Hong Kong Insolvency Law Reform: Preparing for the Next Millenium

By Charles D. Booth

Introduction

When China resumed sovereignty over Hong Kong on July 1, 1997, Hong Kong’s economy was strong, the stock and property markets were high, and the general consensus was that the economy would continue to prosper. But the general consensus proved egregiously wrong. In the second half of 1997, an economic crisis began to engulf Asia and Hong Kong. Regional currencies collapsed, speculators attacked the Hong Kong dollar, local stock and property prices plummeted, and Hong Kong slid into recession.

Some recent statistics help to put the current economic problems into perspective. The Hong Kong GDP declined 5.1% in 1998 from the 1997 levels, having experienced negative growth in each quarter of the year. The 6.9% decline in the Hong Kong economy in the third quarter of 1998 was the “worst on record” and was followed by a 5.7% decline in the fourth quarter. Although the GDP continued to shrink by 3.4% in the first quarter of 1999, the amount of the decline was an improvement over the final two quarters of 1998 and slightly better than the government had forecast. However, unemployment continues to rise and recently increased from a seasonally adjusted level of 5.7% in the final quarter of 1998 to 6.2% in the first quarter of 1999, both of which are all-time post-war highs.

The Hong Kong property market also fell dramatically – almost 50% from its peak 1997 levels – before recently rebounding slightly. This collapse has put pressure on both individual homeowners and corporate buyers. Homeowners are desperately trying to make their mortgage payments and, surprisingly, are proving successful; the default rate remains low (only 0.84%). But the financial hardship on homeowners has led to a dramatic decrease in consumer spending. Retail monthly sales in late 1998 were 16% lower than their 1997 counterparts, and the first quarter results for 1999 show a further 10% decline. On the corporate front, many Hong Kong companies invested heavily in property when the market was rising – at times, through the misuse of trade finance loans. Many companies are now finding it difficult to pay back these loans. Such problems, as well as general difficulties in corporate lending, caused Hong Kong banks’ bad debts to triple in 1998 and to reach their highest levels in over a decade. These levels are expected to increase even further, especially in the light of the heavy exposure of many banks to companies in mainland China that have recently been declared bankrupt or are in serious financial difficulties. And lastly, after a dramatic fall, the Hang Seng stock index has been recovering. As of early July 1999, the Hang Seng has risen more than 20% from the October 1997 level at which it stood when the Asian crisis hit Hong Kong, and more than 110% from the lowest levels of the crisis in August 1998 before the government’s massive intervention in the Hong Kong stock market. Overall, these statistics may signal a bottom to the current problems in Hong Kong – although commentators are divided – and one investment house has named this year the “Year of Confidence Restoration.”

The economic crisis has led to a sharp increase in the number of insolvencies in Hong Kong. It has also increased the awareness of the role that insolvency law can play in facilitating economic
recovery. This chapter discusses insolvency law reform in Hong Kong, focusing on bankruptcy law and corporate rescue. Part I provides background information, including a brief description of the financial and credit and security structure in Hong Kong, an overview of Hong Kong insolvency law and insolvency statistics, and a summary of the Hong Kong insolvency law reform process. Part II identifies trends in the new bankruptcy resulting from the enactment of the Bankruptcy (Amendment) Ordinance 1996 (the “B.A.O.”), and discusses many of the recently enacted provisions. Part III describes the existing procedures for corporate rescue in Hong Kong and then considers the proposals of the Law Reform Commission of Hong Kong (the “Law Reform Commission”) for improving the corporate rehabilitation process.

I. Background Information

Financial and Credit and Security Structure

Hong Kong is one of the world’s financial centers with the second largest stock market in Asia, a vibrant banking sector, an active foreign exchange market, growing derivatives and debt markets, and one of the world’s largest gold bullion markets. In 1994 the U.S. government rated Hong Kong “as one of the most open, transparent and fair markets in which to conduct banking business in Asia.”

Companies in Hong Kong raise capital either through either issuing shares or, more commonly, by borrowing money. The mechanisms most frequently relied upon by banks lending to companies in Hong Kong are mortgages over land, fixed and floating charges, and guarantees. The difference between a fixed and a floating charge may be summarized as follows: whereas a fixed charge “attaches” to “ascertained and definite” property (e.g., machinery), a floating charge “hovers” over a changing class of assets (e.g., inventory). A noted commentator describes the underlying notion of a floating charge as follows:

that of a class of revolving assets which the company is to be free to manage and deal with in the ordinary course of business until an event occurs which entitles the creditor to intervene and assert his security rights over the assets then held or subsequently acquired by the company.

Typically, a corporate loan will be made subject to a debenture. A debenture will typically provide a bank with a fixed charge over certain specified assets and/or a floating charge over the “undertaking” or “undertaking and property” of a company. The debenture will further provide that upon a specified event of default, the lender will be entitled to appoint a receiver to take control of the charged assets and, in the case of a floating charge over the undertaking (or undertaking and property) of a company, to carry on the business of company. Other methods of protection available to creditors include liens, pledges or hypothecations, retention of title, and set-off.

Insolvency Law

The insolvency of individuals is regulated by the Hong Kong Bankruptcy Ordinance (the “Bankruptcy Ordinance”) which, until recently amended by the B.A.O., was based on English legislation dating back to the 1880’s. The insolvency of companies is regulated by Parts V and X of the Hong Kong Companies Ordinance (the “Companies Ordinance”), which, in many respects, is still based on the United Kingdom Companies Act 1929.
Although the decisions of most English courts were not strictly binding on Hong Kong courts prior to July 1, 1997, where legislation enacted in Hong Kong in substance had been copied from English provisions it was rare for the Hong Kong courts to adopt a different position from that taken in England. This trend is most likely to continue after the handover. Article 8 of the Basic Law of the Hong Kong Special Administrative Region of the People’s Republic of China (the “Basic Law”), which is the now the mini-constitution of the Hong Kong SAR, provides that the laws previously in force in Hong Kong (including the common law and the rules of equity) shall be maintained unless they contravene the Basic Law or are amended by the Hong Kong SAR legislature. Furthermore, Article 84 of the Basic Law provides that the courts of the Hong Kong SAR “may refer to precedents of other common law jurisdictions.”

In Hong Kong a liquidation of a company is also called a “winding up.” A company may be wound up through either a voluntary winding up (a winding up without a court order) or a compulsory winding up (a winding up by the court). The Official Receiver is the government official who is involved in insolvencies in a variety of ways. The Official Receiver’s Office Mission Statement is as follows:

To provide an effective insolvency service to creditors and the public by promoting high standards of insolvency administration when the Official Receiver is appointed to act as a trustee or as liquidator and by monitoring the conduct of private practitioner compulsory liquidators, to investigate the causes of business failure, to prosecute persons for insolvency offences and to apply in appropriate cases for the disqualification of company directors.

One of the primary failings of Hong Kong’s corporate insolvency legislation is the lack of an effective procedure for restructuring insolvent companies. The Companies Ordinance does include a provision for the negotiation of a scheme of arrangement or composition, but the mechanism is cumbersome and rarely used. Given the absence of an effective statutory reorganization procedure, creditors at times attempt to rehabilitate a company through either receivership or out-of-court restructuring. In a multibank-lending situation, the banks follow the Guidelines on Corporate Difficulties issued by the Hong Kong Association of Banks (the “H.K.A.B.”). These procedures are helpful, but do not diminish the need for an effective formal corporate rescue procedure.

**Insolvency Statistics**

Historically, Hong Kong has had a low rate of insolvency, both in absolute terms and as compared to the rates in other jurisdictions. This low rate is in part due to the limitations of the insolvency procedures and the lack of incentives for its use by either creditors or debtors. Over the last ten years the number of receiving orders (or bankruptcy orders since April 1, 1998) in bankruptcy cases and compulsory winding-up orders in corporate liquidations has been as follows:

<table>
<thead>
<tr>
<th>Year (April 1 – March 31)</th>
<th>Receiving or bankruptcy orders</th>
<th>Winding-up orders</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988/89</td>
<td>194</td>
<td>151</td>
</tr>
<tr>
<td>1989/90</td>
<td>178</td>
<td>187</td>
</tr>
<tr>
<td>1990/91</td>
<td>226</td>
<td>306</td>
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<tr>
<td>1991/92</td>
<td>294</td>
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<tr>
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<td>1997/98</td>
<td>643</td>
<td>459</td>
</tr>
<tr>
<td>1998/99</td>
<td>1,179</td>
<td>763</td>
</tr>
<tr>
<td>1999/00 April-May</td>
<td>327</td>
<td>169</td>
</tr>
</tbody>
</table>

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The recent online figures of the Official Receiver’s office show a dramatic increase in the number of both bankruptcy and winding-up orders. For example, in the first two months of the 1999/00 reporting year, the total of 327 bankruptcy orders already exceeds the annual total for the number of receiving orders in the years 1988/89 to 1994/95. Similarly, the two-month total of 169 winding-up orders for April-May 1999 exceeds the total number of winding-up orders made in 1988/89.

**Insolvency Law Reform Process**

During the run-up to July 1, 1997, there was a flurry of legislative activity and law reform efforts, and insolvency law was no exception. In September 1990 the Law Reform Commission appointed a Sub-Committee on Insolvency (under the Chairmanship of Professor E.L.G. Tyler) to conduct a review of bankruptcy and liquidation law and practice in Hong Kong. The Sub-Committee commenced work on November 12, 1990 and issued its *Consultative Document on Bankruptcy* in August 1993. In accordance with standard practice the *Consultative Document* was circulated to interested professional bodies and experts for comment. After reviewing the submissions, the Law Reform Commission published its final recommendations for bankruptcy law reform in its *Report on Bankruptcy* in May 1995. These recommendations (which for the most part adopted the proposals of the Sub-Committee on Insolvency) were incorporated into the Bankruptcy (Amendment) Bill and then into the B.A.O. Although the B.A.O. was enacted in December 1996, it was not brought into force until amendments were drafted to the Bankruptcy Rules (the “Bankruptcy Rules”). Part of the reason for the lengthy delay was that the Hong Kong economy in late 1996 remained strong and there was little incentive to give high priority to drafting new insolvency laws at that time. However, this process was finally completed in early 1998 and the new bankruptcy law and rules came into operation on April 1, 1998.

The second area of review – corporate rescue and insolvent trading – led to the publication of the Sub-Committee’s *Consultation Paper on Corporate Rescue and Insolvent Trading* in June 1995 and to the Law Reform Commission’s *Report on Corporate Rescue and Insolvent Trading* (the *Report on Corporate Rescue*) in October 1996, both of which proposed that a provisional supervision procedure be enacted to facilitate corporate rescue. A bill is being drafted but has been delayed by disagreement as to how best to deal with the rights of workers during provisional supervision. On December 21, 1998, the Financial Services Bureau issued a short consultation document on this topic, the *Consultation Paper on Corporate Rescue and the Protection of Wages on Insolvency Fund (Treatment of Employees in “Provisional Supervision”)* (the “FSB Consultation Paper on Corporate Rescue”). The consultation period lasted until March 31, 1999, and on June 2, 1999 the Financial Services Bureau circulated a paper entitled, *Report on consultation on Proposed Statutory Procedures for Corporate Rescue*, that the Financial Services Bureau submitted to the Legislative Council for Financial Affairs. This paper summarizes the current position of the Hong Kong government as to how to proceed to resolve the matter. A bill should be gazetted in the second half of 1999 and enacted in late 1999 or early 2000.

The third area of review – winding up – is at an earlier stage. The Sub-Committee on Insolvency issued its *Consultation Paper on the Winding-Up Provisions of the Companies Ordinance* in April 1998, which was open for comment until the end of July 1998. A Law Reform Commission *Report* will likely follow later in 1999, to be followed by the gazetting and enactment of new legislation in 2000.

**II. Bankruptcy Law**
Changing Philosophical Underpinnings

The B.A.O. makes the first comprehensive changes to Hong Kong bankruptcy law in over a century. Although these changes were made in an “Amendment” Ordinance, they resulted in a dramatic overhaul of Hong Kong bankruptcy law and process. Archaic nineteenth-century legislation has given way to a progressive twentieth-century approach that better reflects the existing commercial and social practices. Thus, many old premises have been replaced. For example, the primary focus on a debtor’s wrongful behavior under the old law has given way to an acknowledgement that a debtor’s insolvency might well have been caused by poor, or badly timed, business or personal financial decisions. Thus, many of the harsh anti-debtor policies in the old law have been liberalized. For example, under the new law it will be much easier for a debtor to obtain a discharge from bankruptcy and to retain a greater portion of his pre-bankruptcy personal property. And the enactment of a voluntary arrangement procedure increases the likelihood that many debtors will be able to avert the need to resort to bankruptcy at all.

The reliance in the old law on the wrongful nature of a debtor’s conduct as a justification for the commencement of bankruptcy was most evident in the use of the concept of “acts of bankruptcy,” which dates back to English statutes from the Middle Ages. This notion required that a debtor commit an “act of bankruptcy” before creditors were allowed to petition for the debtor’s bankruptcy. Most of the former acts of bankruptcy in old Section 3 of the Bankruptcy Ordinance set out various types of wrongful conduct by a debtor – e.g., making a fraudulent conveyance or removing one’s property from Hong Kong with the intent to defeat or delay one’s creditors. It is quite telling, however, that although the majority of the acts of bankruptcy focused on a debtor’s wrongful behavior, perhaps 95% of bankruptcy cases under the old law were commenced by creditors relying on a debtor’s failure to comply with a bankruptcy notice under old Section 3(1)(g) of the Bankruptcy Ordinance.

In replacing acts of bankruptcy with new grounds, the starting point was this 95% figure and the notion that bankruptcy should normally be premised on a debtor’s inability to pay. Thus, the new grounds include the following:

(i) a debtor’s failure to comply within three weeks with a statutory demand for the repayment of HK$10,000 or more;
(ii) a debtor’s failure to satisfy an execution of a judgment debt for HK$10,000 or more; and
(iii) a debtor’s default in connection with a voluntary arrangement.

However, not all of the new grounds are based solely on the financial difficulties of a debtor, for new Section 6(4) also includes a fourth ground premised on the absconding of a debtor or the intention of a debtor to abscond. This ground, which has its origins in former Section 3(1)(d) of the Bankruptcy Ordinance, was enacted, in part, to address a concern in the run-up to the 1997 transition, that debtors were incurring substantial debts that they had no intention of repaying and then absconding from Hong Kong.

The abolition of the acts of bankruptcy also led to changes in the jurisdictional criteria that must be satisfied to ensure that a debtor has sufficient contacts with Hong Kong to justify the commencement of a bankruptcy under Hong Kong law. Under the old law the jurisdictional criteria had to be satisfied at the time of the occurrence of an act of bankruptcy and, in the case of a creditor’s petition, at the time that (or, for some of the factors, within a year before the date on which) the bankruptcy petition
was filed. With acts of bankruptcy now gone, the relevant starting point for determining jurisdiction is the day of the bankruptcy petition. New Section 4 of the Bankruptcy Ordinance, which is based on Section 265 of the United Kingdom Insolvency Act 1986 (the “U.K. Insolvency Act 1986”), provides as follows:

(1) A bankruptcy petition shall not be presented to the court . . . unless the debtor—
(a) is domiciled in Hong Kong;
(b) is personally present in Hong Kong on the day on which the petition is presented; or
(c) at any time in the period of 3 years ending with that day—
   (i) has been ordinarily resident, or has had a place of residence, in Hong Kong;
   (ii) has carried on business in Hong Kong.

(2) The reference in sub-section (1)(c) to a debtor carrying on business includes—
(a) the carrying on of business by a firm or partnership of which the debtor is a member; and
(b) the carrying on of business by an agent or manager for the debtor or for such a firm or partnership.

These new jurisdictional criteria increase the relevant period of residency and carrying on of business from one to three years. It must be kept in mind that satisfaction of the jurisdictional criteria does not automatically enable a bankruptcy case to go forward. Pursuant to new Section 5(3) of the Bankruptcy Ordinance, the court has the discretion to dismiss a bankruptcy petition or to stay proceedings on such terms and conditions as it thinks fit.

Streamlining and Simplification of the Bankruptcy Process

Many changes to the law were enacted to streamline and simplify the bankruptcy process. Some amendments track existing procedures in the Companies Ordinance for corporate liquidation – thus, the old two-step procedure, comprising the making of both a receiving order and an adjudication order, has been replaced with a one-step procedure involving the making of only a bankruptcy order. The theory behind the two-step procedure was that it provided the debtor with a period in which he could either pay his creditors in full or enter into a scheme of arrangement or composition with them. In practice, however, such settlements were rare, and the entering of a receiving order was most frequently followed by the making of an adjudication order.

Many amendments were sought by the Official Receiver to enable his office to conduct bankruptcies more efficiently. The Official Receiver serves as the trustee in almost all bankruptcy cases in Hong Kong. The lack of a strong tradition of creditor participation in Hong Kong bankruptcies has frequently caused difficulties for the Official Receiver – for example, in regard to satisfying the quorum requirements for meetings of creditors. To address such problems, the Official Receiver proposed that the bankruptcy procedures be streamlined and that he be given the discretion to dispense with various meetings and requirements. These recommendations were accepted by both the Sub-Committee on Insolvency and the Law Reform Commission and were enacted in the B.A.O. Among the changes were the following:

n the Official Receiver has been given the discretion to cancel unnecessary meetings and to decide within twelve weeks of the making of the bankruptcy order whether or not to serve as the bankruptcy trustee (except in cases where a criminal bankruptcy order has been made);

n the first meeting of the creditors’ committee (formerly the “committee of inspection”) must be held within three months of the trustee’s appointment, or of the establishment of the committee, whichever is later, and subsequent meetings are to be held when determined by the trustee or if so requested by a member of the committee or as specified by the creditors’ committee;

n and the quorum for meetings of creditors has been reduced to two creditors present or represented at a meeting.
Other amendments enacted in the B.A.O. to improve bankruptcy procedures include changes to the procedures regarding the statement of affairs; amendments to the procedures for the holding of public examinations of the debtor and of private examinations of third parties and the debtor; and the abolition of the timing requirements for the declaration and distribution of dividends.

Although many of the recommendations of the Official Receiver increase his discretion and the scope of his powers, the Law Reform Commission was cognizant of the need to enable creditors to participate in the bankruptcy process. Most importantly, the Commission refused to recommend the adoption of the U.K. practice of not appointing a creditors' committee where the Official Receiver serves as the trustee. It noted that since the Official Receiver serves as the trustee in most bankruptcies, adoption of this provision “would effectively mean that creditors’ committees would cease to exist.” In addition, several amendments to the Bankruptcy Ordinance increase the control of both the court and unsecured creditors over the trustee. In addition, the B.A.O. made several changes to the law that liberalize the treatment of creditors.

Modernization of Procedures

The desire to modernize the bankruptcy process has led to substantial changes regarding proof of debts and interest on debts. Among the more important amendments to the proof of debt procedures is the change to Section 34(1) of the Bankruptcy Ordinance, which now allows proofs of debt for unliquidated tort claims to be admitted in bankruptcy. This amendment abolishes the long-held, but now archaic, distinction between unliquidated contract claims (which were allowed under the pre-amended ordinance) and unliquidated tort claims (which were not). These changes reflect the views of the Cork Report in the United Kingdom:

It is a basic principle of the law of insolvency that every debt or liability capable of being expressed in money terms should be eligible for proof in the insolvency proceedings, so that the insolvency administration should deal comprehensively with, and in one way or another discharge, all such debts and liabilities.

Other changes include the following: providing for the handling of issues involving claims in foreign currency and currency conversion matters, and providing that no government fine or monetary penalty will be admissible to proof and therefore will not be released by the bankrupt’s discharge.

Section 71 of the Bankruptcy Ordinance provides for the treatment of matters involving interest on debt in bankruptcies. A serious problem arising under old Section 71(1) was the 8% per annum limitation on interest on debts up to the date of the receiving order. This restriction required a trustee to recalculate the interest on any debt with an interest rate greater than 8%. To address this problem, the 8% limitation was abolished and replaced by new Section 71(1), which provides that interest is provable up to the time of the commencement of the bankruptcy.

Automatic Discharge and Exempted Property

Among the most important changes made by the B.A.O. are the amendments regarding the debtor’s discharge and the property that may be retained by the debtor. Old Section 30 provided for the discharge of bankrupts, but the criteria were so difficult to satisfy that in practice bankruptcy became a “life sentence” for most bankrupts in Hong Kong. This factor, perhaps more than any other, was responsible for the low number of filings by debtors under the old law.

The new discharge provisions, which incorporate aspects from both U.K. and Australian law, reflect the modern trend to enable most bankrupts to emerge from bankruptcy with a “fresh start” after a reasonable period of time. These new provisions are primarily responsible for the dramatic increase in the number of bankruptcy petitions being filed by
In the case of a person not previously adjudged bankrupt, new Section 30A(2)(a) provides for the automatic discharge of the bankrupt at the end of four years from the date of the making of a bankruptcy order. In the case of a person who has been previously adjudged bankrupt, Section 30A(2)(b) delays the discharge for an additional year. However, Section 30A(3) provides that the date of discharge may be extended for specified periods in cases in which the trustee or a creditor raises a valid objection pursuant to new sub-section (4). Among the objections which may be raised are the following: that a first-time bankrupt is likely within five years of the date of the bankruptcy order to be able to make a significant contribution to his estate; that the bankrupt's discharge would prejudice the administration of his estate; that the bankrupt has failed to cooperate in the administration of his estate; that the bankrupt's conduct has been unsatisfactory; that the bankrupt has departed from Hong Kong and failed to comply with a request by the Official Receiver or trustee to return to Hong Kong; that the bankrupt has continued to trade after knowing that he was insolvent; that the bankrupt has committed a bankruptcy offence; and that the bankrupt has failed to prepare an annual report for the trustee.

New Section 30A(9) provides that a bankrupt who receives a discharge may be required to continue contributing to his estate for up to eight years from the date of the bankruptcy order. New Section 30B allows bankrupts to apply to the court for an early discharge. In essence, the harshness of the former discharge regime has been replaced with a new regime that offers attractive inducements for bankrupts to cooperate (e.g., the automatic discharge or an early discharge) and serious repercussions for bankrupts who fail to cooperate (e.g., a delay in, or prevention of, the making of the discharge where valid objections are made by the trustee or creditors).

Transitional provisions were included in the B.A.O. to address the situation of the thousands of bankrupts in Hong Kong who had been adjudicated bankrupt under the old bankruptcy law. New Section 30C of the Bankruptcy Ordinance provides, as a rule, that first-time bankrupts who have been bankrupt for 42 months or more (or 54 months or more in the case of individuals who have previously been made bankrupt) shall be deemed to be discharged from bankruptcy one year after the day that the new discharge provisions come into operation (i.e., April 1, 1999) except in those cases in which the trustee or a creditor raises a valid objection.

Under the old bankruptcy provisions, most of a debtor's property was used to satisfy his creditors' claims. Old Section 43 provided that a debtor was entitled to retain quite little – goods up to a value of HK$3,000, inclusive of a debtor's tools of trade and necessary wearing apparel and the bedding of himself and his dependants. Given the unreasonable and outdated limitations of this section, in practice the trustee usually ignored the limitation. New Section 43 removes the HK$3,000 limitation and provides that a bankrupt is entitled to retain:

(i) such tools, books, vehicles, and other items of equipment as are necessary to the bankrupt for use personally by him in his employment, business, or vocation; and

(ii) such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family.

New Section 43 also abolishes the outdated doctrine of "reputed ownership." This doctrine held that "if the debtor appeared..."
to be in possession of property which secretly belonged to another, that would boost his creditworthiness, and therefore his
creditors should be entitled to treat that property as part of the bankrupt’s estate.”

The old law provided that all-post petition property of the debtor (e.g., wages) vested in the trustee. This rule,
of course, proved administratively cumbersome and, as with the exemption requirements, was not strictly adhered to by
trustees. New Section 43A incorporates the existing practice for it provides that property acquired post-
petition by a bankrupt does not vest in the trustee unless the trustee serves a notice in writing to so
claim the property. Since the category of exempted property has been dramatically expanded, new
Section 43B enables a trustee to recover certain items of excess value. New Section 43C prescribes
the time-limits for recovering property under new Sections 43A and B, and new Section 43D sets forth
the procedures whereby either a bankrupt or any of his creditors may apply to the court to include or
exclude any particular item from the estate. It should also be noted that pursuant to Section 43, a
trustee may seek the application of “an income payments order” pursuant to which the bankrupt must
pay to his estate a portion of his income for the period in which the order is in effect.

To ameliorate the problems caused by high real estate prices in Hong Kong, Section 43F of the new law entitles the
bankrupt to continue occupying the family home for a period of six months from the time of the making of the bankruptcy
order and, in exceptional circumstances, for up to a full year. Similarly, amended Section 61 provides that when a trustee
(with permission of the creditors’ committee) allows a bankrupt to restructure his business where such restructuring is in the
interests of the creditors, the trustee “may permit the debtor to retain any leasehold interest in property in which his business
is situated.”

These amendments ensure that most debtors will be able to emerge from bankruptcy with sufficient personal
belongings to provide a fresh start. More particularly, the new provisions regarding the exemptions for tools of trade and
the restructuring of a business increase the likelihood that a debtor will be able to remain solvent upon emerging from
bankruptcy. However, the interests of creditors are not ignored; both a trustee and a debtor’s creditors will be able to apply
to the court to ensure that the bankrupt does not unjustly benefit from the post-petition acquisition of property and earnings
or from the exemption of an unreasonably large amount of personal property. In addition, in some cases an income pay-
ments order may be sought.

Individual Voluntary Arrangements

Under the old bankruptcy law, by the time a bankruptcy petition was filed it was usually too
late for the debtor to negotiate a settlement with his creditors. The individual voluntary arrangement
procedure (which is based on Part VIII of the U.K. Insolvency Act 1986) is one of the more important
innovations of the new law and enables a debtor to seek relief at an earlier stage of his financial dif-
ficulties with the aim, in most cases, of averting the need to resort to bankruptcy.

This procedure is set out in new Sections 20-20L of the Bankruptcy Ordinance. New Section 20A(1) provides
that an application may be made to the court for an interim order where the debtor intends to make a voluntary arrange-
ment proposal. New Section 20(2) provides that the making of such an order leads to the imposition of
a moratorium, which will provide the debtor with a “breathing spell” against the actions of unsecured
creditors. During the moratorium, no bankruptcy petition may be presented or proceeded with against the debtor and no other proceedings, execution, legal process, or distress may be commenced or continued against the debtor except with the leave of court. The moratorium will thus encourage negotiation. However, as is generally the case in Hong Kong insolvency law, secured creditors will not be bound by the moratorium and will be free to take steps to realize their security. New Section 20F(3) of the Bankruptcy Ordinance further protects secured creditors by providing that any proposed voluntary arrangement that affects the rights of a secured creditor will only be effective if the secured creditor consents.

Individual voluntary arrangements will prove beneficial to both debtors and creditors. By avoiding bankruptcy, debtors will be able to avoid the resulting stigma as well as many of the disqualifications for undischarged bankrupts, such as the restriction against serving as a company director without the leave of the court or as practicing as a solicitor. Unsecured creditors are also likely to recover more in voluntary arrangements than they would in bankruptcy, as has been the experience in the United Kingdom. For these reasons, in the years to come individual voluntary arrangements will surely outnumber personal bankruptcies. But in the current recession, the financial circumstances of many debtors are so severe that it is too late to benefit from individual voluntary arrangements, and therefore debtors are instead resorting to bankruptcy. Thus, it is no surprise that the number of bankruptcies filed by debtors has soared since the new bankruptcy law came into operation on 1 April 1998.

Improved Avoidance Powers

One of the intended consequences of the B.A.O. was to improve the scope of the ineffective avoidance powers contained in the Bankruptcy Ordinance. However, the situation was somewhat complicated by the fact that there was no mention in the B.A.O. as to whether the new avoidance powers were to be given retroactive effect. The result is that the old avoidance powers, namely the fraudulent preference provisions of old Section 49 and the avoidance of settlement provisions of old Section 47, continue to apply to all bankruptcy cases commenced prior to April 1, 1998. As for cases commenced on or after April 1, 1998, the new avoidance powers are applicable in all cases commenced on or after April 1, 1998 to all transactions occurring on or after that date. However, the old law continues to apply in cases commenced on or after April 1, 1998 to transactions occurring prior to that date.

Old Section 49 enables a trustee to avoid as a fraudulent preference, *inter alia*, any payment or transfer of property by a debtor to his creditor that is made

(i) with the “dominant intention” to prefer the creditor;
(ii) within six months of the commencement of the bankruptcy; and
(iii) when the debtor is unable to pay his debts as they became due.

Moreover, a payment or transfer made by a debtor under the fear of legal process or as the consequence of the pressure of a creditor is not considered voluntarily made and, therefore, may not be avoided as a fraudulent preference. The focus on the voluntary nature of the debtor’s act – and therefore on the debtor’s state of mind in making a
transfer or payment – means that the section often proves ineffective in making recoveries from creditors.

Former section 47 has proved even less useful. This section enables trustees to avoid certain settlements that the debtor has made within ten years of the debtor’s bankruptcy. The provision suffers from many problems, such as that some of the exemptions are rather archaic. Moreover, the most frequently used defence to the trustee’s attempt to avoid a settlement – that the settlement was “made in favour of a purchaser or incumbrancer in good faith and for valuable consideration” – has the potential for leading to litigation about whether there was “valuable consideration.”

Section 36 of the Bankruptcy (Amendment) Ordinance abolished these sections and replaced them with new provisions based on Sections 339-42 and 435 of the U.K. Insolvency Act 1986. New Section 49 allows the trustee to challenge transactions at an undervalue and Section 50, unfair preferences. New Section 51(1) sets forth the time requirements for the application of these sections: five years from the day the bankruptcy petition is filed for a transaction at an undervalue; six months, for an unfair preference to a person who is not an “associate” of the debtor; and two years, for an unfair preference to a person who is an “associate” of the debtor. “Associate” is defined in new Section 51B to include the debtor’s spouse and relatives (and the spouse’s relatives), as well as the debtor’s business partners or corporations controlled by the debtor.

For unfair preferences, new Section 50(4) replaces the dominant intention to prefer test with a requirement that the debtor is influenced by a “desire” to put a creditor into an advantageous position. New Section 50(5), in turn, provides that an unfair preference by a debtor to an associate (other than by reason only of being the debtor's employee) is presumed, unless the contrary is shown, to have been influenced by the desire of the debtor to put the associate in an advantageous position. New Section 51(2) also requires that for an unfair preference to be avoided, the debtor must be insolvent at the time of the transfer or become insolvent as a consequence of the preference.

New Section 49 provides that a transaction at an undervalue may involve a gift, a transaction in consideration of marriage, or a transaction in which the a transferee’s consideration is “significantly less” than the value of the debtor’s consideration. The insolvency of a debtor is not a relevant factor for transactions at an undervalue that occur during the two-year period immediately preceding the filing of the bankruptcy petition. For transactions at an undervalue made between two and five years of the commencement of the bankruptcy, the debtor must be insolvent for the transaction to be avoided; however, where a debtor prefers an associate (other than by reason only of being the debtor’s employee), the debtor will be deemed to have been insolvent at the time of, or as a result of, the transaction, unless the contrary is shown.

The new avoidance provisions improve upon the old law, especially in regard to transactions involving associates. However, although the new test of a “desire” to put a creditor in an advantageous position is easier to satisfy than that requiring a “dominant intention” to prefer, it would have been better for the legislation to have dropped the “desire” test and to have focused primarily on the effect of the transaction in question and on preventing “last minute grabs” by creditors.

III. Corporate Rescue

The most serious weakness in Hong Kong insolvency legislation is the lack of a satisfactory corporate rescue procedure, with the result that under existing law it is difficult to reorganise or restructure a company in financial difficulty. As noted above, the options available to rescue a company are limited primarily to the following: (1) an informal workout (which in a multibank-lending situation involves the application of the H.K.A.B.’s Guidelines on Corporate Difficulties); (2) receivership; or (3) Section 166 of the Companies Ordinance. Section 166 is seldom used and receiverships that successfully rescue a company are also rare. Thus, under the existing framework, an informal workout is the preferred option for creditors and debtors alike.

H.K.A.B. Guidelines
These guidelines came into operation in April 1998 and are intended to facilitate corporate rescue in multibank lending situations. The Guidelines provide that once it is public knowledge that a debtor company is in distress, the banks should be supportive of the company: “They should not withdraw facilities or hastily put the company into receivership, or issue . . . writs demanding repayment.”105 Although the H.K.A.B. Guidelines improve the likelihood of a negotiated solution, they too are subject to limitations. First of all, they only apply to banks, and secondly (and more importantly), they require unanimity. Therefore, unless the banks agree to pay off the unsecured non-bank creditors (either in full or at least a substantial portion of their debts), such creditors are likely to commence or continue litigation against the company (perhaps with the aim of executing against the company’s assets) or even petition for the company to be wound up. Thus, from the perspectives of both debtors and creditors, the need remains for the enactment of a formal legislative rescue procedure that does not require unanimous approval of creditors, that protects the rights of employees, and that functions efficiently.

**Receivership**

As noted in Part I above, pursuant to a typical debenture, upon the occurrence of certain specified events of default, the holder of a fixed charge may appoint a receiver or the holder of a floating charge may appoint a receiver and manager. The chairman of the Sub-Committee on Insolvency has observed that “[b]ecause receivers sometimes ‘save’ companies in financial difficulties they have been called “company doctors’ . . . .”106 However, the ability of a receiver to “save” a company ultimately depends on whether the secured creditor is adequately protected by the secured assets and on whether this protection is likely to continue if the company continues trading. Frequently, however, a receivership ultimately leads to the liquidation of a company.

**Section 166**

Finally, a company and its creditors could agree to enter into a compromise or a scheme of arrangement under Section 166 of the Companies Ordinance. Section 166 may be utilised after a company has been wound up. Typically, however, a company or its creditors propose a compromise or arrangement as a means of avoiding liquidation. For a proposal to be binding on creditors or classes of creditors, it must be accepted by a majority in number and ¾ in value of the creditors or classes of creditors (as the case may be) who are present and voting either in person or by proxy, and then be sanctioned by the court.

There are several weaknesses with the Section 166 process:

- secured creditors retain veto power over the restructuring process because there is no mechanism to compel an unwilling, or uncooperative, secured creditor to agree to a modification of its contract rights;107
- there is no stay that binds the actions of creditors;108
- and other problems frequently arise during the reorganization process, including difficulties in determining the proper classification of creditors and the overall process is expensive and time consuming.109

The overall result is that there are relatively few successful restructurings of substantial companies in Hong Kong under Section 166.110
Proposed Provisional Supervision Procedures

Provisional supervision is intended to supplement, rather than replace, Section 166 of the Companies Ordinance. Chapter 1 of the Report elucidates five advantages of provisional supervision over Section 166. In short:

(1) It will be easier to calculate the time and costs involved in putting a proposal to creditors under provisional supervision than is possible under the open-ended procedures in Section 166.

(2) A moratorium on creditors’ actions will be provided under provisional supervision.

(3) The costs of court appearances will be decreased under provisional supervision, as the number of court applications and hearings will be limited.

(4) Provisional supervision will include several innovations:
   (a) the role of the provisional supervisor will be set out;
   (b) the provisional supervisor will be provided with the power of management;
   (c) ‘rogue creditors’ will be prevented from leveraging their position by threatening proceedings;
   (d) lenders during provisional supervision will benefit from super priority; and
   (f) there will be a smooth transition into company voluntary arrangement or winding up, as the case may be; and

(5) Provisional supervision will provide certainty; creditors will have the opportunity in most cases to vote on a proposal within six months.¹¹¹

Commencement of provisional supervision

The provisional supervision “procedure aims to facilitate the rescue of those companies that have viable businesses which are worth saving in whole or in part.”¹¹² The procedure will be applicable to Hong Kong companies (which are formed and registered under Part I of the Companies Ordinance) and to oversea companies (which are registered under Part XI of the Companies Ordinance), with the exception of certain regulated industries.¹¹³ It will also be available to both solvent and insolvent companies.

The procedure normally will be initiated by a majority of the directors of the company or by the members of a company by ordinary resolution. Where a winding-up petition has been filed but a winding-up order has not yet been made, a provisional liquidator may initiate the procedure (except where the directors have made a declaration under Section 228A of the Companies Ordinance). Where a liquidator has been appointed, the liquidator’s consent will be necessary for a provisional supervision to go forward. In addition, in certain circumstances a receiver appointed over the whole or substantially the whole of a company’s assets may initiate the procedure.

The provisional supervisor

The party that initiates the procedure will nominate the “provisional supervisor,” the person responsible for preparing the corporate rescue proposal. The provisional supervisor will be chosen from a panel of insolvency practitioners (initially, accountants) in order of rotation.¹¹⁴ In addition to formulating a draft plan of voluntary arrangement,
during the period of provisional supervision the provisional supervisor's other functions will include “manag[ing] the affairs, business and property of the company with the primary purpose of preserving the assets of the company for the creditors as a whole.” To assist him in achieving his goals, Chapter 8 of the Report on Corporate Rescue outlines the provisional supervisor's powers, and Chapter 9, his duties, rights, and liabilities.

Upon his appointment, the provisional supervisor will take control of the company and the powers of directors will be suspended. Thus, although the directors will normally initiate the procedure, as a rule the provisional liquidator will immediately displace them. (This fact in and of itself may lead, at least initially, to few initiations by the directors of small-to medium-sized family-controlled.) However, the provisional supervisor may choose to delegate certain powers back to the directors, in which case the directors will be answerable to him. Clearly, provisional supervision will more likely succeed in cases in which the directors co-operate with the provisional supervisor. Such cooperation is likely to be more forthcoming from the directors of larger, public companies.

Company officers and other specified individuals will be required to provide the provisional supervisor with a statement of affairs. This information will assist the provisional supervisor in assessing the company's financial position and in deciding whether to formulate a plan of voluntary arrangement. The provisional supervisor will be required to draft his assessment in the form of a report that will assist creditors in making an informed decision as to whether to support the proposed corporate rescue proposal.

The provisional supervisor's powers include the powers to borrow money, to grant charges over the company's assets, and to disclaim onerous contracts. There are limitations, however – for example, a provisional supervisor will not be allowed to dispose of assets secured by a charge without receiving the consent of the holder of the charge.

The moratorium

The "cornerstone" of provisional supervision is the inclusion of a moratorium, or stay of proceedings. With a moratorium in place, provisional supervision will be able to avoid the problems that occur under Section 166 — e.g., a single creditor presenting a winding-up petition against the company or a secured creditor appointing a receiver to realize the assets subject to its charge. It will also create a “cooling-off” period during which the provisional supervisor may meet with creditors with the aim of structuring a proposal.

An intended goal of the procedure is for the provisional supervisor to determine as quickly as possible whether the company is likely to be saved. Therefore, the moratorium will only last for an initial thirty-day period. During this period, the provisional supervisor will be expected to determine whether the purposes of a voluntary arrangement are capable of being
achieved. If the provisional supervisor is able to formulate a plan within that period, the moratorium may continue for up to six months; if the provisional supervisor is unable to formulate a plan within the thirty days, then he must apply to the court for an extension. However, in all cases the moratorium may not extend beyond six months except with the agreement of creditors. The aim is for the provisional supervisor to put a proposal to creditors for a voluntary arrangement within six months, and the moratorium is structured to assist in achieving this goal.

A major improvement over Section 166 is that the provisional supervision moratorium also applies to secured creditors. However, the moratorium against secured creditors is not as far-reaching as it first appears – some secured creditors, those defined in the Report on Corporate Rescue as “major secured creditors” are given the right to elect whether or not to participate in a provisional supervision. A major secured creditor is defined as a “holder of any charge [whether fixed or floating or a combination of the two] over the whole or substantially the whole of a company’s assets, whose level of exposure or lending would warrant such an extensive charge.” If a major secured creditor elects not to participate, then provisional supervision will immediately cease. Non-major secured creditors will not have the option of electing whether or not to participate.

Any secured creditor that elects to participate, or which does not have the right to electing to participate, will be bound by the moratorium. During the continuance of the stay, a secured creditor may not appoint a receiver; if the creditor has already done so, the receiver may not exercise any powers incidental to receivership. Furthermore, a secured creditor may not enforce its charge over the company’s property or repossess goods in the company’s possession.

**Treatment of employees**

At present, when a company is wound up, employees are entitled to seek payments from the Protection of Wages on Insolvency Fund, for certain unpaid wages, unpaid wages in lieu of notice, and unpaid severance payments. Under the proposed provisional supervision scheme, many employees will retain jobs that would otherwise have been lost if their employer had been wound up. However, in many cases some employees will be laid off in a cost-saving move by the provisional supervisor. The Report on Corporate Rescue proposed that statutory changes be enacted to enable such employees to claim upon the Protection of Wages on Insolvency Fund. However, the financial consequences of this proposal have led to much debate. In December 1998, the Financial Services Bureau, issued its FSB Consultation Paper on Corporate Rescue, which set forth the following four options for comment:

**Option A** – Protection of Wages on Insolvency Fund to pay (Law Reform Commission Proposal)

- widen the ambit of the Protection of Wages on Insolvency Fund to accommodate employees affected by provisional supervision.

**Option B** – employer to pay in full prior to initiating corporate rescue

- require the company to clear all arrears of wages before it undergoes corporate rescue.

**Option C** – to exempt all employees from the moratorium

- not have the moratorium bind employees and allow them to petition anytime to the court for the
company to be wound up. The Protection of Wages on Insolvency Fund to pay upon the presentation of a winding-up petition against the company by employees but the company may, instead of being wound up, continue as a going concern under corporate rescue.

**Option D – Protection of Wages on Insolvency Fund to pay first, then seek 100% recourse from the company as a priority debt in a voluntary arrangement**

- widen the ambit of the Protection of Wages on Insolvency Fund to allow employees to get quick relief, but simultaneously require that payments so made by the Fund be treated as a priority debt in a voluntary arrangement plan of the company.

After reviewing the 26 submissions made in regard to its *Consultation Paper on Corporate Rescue*, the Financial Services Bureau recently proposed that Option B above should be pursued – that statutory rescue should be "subject to the condition that the company undergoing rescue must clear the arrears of wages and other statutory entitlement of employees as if it is a going concern."\(^{127}\) In the view of the Financial Services Bureau, the advantages of this option are the following—

- employee’s rights are fully protected in line with existing labour legislation;
- it does not involve the Protection of Wages on Insolvency Fund;
- it does not require any contribution from the tax-payers or increase in the [HK]$250 Protection of Wages on Insolvency Fund levy or business registration fee for the creation of a new fund;
- it would help remove opportunities for possible abuse of [the] Protection of Wages on Insolvency Fund or any new fund in the course of corporate rescue;
- the requirements under this option would be an effective tool to screen out the non-viable companies which should not have been qualified for statutory corporate rescue in the first place.\(^{128}\)

The likely effect of implementing this recommendation will be to dramatically curtail the ability of many companies, especially small- and medium-sized companies to resort to provisional supervision. In addition, this recommendation might well increase the likelihood that a major secured creditor holding a floating charge will decide to appoint a receiver at an earlier stage. For, in those cases where the benefits payable to employees (if a company opts for provisional supervision) will exceed the amounts payable as priorities to employees in a receivership (under Section 79 of the Companies Ordinance), a secured creditor may well prefer pursuing receivership rather than provisional supervision.

**Super priority borrowing**

The success or failure of a provisional supervision will frequently depend on whether the company is able to borrow sufficient amounts of working capital to keep the company afloat. The Law Reform Commission therefore recommended that loans made to a company during provisional supervision should receive super priority over the debts of all creditors that are subject to the moratorium, with the exception of debts secured by fixed charges.\(^{129}\) Super priority lending will enable companies to receive crucial funding during provisional supervision. Since the awarding of a super priority does pose risks for existing creditors, the *Report on Corporate Rescue* proposes that existing creditors should have the right of first refusal to decide whether to provide super priority lending. Only upon the refusal of existing creditors would the provisional supervisor be able to approach other sources for borrowing.\(^{130}\)
Avoidance powers

The Report on Corporate Rescue does not include a detailed discussion on the proper scope of a provisional supervisor’s avoidance powers. It is understood that the gazetted bill will not provide for the application of avoidance powers in provisional supervision. Rather, if the creditors decide that a provisional supervision should be terminated in favor of liquidation, “the company shall be deemed to have been in a creditors’ voluntary winding up from the date of the appointment of the provisional supervisor.” This would enable a liquidator to use Section 266 of the companies Ordinance to attack transactions occurring before the commencement of provisional supervision.

The plan of voluntary arrangement

The provisional supervisor is responsible for drafting the proposal for voluntary arrangement. The draft arrangement plan should be in the form “of a concise statement of the proposed voluntary arrangement which should be capable of being understood by an average creditor in a reasonably short time.” Beyond that, the requirements for the plan contents have deliberately been left open-ended “entirely at the discretion of the provisional supervisor.” In the draft plan, the provisional supervisor might propose a variety of restructuring solutions for the company including the following:

(a) an extension of time for payment of debts,
(b) a composition in satisfaction of its debts,
(c) the compromise of any claims against the company,
(d) the variation or the reordering of the rating for payment of its debts or any class of its debts,
(e) the conversion of its debts in whole or in part into shares or other securities to be issued by the company, or . . .
(f) any other scheme or arrangement in relation to the affairs of the company.

The provisional supervisor must call a meeting of creditors to consider the proposed plan. Before the meeting, each creditor will receive a summary of the main features of the plan of arrangement and have the opportunity to inspect the draft plan, the provisional supervisor’s report, a projected cash flow statement, and a statement by the provisional supervisor relating to the voluntary arrangement. At the meeting, creditors should be able to:

(1) approve the draft arrangement plan with or without modifications, or
(2) adjourn the meeting to allow the provisional supervisor to submit a modified arrangement plan, or
(3) reject the plan and resolve that the company should be wound up and a liquidator appointed.

The proposal will be voted upon by a single class of creditors, and for any resolution to pass it will be necessary to gain the assent of a majority in number and in excess of two-thirds in value of all creditors voting on the resolution either in person or by proxy. Where the creditors approve a voluntary arrangement plan, the provisional supervision will cease and the terms of the voluntary arrangement will take effect. The voluntary arrangement will be binding on the company and its members and all creditors who were entitled to vote on the plan. These restrictions shall continue unless and until the company breaches
any of its obligations under the arrangement.

Although it is true that a single class is administratively simpler and less likely to delay the rehabilitative process, it does have the potential to cause serious conflicts between different groups of creditors.\textsuperscript{136} It would be better to separate secured and unsecured creditors for the purpose of voting on the plan. In addition, there should be a “best interest of creditors test” which ensures that objecting creditors in a class will receive not less than they would receive if the company were to be wound up.\textsuperscript{137} Lastly, there should also be a “cramdown” mechanism to ensure that a plan may be approved over the objection of a class of creditors unfairly withholding its consent.\textsuperscript{138} Of course, such procedures must be easily administered to ensure that undue time and expense is not wasted in enforcement.

**Conclusion**

It seems to take an economic crisis to get governments to focus on the need to enact modern, efficient insolvency laws and procedures. In this regard, Hong Kong is no different from other jurisdictions in the region. However, given the slow pace at which the new insolvency legislation is being enacted, it is unlikely that the new laws will play a major role in addressing the existing economic problems.

In the area of insolvency reform, what Hong Kong needs the most is a mechanism for corporate restructuring, but the provisional supervision scheme is unlikely to come into operation until late 1999 or early 2000. And even then, the number of cases is likely to be low. It should be anticipated that, initially, directors of small- and medium-sized family-controlled companies will be hesitant about resorting to provisional supervision for fear of losing control of their companies; and directors of small- and medium-sized companies in general will be concerned about the need to satisfy employees’ claims before commencing the new procedure. It will be crucial to the long-term success of provisional supervision that there are some early successes among the companies that resort to the procedure.

The new bankruptcy law has quickly led to a skyrocketing number of filings by individual debtors who wish to benefit from the automatic discharge. However, greater economic benefits will result when individuals are able to resort to individual voluntary arrangements rather than to personal bankruptcy. This is unlikely to occur until business conditions improve. Thus, it will likely be several years – into the next millennium – until the full effect of the new bankruptcy laws will be evident.


2 Hong Kong GDP Contracted 3.4% in First Quarter, Asian Wall Street Journal, June 22, 1999, p. 3.


4 Id. Hong Kong Economy: Economic situation in the first quarter of 1999: The property market. In addition, the value of property transactions in 1998 fell 61% from their 1997 levels. Sandy Li, Property sales value plummets 61pc as economic crisis hits, S. China Morning Post (Business Post), Jan. 4, 1999, p. 1 (citing estate agent Chi Cheung Property).

5 6% according to government estimates. See supra note 4, at Hong Kong Economy: Economic situation in the first quarter of 1999: The property market. Even at these lower levels, Hong Kong property is still among the most expensive in the world. Cheah Cheng Hye, Once useful currency peg now seen as SAR obstacle, S. China Morning Post (Business Post), Feb. 10, 1999, p. 6.


7 See supra note 4 at Hong Kong Economy: Economic situation in the first quarter of 1999: Domestic demand.

8 Statement of David Carse, Deputy Chief Executive of the Hong Kong Monetary Authority [the ‘HKMA’], quoted in Enoch Yiu, Bad debts soar as mainland woes escalate, S. China Morning Post (Business Post), Jan. 16, 1999, p. 1.

9 Id.

10 Id. For example, in January 1999, Guangdong International Trust and Investment Corp ["GITIC"] was declared bankrupt, and serious problems also surfaced at Guangdong Enterprises (Holdings). Id. However, given the strength of local banks before the crisis, no banks appear to be in any immediate financial danger. Id.

11 See Philip Segal, Asian Tigers Claw Back, Int’l Herald Trib., July 8, 1999, at 1; Cathy Holcombe, Barry Porter & William Barnes, Brokers await rally rewards, S. China Morning Post (Business Post), July 9, 1999, p. 1. For a good discussion of the government’s intervention in the local stock market, see Katherine Lynch, The temptation to intervene: problems created by government intervention in the Hong Kong stock market, 29 Hong Kong L.J. 123 (1999). In June 1999, the Hong Kong government announced its intention to sell off most of its portfolio, which has grown in value by more than US$10 billion. Mark Landler, Hong Kong Ready to Sell $26Billion In Blue Chips, Int’l Herald Trib. (Business/Finance), June 22, 1999, at 13.
Lloyd-Smith, supra note 2.


The Hong Kong Bankruptcy (Amendment) Ordinance 1996, Ordinance No. 76 of 1996 [hereinafter the B.A.O.]

http://www.info.gov.hk/fsb/fs/content.htm, Hong Kong Financial Services Bureau, Fact Sheet on Financial Services, (July 3, 1999).


Cap. 6, L.H.K. (1999) [hereinafter the Bankruptcy Ordinance].

See supra note 15.

For “registered” companies, i.e. companies “formed and registered” under Part I of the Companies Ordinance.

For “unregistered” companies, which, for the most part, are foreign companies and include overseas companies registered under Part XI of the Companies Ordinance. For a discussion of the issues involving the insolvency of foreign companies in Hong Kong, see Charles D. Booth, the Transnational Aspects of Hong Kong Insolvency Law, 2 Southwestern J.L. & Trade in the Americas 1 (1995); Charles D. Booth, “Living in Uncertain Times: The Need to Strengthen Hong Kong Transnational Insolvency Law, Colum. J. Transnat’l L. 389.


United Kingdom Companies Act, 1929, 19 & 20 Geo. 5, ch. 23. Major amendments were made to Hong Kong companies law in 1984, many of which were based on the United Kingdom Companies Act 1948, 11 & 12 Geo. 6, ch. 38, but little change was made to the liquidation provisions.

The insolvency of partnerships is more complicated. A partnership carrying on business in Hong Kong may be subject to bankruptcy proceedings under s. 7(1) of the Bankruptcy Ordinance. In addition, a Hong Kong partnership with eight or more partners or a foreign partnership may also be wound up under Part X of the Companies Ordinance as an “unregistered company.” See Companies Ordinance, s. 326.

See Peter Wesley-Smith, An Introduction to the Hong Kong Legal System 72-73 (2d ed. 1993).

Basic Law of the Hong Kong Special Administrative Region of the People’s Republic of China, ch. 1, art. 8 [hereinafter the Basic Law], reprinted in Public Law and Human Rights – A Hong Kong Sourcebook 85(Andrew Byrnes & Johannes Chan eds. 1993) [hereinafter Public Law and Human Rights].

Basic Law, ch. 4, s. 4, art. 84, reprinted in Public Law and Human Rights, supra note 27, at 99.

See Companies Ordinance, ss. 228-296. There are two types of voluntary winding ups: a members’ voluntary winding up (for solvent companies), see id, ss. 234-239A, and a creditors’ voluntary winding up, see id, ss. 240-248.

Id. ss. 176-227F, 263-296.

31 See Companies Ordinance, s. 166.

32 For further discussion of these problems, see Charles D. Booth Hong Kong corporate rescue proposals – making secured creditors more secure, 14(4) Insolvency L. & Prac. 248, 249 (1998) [hereinafter Hong Kong corporate rescue proposals] (also published at 28 Hong Kong L.J. 44 (1998)).


34 Comparative data is not readily available, but for the three-year period from 1986-89, the annual corporate rate in Hong Kong averaged 0.97%, in comparison to a 2.27% rate in the United Kingdom. E.L.G. Tyler, Current Issues in Insolvency, in Commercial Law 20 (Caroline Hague ed. 1991).

35 For other relevant factors, see Charles D. Booth, Recent Developments in Hong Kong Bankruptcy Law Reform, 2 International Insolvency Review 120, 122-23 (1993).

36 Receiving orders were made in cases commenced prior to April 1, 1998 and bankruptcy orders after that date. For a discussion of these orders, see the text accompanying infra notes 64-65.


38 See Official Receiver’s Office Website, supra note 38.


41 But see the Law Reform Commission’s discussion of the jurisdictional criterion involving the presence of assets, id., paras. 2.12-.36, at 23-29, and of the relation back doctrine, id, paras. 14.5-.13, at 134-37.

42 Bankruptcy (Amendment) Bill 1996, Legal Supplement No. 3 to the Hong Kong Government Gazette, March 1, 1996.


45 The Law Reform Commission of Hong Kong Sub-Committee on Insolvency, Consultation Paper on Corporate Rescue and Insolvent Trading (June 1995) [hereinafter the Consultation Paper on Corporate Rescue].


47 The Hong Kong SAR Financial Services Bureau [hereinafter the Financial Services Bureau], Consultation Paper on Corporate Rescue and the Protection of Wages on Insolvency Fund (Treatment of Employees in “Provisional Supervision”) (Dec. 21, 1998).

48 Financial Services Bureau, Report on consultation on Proposed Statutory Procedures for Corporate Rescue, submission to the Legislative Council for Financial Affairs (June 2, 1999.) These recommen-
dations are discussed in the text accompanying infra notes 126-127.


50 This section incorporates portions of my earlier work, Leaping forward to 1997: Bankruptcy Law Reform in Hong Kong, 6 Intl’l Insolvency Rev. 183 (1997) [hereinafter Bankruptcy Law Reform in Hong Kong]. See also Booth, Recent Developments in Hong Kong Bankruptcy Law Reform, supra note 36.

51 See Act Against Such As Do Make Bankrupt, 34 and 35 Henry VIII ch. 4 (1542); 13 Eliz. ch. 7 (1571).

52 Bankruptcy Ordinance, old s. 3(1)(b).

53 Id. s. 3(1)(d).

54 Consultative Document on Bankruptcy, supra note 40, para. 2.13, at 10.

55 Bankruptcy Ordinance, new ss. 6 & 6A(1)(a), (2). The minimum debt upon which a creditor may petition for a debtor’s bankruptcy has been raised from HK$5,000 to HK$10,000. See id. new s. 6(2)(a). In addition, the inclusion of a three-week period tracks the existing practice in s. 178(1) of the Companies Ordinance for use in corporate insolvencies. Finally, the statutory demand will no longer have to be based on a judgment. This follows from the deletion of old s. 3(1)(g) of the Bankruptcy Ordinance by s. 4 of the B.A.O.

56 Bankruptcy Ordinance, new ss. 6 & 6A(1)(b).

57 Id., new ss. 3(1)(c); new s. 20L.

58 Consultative Document on Bankruptcy, supra note 40, para. 2.19, at 12.

59 As well as to the abolition of the “relation back” doctrine, which was based on the notion that the commencement of a debtor’s bankruptcy had relation back to the occurrence of the act of bankruptcy upon which a receiving order was made (or, where the debtor had committed more than one act, to the earliest act of bankruptcy within the three months before the filing of the petition). Under the old law, the debtor’s bankruptcy was deemed to commence at that date, and the debtor’s property vested in the trustee as of that date as well. This enabled a trustee to overturn transactions to the detriment of the estate that were entered into by the debtor from that date onward. See the Report on Bankruptcy, supra note 41, paras. 14.2-.4 at 133-34. New s. 42 of the Bankruptcy Ordinance abolishes the relation back doctrine.

60 Bankruptcy Ordinance, old s. 3(2).

61 Id., old s. 6(1)(d).


63 Report on Bankruptcy, supra note 38, para. 5.7, at 42.

64 See id., paras. 5.7-.8, at 42.


66 See, e.g., Consultative Document on Bankruptcy, supra note 40, chpt. 9, at 60-65; Report on Bankruptcy, supra note 41, chpt. 8, at 67-72.

67 See Bankruptcy Ordinance, new s. 17A(1), which requires the Official Receiver to decide (in cases not involving a summary administration of the bankrupt’s assets under s. 112A of the Bankruptcy Ordinance) as soon as practicable within twelve weeks from the date of the bankruptcy order, whether or not to call a first meeting of creditors for the purpose of appointing a trustee of the bankrupt’s estate. If
the Official Receiver does not call such a meeting, he becomes the trustee of the debtor’s estate, and must give notice to all creditors of his decision. *Id.*, new s. 17A(3)-(4). New s. 17B allows creditors to request the Official Receiver to hold a meeting for the purpose of selecting a trustee, and the Official Receiver must summon such a meeting if the request appears to be made with the concurrence of not less than 1/4, in value, of the bankrupt’s creditors. For a critique of the new procedure involving ss. 17A and 17B, see Booth, *Bankruptcy Law Reform in Hong Kong*, supra note 51, at 195.

68 Bankruptcy Ordinance, new s. 17A(2).
69 Bankruptcy Rules, new r. 122ZG(2).

70 *Id.* Rather than meeting monthly as was required under old s. 24(3) of the Bankruptcy Ordinance.

71 See *id.*, r. 122ZI. Both the Sub-Committee on Insolvency and the Law Reform Commission had recommended a quorum of only one creditor.

72 See the following sections of the Bankruptcy Ordinance: new s. 18(1) (requiring the debtor to file a statement of affairs within twenty-one days of the day of the bankruptcy order in cases commenced by a creditor); new s. 10(2) (requiring the debtor to file the statement of affairs with the petition when the debtor petitions for his own bankruptcy; new s. 18(3)(a) (giving the Official Receiver the discretion to dispense with the statement of affairs in cases where he considers it unnecessary, without having to apply for an order of the court as was required under old r. 81A of the Bankruptcy Rules); and new s. 18(3)(b) (giving the Official Receiver the power to extend the time for submission of the statement of affairs without having to file a certificate in court, as was required under old r. 82 of the Bankruptcy Rules).

73 See Bankruptcy Ordinance, new s. 19(1) (requiring a public examination to be held only when requested by the Official Receiver.) See also *id.*, new s. 19(2) and (3) (requiring the Official Receiver to apply for an examination pursuant to a request from a creditor with or without the concurrence of not less than 1/4 in value of such creditors. However, where less than 1/4 in value of the creditors concurs, the court has the discretion to decline to direct that a public examination be held.); *id.*, new s. 19(5) (providing that the Official Receiver, the Official Petitioner (where a criminal bankruptcy order has been made against the debtor), the trustee, a special manager, or any creditor who has submitted a proof may take part in the public examination). Other changes include *id.*, new s. 19(6) (enabling a bankrupt at his own expense to employ legal representation at the public examination); *id.*, new s. 19(7) (providing that the bankrupt will have the right either to be read or to read the record of the examination; *id.*, s. 19(8) (providing the court with the discretion to order that the costs of an examination be borne by creditors who required a public examination in those cases where the court finds that the examination was “frivolous or vexatious”).

74 See *id.*, amended s. 29(3) (expanding the scope of a private examination to include “any other matter the court considers relevant”); *id.*, new s. 29(1A) (providing that a third party respondent may be required to submit an affidavit “containing an account of his dealings with the bankrupt or to produce any documents in his possession or under his control relating to the bankrupt or the bankrupt’s dealings, affairs, or property”); *id.*, new s. 29(3A) and (3B) (providing that every person examined under s. 29 must answer all questions put to him, but that evidence obtained in the examination may not be used against him in criminal proceedings except for purposes of perjury); *id.*, amended s. 29(4) and (5) (providing that “[i]f on the examination of any person it appears to the court” that he is indebted to the bankrupt or has in his possession any property of the bankrupt, the court may order the individual to pay the debt in full or in part, or to deliver the property or any part thereof to the Official Receiver or the trustee).

75 See *id.*, amended s. 67. Old Section 67 required that the first dividend be declared and distributed within four months of the first meeting of creditors, with subsequent dividends being declared and distributed at intervals not exceeding six months.
Report on Bankruptcy, supra note 41, para. 9.15, at 79.

See, e.g., Bankruptcy Ordinance, new s. 61 (including three additional powers for which the trustee must seek the permission of the creditors’ committee before taking action); id., new s. 61A (providing that “[t]he exercise by the trustee of the powers conferred by Sections 60 and 61 [of the Bankruptcy Ordinance] shall be subject to the control of the court, and any creditor may apply to the court with respect to any exercise or proposed exercise of any of those powers”); id., amended s. 84 (going “some way towards imposing a statutory duty on trustees in providing that a trustee may be liable for his actions in the event that he behaves improperly” in several defined circumstances. Report on Bankruptcy, supra note 41, para. 9.33, at 84-85).

See, e.g., Bankruptcy Rules, new r. 122ZP (enabling the agreement of members of the creditors’ committee to a resolution to be obtained by obtained by post, rather than only at a meeting); Bankruptcy Ordinance, amended s. 24(2) (permitting members of the creditors’ committee to be represented by any person in possession of a letter of authority).

Insolvency Law and Practice; Report of the Review Committee (Cmnd. 8558, 1982), under the Chairmanship of Sir Kenneth Cork, CBE [the Cork Report], para. 1289 (quoted in the Report on Bankruptcy, supra note 41, para. 15.5, at 140).

See Bankruptcy Ordinance, new s. 34(3B) (requiring that the value of foreign currency debts be determined by converting the amount of such debts into a Hong Kong dollar equivalent as of the date of the making of the bankruptcy order). See Report on Bankruptcy, supra note 41, para. 15.7, at 140; id., new s. 34(3C) (permitting the trustee to pay dividends in respect of foreign currency claims either in Hong Kong dollars or in the foreign currency equivalent of Hong Kong dollars; when payment is made in the foreign currency equivalent, the amount of the dividend is to be determined by using the conversion rate as of the day of the payment of the dividend); id., new s. 61(k) (permitting the trustee (with the permission of the creditor’s committee and after taking expert advice) to delay conversion of foreign currency into Hong Kong dollars). For a more detailed discussion of the amendments relating to foreign currency claims, see Booth, The Transnational Aspects of Hong Kong Insolvency Law, supra note 23, at 74-76.

See Bankruptcy Ordinance, new s. 34(3A). This amendment changed the treatment of such debts in Hong Kong, because although the pre-B.A.O. law did not provide that fines and penalties were provable, the practice was that they were. See Report on Bankruptcy, supra note 41, para. 15.29, at 145.

See Bankruptcy Ordinance, new s. 32(5).

In compulsory liquidations, the limitation applied up to the date of the filing of the winding-up petition. See Report on Bankruptcy, supra note 41, para. 19.4, at 183. In some corporate cases, this involved reviewing thousands of accounts over a number of years. Id., para. 19.6, at 184.

New s. 71(2) and (3) of the Bankruptcy Ordinance includes guidelines regarding the payment of interest out of the surplus remaining after the payment of provable debts. It sets the rate of interest at the higher of judgment rate or the contractual rate. Lastly, new sub-section (4) applies to debts for which interest is not reserved or agreed for, and which are overdue at the commencement of the bankruptcy. In such cases, interest may be claimed at the judgment rate from the time the debt was payable, or from the time a written demand has been made, as the case may be, up to the date of the commencement of the bankruptcy.

Similar amendments were made to the Companies Ordinance for application in liquidations. See s. 43 of the Companies (Amendment) Ordinance, Ord. No. 3 of 1997, L.H.K., which came into operation in February 1997. This section added to the Companies Ordinance new s. 264A (Interest on debts), which is applicable only to solvent companies, and s. 264B (Extortionate credit transactions).

Report on Bankruptcy, supra note 41, para 17.1, at 156. For example, during the ten-year period
from 1983 to 1992, only 25 of roughly 2400 bankrupts were discharged. *Id.*, para 17.8 at 161.

86 For example, the number bankruptcy petitions filed by debtors since the new law came into operation on April 1, 1998, is 1,468. To put the numbers in perspective, the number of filings in May 1999 (253) was more than triple the total number of petitions filed by debtors during the 4-year period 1993/94 to 1997/98 (75). See Official Receiver's Office Website, *supra* note 38.

87 Bankruptcy Ordinance, new s. 30A(10) includes further restrictions on the obtaining of a discharge by debtors who remain out of Hong Kong or who leave Hong Kong without notifying the trustee of their itineraries and contact details.


92 The application is to be made by the debtor, except if the debtor is an undischarged bankrupt, either the trustee or the Official Receiver may also file an application. Bankruptcy Ordinance, s. 20A(3). A debtor’s creditors may not file an application.

93 See Companies Ordinance, s. 156.

94 Legal Practitioners Ordinance, s. 6(7) (cap. 159) L.H.K. (1999).


96 See *supra* note 87.

97 Bankruptcy Ordinance, new s. 20I.


99 For further discussion of this issue, see Charles D. Booth & Philip St. J. Smart, *Retrospective or Prospective?: Determining the Scope of Hong Kong’s New Insolvency Law*, 8 Int’l Insolvency Rev. 27 (1999); Charles D. Booth & Philip St. J. Smart, *New Insolvency Law: Traps and Gaps*, Hong Kong Law. 62 (January 1999).


101 The same may be said of old s. 31 of the Bankruptcy Ordinance, which applies to fraudulent settlements. This section was repealed by s. 22 of the B.A.O.

102 See, *e.g.*, U.S. Bankruptcy Code, s. 547.

Tied to the abolition of the 8% limitation (discussed in the text accompanying *supra* notes 84-85) was the enactment of another avoidance power, new s. 71A of the Bankruptcy Ordinance, which provides that on the application of the trustee the court is empowered to may make an order with regard to extortionate credit transactions entered into within three years of the commencement of the bankruptcy.

103 This section is an updated and condensed version of my earlier work, *Hong Kong corporate rescue proposals*, *supra* note 33.
See supra note 34.

Id., para. 2(a).


Id., at 244-47; Tyler, *supra* note 107, at 55-56.


Id., para. 1.7, at 8-9.

Id., para. 2.3, at 20.

E.g., the banking, insurance, and securities and futures industries. Id., paras. 2.12-.23, 22-25.

This panel will be similar to a scheme used at present in non-summary compulsory liquidations. The panel will be composed of firms that have at least two qualified practitioners with the required amount of insolvency experience. Id., paras. 7.4-.6, at 48-49. In exceptional circumstances, the court may approve the appointment of an individual not on the panel who possesses skills not available on the panel.

Id., para. 8.7(h), at 54.

Of course, the directors would have to be careful that they did not continue trading when “there was no reasonable prospect of preventing the company becoming insolvent,” or they would risk liability for the proposed offense of “insolvent trading.” Id., para. 19.1; id., Ch. 19 generally.

Id., para. 8.25(g) & (j), at 58.

Id., para. 13.17, at 79.

Id., para. 5.2, at 33.

Id., paras. 5.13-.14, at 35.

Id., para. 5.5 at 33; para. 5.32, at 40.

Id., para. 13.8, at 76-77.

Id., paras. 13.7-.8, at 76.

Protection of Wages on Insolvency Ordinance, s. 15 (cap. 380, L.H.K., 1999). The Protection of Wages on Insolvency Fund, in turn, attempts to recoup such payments in the company winding up. See Companies Ordinance, s. 265.


See *supra* note 48.

Letter of Miss Julina Chan for Secretary for Financial Services to respondents on the *Consultation Paper on Corporate Rescue*, June 2, 1999.

Id.


Id., para. 12.2, at 73.
131 Id., para. 14.11, at 82.
134 Id., para. 3.6, at 26-27.
135 Id., para. 15.10, at 85.
136 See Booth, *Hong Kong corporate rescue proposals*, supra note 33, at 253.
138 Id., s. 1129(b).