substantially the same facts → it considerably broadened the scope of factual inquiry
  - The amendment was made outside the limitation period

Moulin (cont'd)

Court of Final Appeal:-

If the nature and scope of the claims were within the scope of the writ, they would not be new causes of action. All three claims were within the purview of the indorsement on the writ → not time barred

- The **Share Repurchases Loss** claim: allowed to be added
- The **Convertible Notes Loss** claim: Plaintiff to seek leave to re-plead
  - Not time-barred
  - Plaintiff's proposition arguable
  - But the **Convertible Notes Loss** claim pleaded did not plead a triable cause
- The **IND Loss** claim: allowed to be added
  - Not time-barred

Moulin (cont'd)

The **Convertible Notes Loss**

- the CFA held that, even though in one sense the company suffered no loss, the claim was maintainable if framed as a claim for breach of the prescriptive fiduciary duty, i.e., the director not acting in the best interests of the company (the creditors as a whole) by favouring a particular creditor.

- **Implication:** The final outcome is still pending, but the Moulin case demonstrates the possibility of a misfeasance claim based on insolvent trading and preferring particular creditor (even though the claim is outside the 'unfair preference' regime).

PART 2: MODES OF WINDING UP

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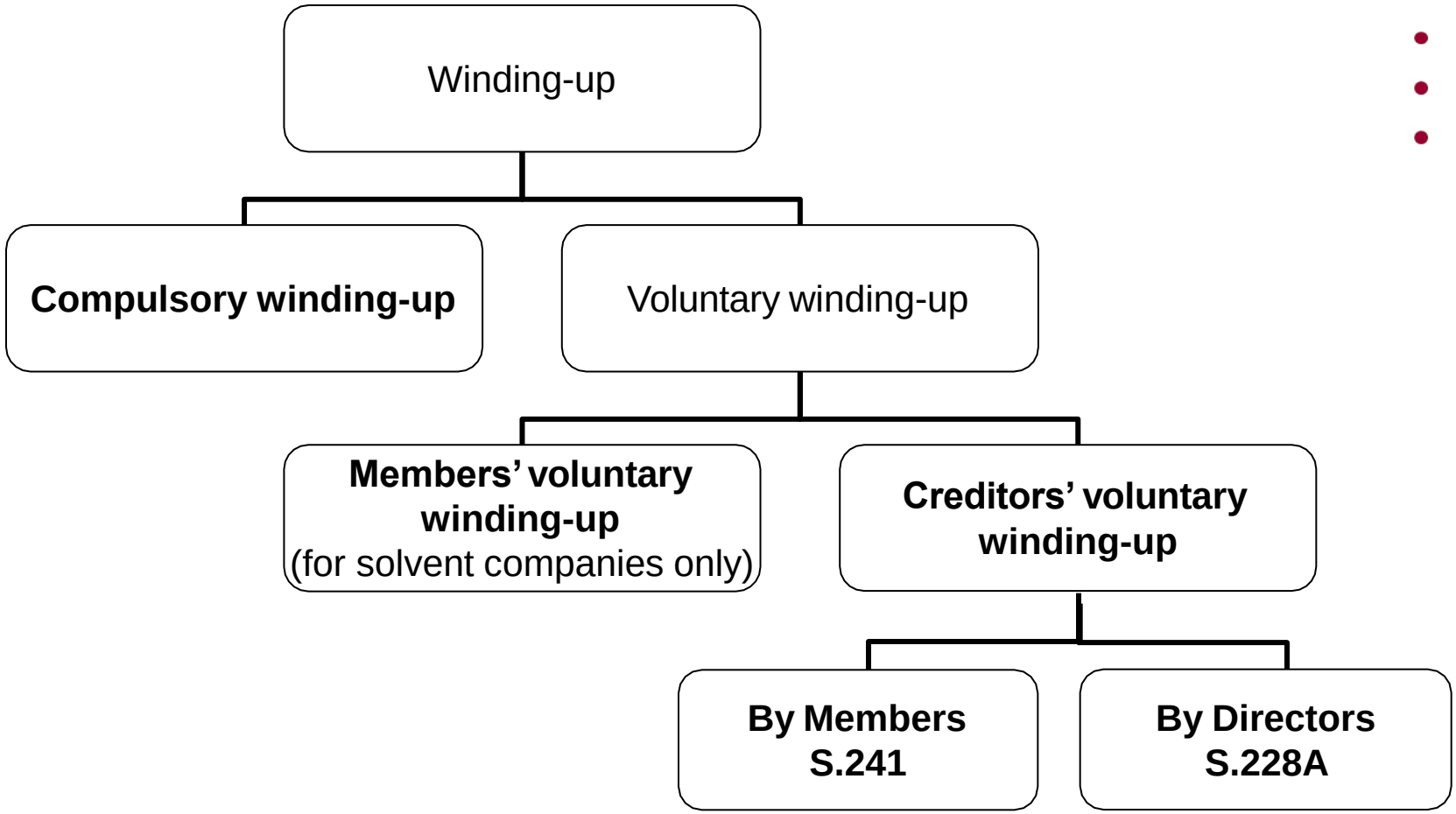
Procedures of winding-up: types of winding-up



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Compulsory winding-up

- The court makes an order to wind up a company.
- Common scenarios of compulsory winding-up:
  - Insolvency: when a company is “unable to pay its debts” (s.177(1)(d) CWUMPO).
  - Shareholder disputes in private companies (s. 177(1)(f) CWUMPO).
- Compulsory winding-up is commenced by way of a winding-up petition issued against it by the company itself, creditors or shareholders, etc.
  - Date of **issuance of the petition** is deemed to be date of commencement of winding-up (s. 184 CWUMPO).

Compulsory winding-up (cont'd)

Pay Official Receiver ("**OR**")'s deposit and court fee for filing petition

↓

File petition and fix date for hearing (s. 179 CWUMPO)

↓

Appoint Provisional Liquidators, if necessary (s.193 CWUMPO)

↓

Serve petition on the OR and Chief Bailiff within 24 hours of filing of petition (CWUR r. 23A)

↓

Serve petition on the company

↓

File verifying affidavit within 4 days of filing

↓

Advertise petition at least 7 clear days before hearing

Compulsory winding-up (cont'd)

↓

Before hearing: (CWUR r. 30, 31)

1. Parties interested in attending hearing prepare notice of intention to appear at hearing and send to petitioner/solicitors
2. Petitioner prepares list of parties attending the hearing

↓

Hearing

↓

Winding-up order made / Appointment of Liquidators (s.180 & 194 CWUMPO)

↓

Winding-up order declined with appropriate costs order / Adjournment /

↓

Petitioner files copy of court's order with CR (s. 185 CWUMPO)

↓

Company states its liquidation in every invoice, order for goods, business letters, etc. (s. 280 CWUMPO)

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Compulsory winding-up (cont'd)

↓

Liquidators investigate into the company's affairs

↓

Liquidators collect the company's assets.

↓

Liquidators accept / adjudicate proof of debt (s.227E CWUMPO)

↓

Liquidators distribute the company's assets to creditors

↓

Closing of liquidation

The just and equitable ground of winding-up

- S.177(1)(f): A Hong Kong company may be wound up by the court if the court is of opinion that it is just and equitable that the company should be wound up.

- The words "just and equitable" carry a wide meaning. It is ultimately a question of fact and each case depends on its own facts.

Commencement of winding-up

- When a winding-up **petition** is filed, the company is **not** wound up immediately but pending a winding-up order.
  - The directors are still in control of the company and owe it duties.
  - Once a winding-up **order** is made, the commencement of the winding-up will be **deemed** to be the date of the presentation of the petition (s. 184 CWUMPO).
    - Any transaction **after the commencement of winding-up** shall be subject to the **validation order** from the court under s. 182 CWUMPO.
    - all legal actions against the company will be stayed: s.186 CWUMPO.

Members' voluntary winding-up

- A **solvent** company passes a **special resolution** for voluntary winding-up.
- Common scenarios of members' voluntary winding-up:
  - Group restructuring
  - Company ceases to operate.
- Members' voluntary winding-up is commenced by the passing of the company's special resolution for voluntary winding-up.
  - The directors of the company are required to issue a **Certificate of Solvency** to certify that the company will be able to pay its debts in full within 12 months from the commencement of the winding-up (s.233 CWUMPO).
  - Date of **passing of the special resolution** for voluntary winding-up is deemed to be date of commencement of voluntary winding-up (s.230 CWUMPO).

Members' voluntary winding-up (cont'd)

Board meeting forms opinion (after full enquiry) that company will be able to pay its debts in full within12 months after commencement of the proposed winding-up	(s. 233 CWUMPO)
↓	
Directors issue a Certificate of Solvency with Statement of Assets and Liabilities of the company	(s. 233 CWUMPO and Form NW1)
↓	
Certificate of Solvency issued within 5 weeks before passing of special resolution for voluntary winding-up and filed with CR not later than the filing of that resolution	(s. 233(2)(a) CWUMPO)
↓	
Obtain consent of proposed liquidator to his appointment	
↓	

Members' voluntary winding-up (cont'd)

↓

Convene general meeting on 14 days' notice to members (s. 564, 571 CO)

↓

Pass special resolution for voluntary winding-up and appointment of liquidator (s. 228, 235 CWUMPO)

↓

File special resolution with CR within 15 days and advertise notice of special resolution for voluntary winding-up in the Gazette within 14 days, insert copy of resolution to every print of M&A (s. 229 CWUMPO, s. 622 CO)

↓

Liquidator publishes notice of his appointment in the Gazette and registers with CR within 21 days of appointment (s. 253 CWUMPO)

Creditors' voluntary winding-up

- CVL happens when a company:
  (1) passes a **special resolution** for voluntary winding- up in the absence of a Certificate of Solvency (s. 233(4) CWUMPO); or
  (2) is not solvent in the opinion of
    - the directors (s. 228A CWUMPO); or
    - the liquidator (Conversion from members' voluntary winding-up) (s. 237A CWUMPO).

Creditors' voluntary winding-up (excluding S.228A proceedings) (cont'd)

↓

Board resolution to convene general meeting and creditors' meeting, determine date for general meeting and creditors' meeting (appoint director to preside the general meeting and creditors' meeting) (s. 241 CWUMPO)

↓

Send 14 days' notice (or shorter period as allowed) of general meeting to shareholders and notice of creditors' meeting to creditors (notice of creditors' meeting at least 7 days) (s. 241 CWUMPO)

↓

Advertise notice of creditors' meeting in Gazette, English and Chinese newspaper (s. 241 CWUMPO)

↓

General meeting held and passed special resolution for voluntary winding-up (liquidators appointed)

↓

Chairman signed minutes of general meeting and at least 3 copies of special resolution for voluntary winding-up and appointment of liquidator and notice of confirmation of appointment of liquidator

↓

Creditors' voluntary winding-up (cont'd)

One copy of special resolution to be filed with CR within 15 days, advertised in Gazette within 14 days and inserted into every print of M&A	(s. 229 CWUMPO, s. 622 CO)
Creditors meeting held attended by directors and proposed liquidator to answer creditors' questions. Director lays statement of affairs and creditors list in the meeting	(s. 241 CWUMPO)
Creditors have priority to appoint liquidator. If creditors do not nominate any, the person nominated by company shall become liquidator	(s. 242 CWUMPO)
Creditors may appoint committee of inspection of not more than 5 persons	(s. 243 CWUMPO)
Chairman signs minutes of the creditors' meeting and at least 3 copies of Notice of Confirmation of Appointment of Liquidator	
Liquidator publish notice of his appointment in Gazette and register with CR within 21 days of his appointment	(s. 253 CWUMPO)

Voluntary Winding-up by Directors (s.228A CWUMPO)

Directors' meeting called and a majority of them resolve to deliver a winding-up statement of the Registrar (s. 228A(1) CWUMPO)

↓

Statement to be made by one of the directors recording that (s. 228A(1) & (2) CWUMPO)

i)The company cannot because of its liabilities continue its business;

ii) The directors consider it necessary that the company be wound up;

iii)It is not reasonably practicable for the winding up to be commenced under another section of the CWUMPO

iv)Meetings of the company's shareholders and creditors will be held within 28 days of the filing of the declaration with the Registrar

↓

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Voluntary Winding-up by Directors (s.228A) (cont'd)

Statement filed with the Registrar within 7 days after it has been made	(s. 228A(3) CWUMPO)
↓	
Provisional Liquidator shall be appointed forthwith after the statement has been filed	(s. 228A(5)(b) CWUMPO)
↓	
Within 14 days of the appointment of the provisional liquidator, a notice of appointment shall be delivered to the Registrar and the notice of the commencement of the winding up and the details of the provisional liquidator be advertised in the Gazette	(s. 228A(9) CWUMPO)
↓	
Send 7 days' notice to creditors and advertise in the Gazette and one Chinese and one English newspaper for the creditors' meeting	(ss. 228A(17) & 241 CWUMPO)
↓	
Creditors' meeting be held within 28 days from the filing of the statement (to confirm or replace the provisional liquidator)	

PART 3: DEBT RESTRUCTURING OPTIONS

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Debt restructuring options

- Voluntary restructuring
- Formal scheme of arrangement
- Appointment of provisional liquidator

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Voluntary restructuring

- **Informal and non-statutory** arrangements between the company, all shareholders, and creditors on a voluntary basis.
- The parties may adopt the Hong Kong Approach to Corporate Difficulties published jointly by the Hong Kong Association of Banks and the Hong Kong Monetary Authority as the guiding principles for the conduct of corporate restructuring.
- Limitation:
  - The voluntary nature of this route requires the consent and cooperation of all parties involved.
  - The lack of moratorium and the law about unfair preference make it difficult to accomplish voluntary restructuring.

Formal scheme of arrangement

- Companies and creditors/members may reach compromise agreements and apply for the **court's sanction** under s. 673 and 674 CO.
  - The court may order a meeting of the creditors/members for approving the proposed scheme of arrangement.
  - With approval by 75% of the creditors/members in value and 50% by head count, the scheme becomes binding on all creditors/members.
  - The court has discretion with the headcount test for court schemes if the result of the vote has been unfairly influenced by share/debt splitting: ***Re PCCW Ltd*** [2009] 3 HKC 292; ***Re Dee Valley Group plc*** [2017] EWHC 184 (Ch)

Formal scheme of arrangement (cont'd)

- Limitations:
  - This method requires intensive court involvement and is generally expensive and time-consuming.
  - A pending application for statutory scheme of arrangement under s. 673 and 674 CO does not confer a creditor moratorium.
    - Before the proposed scheme is sanctioned by the court, creditors can still commence legal proceedings against the company or seek to wind- up the company.
    - This often hinders the parties from reaching a compromise.

Appointment of provisional liquidator

- In some situations, a provisional liquidator may be appointed under s. 193 CWUMPO and be given the power for the purpose of corporate restructuring.
  - The liquidators may also apply to the court under s. 673 and 674 CO to have a proposed scheme of arrangement approved and implemented.
- Appointment of a provisional liquidator has the effect of a moratorium because of s.186 CWUMPO:
  - *When a winding-up order has been made, or a provisional liquidator has been appointed, no action or proceeding shall be proceeded with or commenced against the company except by leave of the court, and subject to such terms as the court may impose.*
- This may be used in conjunction with s. 673 and 674 CO to achieve corporate restructuring.

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Appointment of provisional liquidator (cont'd)

- ***Re Legend International Resorts*** [2006] 2 HKLRD 192
  - It was held that "the primary purpose of appointing provisional liquidators must always be the purposes of the winding-up", not for the purposes of avoiding the winding-up, and that "restructuring a company is an alternative to a winding up".
  - These statements cast doubt on whether and the extent to which provisional liquidators are allowed to carry out restructuring, which would have the effect or preserving and extending the life of a company and thus preventing winding-up.

- In ***Re Easy Carry Ltd*** (unrep., HCCW 297/2014, 31 October 2016), Harris J reiterated that the jurisdiction of provisional liquidation is to allow court to appoint provisional liquidators in order to preserve the company's assets rather than to be used as a mechanism to restructure debts.

Appointment of provisional liquidator (cont'd)

- Recent development – ***Re China Solar Energy Holdings Ltd*** [2017] 2 HKLRD 1074 – Court rejected the contention that when the provisional liquidators embarked upon a restructuring exercise, their power came to an end when that exercise became their only purpose

- **Facts:**
  - China Solar Energy Holdings Ltd ("**the Company**") is listed on the Hong Kong Stock Exchange but its trading has been suspended since 13 August 2013. On 26 March 2015, Crown Master International Trading Co Ltd ("**Crown Master**") presented a winding up petition against the Company due to its inability to answer a statutory demand.

Appointment of provisional liquidator (cont'd)

- **Facts (cont'd):**
  - Crown Master subsequently assigned its debt to Ankang Ltd ("**Ankang**") and Ankang was substituted as the Petitioner in place of Crown Master. The provisional liquidators ("**PLs**") were appointed.
  - Under the Appointment Order, the PLs were empowered to procure a restructure of the Company. On 17 December 2015, the PLs entered into an exclusivity agreement with Happy Fountain Ltd for restructuring.
  - The Petitioner questioned the power of PLs to carry out the restructuring exercise. To avoid dispute, the PLs applied to court for approval of the various contractual documents arising from the restructuring.

Appointment of provisional liquidator (cont'd)

- **Findings:-**
  - The Petitioner argued that notwithstanding that the PLs were properly appointed and were acting within the parameters of the Order, when it embarked upon the restructuring exercise, there came a time when that exercise became the only purpose of the PLs and at which point their power came to an end.
  - The Court disagreed with such proposition and held that whilst provisional liquidator could not be appointed for the sole purpose of corporate rescue, it is still within their power (if so provided for in the order appointing them) to carry out corporate rescue if later it is found that the company could be rescued.

Appointment of provisional liquidator (cont'd)

- Companies incorporated in offshore jurisdictions with assets in Hong Kong may consider appointing provisional liquidators in the place of incorporation for restructuring purposes. The PLs appointed overseas then may apply for the issue of a letter of request to the Hong Kong Court for assistance in the form of promoting a parallel scheme of arrangement in Hong Kong.

- In ***In the matter of Z-Obee Holdings Limited and in the matter of the Companies Act 1981*** [2017] SC (Bda) 16 Com, Z-Obee Holdings Limited, a company incorporated in Bermuda and listed on the Hong Kong Stock Exchange has been in provisional liquidation. The Hong Kong joint provisional liquidators have found a potential investor to rescue the company. In light of the restriction and uncertainty on PL's powers in HK, the company applied to appoint the Hong Kong JPLs as Bermuda JPLs for the explicit purpose of restructuring the company.

Appointment of provisional liquidator (cont'd)

- ***In the matter of Z-Obee Holdings Limited and in the matter of the Companies Act 1981*** [2017] SC (Bda) 16 Com (cont'd)
  - The Bermudian Supreme Court noted that it is the Bermudian Court's established practice to use provisional liquidation in a wide range of circumstances as a mechanism to implement financial or operational restructurings to effect corporate rescue.
  - Further, the Bermudian Courts have a broad discretion to order adjournment to enable alternatives to a winding-up to be explored: ss 164(1) and 170(3) of the Bermuda Companies Act 1981.

Thank you! ☺

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