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FSTB Publishes Consultation Conclusions on Improving Corporate Insolvency Law and Proposals for a New Statutory Corporate Rescue Procedure

Introduction

In April 2013, the Financial Services and the Treasury Bureau (**FSTB**) launched a three-month public consultation (the **Consultation**) on proposals to improve the corporate insolvency and winding-up provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Chapter 32) (**C(WUMP)O**). The aims of the proposals were to facilitate more efficient administration of the winding-up process and increase protection of creditors.

The FSTB published its conclusions on the Consultation on 28 May 2014 and plans to introduce an amendment bill into the Legislative Council in 2015. The following is a summary of the changes to be implemented.

Summary of the Proposed Amendments

The amendments to be implemented fall into five main areas:

a) **Commencement of Winding-up**

- Providing for a prescribed form for statutory demand by a creditor;
- Improving the section 228A procedure to reduce the risk of abuse; and
- Improving efficiency and enhancing the protection of creditors in a creditors' voluntary winding-up.

b) **The Appointment, Powers, Vacation of Office and Release of Provisional Liquidators and Liquidators**

- Expanding the list of persons disqualified for appointment as liquidator or provisional liquidator;
- Disclosure of relevant relationships in relation to the appointment of provisional liquidators and liquidators;
- Expanding the existing prohibition on inducement affecting appointment as liquidator;
- Clarifying the nature of provisional liquidators in a court winding-up;
- Modernising the provisions on liquidators' powers; and
- Enhancing the regulation of liquidators by enforcing liabilities of liquidators notwithstanding their release by the court.

c) **The Conduct of Winding-up**

- Stipulating the maximum and minimum number of members of a committee of inspection (**COI**);
- Streamlining and rationalising the proceedings of the COI;
- Simplifying the process for the determination of costs or charges of liquidators' agents in a court winding-up; and

- Allowing communication by liquidators with creditors, contributories, members of COI and other interested parties by electronic means.

d) **Voidable Transactions**

- Introducing new provisions on "transaction at an undervalue";
- Rectifying the anomalies in the application of existing provisions on "unfair preferences"; and
- Improving the effectiveness and flexibility of the provision for invalidating floating charges created before the winding-up of the company.

e) **The Investigation during Winding-up, Offences antecedent to or in the course of Winding-up and Powers of the Court**

- Enhancing the effectiveness of the private and public examination procedures by providing for the express abrogation of the privilege against self-incrimination;
- Widening the scope of application of public examination procedure; and
- Providing for liability of past directors and members in connection with a redemption or buy-back of shares out of capital.

The Commencement of Winding-Up

Providing for a Prescribed Form for a Statutory Demand by a Creditor

One of the most frequently invoked grounds for winding up a company by the court is that the company is unable to pay its debts. C(WUMP)O sets out three circumstances in which a company is deemed to be unable to pay its debts. One of these is when a creditor to whom the company owes a sum equal to or exceeding a specified amount (currently HK$ 10,000) has served on the company a demand requiring payment of such sum (a **statutory demand**) and the company fails to do so within three weeks.

It is proposed that C(WUMP)O should provide a prescribed form for a statutory demand, which will contain a statement of the consequences of ignoring the demand, key information (e.g. the name and address) of the debtor-company, contact information of the creditor, a description of and the amount of the debt and appropriate actions for the recipient.

Improving the Section 228A Procedure to Reduce Risk of Abuse

Section 228A of C(WUMP)O provides that if the directors, or a majority of the directors, have formed the opinion that the company cannot by reason of its liabilities continue its business, they may resolve at a meeting of the directors the matters stated in section 228A(1) of C(WUMP)O and deliver to the Registrar of Companies (**Registrar**) a winding-up statement certifying the passage of the resolution. The matters specified in section 228A(1) which may be the subject of a board resolution are that:

a) the company cannot by reason of its liabilities continue its business;

b) the directors (or a majority of them) consider it necessary that the company be wound up and that the winding-up should be commenced under section 228A of C(WUMP)O because it is not reasonably practicable for it to be commenced under another section of that ordinance; and

c) meetings of the company and of its creditors will be summoned for a date not later than 28 days after the delivery of the winding-up statement to the Registrar.

To reduce the risk of abuse of this provision, the following changes will be made:

a) The winding-up statement delivered to the Registrar will be required to state that the directors have already called the meeting of the company required to be held under section 228A;

b) The winding-up statement will be required to state that the appointment of the provisional liquidator will take effect on delivery of the winding-up statement to the Registrar. This is intended to reduce the time gap between delivery of the winding-up statement and the appointment of the provisional liquidator which is currently susceptible to abuse by directors since they may delay the appointment of the provisional liquidator in order to remain in control of the company (directors' powers cease only on appointment of the provisional liquidator); and

c) The powers of the provisional liquidator in a section 228A procedure will be restricted so that he can only exercise powers conferred on a liquidator in a voluntary winding-up under C(WUMP)O, if he has obtained the sanction of the court. This will be subject to exceptions allowing the provisional liquidator to take into his custody the property of the company, dispose of only perishable goods and other goods the value of which is likely to diminish if they are not disposed of immediately, and do all things necessary for the protection of the company's assets. The rationale for the restrictions is that the provisional liquidator appointed under the section 228A procedure should not be given the wide powers of a liquidator as his appointment should be solely for the purpose of preserving the company's assets pending the appointment of a liquidator by the company's members and creditors.

Improving Efficiency and Enhancing the Protection of Creditors in a Creditors' Voluntary Winding-up

Currently, in the case of a creditors' voluntary winding-up, the company is required to cause the first creditors' meeting to be summoned for the same or the next following day when the resolution for voluntary winding-up is proposed at a members' meeting. The position is unsatisfactory because the minimum period of notice for the members' meeting, not being expressly stipulated, may vary in different situations. If the company's members agree to the members' meeting being held on short notice, it may be held very quickly or even immediately. Since the length of notice for the members' meeting determines the length of notice to be given of the first creditors' meeting, the creditors may have insufficient time to prepare for the first creditors' meeting if the meetings are held by short notice.

On the other hand, if the company gives reasonable notice to creditors of the first creditors' meeting, the decision on whether to wind up the company voluntarily will be delayed until the first creditors' meeting is ready to be held. This is also unsatisfactory for a company which is in serious financial difficulty or insolvency since it exposes the company, its management and the creditors, including employees, to various risks.

The following amendments, which are modelled on UK legislation, will be made to ensure that reasonable notice is given to creditors and to reduce the time required for commencing a creditors' voluntary winding-up:

a) The first creditors' meeting will be required to be held on a day not later than the 14th day after the day on which the members' meeting is to be held. This will replace the existing requirement that the first creditors' meeting must be held on the day of the members' meeting to commence a creditors' voluntary winding-up, or the following day;

b) A minimum notice period of seven days for calling the first creditors' meeting will be prescribed;

c) The powers of the liquidator appointed by the members will be limited during the period before the holding of the first creditors' meeting; and

d) The powers of the directors will be restricted before the appointment of a liquidator.

Appointment, Powers, Vacation of Office and Release of Provisional Liquidators and Liquidators

Expanding the List of Persons Disqualified for Appointment as Liquidator or Provisional Liquidator

Court Winding-up or Creditors' Voluntary Winding-up

Certain categories of persons considered to have a conflict of interest will be specified as not being qualified for appointment as a provisional liquidator or a liquidator in a court winding-up or a creditors' voluntary winding-up. These include a person who:

a) is a creditor of the company;

b) is a debtor of the company;

c) has been a director or secretary of the company;

d) has, at any time before the appointment and up to two years before the commencement of the company's winding-up, been an auditor of the company; or

e) is a receiver or a receiver and manager of the property of the company.

To cater for circumstances in which the appointment of the above persons is justified, such persons may be appointed with the leave of the court.

All Types of Winding-up

A person will not be qualified for appointment as a provisional liquidator or a liquidator if he is found by the court under the Mental Health Ordinance (Cap. 136) to be incapable, by reason of mental incapacity, of managing and administering his property and affairs, or where he is subject to a guardianship order under Part IVB of that ordinance.

A person who is subject to a disqualification order under Part IVA of C(WUMP)O will not be qualified for appointment as a provisional liquidator or a liquidator for all types of winding-up.

A provision will be introduced to render void the appointment of a person not qualified for appointment as a provisional liquidator or a liquidator and that person will be liable to a fine if he acts as such.

The consultation paper originally proposed that the above proposals should also apply to the appointment of a receiver or a receiver and manager of the property of a company, with appropriate modifications. Taking into account responses to the consultation, these proposals will not apply to the appointment of a receiver or a receiver and manager of the property of the company, since such persons are usually appointed by a secured creditor and are mainly accountable to the latter. The question of whether a person is appropriate to take on the role of receiver or receiver and manager will instead rest with the secured creditor concerned.

Disclosure of Relevant Relationships in relation to the Appointment of Provisional Liquidators and Liquidators

The prospective provisional liquidator or liquidator of a company in a court winding-up and a creditors' voluntary winding-up (including one commenced by the section 228A procedure) will be required to make a statement of relevant relationships to state the following facts or relationships (if they or any of them exist):

a) the prospective provisional liquidator or liquidator is or in the preceding two years has been:

- a member of the company or its holding company or subsidiary;
- a creditor or debtor of the company or its holding company or subsidiary;
- a director, secretary or employee of the company or its holding company or subsidiary;
- an auditor of the company;
- a receiver or receiver and manager of the company's property;
- a legal adviser of the company or its holding company or subsidiary; or
- a financial adviser of the company or its holding company or subsidiary; and

b) the prospective provisional liquidator or liquidator is an immediate family member of:

- a director, secretary, or auditor of the company, or a person who has at any time within the immediately preceding two years been a director, secretary, or auditor of the company;
- a director or secretary of a holding company or subsidiary of the company, or a person who has at any time within the immediately preceding two years been a director or secretary of a holding company or subsidiary; or
- a person who has, at any time within the immediately preceding two years, been a liquidator or provisional liquidator of the company; or

If any of the above facts or relationships exists, the prospective provisional liquidator or liquidator must also state in the statement of relevant relationships his reasons for believing that none of the facts or relationships results in the prospective provisional liquidator or liquidator having a conflict of interest or duty.

The statement of relevant relationships must be made by the prospective provisional liquidator or liquidator, and must be provided to the party empowered to make the relevant appointment. For example, if the appointment is made by the creditors at the first creditors' meeting, the statement must be provided to the creditors before or at such meeting.

Failure to include a particular matter in the statement will be an offence, although it will be a defence if the prospective provisional liquidator or liquidator, having made reasonable

enquiries, has no reasonable grounds for believing that the matter should have been included in the statement of relevant relationships.

In addition to the requirement for the prospective provisional liquidator or liquidator to disclose the facts or relationships in the statement of relevant relationships, that person will also have to state whether any of his immediate family members have, at any time in the preceding two years, been a receiver or receiver and manager of the company's property.

Expanding the Existing Prohibition on Inducement Affecting Appointment as Liquidator

Currently, any person who gives (or agrees or offers to give) an inducement (being any valuable consideration) to a member or creditor of a company with a view to securing his own appointment or nomination, or to securing or preventing the appointment or nomination of some other person, as the company's liquidator, is liable to a fine under section 278A C(WUMP)O.

This provision will be amended so that a person will be prohibited from offering an inducement to any person (not only the company's creditors and members) with the aim of securing his appointment or nomination as a liquidator, or preventing the appointment or nomination of another person as liquidator. The prohibition on appointment by inducement will also be extended to the appointment of provisional liquidators, receivers, and receivers and managers other than the liquidator of a company.

Clarifying the Nature of "Provisional Liquidators" in a Court Winding-up

Present position

The term "provisional liquidator" is currently used to describe the following persons in relation to a court winding-up:

a) provisional liquidators appointed by the court before the making of a winding-up order under section 193 of C(WUMP)O (a **section 193 PL**); and

b) provisional liquidators who take office upon and after the making of a winding-up order under different sub-sections of section 194 of C(WUMP)O (a **section 194 PL**).

The role of a section 193 PL is to protect and preserve the company's assets pending the hearing of the petition for winding-up. A section 193 PL does not carry out the task of winding up the company. In contrast, a section 194 PL is required to conduct and administer companies' winding- up and must be given the requisite powers so that companies can be wound up as soon as practicable after the making of a winding-up order by the court. A section 194 PL must also be subject to the supervision and control of the court or the Official Receiver.

Despite the differences in the roles of provisional liquidators appointed under sections 193 and 194 of C(WUMP)O, the existing legislation has a number of shortcomings in that:

a) it is not sufficiently clear in some provisions that make reference to "provisional liquidator" as to which type of "provisional liquidator" the term is intended to refer to;

b) it is not clear whether the reference to "liquidator" in the provisions of C(WUMP)O apply to all or any one type of provisional liquidator;

c) provisions applicable to different types of provisional liquidator are often not applied consistently (e.g. sections 196(1A) and 199(4) to (6) respectively provide for the remuneration and powers of a section 194 PL appointed by the Official Receiver under section 194(1A), but no provision is made for the powers, functions and duties of a section 194 PL appointed under section 194(1)(a) or 194(1)(a)(a)).

Amendments

To put beyond doubt that all section 194 PLs have all necessary duties, functions and powers to conduct and administer a winding-up, all section 194 PLs will be designated as "liquidators". Thus, all persons taking office on or after a winding-up order will be called the "liquidator" and they will be subject to the C(WUMP)O provisions applicable to liquidators. Accordingly, they will have the full powers of a liquidator and will be entitled to remuneration determined in accordance with the relevant provisions. The exception will be provisional liquidators appointed under section 194(1A): since they are appointed by the Official Receiver directly (and not by the court), their powers are restricted by sections 199(4) to (6) and special provisions for determination of their remuneration are provided in section 196(1A).

As a result of the proposed amendments, the term "provisional liquidator", when used in relation to a court winding-up, will only signify the provisional liquidator appointed prior to the winding-up order (i.e. a section 193 PL). It will also be more clearly provided that it is the responsibility of the court, taking into account case-specific circumstances, to determine the powers, duties and remuneration of a section 193 PL and to consider any application for the termination of his appointment by resignation or removal.

Modernising the Provisions on Liquidators' Powers

Present position

Currently, sections 199(1) and (2) of C(WUMP)O set out liquidators' powers which apply to all types of winding-up. Other sections contain powers specific to different types of winding-up. In addition, a liquidator in a court winding-up must obtain the sanction of the court or the committee of inspection (**COI**) for the exercise of the power to appoint a solicitor to assist him in the performance of his duties under section 199(1)(c).

Amendments

The powers currently set out in sections 199(1) and (2) will be set out in a table in a schedule to C(WUMP)O. Further consideration will be given to how to present the powers in a schedule in a reader-friendly manner. For example, powers may be grouped into three broad categories based on the need to obtain a sanction, i.e.: (a) powers exercisable with sanction in all forms of winding-up; (b) powers exercisable without sanction in a voluntary winding-up but with sanction in a court winding-up; and (c) powers exercisable without sanction in all forms of winding-up.

The requirement for a liquidator to apply to the court or the COI to exercise the power to appoint a solicitor in a court winding-up will be removed since it is very common for a liquidator to appoint a solicitor to assist him in a court winding-up. The liquidator will however be required to give notice to the COI or, where there is no COI, to the creditors, of his exercise of this power.

Enhancing the Regulation of Liquidators by Enforcing Liabilities of Liquidators notwithstanding their Release by the Court

Present position

The court can make orders (e.g. to repay money or restore property) against a liquidator who has misapplied or retained any money or property of the company, or has been guilty of any misfeasance or breach of trust in relation to the company under section 276 of C(WUMP)O. The court will exercise such power on the application of the Official Receiver, the liquidator or any creditor or contributory.

However, section 205(3) C(WUMP)O provides that an order of the court releasing the liquidator will discharge him from all liability in respect of any act done or default made by him in administering the company's affairs, or otherwise in relation to his conduct as liquidator. Such an order can be revoked on proof that it was obtained by fraud or by suppression or concealment of any material fact.

Amendments

Since a liquidator's misfeasance is sometimes only discovered after the court's grant of release, section 205(3) may be detrimental to the rights of creditors, contributories and other interested parties wishing to seek redress against a delinquent liquidator. The court's release of a liquidator will therefore not prevent the court from exercising its power under section 276, subject to the law on limitation period for starting legal proceedings.

However, to strike a balance between minimising the risk of frivolous litigation and the need to protect creditors and other interested parties, where the court has granted a release to a liquidator, the power to apply under section 276 will only be exercisable with the leave of the court.

Conduct of Winding-Up

Stipulating the Maximum and Minimum Numbers of Members of the COI

Present position

There is currently no minimum number set for the number of members of a COI in either a court winding-up or a creditors' voluntary winding-up. In practice, a COI must have at least two members in order to act since C(WUMP)O provides

that notwithstanding any vacancy in the COI, the continuing members may act provided that the number of members does not fall below two.

No provision is made setting a maximum number of members for a COI in a court winding-up. In a creditors' voluntary winding-up, a creditors' meeting can appoint a COI consisting of not more than five persons.

Where there is a vacancy in a COI in either a court or creditors' voluntary winding-up, the liquidator must summon a meeting of creditors or of contributories to fill the vacancy, unless the liquidator applies to the court for an order not to fill the vacancy.

Amendments

The following changes will be made:

a) for both a court winding-up and a creditors' voluntary winding-up:

   - the **maximum number** of members of a COI should be set at **seven**; and
   - the **minimum number** of members of a COI should be set at **three**;

b) the maximum and minimum numbers may be varied by the court if it thinks fit on application by the liquidator; and

c) it will not be necessary to fill a vacancy in the COI if the liquidator and a majority of the remaining members of the COI so agree, provided that the total number of members does not fall below the minimum number of three.

Streamlining and Rationalising COI Proceedings

The following changes will be implemented:

a) the requirement that, failing the appointment by the COI to meet, the COI must meet at least once a month will be removed;

b) a liquidator will be required to call a first meeting of the COI to be held within six weeks of the later of: (i) his appointment; and (ii) the COI's establishment;

c) liquidators will have to give five business days' written notice of the date, time and venue of a meeting to every member of the COI (or his representative designated for that purpose). The notice requirement can be waived by or on behalf of any member to enable meetings to be held on short notice under special circumstances;

d) after the first meeting of the COI, liquidators will be required to call a meeting of the COI:

   - if requested by a COI member (or by a representative of a COI member). Such meeting must be held within 21 days of receipt of the request; and
   - if the COI has previously resolved that a meeting be held on a specified date.

The COI will be able to appoint the time for meeting by way of resolution.

These provisions will not affect the liquidator's power to call a COI meeting when he considers it necessary. The liquidator will also be able to determine where the COI meeting is held.

In order to encourage creditors' and contributories' participation in the COI, the COI will be able to function through written resolutions sent by post or using electronic means (such as email or websites). The liquidator may obtain the agreement of COI members to a resolution by sending a copy of the proposed resolution to each member (or his representative designated for the purpose). Any COI member can, within seven business days after the liquidator sends the resolution, require the liquidator to summon a COI meeting to consider matters it raises. If no such request is made, the resolution will be deemed to have been passed by the COI when the liquidator receives notice in writing from a majority of the COI members that they agree to it.

Simplifying the Process for Determining Costs or Charges of Liquidators' Agents in a Court Winding-up

Present position

Currently, if requested by the Official Receiver or the liquidator, the bills of the costs or charges of persons employed by the Official Receiver or the liquidator in a court winding-up (e.g. solicitor, accountant, auctioneer etc.) must be delivered for taxation to facilitate the determination of the amount of costs or charges that are payable out of the company's assets. The liquidator (other than the Official Receiver) in a court winding-up receives remuneration by way of percentage or otherwise

as is determined by agreement with the COI, or by the court if there is no COI or there is no agreement between the liquidator and the COI.

Amendments

The bills of costs or charges of agents employed by the liquidator will be allowed to be determined by agreement with the COI. The liquidator will provide the COI with details of the work performed by the agents he employs and the proposed costs and charges. If the COI resolves to agree to the proposed costs and charges, they will be considered as approved without the need to deliver them for taxation by the court.

Where there is no COI, or if the liquidator fails to agree with the COI on the agents' bills of costs or charges, the matter will have to be determined by the court under the present procedure.

Allowing Communication by Liquidators with Creditors, Contributories, Members of COI and other Interested Parties by Electronic Means

Liquidators and provisional liquidators will be able to deliver or send any notice or document required to be delivered or sent by them under C(WUMP)O by electronic means (including via emails or websites), provided that:

a) the liquidator or provisional liquidator must first secure the consent of the intended recipient to delivery of notices and documents by electronic means; and

b) if the notice or document is to be disseminated through a website, the liquidator or provisional liquidator must send a notice to the intended recipient stating that the recipient may request a hard copy of the notice or document and giving the contact details for requesting a hard copy.

Voidable Transactions

New Provisions on "Transactions at an Undervalue"

The new provisions intend to empower the court to make an order in relation to a company which has entered into a transaction at an undervalue before its winding-up for the purpose of protecting creditors against depletion of the assets of an insolvent company.

A transaction at an undervalue occurs when a company:

a) makes a gift to, or enters into a transaction with, a person on terms that provide for the company to receive no consideration; or

b) enters into a transaction with a person for a consideration the value of which is significantly less than the consideration provided by the company at a "relevant time".

Where a company goes into liquidation and the company has at a "relevant time" entered into a transaction at an undervalue with any person, the court shall be able, on the application of the liquidator, to make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into the transaction at an undervalue.

For these purposes, a company "goes into liquidation" if:

a) it passes a resolution for voluntary winding-up;

b) a winding-up statement made under section 228A of C(WUMP)O is delivered to the Registrar of Companies under that section; or

c) an order for its winding-up is made by the court at a time when it has not already gone into liquidation by passing a resolution for voluntary winding-up.

The "relevant time" is any time within the five years ending with the commencement of the winding-up, but only if the company is unable to pay its debts at that time or becomes unable to pay its debts as a result of the transaction. For the purpose of determining whether a transaction at an undervalue is entered into at a "relevant time", the company is presumed (in the absence of proof to the contrary) to be unable to pay its debts at that time or to become unable to pay its debts as a result of the transaction, where the transaction is entered into with a person "who is connected with the company" (otherwise than by reason only of being its employee).

In order to provide statutory protection for the party resisting an application by the company's liquidator in respect of a transaction at an undervalue, the court will not set aside the transaction if it is satisfied that:

a) the company entered into the transaction in good faith and for the purpose of carrying on its business; and

b) at the time, there were reasonable grounds for believing that the transaction would benefit the company.

Rectifying Anomalies in the Application of Existing Provisions on "Unfair Preferences"

Present position

The C(WUMP)O does not currently contain provisions on unfair preferences in relation to companies being wound up. Instead, the provisions on unfair preferences in the Banking Ordinance (**BO**) are applied with modifications to winding-up cases by relying on cross-references to relevant provisions of the BO.

The BO's unfair preference provisions provide that:

a) A debtor gives an unfair preference to a person if:

   i) that person is a creditor of the debtor or a surety or guarantor for any of his debts or other liabilities; and

   ii) the debtor 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 debtor's bankruptcy, will be better than the position he would have been in if that thing had not been done.

b) Where a debtor is adjudged bankrupt and he has at a "relevant time" given an unfair preference to any person, the court shall, on the application of the trustee-in-bankruptcy, make such order as it thinks fit for restoring the position to what it would have been if that debtor had not given that unfair preference.

c) The court shall not however make an order under (b) above, unless the debtor who gave the unfair preference was influenced in deciding to give it by a desire to produce in relation to that person the effect as set out in (a)(ii) (a "desire to prefer"). The desire to prefer is presumed (in the absence of proof to the contrary) if the unfair preference is given to an "associate" of the debtor (otherwise than by reason only of being his employee).

d) Where the unfair preference is not a transaction at an undervalue and is given to an "associate" of the debtor, the "relevant time" is any time within the two years ending on the day of the presentation of the relevant bankruptcy petition on which the debtor is adjudged bankrupt, but only if the bankrupt is insolvent at that time or becomes insolvent as a result of the unfair preference. In any other case of an unfair preference which is not a transaction at an undervalue, the two-year period referred to above will be replaced by a period of six months.

Problems in Application of BO Unfair Preference Provisions to Companies being Wound-up

When the above BO provisions are applied in the context of a company's winding-up, a number of problems arise which have limited their application and effectiveness. These include the following:

a) In the application of the term "associate" as defined in the BO, while the expression "debtor" refers to the bankrupt in the bankruptcy context, the same expression can only mean the debtor company and not a director of the debtor company in the context of company winding-up. Hence the definition of "associate", which includes the spouse and relatives of the bankrupt, does not cover the spouse and relatives of a director of the debtor company when applied in a company winding-up context;

b) In the definition of "associate" under the BO, a company is an associate of a debtor if that debtor has control of the company or if the debtor and persons who are his associates together control the company. Applying the definition in the context of a company winding-up, a subsidiary of the debtor company is included as its associate, but the debtor's holding company and other subsidiaries of such holding company are not included.

Amendments

Self-contained provisions on unfair preference will be introduced in C(WUMP)O and will replace the existing cross-references to the BO. The new self-contained provisions will largely reinstate the position under the current law, with modifications to address the anomalies outlined above.

The only major change in the new standalone provisions from the current position is that they will refer to a "person who is connected with the company" instead of to an "associate of the debtor" in order to rectify the anomalies in the application of the BO definition of "associate" referred to above.

A "person who is connected with the company" will include:

a) a director or shadow director of the company or an associate of such a director or shadow director; or

b) an associate of the company.

A separate definition of "associate" will be provided for the purpose of defining a "person who is connected with the company" which will cover the following persons:

The associates of an **individua**l will include:

a) any person who is:

   i) the individual's husband or wife or a person who is in a cohabitation relationship with the individual (**cohabitant**);

   ii) a relative of the individual or the individual's husband or wife or cohabitant; or

   iii) the husband or wife or cohabitant of a relative of the individual or the individual's husband, wife or cohabitant;

b) a person with whom the individual is in partnership;

c) the husband, wife or cohabitant or a relative of a person with whom the individual is in partnership;

d) his employees and employer; and

e) the trustee of a trust (i) whose beneficiaries include the individual or his associate; or (ii) whose terms confer a power that may be exercised for the benefit of the individual or his associate.

A company will be an associate of another company if:

a) the same person has control (i.e. control more than 30% of the voting power at general meetings of the company or of another company having control over it or where the company's directors are accustomed to act in accordance with that person's instructions) over both companies, or a person has control of one company and his associates, or he together with his associates, control the other; or

b) a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by a person of whom he is an associate.

A company will be an associate of another person if that person has control of it or if that person and his associates control it together.

The above definition of "associate" will apply to the definition of "person connected with the company" used in relation to both the provisions on unfair preference and those on transactions at an undervalue.

The existing protection for persons who receive benefits or acquire or derive interests in property in good faith and for value from an unfair preference will be included in the new standalone provisions on unfair preference in the winding-up context and will also apply to the new provisions on transactions at an undervalue, with appropriate modifications.

Improving Effectiveness and Flexibility of Provision for Invalidating Floating Charges Created before a Company's Winding-up

New provisions will be included to allow floating charges to be invalidated where they give no new value to the company and are created in favour of persons connected with the company at a time when liquidation of the company is imminent. Whereas the existing provisions allow the invalidation of a floating charge on a company's undertaking or property which is created in the twelve months prior to the commencement of its winding-up (unless it is shown that the company was solvent immediately after creation of the charge), the additional new provision will allow the invalidation of a floating charge created within two years prior to the commencement of the company's winding-up in favour of a person who is connected with the company. In considering the validity of such a floating charge, it will not be necessary to ascertain whether the company was solvent immediately after the creation of the charge.

Since the invalidation provisions are not intended to catch genuine credit transactions which create floating charges to secure value to a company, the current provisions provide that a floating charge is not invalid to the extent of "the amount of

any cash paid to the company" at the time of, or subsequently to, the creation of the floating charge and in consideration of the floating charge. This provision exempting genuine credit transactions will continue to apply to a floating charge created in favour of a "connected person" within the extended period of two years, so that the floating charge is not invalidated to the extent of the new value given to the company on or after, and in consideration for, the creation of the floating charge. The scope of the exemption will also be expanded to:

a) amend the existing reference to "cash paid to the company" to "money paid to or at the direction of the company" to cover situations where the floating charge is created to secure other forms of valuable consideration which arise from day-to-day trading and finance; and

b) add "property or services supplied to the company" as new forms of consideration that may be exempted to cater for credit arrangements involving supply of property or services on credit.

Investigation during Winding-Up, Offences Antecedent To Or In The Course Of Winding-Up and Powers of the Court

Enhancing the Effectiveness of the Private and Public Examination Procedures by Providing for Express Abrogation of the Privilege against Self-incrimination

The legislation will expressly set out that a person summoned before the court for either a private or public examination cannot invoke the privilege against self-incrimination during the examination. Accordingly, all questions must be answered and a person cannot be excused from answering any question on the ground that the answer might incriminate him or make him liable to a penalty.

Provisions will also be included to the effect that if certain conditions are satisfied, answers given or statements made by a person during either examination are not admissible as evidence against him in subsequent criminal proceedings brought against him. The conditions are that the answer or statement might tend to incriminate him and that he so claims before giving the answer or making the statement. However, the answers given or statements made can be used in a proceeding in which a person is charged with offences relating to perjury or provision of false statements or offences under C(WUMP)O.

Widening the Scope of Application of the Public Examination Procedure

Currently, the court can only order a public examination if the Official Receiver or the liquidator (as the case may be) has made a "further report" for the court's consideration which states that, in his opinion, a fraud has been committed by any person in the promotion of formation of the company or by any officer of the company in relation to the company since its formation. Only a person who is alleged to have committed fraud can be summoned for public examination.

In order to make it easier to initiate the public examination procedure, the requirement that the Official Receiver or the liquidator has alleged the commission of fraud will be removed. Instead, the court will be able to order a public examination upon application by either the liquidator or the Official Receiver without there being a "further report" alleging fraud.

Other categories of persons who may be summoned to attend a public examination will be added. Persons who can be examined will include:

a) a person who is or has been an officer of the company;

b) a person who has been concerned, or has taken part in, the promotion or formation of the company;

c) a person who has acted as liquidator of the company or receiver or receiver and manager of the property of the company; and

d) a person who is or has been concerned, or has taken part, in the management of the company.

The scope of matters that may be examined will be amended to correspond with the types of persons who may be examined.

Providing for Liability of Past Directors and Members in connection with a Redemption or Buy-back of Shares out of Capital

It is of fundamental importance to creditors that the share capital of the company be preserved and kept intact because they generally do not have recourse against the company's members in the event that the company cannot pay its debts and the creditors are forced to rely on the company's assets – the capital – for repayment.

To safeguard against abuse and ensure that the paid-up capital of a company is not returned to its members improperly prior to the insolvent winding-up of a company, where a company has redeemed or bought back its own shares by payment out of its capital and the company is wound up insolvent within one year of the redemption or buy-back, certain persons will be jointly and severally liable to contribute to the assets of the company to meet the deficiency in the company's assets. The amount which may be required to be contributed will be limited to the amount paid by the company in respect of the shares redeemed or bought back by the company. The categories of persons who may be liable to contribute include:

a) the recipient(s) of the payment of the redeemed or bought-back shares; and

b) the directors who made the solvency statement which supported the redemption or buy-back without having reasonable grounds for the opinion expressed in the statement.

Since the persons liable under these provisions could have personal liability, they have an interest in the early winding-up of the company in order to prevent the company's business or assets, which have become bad or depleted within the year following the redemption or buy-back, from becoming worse. These persons will therefore be allowed to petition for winding up the company on the grounds that the company is unable to pay its debts, or that the court is of the opinion that it is just and equitable that the company should be wound up. It should be noted that a listed company is not allowed to buy back its own shares out of capital on an approved stock exchange under section 257 of the new Companies Ordinance (Cap. 622).

Other Technical Amendments

A number of technical amendments will also be made which are set out in Annex C of the consultation paper.

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