Introduction to Hong Kong winding-up regime

DENTONS

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Under Hong Kong law, the terms "insolvency", "liquidation" or "winding-up" are used with reference to companies, and "bankruptcy" is used in relation to individuals. The former are primarily regulated by Companies (Winding Up and Miscellaneous Provisions Ordinance) (**CWUO**) (Cap. 32), and the latter by the Bankruptcy Ordinance (Cap 6). The article below focuses on the corporate insolvency regime, in relation to financially distressed companies which are unable to pay their debts or discharge their payment obligations.

The underlying purpose of corporate insolvency law is to resolve all claims against insolvent companies and provide a fair and orderly process for collecting and realising the assets of insolvent companies, such that the same can be distributed amongst creditors in accordance with the statutory scheme of distribution.

At present, the legal framework provides assistance to financially distressed businesses through (i) a statutory debt restructuring scheme called a scheme of arrangement and (ii) formal liquidation/winding-up procedures.

Option 1: Restructuring without a winding-up

Debt restructuring is a process whereby a company restructures its debts without liquidation or dissolution. It can be non-statutory and/or statutory. Non-statutory workouts are out-of-court arrangements freely entered into between a debtor company and its creditors and are governed by common law contractual rules. Statutory schemes of arrangement are court-sanctioned compromises pursuant to CWUO, which bind all creditors of the debtor company, even though not all consent to the arrangements. Statutory schemes can be utilised alone or in combination with a non-statutory scheme. The creditors may try to reach a consensual workout among themselves in the first instance. If no consensus is reached, majority creditors may then apply to the court to sanction their proposed scheme of arrangement.

In many cases, debt restructuring is preferred over winding-up, as the potential return for creditors is usually more. Debt restructuring is, however, not without its detractors who often point to the fact that the process can be unduly cumbersome. Due to the absence of a statutory moratorium or stay of proceedings, dissenting creditors are able to bring claims and actions against the company in the course of the restructuring scheme (unless the court has already sanctioned a statutory scheme of arrangement which is binding on all creditors of the company), thereby impeding the conclusion of the entire process. In such circumstances, liquidation is seen as a better alternative for the purpose of timely disposal of the matter, given the moratorium pending winding-up proceedings.

Option 2: Formal liquidation/winding-up procedures

Liquidation occurs where a court-appointed liquidator assumes control of a company and realises its assets for distribution, with the company dissolved at the end of the process. Under CWUO, there are two paths to winding up a company in Hong Kong – voluntary winding-up or compulsory winding-up.

Voluntary winding-up occurs via a decision of the company to dissolve itself in a general meeting. It can be further divided into members' voluntary liquidation (**MVL**) and creditors' voluntary winding-up (**CVL**). MVL is for solvent companies. As evidence of the company's solvency, the directors have to sign a "certificate of solvency", to the effect that they have made a full inquiry into the affairs of the company, and formed the opinion that the company will be able to pay its debts in full within such period not exceeding 12 months from the commencement of the winding-up. On the other hand, CVL is for insolvent companies, whose liabilities exceed the assets available. It is not difficult to distinguish between an MVL and a CVL. Any voluntary liquidation without a certificate of solvency will be a CVL. Both MVL and CVL require shareholders' sanction, but only the latter is subject to creditors' oversight due to the insolvent nature of the business.

In contrast, compulsory winding-up takes place following a court order for the company to be wound up upon a petition presented by a creditor of the company. Before the grant of a court order, a creditor must satisfy one of the statutory grounds set out in the CWUO, with the most common ground being the company's failure to pay its debts. Different from voluntary winding-up which is instigated internally, compulsory winding-up can be initiated by the debtor company, shareholders, liquidators, official receiver, the Registrar of Companies and, most commonly, creditors. It is subject to a higher degree of external supervision and control, given the involvement of the court.

Pursuant to CWUO s.177, the court may make a winding-up order against a company if it is satisfied that one of the following grounds is made out:

- The company has resolved by special resolution (which requires a majority of 75%) that the company be wound up by the court;
- The company does not commence its business within a year from its incorporation or suspends its business for a whole year;
- The company has no members;
- The company is unable to pay its debts;
- The event, if any, occurs whereby the memorandum and articles provide that the company is to be dissolved; or
- The court is of the opinion that it is just and equitable that the company should be wound up.

The company being unable to pay its debts is the most common ground for invoking compulsory winding-up in Hong Kong. Under CWUO s.178, a company is considered unable to pay its debts if:

- It is unable to satisfy a statutory demand for a debt of not less than HK$10,000 within three weeks from the date of the demand;
- It is unable to satisfy a judgment against a company in part or in whole; or
- It is proved to the satisfaction of the court that the company is unable to pay its debts.

The court will not make a winding-up order if it is satisfied that the debt upon which the petition is based is the subject of a bona fide dispute on substantial grounds.

Future option: Corporate rescue

In line with international practice, the Hong Kong government will very soon introduce a long-awaited statutory corporate rescue procedure, whereby a company which is or is likely to be insolvent may initiate provisional supervision to yield a corporate rescue proposal and foster restructuring efforts. A prominent feature of corporate rescue is the imposition of a statutory moratorium. The effect is to enable the business to be kept alive without going into liquidation, while at the same time preventing creditors from lodging claims to the detriment of ongoing rescue efforts. Such moratorium or stay of winding-up proceedings shall last for 45 business days in the first instance, which can be extended to up to six months with the consent of creditors and beyond six months for complex cases with leave of the court.

The Hong Kong government tabled the Companies (Corporate Rescue) Bill in late 2020, which is expected to be presented to the Legislative Council in 2021, together with subsidiary legislations relating to the operational matters of corporate rescue procedures. Once introduced, the regime may alter the future landscape of restructuring financially distressed businesses, enabling Hong Kong to retain its status as a regional if not global debt restructuring hub.

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