



**A Procedural Guide to
Compulsory Liquidation
in Hong Kong**

Compulsory Liquidation

The purpose of this guide is to provide a brief, plain English introduction to the compulsory liquidation procedure in Hong Kong. It is not exhaustive and is not meant to be an alternative to legal or professional advice on specific issues. However, if you are in doubt regarding any of the matters dealt with in the guide, please do not hesitate to contact us

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Winding-up Petition

The process starts with the presentation to the Court of a winding-up petition. The petition is usually based on an outstanding debt of HK\$10,000 or more.

It may be that the petitioner has obtained a judgment against a company. Alternatively, it may have served a statutory demand that has not been complied with. (A statutory demand requires that an outstanding debt be paid within 21 days of the service of the demand, failing which the creditor may present a winding-up petition to the Court.)

Effects of a Winding-up Petition

Between the date of the presentation of the petition and the date of the hearing there is usually a gap of two or three months. During this period any disposition of the company's assets is void unless approved by the Court. One of the liquidator's role is to investigate whether there has been any dispositions and if so, to recover them for the benefit of the company's creditors. It is quite likely that as a result of the winding-up petition being advertised that the company's bank accounts will be frozen.

Provisional Liquidator

It is sometimes the case that during the period between the date of the presentation of the petition and the date of the hearing, the creditor believes that the assets of the company are in jeopardy. Fortunately, the creditor can apply to the Court for a provisional liquidator to be appointed. The role of the provisional liquidator is primarily to protect and safeguard the assets of the company until the winding-up petition has been heard. A provisional liquidator will only be appointed if the creditor can prove to the satisfaction of the Court that the assets are in jeopardy.

Winding-up Order

If at the hearing of the petition, a winding-up order is made, the Official Receiver automatically becomes the provisional liquidator of the company, unless a provisional liquidator has already been appointed as above.

However, in recent years, the Official Receiver has developed a policy of contracting out compulsory liquidation work to private sector Insolvency Practitioners. Immediately following his appointment as provisional liquidator the Official Receiver will, in 95% of cases, immediately appoint a provisional liquidator from his panel of Insolvency Practitioners as his replacement. Access to this panel is by a tender process which takes place every two years, where the firms which submit the lowest tenders are appointed. It is the Insolvency Practitioner's job to deal with the administration of the affairs of the company.

Summary Procedure Order

In the vast majority of liquidations in Hong Kong, the assets of the company are worth less than HK\$200,000. This gives rise to what are known as "Summary" cases. If the provisional liquidator is satisfied that the assets of the company are worth less than HK\$200,000, he must apply to the Court for a summary procedure order. The effect of this order is that the provisional liquidator becomes liquidator of the company and there is no requirement for him to convene meetings of shareholders and creditors.

Meetings of Creditors and Shareholders

In a small number of cases, the assets of the company are estimated to be worth in excess of HK\$200,000. In these cases, meetings of shareholders and creditors must be convened either by the Official Receiver or by the provisional liquidator.

At the meetings, the creditors have the opportunity to appoint a liquidator of their own choosing. If they think fit, shareholders and creditors may also appoint a Committee of Inspection (see below).

The shareholders also have the right to nominate a liquidator, but if the creditors' nomination for liquidator is someone different from the person nominated by the shareholders, it is the creditors' nomination which is usually accepted. The directors of Briscoe Wong Advisory are frequently nominated to act as liquidators.

If there are different nominations by the shareholders and creditors, it will be for the Court to decide who will be appointed as liquidator at a determination hearing. This hearing usually takes place within two or three months of the meetings of shareholders and creditors.

Committee of Inspection

A Committee of Inspection is a representative body of creditors and sometimes shareholders. Its role is to assist and advise the liquidator in undertaking his duties. It comprises a minimum of two and a maximum of five creditors.

The Committee is required to meet every month. However, in practice it usually meets either at the request of the liquidator or at the request of one or more members of the Committee. One of the roles of the Committee is to agree the liquidator's remuneration.

A separate guide outlining the role of the Committee is available at www.briscoewong.com.

Role of the Liquidator

The role of the liquidator is to realise the assets of the company; distribute the proceeds to the creditors in accordance with their statutory priority; and to investigate the circumstances surrounding the failure of the company.

Realisation of Assets

The liquidator's job is to realise the assets for the best possible price. It does not necessary mean that the liquidator must sell the assets of the company immediately following his appointment, but it is often the case that assets can deteriorate in value if they are not disposed of on a timely basis.

All the funds realised by the liquidators are paid into an account known as the Companies Liquidation Account, which is maintained by the Official Receiver's Office. The liquidator is only allowed to retain sufficient funds in his own bank account, usually HK\$10,000, to meet day-to-day expenses associated with the liquidation. If the liquidator wishes to withdraw funds from the Companies Liquidation Account he must provide the Official Receiver with the necessary documentary support in respect of any withdrawal. All funds received by the liquidators from realising the Company's assets are paid into the Companies Liquidation Account and are subject to "ad valorem duty". This duty is paid to the Official Receiver.

Priority of Claims

Preferential Creditors

Certain creditors, i.e. employees and certain government departments, enjoy a priority in respect of their claims against the company. Employees' claims are preferential to the extent of all accrued holiday pay, arrears of wages (HK\$8,000), pay in lieu of notice (HK\$2,000) and severance pay (HK\$8,000).

Employees are also entitled to apply to the Protection of Wages on Insolvency Fund Board ("PWIFB") for an ex-gratia payment, if their employer goes into liquidation. The maximum amounts which will be paid by the PWIFB are HK\$36,000 for arrears of wages; HK\$10,500 in respect of holiday pay; HK\$22,500 for pay in lieu of notice; and HK\$50,000 plus 50% of any amount in excess up to a maximum of HK\$250,000, for severance pay.

Secured Creditors

Secured creditors are those creditors who have a legal charge over assets of the company. This is usually a financial institution which has a charge over say, land and buildings or plant and machinery.

The liquidator will investigate the validity of the security. If he is satisfied it is valid then the secured creditor is entitled to the proceeds from the sale of the assets up to and including the amount of capital and interest outstanding. Any surplus is paid over to the liquidator.

Unsecured Creditors

Once the preferential claims have been dealt with and the costs of the liquidation have been paid, the balance is then made available to the unsecured creditors whose claims are paid on a pari-passu basis.

Liquidator's Investigations

As part of his duties, the liquidator is required to investigate the circumstances leading to the failure of the company. In particular, the liquidator will investigate the following:

Disposals after the Presentation of the Petition

Any disposal of assets or payment to creditors after the date of the presentation of the petition is void unless otherwise approved by the Court.

The liquidator is required to investigate whether or not any such disposals/payments have been made and, subject to the commerciality of pursuing them, can ask for an order of the Court that the recipient return the funds to the company for the benefit of the general body of creditors.

Unfair Preferences

An unfair preference occurs where a payment has been made to a creditor in the period leading up to the presentation of the petition. The effect of that payment is to put the recipient in a better position than other creditors when the liquidation starts.

The liquidator can investigate transactions which took place in the six months prior to the presentation of the petition to see whether any of them constitute unfair preferences.

However, if the transaction involves a connected person i.e. someone who has a relationship with the company and/or its directors, the liquidator can go back as far as two years to overturn transactions of this nature.

Floating Charges

A floating charge is one which attaches to moveable classes of assets such as plant and machinery, stock, work in progress and accounts receivable. If a floating charge has been created within 12 months prior to the presentation of the petition, the liquidator will investigate whether or not it has been validly created. It is often the case that floating charges are created, but no money is advanced to the company. In such a case, the liquidator will seek to have the floating charge invalidated by the Court. However, if funds were advanced to the company in return for the creation of the floating charge, it is often the case that the charge is valid. In those circumstances, the floating charge holder is entitled to the proceeds of the disposal of the assets secured by the floating charge, but only after the claims of the preferential creditors have been paid.

Misfeasance

It is possible, in certain circumstances, for the liquidator to apply to the Court for an order that a director or shadow director be ordered to make a contribution to the assets of the company from their personal resources.

This occurs where the liquidator is able to show that the party concerned has taken assets of the company and used them for his own purposes.

S.221 Examinations

Sometimes, when a company goes into liquidation, some of the people associated with the company are unwilling to co-operate with the liquidator or assist him in undertaking his duties.

With that in mind, liquidators have the power to obtain an order from the Court that directors, professional advisors such as auditors and solicitors and other people associated with the company, or who have knowledge of company's affairs, attend before the Court to be questioned on oath and to provide information relating to the company's affairs.

This is known as a private examination and a person cannot refuse to answer questions on the grounds that he may incriminate himself.

This ability to bring uncooperative people before the Court is a power which is now being used more and more frequently by liquidators in Hong Kong. It is a way in which liquidators are able to obtain further information about the affairs of the company, which often leads to the realisation of further assets for the benefit of the company's creditors.

Closure of the Liquidation

Once the liquidator has realised all the assets, distributed the funds to creditors and completed his investigations, he will apply to the Court to be released as liquidator. Following his release, the company will be dissolved and the liquidation process has been completed.

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