



**A Guide to
Provisional Liquidation
in Hong Kong**

Provisional Liquidators

Before addressing the use of the provisional liquidation process it is perhaps useful to explain that in Hong Kong there are three types of provisional liquidators.

This guide focuses on provisional liquidators appointed under s.193 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (“C(WUMP)O”).

However, there are two other types of provisional liquidators and it is perhaps useful, to briefly summarise these, so as to avoid confusion with the “traditional” s.193 appointment.

Types of Provisional Liquidators

Section 228A- Creditors’ Voluntary Liquidation

This is a voluntary liquidation process where the directors of an insolvent company start the liquidation process by appointing a provisional liquidator pursuant to the provisions of s.228A of the C(WUMP)O.

The role of the provisional liquidator here is simply to safeguard and protect the assets of a company. This process should only be used where there is no “reasonably practicable” alternative to using this way of placing a company into liquidation.

In this case, a meeting of creditors must be held no later than 28 days after the date on which the provisional liquidator is appointed. During this hiatus period, the provisional liquidator does not have the power to dispose of any of the assets of the company, except in circumstances where it can be shown that the assets are likely to deteriorate in value if not disposed of on a timely basis.

These assets may include perishables, or financial instruments which may need to be brought to a conclusion prior to the meeting of creditors.

Section 194(1A) – Panel T “Tender” Appointment

This is what is known as a “Panel T” appointment where a winding-up order has been made and the Official Receiver is appointed provisional liquidator. Pursuant to section 194(1A) of the C(WUMPO)O, the Official Receiver will appoint a private sector liquidator to act as provisional liquidator in her place, where it is believed that the assets are worth less than HK\$200,000. For those winding-ups with assets in excess of HK\$200,000, the Official Receiver will continue to act as provisional liquidator until a liquidator is appointed at a meeting of creditors.

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Section 193 – Traditional Appointment

Unarguably the most significant type of provisional liquidator appointment is one that is made pursuant to s.193. This is where a winding-up petition has been filed and the petitioner, or another creditor is concerned that the assets of the company are in jeopardy and applies to the Court for the appointment of a provisional liquidator.

If the Court is satisfied that the assets are in danger, it can appoint a provisional liquidator whose role is to safeguard and protect the assets of the company until the hearing of the petition. The period between the date of the presentation of the petition and the winding-up hearing can be as much as ten to twelve weeks and for that reason it is not unusual for a creditor to make such an application.

After a provisional liquidator has been appointed, all other actions and proceedings are automatically stayed. Litigants who wish to commence or proceed with their actions may only do so with the leave of the Court.

It is a peculiar limitation of Hong Kong's insolvency legislation that it has no formal corporate rescue procedure. Consequently, between 1998 and 2006, there were a series of Court decisions where provisional liquidators were appointed, often in respect of listed companies, with a view not simply to protecting and safeguarding the assets, but to developing and implementing corporate rescue proposals often in conjunction with a scheme of arrangement.

However, further changes to the way in which provisional liquidation is used may be on the horizon following the 2006 Court of Appeal decision in the case of Legend International Resorts Limited (see below).

The Legend Case

Briefly the background to this case was that the company, whose major asset was the operation of a casino in the Philippines was in serious financial difficulties. A major creditor applied to the Court for a provisional liquidator to be appointed, one of the grounds being to facilitate the rescue of the company by way of a scheme of arrangement.

The initial application for the appointment of a provisional liquidator was rejected. However, the reasons for the rejection were based on the existing appointment of a locally based insolvency practitioner to deal with the affairs of the company in the Philippines.

The petitioner appealed against the decision and the matter came before the Court of Appeal. The decision of the Court of Appeal was and still is potentially quite significant for the appointment of provisional liquidators going forward.

The Court took the view that the practice of appointing provisional liquidators to rescue companies in financial difficulties was beyond the scope of the Hong Kong Companies Ordinance.

The Court made it clear that in its opinion, the primary purpose behind presenting a winding-up petition was not to rescue the company, but to obtain a winding-up order.

The Legend Case (cont'd)

That is not to say that once a provisional liquidator had been appointed, if he felt there were prospects for rescuing the company, that he could not go back to the Court and seek an extension of his powers in order to participate in that rescue process.

Regardless, the Court was of the view that in order to successfully apply to the Court for the appointment of a provisional liquidator, in the future it would be necessary at least to satisfy the traditional test of showing jeopardy to the assets of the company.

One interesting argument in this respect is whether or not “jeopardy to the assets” can be equated with “benefits for the creditors”.

Some of the arguments put forward in the past to justify the appointment of a provisional liquidator are now unlikely to work unless it is possible to show that there is jeopardy to the assets of the company. The question is, would it be possible to argue that the appointment of a provisional liquidator would be beneficial from the point of view of the creditors, rather than having to show jeopardy to the assets.

In practice, anecdotal evidence suggests that the decision in Legend has not had a material impact on the appointment of provisional liquidators in Hong Kong. This is important as in the continued absence of a proper corporate rescue regime, distressed and ailing companies need all the help they can get.

Powers of Provisional Liquidators

The powers of a provisional liquidator appointed under s.193, are those set down in the order pursuant to which he is appointed. In most cases, the solicitors acting for the petitioner will present to the Court a fairly extensive list of powers but it cannot be assumed that the Court will automatically agree with the powers sought.

The Court, together with counsel for both sides will seek to establish what powers are necessary in the circumstances, but at the same time giving the provisional liquidator the authority to go back to the Court for an extension of those powers if he so wishes, or if it becomes necessary in the circumstances.

Normally these powers do not include the power to dispose the Company's assets. Therefore a separate application will need to be filed with the Court by the provisional liquidator seeking sanction to sell the Company's assets.

Exit Route from Provisional Liquidation

In most cases where a provisional liquidator has been appointed, it is likely that the company will eventually be wound-up. Once the winding-up order has been made, the provisional liquidator continues in office but it is then his duty to convene a meeting of creditors within three months from the date of the winding-up order. At that meeting, he will be required to report to the creditors on his administration to date and give them the opportunity to vote on the appointment of a liquidator and a committee of inspection.

Remuneration of Provisional Liquidators and Their Agents (Solicitors)

As part of the order under which they are appointed, there is usually a provision that the remuneration of the provisional liquidators be approved by the Court under the usual assessment process for Court appointed insolvency practitioner's fees. Typically this will take several months.

However, as a result of the recent rulings in the Lehman Bros and MF Global cases it is now possible in some cases for provisional liquidators to apply to the Court for a payment on account of their fees and those of their solicitors and other agents acting for them, pending their final assessment or taxation by the Court. However, this is only likely to happen in very substantial cases.

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