Hong Kong Institute of
Certified Public Accountants
香港會計師公會

7 February 2012

Our Ref.: C/RIFEC, M816010

Mr. Darryl Chan
Deputy Secretary for Financial Services
and The Treasury (Financial Services)3
Financial Services and Treasury Bureau
15th Floor, Queensway Government Offices
66 Queensway
Hong Kong

Dear Darryl,

Review of the Law Relating to Corporate Insolvency

--- Please find attached a set of proposals from the Hong Kong Institute of CPAs on reviewing and updating the law relating to corporate insolvency in Hong Kong.

Following recommendations on broader policy matters, the submission examines in more detail the winding up provisions of the Companies Ordinance and related matters. The Institute's comments and recommendations are set out in serial order of the relevant provisions.

Separately, the Restructuring and Insolvency Faculty of the Institute is looking at the issue of possible licensing of insolvency particulars and we may in due course have additional proposals in this regard.

If you have any questions on our submission, please give me a call.

Yours sincerely,

Peter Tisman
Director, Specialist Practices

PMT/ay
Encl.

c.c. Miss Au King Chi, JP
Permanent Secretary for Financial Services and The Treasury (Financial Services)

Ms. Teresa Wong
Official Receiver's Office

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓
Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603
Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

Hong Kong Institute of Certified Public Accountants
Restructuring and Insolvency Faculty ("RIF")
Recommendations for Improvements to the Winding-up Provisions of the Hong Kong Companies Ordinance

PART A – RECOMMENDATIONS ON POLICY ISSUES

1. Introduction of a single piece of insolvency legislation to include all matters relevant to winding-up, receivership and bankruptcy

There are numerous examples within the winding-up provisions where cross-references are made to the provisions of the Bankruptcy Ordinance ("BO") or its subsidiary legislation.

It is proposed that Hong Kong should consider introducing a single piece of insolvency legislation to bring together all insolvency and insolvency-related matters, including corporate rescue and insolvent trading provisions, and also section 60 of the Conveyancing and Property Ordinance, which is commonly used by liquidators to recover assets if the disposals are conducted with the intent to defraud creditors. A stand-alone Insolvency Ordinance would provide a comprehensive legal framework for insolvency in Hong Kong, help align definitions, where at present some terms are defined slightly differently in different pieces of legislation, and avoid the necessity of making frequent cross-references. Consolidation would also reduce the time needed to search for the relevant provisions and make Hong Kong insolvency law easier to follow. The United Kingdom ("UK")'s Insolvency Act 1986 ("IA"), which contains provisions on receivership, bankruptcy, winding-up, voluntary arrangements and administration of companies, could be a model for this.

As regards the layout of the separate insolvency ordinance, if it is considered to be appropriate, there could be different sections dealing with different types of insolvency, e.g., one part on bankruptcy, another part on company windings-up, etc.

We understand the winding-up provisions will remain in the residual part of the existing Companies Ordinance ("CO") upon the enactment of the new Companies Bill. This could form the basis of a separate insolvency ordinance.

On the other hand, if, ultimately, it is decided not to propose a separate insolvency ordinance, we would suggest that the remaining parts of the existing CO should be amended to become a stand-alone Companies (Winding Up) Ordinance, which will to avoid the necessity having to cross-refer to the BO in conducting company windings-up (e.g., in relation to section 264 of the CO on the application of the bankruptcy rules and sections 266 and 266B on fraudulent and unfair preferences).

2. Implementation of UNCITRAL model law to deal with cross-border aspects of insolvency engagements

Implementation of the United Nations Commission on International Trade Law ("UNCITRAL") Model Law should be part of the update of the CO, to facilitate

insolvency and restructuring procedures relating to Hong Kong companies with assets overseas and overseas companies with assets in Hong Kong. Legislation based on the model law has now been adopted in around 20 jurisdictions, including the United Kingdom, Australia, New Zealand, the United States, Canada, Japan and South Africa.

There are express provisions in the Mainland's Enterprise Bankruptcy Law to deal with cross-border aspects of insolvency cases. This is true of insolvency legislation in many other countries. One such example is s.426 of the IA, which gives recognition to co-operation between courts in other countries or territories exercising jurisdiction in relation to insolvency. Given that the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap. 597) specifically excludes bankruptcy/ insolvency-related judgments, it is recommended that the law in this regard (i.e., the cross-border aspects, both inbound and outbound, of insolvency cases) should be clarified and codified.

On the practical level, channels of liaison with the relevant authorities on the Mainland, and in other overseas jurisdictions should be developed, to facilitate the recognition of liquidators appointed in Hong Kong, amongst other things.

3. Compulsory/Voluntary Liquidation Procedures

There are numerous examples within the existing legislation where administrative procedures for a compulsorily liquidation are different to those for a voluntary liquidation. Examples include those relating to payment of dividends, committees of inspection and proofs of debt.

As far as possible, it would be advantageous to have similar procedures for voluntary and compulsorily liquidations.

PART B – RECOMMENDATIONS ON INDIVIDUAL PROVISIONS OF THE CO

We have reviewed the recommendations for specific changes to the winding-up provisions of the CO contained in the 1999 report of the Law Reform Commission, "*The Winding-up Provisions of the Companies Ordinance*" ("LRC report"). Although the LRC report was published 13 years ago, a number of the recommendations in it remain relevant today. Where appropriate, we make reference to the relevant recommendations below.

S.178 Definition of inability to pay debts

We support the LRC's recommendation that a statutory demand under section 178(1)(a) of the CO should be in a prescribed/standard format. It is suggested that the form under this provision should mirror section 6A of the BO, requiring certain particulars, similar to those set out in the Bankruptcy Rules, to be contained in a valid statutory demand.

As regards the minimum debt amount under section 178(1)(a), it is recommended that the amount should be subject to regular review. It is further suggested that the amount be specified in subsidiary legislation, so that it will be easier to amend in future. We note that the small claims limit is now $50,000. The minimum debt on which a petition can be

presented, which currently stands at $10,000, should be reviewed and may need to be increased.

We also support the LRC's recommendation for the codification of both the cash-flow test and balance-sheet test to determine whether a company is insolvent (see also IA, s.123).

S.183 Avoidance of attachments
S.186 Actions stayed on winding-up order

We support the LRC's recommendation that the principles of sections 183 and 186 be applied to a creditors' voluntary winding-up in that the *pari passu* principle should be upheld. The provisions applying to the various types of liquidations should be harmonised as far as possible.

S.193 Appointment and powers of provisional liquidator

As regards the powers of provisional liquidators ("PLs"), we support the LRC's recommended approach that a standard framework or set of powers be provided in the statute, either in a schedule or in a rule (i.e., subsidiary legislation) in order to facilitate future changes. In addition, the PL would still have the right to apply to the court for additional powers that may be tailored to specific situations. At the moment, the PL's powers are specified only in the order appointing the PL and any subsequent changes, in variations to the order. In future, if the PL's basic powers are specified in the law, it would be helpful if these were in a bilingual form. It would also be useful to have an official Chinese translation of any court order providing for additional powers granted to the PL.

In relation to the specimen powers of a PL, referred to in the LRC report, we do not share the LRC's view that the power to close down a business, which is a business decision, should be a matter for the sanction of the court.

S.194 Appointment, style, etc., of liquidators

We do not support the LRC's recommendation for the introduction of the concept of an “interim liquidator” as we think it would result in unnecessary confusion.

We consider that the views of the creditors should take priority over those of the contributories in a compulsory winding-up, where they differ as to who should be appointed liquidator. Any objection to the appointment by the creditors should be made to the court within, say, 14 days. Under the present system, where there is a difference of opinion between the creditors and the contributories as to nomination of the liquidator, there is often a considerable delay in the confirmation of the liquidator's appointment due to the necessity of a determination hearing. We consider that the creditors’ nomination should immediately be appointed as the liquidator with the option for dissenting contributories to apply to court if they are unhappy with the decision. This could be achieved by the order for the liquidator’s appointment not taking effect until 14 days after the date of the submission of the Official Receiver (“OR”)’s report on the outcome of the meeting to the court. In the interim, the OR should remain as the PL until the appointment of a liquidator by court order.

It is suggested that substantial creditors should be allowed to require that the OR's Office ("ORO") convene a meeting rather than allocating the case to the ORO's panel scheme for contracting out liquidation work. Furthermore, it is suggested that creditors be allowed to nominate a PL at the time the court makes a winding-up order, instead of the OR automatically becoming the PL and allocating the job out to the next firm on the roster. This would save both time and costs. As such, section 194(1) should be amended to give the court the discretion to appoint a liquidator of the creditors' choosing if it is satisfied with the creditors' representation; otherwise, the existing procedure would be followed. It is further suggested that in cases where there are competing nominations by different creditors, the court should be able to hear the respective representations and decide.

It is noted that a creditor whose claim exceeds 10% of the total debt by value can request the OR or liquidator to call a creditors' meeting by paying a small fee. It is suggested that the amount of the fee should be reviewed, with criteria to determine how the amount should be charged. This should also be amended to allow such a request to be made of a PL appointed under section 194(1A). At the moment, the rules regarding the costs of convening the meeting are unclear.

S.195 Provisions where person other than OR is appointed liquidator

This section provides that where someone other than the OR is appointed liquidator, he must, among other things, provide security to the satisfaction of the OR. Both the amount of security and the way in which security is given are determined by the OR. The cost of a security bond constitutes a significant expense for the liquidator, which under the existing law is not recoverable from the assets of the company.

The Institute understands that, to date, no cases have ever triggered the OR to make a call on a bond. However, if it is decided to retain a requirement for this specific type of security, we would support the LRC's recommendation that the cost of a security bond be regarded as an expense of the winding-up, which can be recovered from the assets of the company.

To enhance transparency and consistency, the OR should also be asked to develop and disclose clear criteria for determining the level of the security requirement.

As an alternative to requiring individual bonds, as a matter of practice, the OR should also be able to accept a "global bond", i.e., a single bond to cover all cases handled by an individual insolvency practitioner ("IP"), in respect of which cover can be adjusted either up or down as he is appointed to new cases and/or released from completed cases.

S.196 General provisions as to liquidators

We generally agree with the LRC's recommendations that there should be separate sections for the resignation, removal and remuneration of liquidators.

We also share the LRC's view that, at present, the process for a liquidator to resign, as provided for in the Companies (Winding-Up) Rules, is time-consuming and costly. We agree that the process should be simplified, especially in the circumstance where an IP is replaced by another IP within the same firm, due to, for example, a change in personnel or retirement of the former IP. We consider that a liquidator should be able to resign without the need to

hold a meeting of creditors. However, he must obtain the approval of the court. If the resignation is going to result in a previously unconnected IP from another firm being appointed, we consider that a meeting of creditors should be held.

In relation to remuneration of liquidators' agents, there is an anomaly in the legislation. During the provisional liquidation period, under section 193, the PL's fees are approved by the court, whilst the PL has the power to scrutinise and approve the fees of his agents. However, following his appointment, the fees of a liquidator can be approved by the committee of inspection ("COI"), whilst the fees of his agents have to go through the taxation process. Given that the COI can approve the fees of a liquidator, and the PL can approve the fees of his agents, we do not see why the COI cannot also approve the fees of the liquidator's agents. This would be likely to encourage more solicitors to offer insolvency-related services. At the moment, many are discouraged from doing so by the potentially lengthy delays in the payment of their fees caused by the taxation process. We recommend a change in the legislation to allow the COI to approve the fees of the agents appointed by the liquidators. However, in cases where there is no COI, the fees of the liquidator's agents would still need to be taxed in the same way as those of the liquidator. This should give sufficient comfort to all stakeholders regarding the control of the agents' fees.

We further suggest that as far as possible, there should be consistency between creditors' voluntary liquidations ("CVLs") and compulsory liquidations regarding the procedures for the appointment of agents and the agreement and payment of their fees.

S.199 Powers of liquidators

As regards whether a PL appointed under section 194(1A) should have the power to dispose of assets without waiting for appointment as liquidator, we are of the view that, as the private sector PL under section 194 is an officer of the court, and he is on a list of tenderers approved by the OR, he should be able to dispose of the assets. Whilst it is not suggested that the existing practice whereby a PL appointed under section 194 is required to seek the OR's approval for such a disposal has given rise to any problems in practice, codification of PL's power in this regard would be helpful.

It is further suggested that the powers of liquidators (section 199 for court windings-up ("CWUs") and section 251 for CVLs) should be standardised as far as possible and set out in a separate schedule to the ordinance. The powers, duties and responsibilities of liquidators under CWUs and CVLs are substantially the same. However, we consider that it would be useful to specify not only the powers of a PL/ liquidator but also any approvals required for the exercise of those powers in a CWU and a CVL.

S.202 Payments of liquidator into bank or Treasury

We consider that the word "forthwith" in subsection (2)(b) is ambiguous; and suggest that it should be replaced by "within 28 days" or "not later than 28 days after its receipt" (with a consequential amendment to the number of days specified under subsection (2)(a)).

It is noted that for bankruptcies and compulsory liquidations in the UK, a liquidator must pay in all money received into the Insolvency Services Account ("ISA") in carrying out his IP functions, without deduction, once every 14 days, or immediately if he receives £5,000 or

more (Regulations 5 and 20 of the Insolvency Regulations 1994 refer). For CVLs, a liquidator may pay money into the ISA where this is convenient. However, it was announced last year that the ISA facility for CVL cases would be withdrawn with effect from 1 October 2011. This means that as of 30 September 2011, no new ISA accounts will be opened in CVLs. The decision was made following a consultation exercise conducted in 2010 and in view of the continuing decline in the number of voluntary liquidation ISA estates. This recent development in the UK insolvency law is also worth considering in Hong Kong.

S.203 Audit of liquidator's account

We agree with the LRC's recommendation that the prescribed forms used in sections 203 and 284 should be simplified and the forms should be regularly reviewed and updated.

We further submit that the existing format of the section 203 accounts should be simplified as it can be very confusing for creditors. The current wording of the COI certificate, which requires the COI to certify that the liquidator's accounts are full, true and complete, may be a deterrent to some COI members to sign off on the certificate. Rather than a certification by the COI, as in the current Forms 86 and 88, it is suggested that COI be required to review the accounts and that the accounts be taken as accepted if no committee member has any objection.

We also agree with the LRC's recommendation that the requirement to send a summary of accounts to every creditor and contributory should be replaced by a provision facilitating creditors and contributories to obtain a summary on request. As an alternative, consideration should be given to replacing the existing delivery method with a more cost-effective method. This could be achieved by, for example, section 203(5) being amended to provide flexibility for liquidators to send the accounts to creditors and contributories by electronic means; or to post the accounts on the liquidator's website for inspection. This, together with simplification of the standard forms, would lead to a higher level of transparency and greater clarity of disclosure. It is noted that the CO has been changed to allow companies to communicate with shareholders by electronic means. This could be extended to liquidators, who communicate with stakeholders on behalf of the company.

S.206 Meetings of creditors and contributories to determine whether a COI should be appointed

We agree with the LRC's proposals regarding holding meetings, i.e. section 206(1) should be amended to delete the reference to the obligation on the first meeting of creditors and contributories to determine whether or not a COI should be appointed. An alternative provision should be added to provide that a liquidator may call subsequent meetings for the purpose of appointing a COI.

A liquidator should also have the power to convene a creditors' meeting for the replacement of existing members and/or appointment of additional members to the COI, and such replacement and appointment should subject to court sanction. However, it is too onerous to require the resignation of a COI member or co-option of a member to fill a casual vacancy of the committee to have to follow such procedures.

We support, in principle, the LRC's recommendation that a COI should be able to function through written resolutions sent by post or by electronic means. However, we believe that a majority view should be sufficient rather than having to obtain 100 percent approval, otherwise this could create practical difficulties.

We also support the LRC's recommendation that directors of a company being wound-up by the court or in a CVL should be obliged to attend meetings of creditors, if required to do so by the PL and be available to comment on the company's affairs and answer questions, if necessary. It is further suggested that there should be appropriate penalty imposed on a director who fails to fulfil this obligation, e.g., a possible disqualification order.

S.207 Constitution and proceedings of COI
S.243 Appointment of COI

We suggest that the number of members for the COI should be a minimum of three and a maximum of five for all types of liquidations, both voluntary and compulsory, but that this number could be varied by the court, if it thinks fit.

Section 207(5) – we suggest reducing the number of consecutive meetings from which a COI member may be absent from five to three before his office is deemed to be vacated.

Section 207(7) – The liquidator should have the discretion not to fill the vacancy in the COI without applying to the court, if he is of the opinion that it is unnecessary for the vacancy to be filled.

S.209A Power of court to order winding-up to be conducted as creditors' voluntary winding-up

We consider that, at some stage during the liquidation process, there may be merit to converting a winding-up by the court to a CVL, which would subject to fewer procedures and generally save costs. It is suggested that the relevant provisions should be revised to allow a liquidator or a creditor, based on the merits of the case, to present a conversion proposal for consideration at a meeting of creditors, at any stage during the liquidation process, and not to restrict conversion proposals to being considered only at the first meeting of creditors/ contributories, as is currently the case.

Once the conversion proposal has been passed at a meeting, an application for conversion will still have to be submitted to the court for its approval.

S.211 Delivery of property to liquidator

We support the LRC's recommendation that "*any contributory, trustee, receiver, banker, agent, or officer of the company"* in this section should be replaced by *"any person"* who possesses or controls assets of the company. The IA equivalent is s.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.

We further suggest that this provision should apply to all kinds of liquidations, including where a PL has been appointed.

S.227A Court may make a regulating order
S.227B Appointment of liquidator and committee of inspection

It seems that there is an inconsistency between sections 227A and 227B in relation to bringing an application to the court for a regulating order. Although it appears that the legislation envisages that such an application can be made by the OR or the liquidator/PL, section 227B refers to the OR only.

In the Guangnan (KK) Supermarket Ltd case (HCCW 618/2001), it was noted by Hon Yuen J that:

> "*It is clear under Section 227A that a private provisional liquidator may make the application to the court for a regulating order. Section 227A(2) also says that where a regulating order is made, Section 227B shall apply to the winding up. However, Section 227B(1) says expressly that the court may "on the application of the Official Receiver" by order dispense with the summoning of first meetings of creditors and contributories, etc. It would appear therefore that under Section 227B, a literal interpretation of the express provisions of sub-section (1) would restrict the application under Section 227B to one made by the Official Receiver and not by a private provisional liquidator. … It may well be that the draftsman was not aware of certain other provisions when he drafted Section 227B(1) to refer to the Official Receiver only, but be that as it may, in light of the express provision of Section 227B(1), it seems to me that there was at least a substantial query as to the Provisional Liquidators' locus standi. ... … I am told by the Official Receiver that the attention of the law draftsman will be brought to what would appear to be an unnecessary distinction between Section 227A and Section 227B. …*"

We recommend that the inconsistency between the two sections be resolved.

S.228A Special procedure for voluntary winding up of company in case of inability to continue its business

It is suggested that consideration be given to easing the circumstances in which this section can be used. There are still situations in which it would be beneficial to be able to make use of this section, but many professionals have expressed the view that it is virtually impossible to utilise it because of the restrictive amendments made in 2000, i.e., the additional condition that directors should resolve at a meeting that the winding-up should be commenced under section 228A, because it is not reasonably practicable for the winding-up to be commenced under another section of the CO. If there are no reasonable grounds to justify such a resolution, the directors will be liable to a fine and imprisonment.

While we recognise that it has been suggested that there need to be safeguards against its abuse, we are not aware of any evidence of abuse arising from this section in the past. We suggest removing the above condition introduced in 2000 and reverting to the earlier version of the provision, i.e., the directors must state that there are good and sufficient reasons for the winding-up to be commenced under section 228A.

As an additional safeguard, there could be a provision to restrict the power of the PL to certain activities before the meetings of the company and of the creditors, similar to s.166 of the IA. This means that a liquidator appointed by the company will have no power to do

anything other than take control of the assets, dispose of perishable goods and do such other things as may be necessary for the protection of the company's assets, until such time as his appointment has been confirmed by the creditors at a meeting of creditors.

S.241 Meeting of creditors

We do not have any strong view on the LRC's recommendation to replace this section by a provision like s.98 of the IA, which provides that the company shall summon a meeting of creditors for a day not later than the fourteenth day after the day of passing the resolution for voluntary winding-up.

The statement of affairs should disclose prescribed information by reference to a schedule in the ordinance. At present the amount of information disclosed by private sector IPs when convening such meetings varies considerably. Creditors have a right to expect that a minimum level of information should be provided so that they can make an informed decision.

S.251 Powers and duties of liquidator in voluntary winding-up

We consider that there should be more statutory clarity as to the powers of a liquidator appointed under section 228A (see also sections 199 and 228A, above), and that the powers of liquidators in different types of liquidation should be placed together in subsidiary legislation (e.g., in a schedule to the ordinance or in rules).

S.264 Application of bankruptcy rules in winding-up of insolvent companies

We reiterate our support for the LRC's recommendation that the winding-up provisions of the CO, the provisions on receivership under the CO, the provisions on provisional supervision (when they are introduced), and the BO should be combined in one ordinance.

It addition, we are of the view that cross-referencing between the CO and the BO should be discontinued. Confusion is caused by random cross-referencing to the BO, for example, in relation to proof of debts. Section 184 states that the winding-up of a company commences at the time of the presentation of the petition, suggesting that debts have to be incurred before that date to be provable. However upon closer inspection, section 264 of the CO provides that the law of bankruptcy applies to, amongst other matters, provable debts. If reference is then made to section 34 of the BO, it is found that, in fact, it is debts incurred prior to the date of the order, and not the date of filing the petition, that are provable.

As corporate insolvency is different to bankruptcy, we recommend that there should be separate provisions to deal with issues such as proofs of debt, dividends, meetings of creditors, associates and other areas in the CO, where presently definitions are imported from the BO. Furthermore, these should apply to all types of liquidations unless there are exceptional circumstances.

S.265 Preferential payments

The Institute's submission on the LRC's 1998 consultation paper expressed the view that this section is very complicated and cumbersome, and in particular, the insurance provisions cause significant difficulties. We maintain this view and propose that this section should be completely redrafted and simplified in order to make the preferential provisions understandable, using the following basic underlying principles:

- The priority of payment of creditors' claims in a liquidation should be dealt with in a linear order (rule 179 needs further clarification).

- All references to specific amounts should be excluded from this section and should be placed in subsidiary legislation, such as a separate schedule or the rules, to facilitate future revisions.

- The number of classes of priority creditors should be reduced for specific debts. This would better reflect the principle of *pari passu* than is presently the case.

- Debts within each class should "rank equally among themselves" (*pari passu* principle).

- 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.

- It would be beneficial to merely allow as the preferential claim 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.

We do not suggest that there should be any changes in the preferential status of any of the classes of creditors, except that the government's preferential status should be abolished, as there appears to be no good reason to retain it. The preferential status of the government has been removed in the UK.

It is noted that the Employees Compensation Assistance Fund is a preferential creditor under section 265(1)(ea). There are also other compensation schemes providing protection against insurer insolvency in Hong Kong, e.g., the Insolvency Fund Scheme administered by the Motor Insurers' Bureau of Hong Kong, which provides insolvency protection in relation to motor vehicle policies and the Employees Compensation Insurer Insolvency Scheme, administered by the Employees Compensation Insurer Insolvency Bureau ("ECIIB"), which provides insolvency protection in relation to employee compensation policies.

However, not all of these funds are paid in priority to other creditors under section 265 of the CO, where they have compensated the policyholder following the insolvency of an insurer. Under the ECIIB's agreement with the government, for example, it is expressly stated (clause 7(f)) that where the ECIIB has "an entitlement against the estate of the [insolvent] Insurer, ECIIB shall only rank as an ordinary, non-preferential creditor against that estate". The Employees Compensation Assistance Fund ("ECAF"), on the other hand, is categorised as a preferential creditor, under section 265, for the subrogated rights of policyholders whom

the scheme has compensated. There appears to be some inconsistency here and we suggest that the ECAF's preferential status should be reconsidered.

Section 265(5B) provides that the court may, on the application of the OR or liquidator or relevant creditor, make an order as it deems just, to distribute the assets and the amount of the expenses recovered, to give those creditors who indemnified the cost of recovering such assets and expenses an advantage over others, in consideration of the risk run by them in doing so. In order to encourage creditors to fund the recovery of assets, it is suggested that this provision be extended to empower the court to allow prospective applications, and so enable creditors to consider whether to fund a liquidator, taking into consideration the potential benefits.

We consider that the legislation should be amended to allow the fees of a liquidator to be paid out of the realisations of floating charge assets, as opposed to the current situation in Hong Kong, which follows the English authorities established by the decision in Buchler v. Talbot. Subsequent to this decision, legislation was introduced in the UK to nullify its effects, but as the decision was affirmed by the court of first instance in Hong Kong, in the case of Good Success Catering Ltd., Hong Kong is now bound by this interpretation.

In relation to the law regarding "destinations of recovery" of office holder actions, there are English cases that have held that recoveries from "office holder actions" (i.e. unfair preference and insolvent trading) do not form part of the company's assets. As such recoveries are not the company's assets, liquidators cannot use them or assign them to raise funds to finance litigation under section 199(2)(a). At present, it is not clear how a preference action could be funded. We suggest that the legislation should clarify the position, rather than having to follow the case law principles, which are unnecessarily technical and complicated.

S.266B Fraudulent preference deemed to be an unfair preference

We are of the view that this section needs to be reviewed. The provisions should not rely on cross-referencing to the BO, particularly in relation to the definition of "associates" of companies. We consider that the provisions on "associates" should be tailored to fit the needs of the CO. At present, it is doubtful whether even a director is regarded as an associate for the purpose of the “desire to prefer”.

It is noted that very few cases in Hong Kong can be pursued under this section, as it is very difficult to prove the intent – "desire to prefer" – which is a subjective element. Indeed, it is probable that many cases have simply not been brought before the courts because of the problems with the definition of "associate" and its importation from the BO.

We consider that the legislation should be amended to match more closely the law in Australia, where there is no necessity to establish the “desire to prefer” as in the Hong Kong law. Rather, if payments have been made during the relevant period, they are automatically recoverable by a liquidator, with the onus on the recipients to show that they were not preferred.

We support the LRC's recommendation for introduction of provisions on transactions "at an undervalue" into the CO. This concept would apply 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 a consideration that is significantly less than the actual value of the subject of the transaction. The court should be empowered to make an order to restore the position to what it would have been had the company not entered into the transaction. The provisions of s.423 to s.425 of the IA could provide a useful reference.

We also consider that the provisions for transactions "at an undervalue" should include transactions "at an overvalue", i.e., where an insolvent company has purchased assets at an inflated price, as the effect on the company would be similar.

S.267 Effect of floating charge

In order to improve clarity, we propose that the phrase “within 12 months of the commencement of the winding up” be replaced by “within 12 months after the commencement….". We also suggest that the term "property" in this section be replaced by "anything valuable, including properties, securities, services, secret formulae, tangible and intangible assets, reduction of debts, loans and any type of liabilities, or something people would pay for".

We support the LRC's recommendation 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 (which would follow a similar provision under s.245(3) of the IA).

- a provision along the lines of s.245(2)(b) of the IA should be introduced, to the effect that the value of consideration which consists of the discharge or reduction, at the same time as, or after, the creation of a charge, of any debt of a company, should not be treated as invalid.

S.273 Frauds by officers of companies which have gone into liquidation

To be consistent with section 267, we suggest that the term "property" in this section be replaced by "anything valuable, including properties, securities, services, secret formula, tangible and intangible assets, reduction of debts, loans and any type of liabilities, or something people would pay for".

We propose that the level of fines under this section be increased and kept under review to ensure fines are adjusted in line with inflation and prevailing economic circumstances. In addition, the consequence of the serious crime of fraud should not be a fine only, but also a penalty to compensate the company and creditors. The latter penalty should be as determined by the court.

S.283 Disposal of books and papers of company

We propose that the level of fines under this section should be raised and be kept under review to ensure fines are adjusted in line with inflation and prevailing economic circumstances.

The inconsistency between section 283(2), which requires that books and records be kept five years from the dissolution of the company, and section 121(3A), which provides that any books of account that a company is required to keep must be preserved by it for seven years, from the end of the financial year in which the last entry was made, should be resolved.

S.295 Separate accounts of particular estates

It is noted that section 295(4) requires an amount equal to 1½ per cent per annum of the amount invested under this section to be paid to the credit of the OR, while the balance should be paid to the credit of the company. The percentage required to be paid to the OR is high, given the very low bank interest rates over the past few years, and given that the situation is likely to remain the same for some time. We suggest that the percentage charged by the OR should be adjusted in line with the market interest rate (perhaps by linking it to a percentage of the interest actually earned). To enhance flexibility, it is further suggested that the rate be specified in subsidiary legislation as opposed to the primary legislation.

Hong Kong Institute of CPAs
February 2012