



INTERNATIONAL LAWYERS NETWORK



SIT, FUNG, KWONG & SHUM

Bankruptcy, Insolvency & Rehabilitation Proceedings in Hong Kong

ILN RESTRUCTURING & INSOLVENCY GROUP



KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER HONG KONG LAW

(1) Introduction

Hong Kong provides effective and efficient insolvency resolutions in both compulsory and voluntary contexts, seeking to protect the interests of creditors and companies alike.

While Hong Kong does not operate a formal rehabilitation, moratorium or corporate rescue procedure, Hong Kong has an established practice of individual voluntary arrangements and schemes of arrangements, where debts are compromised pursuant to statutory framework.

Hong Kong maintains an active cross-border insolvency practice which is consistent with other common law jurisdictions. Given the strong ties between Hong Kong SAR and Mainland China, there is mutual assistance and recognition to bankruptcy (insolvency) proceedings between the Courts of Mainland China and the Court of Hong Kong SAR.

(2) Compulsory Insolvency

(A) Personal Bankruptcy

A creditor's bankruptcy petition may be presented against an individual who is unable to pay or have no reasonable prospect of being able to pay a debt being a liquidated sum exceeding HK\$10,000 or a prescribed amount.

A debtor is deemed to be unable to pay such debt if the debt is payable immediately and the debtor fails to satisfy a statutory demand within 21 days on receipt of such demand in its prescribed form. An opposing debtor may apply to set aside the statutory demand within 18 days from the date of service on him of the statutory demand.

A bankruptcy petition shall not be presented unless the debtor is domiciled in Hong Kong, is personally present in Hong Kong on the day of presentation of the petition, or has been an

ordinary resident, or has had a place of residence, or carries on business in Hong Kong 3 years preceding the petition.

(B) Company Winding-up

A creditor's winding-up petition may be presented against a company who is likewise unable to pay a debt being a liquidated sum exceeding HK\$10,000.

Similarly, a company is deemed to be unable to pay such debt if a statutory demand is unsatisfied within 21 days upon service. An opposing debtor may apply for an injunction restraining the presentation of a winding-up petition based on the statutory demand.

A winding up petition can be presented against a company incorporated in Hong Kong, and additionally, a company incorporated outside Hong Kong if various requirements are met.

In gist, for non-Hong Kong companies to be wound up in Hong Kong, there must be a sufficient connection with Hong Kong, a reasonable possibility that the winding-up order would benefit the applicants, and the Court's ability to exercise jurisdiction over one or more persons in the distribution of the company's assets.

Apart from debt grounds, a company can be wound up if it suspends, or does not commence, business for a year, if it has no members, if there is an event of dissolution under the articles, or if it is just and equitable to do so. Just and equitable ground usually arises in the context of shareholders dispute in small to medium sized private companies, for example, where there is a breakdown of trust and confidence between the shareholders or a deadlock in management.



(C) Post-Petition Procedures

Upon presentation of a bankruptcy or winding-up petition, the petition will be fixed for a hearing before a Master of the High Court.

For winding-up petition, before the hearing, the petition shall be verified by affidavit, and served on the debtor, the Official Receiver and the Chief Bailiff. The petition shall also be gazetted and advertised on newspapers.

The petitioner shall satisfy the Registrar of the High Court who certifies that the petition has been duly verified, served, gazetted and advertised, and that all applicable rules have been complied with.

Once the Registrar's certificate is issued, and if the debt remains unpaid in whole or in part, the Petitioner may seek for a winding-up order to be entered.

For bankruptcy petition, before the hearing, the petition shall be verified by affidavit, and shall be served on the debtor, the Official Receiver and the Chief Bailiff. The bankruptcy petition must be served on the debtor personally, or by other substituted means (such as by advertisement on newspapers or by e-mail) as directed by the Court upon the petitioner's application for an order of substituted service.

The petitioner shall satisfy the Court of the service of the petition on the debtor by filing an affirmation of service. Once service requirement is satisfied, and if the debt remains unpaid in whole or in part at the hearing of the bankruptcy petition, the Petitioner may seek for a bankruptcy order to be entered.

If the winding-up/bankruptcy petition is opposed at the hearing, the Master does not have jurisdiction to hear the case, and will adjourn the petition to another hearing before the Companies Judge or Bankruptcy Judge (as the case may be), who will decide or make direction on the disposition of the petition.

Winding-up proceedings and bankruptcy proceedings are generally regarded as summary procedures as they provide a relatively streamlined court process, as opposed to a full-blown trial. For instance, parties will only rely on affidavit evidence and will be restrained from calling witnesses at the hearing. The Court does not normally decide the merits of the underlying debt, which is expected to be resolved in separate legal proceedings. In case the opposing debtor is able to satisfy the Court that there is a *bona fide* dispute on substantial ground in respect of the debt, the Court may dismiss the petition.

Put it differently, any petitioner who commences insolvency proceedings knowing that the debt is subject to a *bona fide* dispute on substantial ground may risk the petition being dismissed with an indemnity costs order being granted against the petitioner, on the ground of an abuse of process.

(3) Voluntary Insolvency

An individual debtor can enter into self-bankruptcy by filing a debtor's bankruptcy petition, together with a statement of affairs, to the Official Receiver and the High Court.

Likewise, a company can enter into creditor's voluntary winding-up or member's voluntary winding-up. Corresponding approvals of the creditors and the members are required.

Compared with compulsory insolvency, voluntary insolvency is generally faster and more cost-effective, benefiting the creditors as a whole.

(4) Liquidation

(A) Appointment of Trustees-in-bankruptcy and Liquidators

When bankruptcy or winding-up orders are made, trustees-in-bankruptcy or liquidators will be appointed. In a situation where there is



urgency e.g. for preservation and investigation of assets and transactions, provisional liquidators may be appointed with restrictive powers, before winding-up orders are made.

Trustees-in-bankruptcy and liquidators have a wide range of powers including selling, executing documents, claiming and receive money, paying bills, employing solicitors and all other matters as may be necessary for winding up the affairs of the debtor and distributing its assets in the priorities under the statutory framework.

Meanwhile, there are duties on the part of the debtor and/or its directors to attend interviews, to answer questions, to provide assistance in realizing properties, to provide statements of affairs and so on. If the debtor and/or its directors fail to do so, the trustees-in-bankruptcy or liquidators may apply to the Court for public examination against the debtor and/or its directors. In addition, in bankruptcy context, failure to assist may result in a non-commencement order, which postpones the commencement date of the period of bankruptcy such that the bankruptcy order will not automatically discharge after 4 years from the commencement date.

If undervalue transactions, preferential payments, fraudulent transfers or other causes of actions are involved, trustees-in-bankruptcy and liquidators also have the power to commence appropriate legal actions against the parties concerned in order to claw back assets into the estate.

(5) Employees

Hong Kong safeguards labour rights by providing timely alleviations. Once a winding-up or bankruptcy petition is presented in the Court against the individual employer (whether a company or an individual), the Protection of Wages on Insolvency Fund may make ex gratia

payments to the affected employees whom the employer is still indebted to arrears of wages, wages in lieu of notice, accrued holiday remuneration and severance payment under the statutory framework.

Upon liquidation of the employer, employees are entitled to payment out of the assets of the employer in priority to most other creditors in respect of arrears of wages, wages in lieu of notice, accrued holiday remuneration and severance payment, subject to statutory limits.

(6) Rehabilitative Options

(A) Options

As an alternative to insolvency, an individual debtor may apply for an Individual Voluntary Arrangement (IVA) which allows the debtor to make a repayment proposal to the Court and the creditors. The proposal, once approved by a majority in excess of 75% in value of the creditors present in person or by proxy and voting on the resolution, will be binding on every creditor who had notice of and was entitled to vote at the meeting whether or not he was present or represented.

A company can also enter into a scheme of arrangement which allows repayment proposals to be accepted by the creditors, which may include compromises e.g. instalments, haircuts and deferrals, with a view that liquidation can be avoided.

Procedurally, a scheme of arrangement will become binding on all creditors upon the Court's leave to convene a creditor's meeting, the approval of the scheme by at least 75% of creditors (by value) and a majority in number (more than 50%) in a validly held creditor's meeting, and the Court's sanction of the scheme. Normally, scheme administrators will be appointed to implement the scheme.

In sanctioning a scheme of arrangement, the Hong Kong Court would consider various factors



including its purpose, class composition, disclosure of information to creditors, as well as international dimensions and effectiveness, if any.

(B) Advantages

Rehabilitative options are commercially advantageous as they reduce hostility and foster the understanding between debtors and creditors on the repayment potential.

Specifically, creditors and debtors are allowed to retain control on the repayment plan in a consensual manner, and if possible, collaborate on the future of the business on a going concern. There is a further advantage on perceptions. In many occasions, confidentiality of business dealings can be preserved. Moreover, compared with insolvency, whether compulsory or voluntary, rehabilitative options do not carry the cultural stigma attached to insolvency individuals or entities.

(7) Mutual Assistance and Recognition with Other Jurisdictions

(A) Pilot Areas in the Mainland China

Under a Cooperation Mechanism between the Supreme People's Court of Mainland China and the Government of Hong Kong SAR, several cities were designated as pilot areas (including Shanghai, Xiamen and Shenzhen) where their Intermediate People's Court may initiate cooperation with the Hong Kong Court on mutual recognition of and assistance to bankruptcy proceedings.

A liquidator or provisional liquidator in insolvency proceedings in Hong Kong may apply to such Courts in the pilot areas for recognition of compulsory winding up, creditor's voluntary winding up and corporate debt restructuring proceedings, and grant of assistance for discharge of his duties.

An administrator in Mainland bankruptcy proceedings may apply to the High Court of Hong Kong for recognition of bankruptcy liquidation, reorganization and compromise proceedings under PRC Enterprise Bankruptcy Law, recognition of his office as an administrator, and grant of assistance for discharge of his duties.

(B) Other Parts of the Mainland China and Other Jurisdictions

For regions outside the pilot areas, the Hong Kong Court may apply common law in dealing with recognition of Mainland China-included foreign insolvency proceedings and assistance.

The power at common law to recognize and assist foreign office-holder does not depend on winding up proceedings having been commenced against the company in the assisting court, as the Court is asked to recognize the office-holder appointed in the place of incorporation as the lawful agent in accordance with principle of private international law.

In principle, common law supports recognition and assistance if the foreign insolvency proceedings are collective, conducted in the jurisdiction in which the company's centre of main interest is located, and if assistance is necessary and consistent with the substantive law and public policy of the assisting court.

As to the extent and terms of assistance, the Hong Kong Court has granted assistance to a foreign office-holder to take control of the assets of the company, to stay the local proceedings against the assets of the company and to obtain and gather information and documents relating to the company from third parties.

(8) Conclusion

Hong Kong, being an international financial centre and an international dispute resolution centre, has established a statutory and common



law framework on insolvency practice. Practitioners are accustomed with advising on procedure, merits and risks of various options to assist local and international clients in making well-informed decisions in the context of financial crisis. Meanwhile, as case authorities on mutual assistance and recognition continue to evolve, it is expected that the Hong Kong Court will continue its open-door policy by committing to cross-border insolvency cooperation in both individual and corporate contexts. For specific questions, please reach out to us and seek legal advice.

SIT, FUNG, KWONG & SHUM

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including leading multinational corporations, public and private companies and professional firms.

We have a strong and substantial Dispute Resolution Department. As the legal advisers to a number of listed companies, property developers, multinational corporations and statutory bodies, our Dispute Resolution Department handles a broad spectrum of civil and commercial litigations, arbitrations, securities related investigations and litigations, insolvency proceedings, family proceedings and intellectual property claims. In addition to representing both local and overseas clients in legal proceedings in Hong Kong, we have also been actively involved in cross-border and overseas litigations where we work closely with overseas lawyers including lawyers from the PRC, USA, UK, BVI and Macau.

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