

Winding up and insolvency law in Hong Kong – key changes in 2016

After many months of consultation and debate, the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Ordinance 2016 (the Amendment Ordinance) has been published. In the first of two briefings looking at the effects of the new legislation, we focus on the major changes brought about by the Amendment Ordinance as it affects the protection of creditors and the winding up process. We also look at what is still to come in the changing landscape of insolvency law in Hong Kong.

Overview

In the press release accompanying the publication, a Government spokesperson said *"The Amendment Ordinance will improve and modernise Hong Kong's corporate winding-up regime by providing measures to increase protection of creditors and further enhance the integrity of the winding-up process."*

Protection of Creditors

The Amendment Ordinance aims to achieve better creditor protection in various ways.

Transactions at an undervalue

Historically, Hong Kong's corporate insolvency law has had no separate concept of transactions at an undervalue, although there is such a concept for personal bankruptcy as provided for in the Bankruptcy Ordinance (Cap 6). The concept is now included in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO).

A transaction at an undervalue occurs when a company makes a gift to, or enters into a transaction with, a person on terms that provide for the company to receive no consideration; or enters into a transaction with a person for a consideration (to be assessed in terms of money or money's worth) the value of which is significantly less than the value of the consideration provided by the company (new section 265E, CWUMPO).

The *"relevant time"* for a transaction at an undervalue to be caught is any time within five years before the commencement of the winding up, but only if at that time the company was unable to pay its debts or became unable to pay its debts as a result of the transaction (new section 266B, CWUMPO).

As a safeguard and reassurance to concerned directors, the Court will not make a remedial order restoring the company to the position it would have been in if it had not entered into the transaction, if it is satisfied that the company entered into the transaction in good faith for the purpose of

Key issues

- The aim of the legislation is to *"improve and modernise Hong Kong's corporate winding-up regime by providing measures to increase protection of creditors and further enhance the integrity of the winding-up process."*
- It intends to achieve this with new provisions concerning transactions at an undervalue, changes to the law on unfair preferences and new liabilities attaching to directors and members in connection with a redemption or buy-back of shares out of capital.
- Long overdue detailed proposals on a new statutory corporate rescue procedure are in preparation.
- No date has been set for the new law to come into operation.

carrying on its business and there were reasonable grounds for believing that the transaction would benefit the company (new section 265D, CWUMPO).

Unfair Preferences

The Amendment Ordinance addresses a long-standing anomaly in the corporate unfair preference regime by introducing a standalone power for the Court to set aside transactions entered into by a company prior to its winding up that unfairly puts a particular creditor in a better position than other creditors (new section 266, CWUMPO). Previously, the unfair preference concept in the corporate arena was inelegantly linked to that relating to individuals under the Bankruptcy Ordinance.

A company gives an unfair preference to a person if that person is one of the company's creditors or a surety or guarantor for any of the company's debts or liabilities, and the company does anything or suffers anything to be done which has the effect of putting that person into a position which, in the event of the company going into liquidation, would be better than the position that person would have been in if that thing had not been done (new section 266A, CWUMPO).

Definition of "Associate"

The definition of "associate" for the provisions on transactions at an undervalue and unfair preferences is now broadened and includes categories of persons which are formulated with specific regard to the usual manner in which corporations operate. This is in contrast to the old definition under the Bankruptcy Ordinance, which was formulated on

the basis of the bankrupt as an individual.

Under CWUMPO, a person may be an associate of a company if he (i) is a director, shadow director or other officer of the company; or (ii) has control of the company, by himself or together with his associates, either by having control over the board of directors or by being entitled to exercise, or control the exercise, of more than 30% of the voting power at any general meeting of the company or of another company which has control of it. In addition, two companies may be associates of each other if they are under common control (section 265C, CWUMPO).

Floating Charges

The Amendment Ordinance changes the law in respect of floating charges and when they may be set aside.

CWUMPO aims to prevent the mischief of last minute floating charges being created by directors or controllers of companies in favour of themselves. Liquidators have been able to treat floating charges made within 12 months of the commencement of the winding up as invalid as a security unless the company was solvent immediately after the creation of the charge.

The new section 267 CWUMPO follows the recommendation of the Law Reform Commission in extending the "*relevant time*" for a floating charge created in favour of a connected person to two years prior to the commencement of the winding up. It also allows liquidators to take into account the provision of property and services as well as cash by way of consideration for the amount of the charge.

Liabilities of directors and members

The Amendment Ordinance contains new provisions for civil liability on directors and members in connection with a redemption or buy-back of shares out of capital.

Where a company has redeemed or bought back its own shares by payment out of its capital and the company has been wound up within one year of the redemption or buy back, the recipient of the payment of the redeemed or bought-back shares and the directors who made the solvency statement are made jointly and severally liable to contribute to the assets of the company an amount not exceeding the payment in respect of the shares (new section 170A, CWUMPO).

The change is intended to protect the interests of creditors by ensuring that the company's paid-up capital is preserved and not returned to its members immediately before the insolvent winding up of the company at the expense of the company's creditors.

The Winding up Process

The Amendment Ordinance includes changes made with the aim of improving the integrity of the winding up process. These include new provisions:

- setting out more clearly the powers of provisional liquidators in a court ordered winding up, together with provisions on the basis for remuneration and tenure of office;
- simplifying the procedure for a liquidator to appoint a solicitor to assist in a court ordered winding up by giving advance notice to the Committee of Inspection;

- restricting the powers of the members-appointed liquidator and the directors before the holding of the first creditors' meeting and the appointment of a liquidator in a voluntary winding up;
- expanding the list of people disqualified for appointment as a provisional liquidator or liquidator to avoid conflicts of interest;
- setting out the procedures for removal and resignation of a liquidator in a voluntary winding up; and
- improving the procedures for private and public examinations.

These amendments will be examined more fully in the second of our briefings.

Timescale

The Amendment Ordinance will come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury. Currently, there is no public information as to when this will be or if the changes will be introduced in stages.

Changes Ahead

The Amendment Ordinance does not include any provisions relating to corporate rescue or to delinquent directors, both areas where Hong Kong's corporate insolvency regime has for some time lagged behind other jurisdictions both within the region (most notably Singapore) and internationally, such as England and Wales.

This is despite various consultation processes in Hong Kong over a number of years dating back to the Asian financial crisis. The Government says it is developing

detailed proposals on corporate rescue, providing an option for companies in short-term financial difficulties to commence a new statutory corporate rescue procedure with a view to reviving the business of the company instead of the rather drastic alternative of immediate liquidation possibly proceeded by a provisional liquidation process.

It is important not only for troubled companies, but equally importantly for their creditors, to have an effective alternative to liquidation so as to encourage a rescue culture with the aim of allowing companies to survive with the benefit of a statutory regime that provides a real alternative to liquidation and which is almost always a value destructive process. It is very much hoped therefore that relevant proposals will be brought before the Legislative Council in the 2017/18 session.

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