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Revamp of Hong Kong's winding up and insolvency regime: key changes to keep in mind

Hong Kong has introduced a sweeping revamp of its winding up and insolvency regime with the amendments to the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) that came into force on 13 February 2017. The amendments represent an important modernization of Hong Kong's existing rules by increasing protection of creditors and further streamlining the winding up process. The key provisions of such amendments are summarised in this note.

By way of background, a Hong Kong company can be wound up through a voluntary winding up or a compulsory winding up. A voluntary winding up can take the form of a members' voluntary winding up and a creditors' voluntary winding up. The principal difference between the two is that for a members' voluntary winding up the company must be solvent while in the second one it is not. A compulsory winding up is commenced by a member petitioning the Court to wind up a company on 'just and equitable' grounds.

1. Improved creditor protection

- **Setting aside transactions at an undervalue**

Transactions at an undervalue are gifts or transactions by a company for which it receives either no consideration at all or consideration of a value far below what the company originally paid.

The Court is given new powers to set aside transactions at an undervalue if:

- they were entered into by a company during the five years before its winding up started; and
- at the time of the transaction, the company was unable to pay its debts or became unable to pay them as a result of the transaction.

If a company entered into a transaction at undervalue, the Court may order that the company be restored to its pre-transaction position. This may, for instance, be by requiring that any property, which was transferred as part of such transaction, be vested back in the company. However, if the Court is satisfied that the transaction was entered into in good faith and on reasonable grounds for believing that the transaction would benefit the company, then no restoration order will be issued.

- **Unfair preferences**

Various elements need to be present before a company will be deemed to have given an unfair preference to a person during the winding up process. First, the person receiving the preference must be one of the company's creditors or a surety or guarantor for any of the company's debts or liabilities. Secondly, for a preference to be an unfair preference the company must have itself done anything or have allowed anything to be done which, after the company has gone into insolvent liquidation, has placed that person in a better position than it would have been in if that thing had not been done.

The Court has the power to set aside an unfair preference given to a person (other than an employee) who is connected with the company, if such preference was given in the period of two years preceding the start of the winding up. In any other case of an unfair preference, the period is reduced to six months provided that at the time the unfair preference was

given, the company was unable to pay its debts or became unable to pay its debts as a result of the unfair preference. If an unfair preference is also a transaction at an undervalue then the longer delays applicable to transactions at an undervalue will be applicable.

- **Longer claw-back period for floating charges**

Under the old law, a floating charge over company property was vulnerable to claw-back by the liquidator if it was created during a period of one year preceding the commencement of a winding up unless it was established that the company was solvent immediately after the creation of the fixed charge. The Amended Ordinance has extended this claw-back period to two years if a floating charge was created in favour of a person connected with the company.

- **Director and shareholder liability for share redemptions and buy-backs**

Directors and shareholders may now bear liability for share redemptions or buy-backs of shares out of capital. The new rules capture the situation in which a company has used its capital funds to redeem or buy back its shares during the period of one year preceding the commencement of the winding up. In that situation, if at winding up the company is found to be insolvent, the shareholder whose shares were redeemed or bought back is liable to repay up to the amount of the capital paid by the company to redeem or buy back the shares. The directors who signed the solvency statement (a requirement for share redemptions or buy-backs in Hong Kong) are jointly and severally liable to contribute to the aforementioned amount, which the shareholder is liable to repay.

This amendment provides increased protection for creditors as it prevents a company's shareholders to extract the company's capital through a buy-back or redemption so as to leave the company insolvent at the expense of the company's creditors.

2. Streamlining the Winding Up Process

The following amendments have been introduced to streamline the winding up process:

- **Committees of Inspection**

In a compulsory or creditors' voluntary winding up, a Committee of Inspection ("COI") may be established to represent the creditors and contributories of a company and to supervise and give directions to the liquidator. A number of changes aimed at simplifying the proceedings of COIs and promoting Court-free procedures have been introduced, which should help reduce the time and cost involved in the winding up process. The changes include:

- Prescribing the number of COI members: a COI may only have three to six members unless varied by way of application to the Court.
- Monthly meeting requirement abolished: the liquidator must hold a first COI meeting within six weeks from the date of his appointment or the appointment of the COI, whichever is the later. Further meetings are held as determined by the liquidator.
- Use of modern communications tools: liquidators may now communicate with the COI by electronic means and COI members may attend COI meetings remotely, by using modern technology. This allows COI members at different locations to attend meetings leading to important cost and times savings. COIs may even make decisions without a meeting by means of written resolutions.

- **Appointment of solicitor by a liquidator in compulsory winding up**

In a compulsory winding up, a liquidator no longer needs to get the sanction of either the Court or the COI to employ a solicitor. He only needs to give the COI (if established) or the creditors a minimum of seven days' prior notice of his intention to do so.

- **Strict timeline for appointing provisional liquidator in voluntary winding up**

The timeline for appointing a provisional liquidator have been tightened. Directors must cause a meeting of the members and creditors to take place no later than 28 days after they delivered the winding up statement to the Registrar. The directors now have to appoint a provisional liquidator with effect from the commencement of the winding up, i.e. at the time of delivery of the winding up statement.

- **Stricter controls over liquidators**

The powers, duties and basis for determining remuneration and tenure of the office of provisional liquidators in a winding up by Court are now set out more clearly. Provisional liquidators must be certified public accountants or solicitors. Anyone with a conflict

of interest in relation to the winding up will be disqualified from acting as a provisional liquidator or liquidator.

Liquidators will now be exposed to a longer period of liability for their actions unlike in the former regime when they were exempt from any liability after their discharge by the Court and the completion of the winding up procedure.

3. Evaluation of the Amendments

The amendments contain some welcome developments by improving the winding up process and building in various safeguards for creditors. Insolvency practitioners, however, are still waiting for the introduction into Hong Kong's insolvency law of an effective mechanism for rescue of a company in financial trouble similar to the US's Chapter 11 or the UK's Insolvency Act 1986. As long as Hong Kong lacks such a mechanism in its insolvency regime, companies in financial trouble will not be able to seek protection against creditors while attempting to steer the company back to financial health. It is hoped that the next round of amendments will provide such a mechanism.

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