WEBINAR SERIES:

2021 - INSOLVENCY, RESTRUCTURING & RECOVERY - A LEGAL, ACCOUNTING AND PRACTICAL OVERVIEW

WEBINAR 2 - RESTRUCTURING OPTIONS

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Financial Restructuring Process

Stakeholder engagement

Recognise signs of financial distress

- Discussed in webinar 1

Perform Independent Business Review

- Diagnose extent of problem and the viability of the business

Consider debt restructuring options

- Identify appropriate solutions, based on existing financial position and forecasted financing needs

Formulate Restructuring Plan

- Present restructuring proposal, obtain feedback & buy-in

Negotiation of terms with lenders and stakeholders

- Finalise terms

Implement restructuring plan (workout or court-assisted)

- Complete the proposal and bind all relevant stakeholders

Financial Advisor engaged to guide the company
or advise the lenders / other stakeholders on the company's proposal

Informal Workouts

Consensual and Contractual: This workout is comprised of contractual arrangements between a debtor and its creditors.

•Advantages:

- Flexible and timely preservation of business value
- Less regulatory impact
- Less costly (no judiciary involvement)

•Requirements:

- A viable business
- Positive attitude towards negotiation
- Homogeneity of creditors

Currently there is no formal corporate rescue procedure under Hong Kong Law. Pursuing workouts or schemes of arrangement are the two main ways by which a Hong Kong company in financial distress may restructure its debts.

Financial Position, Projections and Formulate Turnaround Plan

First step, perform an Independent Business Review (“IBR”) to diagnose the extent of the problem:

1.What is the financial position of the company?
2.What are the short-term cash needs?
3.What are the issues / drivers of underperformance?
4.What are the prospects?
5.What are the interests of key stakeholders?

Normally, a financial advisor (“FA”) would assist to review the business and prepare the IBR.

Review the Balance Sheet

Balance Sheet		
Working Capital		$
Fixed Assets		
Properties	$	
Plant and Machinery	$	
Other Assets		
Investments	$	
Insurance Claims	$	
Shareholder Loans	$	
Prepaid Rent and Rates	$	
Other Prepayments	$	
Cash		$
Liabilities		$
Other Creditors	$	
Accruals	$	
Taxation		$
Sales Tax	$	
Payroll Tax	$	
Corporation Tax	$	
Pension		$
Debt	$	
Net Assets		$
Equity		$
Reserves		$

Example Initiatives:

Redundant asset? Capable of disposal?

Monetise?

Deferral? Rebate?

Pooling? Repatriation?

Deferrals? Reduction schemes?

Reduce payments?

Review P&L Forecast

Profit and Loss	Jan	Feb	Mar		Dec	Year 1	Year 2	Year 3
Sales	26,300	29,410	30,950		41,190	465,530	510,000	551,500
Direct Costs	14,860	16,775	17,725		24,285	267,640	292,800	315,800
Gross Margin	11,440	12,635	13,225		16,905	197,890	217,200	235,700
Gross Margin %	43%	43%	43%		41%	43%	43%	43%
Operating Expenses								
Payroll	6,266	6,966	7,666		6,967	94,100	102,560	104,829
Rent	2,500	2,500	2,500		2,500	30,000	21,000	24,000
Marketing	1,000	1,000	2,000		2,000	23,000	26,000	28,000
Leased Equipment	150	150	150		150	1,800	1,800	1,800
Utilities	125	125	125		125	1,500	21,000	24,000
Insurance	75	75	75		75	900	-	-
Payroll Taxes	1,567	1,742	1,917		1,742	23,525	1,045	1,045
Other	-	-	-		-	-	-	-
Total Operating Expenses	11,683	12,558	14,433		13,559	174,825	173,405	183,674
EBITDA	(243)	77	(1,208)		3,346	23,065	43,795	52,026
Depreciation	1,025	1,025	1,025		1,025	12,300	12,300	12,300
Interest	182	181	180		168	2,106	1,610	1,090
Taxes	-	-	-		215	1,521	2,989	3,864
Net Profit	(1,450)	(1,129)	(2,413)		1,938	7,138	26,896	34,772
Profit / Sales	-6%	-4%	-8%		5%	2%	5%	6%

Critique the underlying drivers, including the basis of assumptions adopted into the forecast.

Assess the business' financing needs and most appropriate capital structure for the business going forward.

Formulate a Plan

After performing the IBR, the FA would work out the appropriate restructuring plan, which comprises a cashflow forecast and considers the company's repayment capacity.

Typically, a restructuring plan will have two elements:

- To demonstrate that the company is proactively taking action to improve performance and cash flows.
- Proposed financial restructuring itself.

A creditor committee would be established to provide oversight to the restructuring process.

Formulate a Plan

Key considerations:

- Early intervention to restructure and communication with stakeholders is key
- Think flexibly to deal with uncertainties
- Fallback planning
- Determine a sustainable level of debt

Debt Restructuring Options

There are a few debt restructuring options to help generate or preserve cash, generally falling within the following considerations:

- Reschedule debt or amend other terms
- Raise new finance on better terms
- Write off or convert debt to equity

Aim:

- Identify the relevant options available to the business, based on existing financial position and forecasted financing needs.

Debt Restructuring Options

Various debt restructuring options include:

- Interest waiver / haircuts
- Payment holidays / rescheduling / term extensions
- Refinancing / new bond issue
- Bridge or debtor in possession loan
- Debt to equity swap
- Securitisation of receivables
- Sale and leaseback of assets

Granting securities over assets

A debtor may seek to alleviate financial difficulty and raise funds to service outstanding debt by:

•negotiating new loan or margin facilities with new or existing lenders; and/or
•negotiating with existing lenders to increase their commitments.

Typically, a creditor would likely require:

•the creation or addition of new or further security over assets of the debtor; and/or
•renegotiation of terms of any existing security package/arrangements, such as adjustment of loan-to-value ratios, if any.

Determining which assets to pledge/charge as security

Where secured financing is considered a feasible option, the debtor would need to determine *which* assets could be used to provide additional security to, and may potentially be acceptable, to the lender.

Some non-exhaustive factors to be considered include, *inter alia*:

(i) whether the creation of new security would result in a breach of existing contractual undertakings

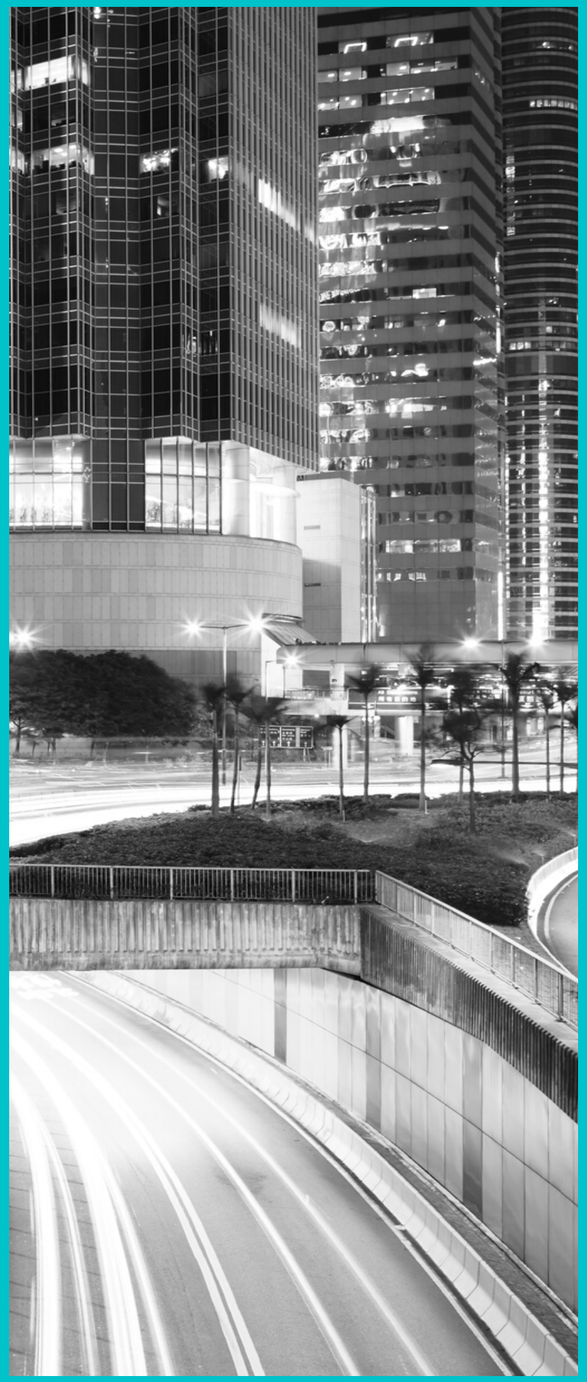
(ii) whether the creation of new security may materially impair its future capital raising capability

(iii) the implications of potentially losing control of the assets being pledged/charged to the business and operations of the debtor/debtor group

(iv) possible alternatives to creating security over unencumbered assets:

- create security over proceeds of the loan or existing credit support from affiliates
- contractual subordination of security over secured assets

(iv) for listed issuers, any legal or regulatory implications (to be discussed in webinar 3)



Forms of security over assets

I. For **Immovable property**: common forms of security include legal mortgage, equitable mortgage and fixed charges

II. For **Movable property**: common forms of security include mortgages, fixed charges and floating charges.

Immovable property / real estate (land and buildings)

•typically taken by way of legal mortgage, which involves a transfer of title with a right of the mortgagor's equity of redemption

•mortgagor is typically permitted to continue to occupy the property

•formalities include execution of a conveyance deed as well as registration with the Companies Registry (if the land is owned by a Hong Kong registered company) and Land Registry within one month of creation of security

Tangible movable property (office equipment, inventories, aircraft and vessels etc.)

•typically taken by way of:

- legal mortgage
- floating charge, which crystalises into a fixed charge upon occurrence of certain pre-agreed events

•these forms of security permit the debtor to continue to use and deal with the property

•formalities include: entering into mortgage/charge; and filing of mortgage/charge with the Companies Registry, or other applicable other registries (such as the Shipping Registry of the Marine Department in respect of a mortgage over registered ships and vessels)

Equity and debt securities

- typically taken by way of:
  - mortgage
    - for unlisted companies only, unless shares are not in CCASS
    - the mortgagor must transfer legal title to shares which is then recorded in the register of members of the company
  - charge
    - the legal title is retained with the charger

- delivered for perfection of security:
  - share certificates
  - pre-executed but undated instruments of transfer, bought and sold notes, irrevocable proxy, undertakings and written resolutions (and in some cases, directors resignation letter) to effect a transfer of shares are delivered

Equity and debt securities (cont')

- for *listed shares* (the share certificates of which are deposited into CCASS), security would typically be created by:

  - charging shares in the securities account together with a notice to the broker
  - arranging shares to be transferred to securities account of the chargee or its nominee

- for *thinly capitalised special purpose vehicle (SPV)* set up to hold certain of the debtor's assets, consider whether intra-group loans advanced by the debtor to the SPV would need to be subordinated to the loans being advanced, or security taken thereon, by the lender

Claims and receivables (cash deposits, trade receivables, rights of payments under contracts/ insurance proceeds etc.)

•security typically taken by way of:

▪fixed charge

- if chargee does not have control over the proceeds of debt, then it would be a floating charge until crystalisation

▪assignment

- which gives the assignee the right to take action against the debtor without joining the assignor
- a statutory assignment of rights to debt deemed effectual in law *provided that notice in writing has been given* to the relevant debtor or other persons from whom the assignor would have been entitled to receive or claim the relevant debtor. Therefore, a creation of a charge is preferred where giving written notice is not desirable

•formalities for perfecting security: registration with the Companies Registry *(NB: charge over cash deposits does not qualify as book debts and is not registrable)*

Intellectual property (trade marks, designs, patents etc.)

•security taken by:

- mortgage
- fixed or floating charge

•formalities for perfecting security:

- registration with the Companies Registry
- registration with relevant registry of the Intellectual Property Department (i.e. Trade Mark Registry, Patents Registry or Designs Registry)

Which assets to be offered as security and what form?

Both legal and commercial considerations should be taken into account.
For example:

A. complexity and formality involved in creating security over assets in foreign jurisdictions (e.g. notarization or certificate requirements and applicable requirements concerning creation of charge over real property)

B.feasibility and commercial implications of sending of written notices to counterparties (such as banks, brokers, customers and clients) involved in creation of security by way of assignment

Lender due diligence and syndication

•*lender due diligence*: conducting of legal and financial due diligence as well as issuance of legal opinions (concerning, *inter alia, the* good standing of the borrower, ownership and title over relevant assets, absence of restrictions imposed by constitutional documents on creation of security, fulfilment of legal requirements for perfection of security etc.)

•*syndication:* where there is more than one lender, then it would be preferable for syndication of loans as well as security (to be managed by a security agent in many cases) to facilitate the performance of the relevant loan documentation and security arrangements

Capitalisation of the company

•sometimes financial difficulties arise as capitalisation of the company does not support the operational growth of the business (for example, where the company is attempting to fund long-term assets with short-term sources of financing)

•where a company in financial distress has a reasonable prospect of being sustainable, it may consider seeking investments from existing shareholders or third parties (in particular, from firms which specialise in investing in distressed assets)

Considerations for equity investors of distressed companies

•events on the horizon which may change the nature or increase the value of the investee company

•strategy for cashing out (e.g. earning of capital gains from re-pricing upon exit, or exercise of put options granted etc.)

•heightened risks involved in the investment in a distressed company and associated costs and tradeoff given scarce resources

• if the investor is in the same industry:

- whether they can benefit from mutual cooperation negotiated on favorable terms
- whether they can acquire access over valuable assets
- whether they can consolidate market share (i.e. sometimes opportunistic or predatory in nature)

Prospective investors

Potential investors may include:

•persons/entities the company are familiar with (such as existing shareholders, creditors, suppliers or customers), and

•investment banks, financial advisers and private equity funds who may be interested in investing themselves or may assist in placing securities of the company to other investors

The company should have a clear understanding of the investment objectives of the investors i.e. whether:

•they would merely be *passive investors* seeking financial returns (require information access, participation in matters which affect interest etc.)

•they would have *strong views* of the business operations or vision of the company (i.e. request participation in or overhaul of management and operations, reorganisation and other terms and conditions linked to investments)

Raising funds from existing shareholders

•quite often the first choice to seek capital for a company in financial distress

•typically does not require material due diligence to be carried out vis-à-vis raising fund from third parties (unless the company is a public or listed company with sufficient analysts coverage, or securities of the company are already part of an investment platform which has conducted operational due diligence)

Some common methods:

I. Rights issue

II. Seeking shareholders' loan from existing shareholders

Rights issue

•an offer by way of rights to existing shareholders which gives right to subscribe securities *pro rata* in proportion to their shareholdings

•no shareholders' approval is required

•no prospectus is required to be registered in Hong Kong and no authorisation from the SFC is required

•formalities:
- board meeting/written resolutions to approve rights issue
- circulation of rights issue document (offer and acceptance forms)
- tendering of acceptance letters and subscription forms by accepting shareholders
- submission of return of allotment by the company in respect of the allotment
- issuance of share certificates and updating of register of members

Seeking shareholders' loan from existing shareholders

•straight loans, secured loans or convertible loans from existing shareholders based on agreed terms

•*however,* company would have accrued more repayable debt (i.e. no improvement in financial position)

•if the debt is unsecured, the loans are junior debts ranked in lower priority of distribution in case of a liquidation

•*tax implications*: interest income for the shareholder and any waiver of shareholders loan would be taxable in Hong Kong

•formalities:
- board meeting/written resolutions to approve the shareholders loan
- execution of loan and security documents
- registration of charge and updating register of charge (if applicable)

Capital raising from third parties

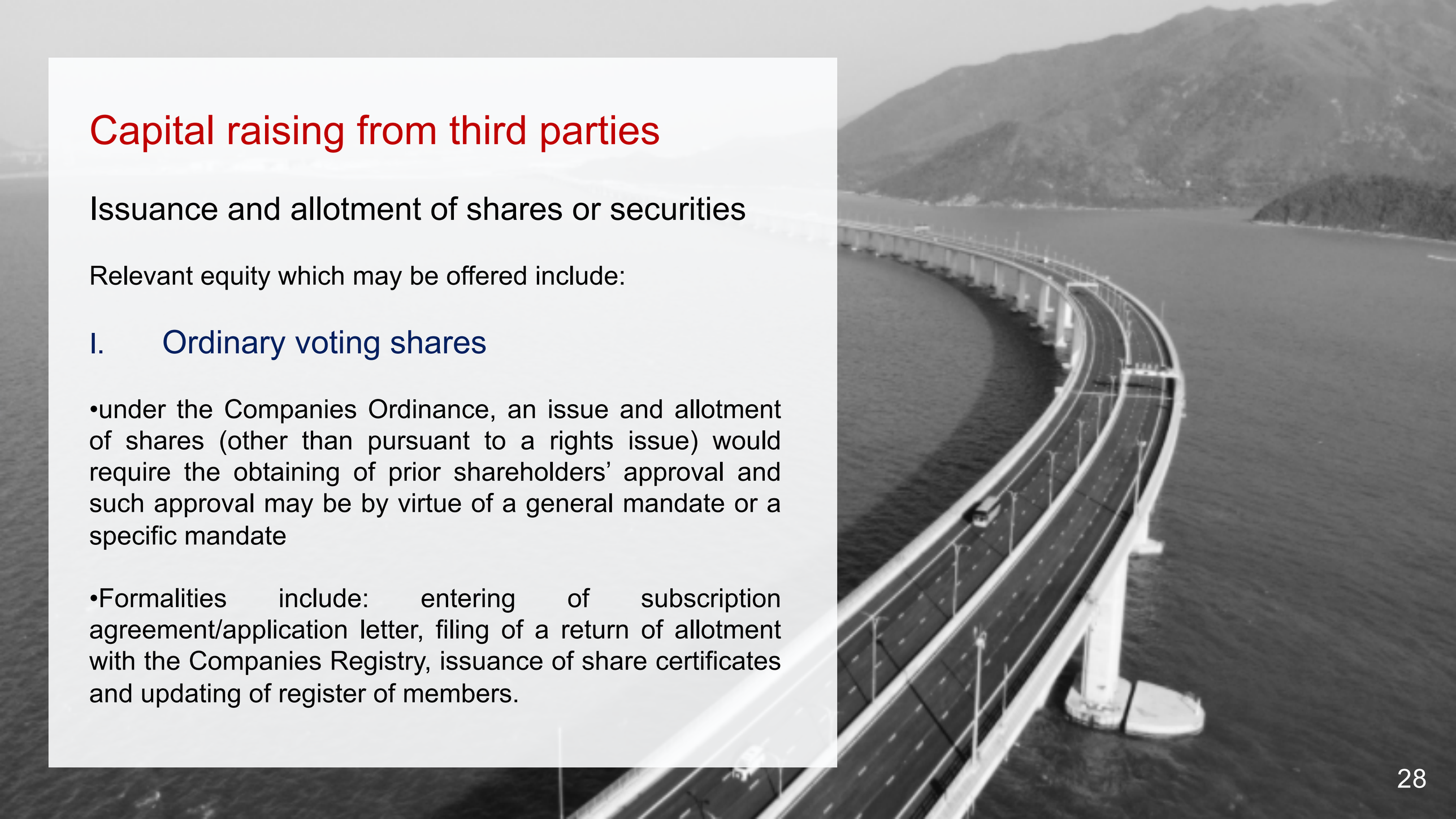
Issuance and allotment of shares or securities

Relevant equity which may be offered include:

I. Ordinary voting shares

•under the Companies Ordinance, an issue and allotment of shares (other than pursuant to a rights issue) would require the obtaining of prior shareholders' approval and such approval may be by virtue of a general mandate or a specific mandate

•Formalities include: entering of subscription agreement/application letter, filing of a return of allotment with the Companies Registry, issuance of share certificates and updating of register of members.



II. Preference shares

- carry a preferential right to dividends and/or distributions in a liquidation ranking ahead of ordinary shares

- depending on specific terms negotiated:

  - holders may enjoy other rights not available to holders of ordinary shares (e.g. right to appoint directors, information access rights etc.)
  - holders may or may not enjoy voting rights
  - may be redeemed by the company or converted into ordinary shares by the holders at a later date

- where no existing preference share class, or a new preference share class with different rights is required, then amendment of the articles of association approved by shareholders and filings to the Companies Registry would be necessary

III. Convertible bonds

•debt instruments issued by a company which can carry an option for the bonds (exercisable by the bond holder or the company upon the occurrence of certain events) to be converted into shares of a company at an agreed price

•particularly attractive instrument for investors as gives the investor:

1.a fixed rate of return (*debt component*): fixed rate coupon and return of capital upon maturity

2.an embedded equity call option (*equity component*): equity upside potential in the ordinary shares of the company

3.preference ranking ahead of ordinary and preference shares in a liquidation of the company.

Benefits to the company

•investors typically accept a lower interest rate than plain vanilla bonds given the added value of the option (or optionality)

•the company would not be required to repay its borrowings upon exercise of the embedded option

•early redemption rights may be negotiated to bring an end to giving up of control of shares (typically at a premium however to compensate the investor).

However, the forward selling of ordinary shares which may lead to dilution of existing shareholders' stake may put pressure on the company's share price and impair future capital raising

Key terms of convertible bond

I. Credit protection

- negative pledge against the carrying out of certain activities
- acceleration of repayment upon certain events of default (such as failure to pay coupon)

II. Mechanisms to protect the equity call option's value

- adjustments to conversion price in the event of capital reorganisations, dividend payments, distributions of cash or non-cash assets to shareholders or further issuance of shares at an undervalue
- optionality adjustments

Formalities involved in an issuance of convertible bond include:

•entering into of convertible bond instrument
•obtaining of board and shareholders' meeting to approve the allotment of convertible bonds as well as the shares to be issued and allotted upon exercise
•filing of return of allotment of debentures to the Companies Registry and further filings of return of allotment of shares upon exercise of embedded equity option

In all of the above capital raising options, the company should review its existing contractual undertakings binding on it when considering the method of raising capital

Adjustment to dividend policies or undertakings for retention of capital

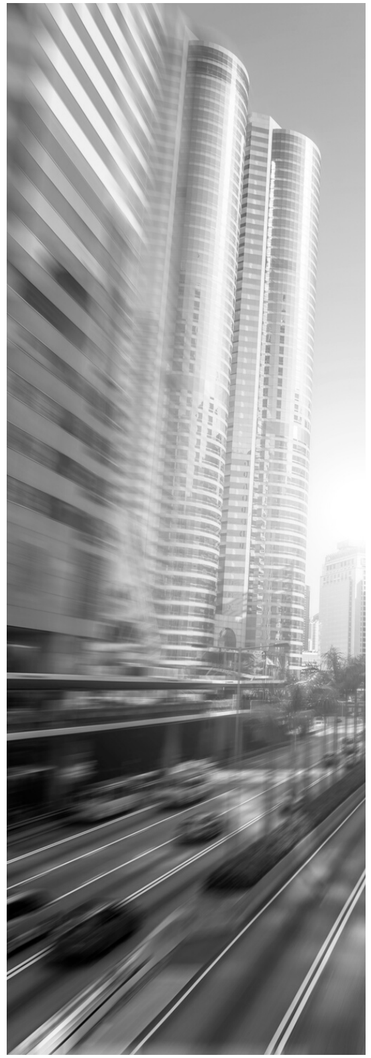
•dividend policies entrenched in articles of association of company or provisions in shareholders' agreement binding on company may payment of dividends based on a predetermined pay-out ratios

•such binding obligations makes any debt restructuring or fund raising of the company unappealing as capital contributed or any latitude granted are not retained or utilised to ensure the sustainability or future profitability of the business of the company

•*Therefore,* necessary for any restructuring proposals to include a *moratorium on dividend payments*. This may involve:

(i) the passing of special resolutions to make amendment to the articles of association of the company if the relevant dividend payments are entrenched in its articles

(ii) the obtaining of waiver of rights to dividend payments if the relevant rights are contained in shareholders or joint venture agreements



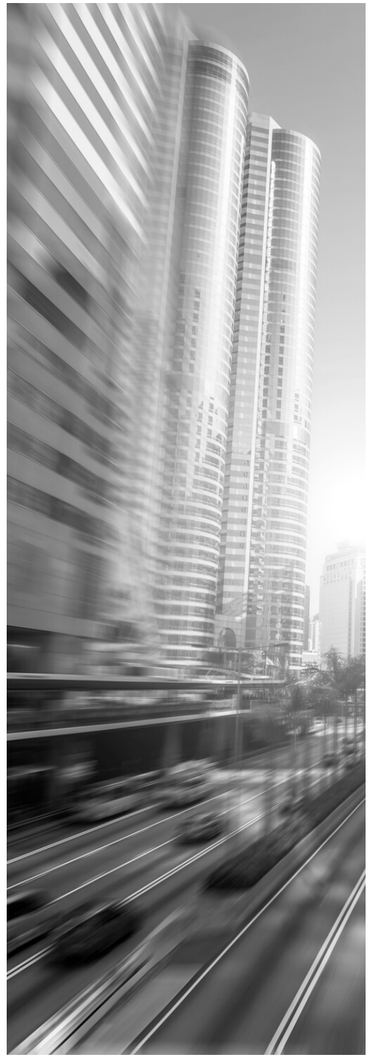
Pre-empting necessity to adjust dividend policies or payouts

•declaration of dividends would only be permissible in compliance with applicable laws

•Companies Ordinance require that distributions may *only* be made out of distributable profits, and not out of capital

▪distributable profits mean accumulated and realised profits (including profits arising from revaluation of assets and financial instruments) which has not been utilised under relevant accounting principles, *less* any accumulated and relised losses which has not been written off

•as such, distribution of dividends would naturally be restricted in the event a company is in financial distress due to accumulation of material loss or otherwise



Pre-empting necessity to adjust dividend policies or payouts

•dividend policies should specify that any decision to declare dividends should be subject to directors' discretion in the exercise of their fiduciary duties and duties of care and diligence

•the dividend policies may state clearly that in determining whether to make any dividends, the directors are empowered to consider:

- the company's immediate cash flow implications
- continuing ability to pay its debts as they fall due
- capital commitments/expenditures (which may be important for the implementation of its strategy and future development)
- any other factors which the board may deemed to be relevant

Court-Assisted Restructuring

Within a legal framework and statutory process, the advantages are:

- Moratorium
- Majority to bind minority creditors
- Shareholders' consent not required
- Provides transparent forum for multi-party negotiations
- Fewer chances of lender liability actions
- Less risk for directors re insolvent trading
- Recognition by foreign courts

Corporate Rescue in Hong Kong

- No tailor-made statutory corporate rescue mechanism, despite there being discussions over the past 20 years for implementing a new statutory procedure, Provisional Supervision, specific for corporate rescue

- Much needed: Allow viable businesses facing short term financial difficulty to have a grace period “moratorium,” and a more timely/less costly statutory framework to restructure their business and debts (or seek a white knight)

Corporate Rescue in Hong Kong

Current Solution for HK Companies:

- Only way of binding dissenting creditor is by way of a **scheme of arrangement**, Part 13 of the CO.
- Usually before a scheme for the purposes of restructuring of financially distressed companies is considered, provisional liquidators would have already been appointed to the company pursuant to section 193 of the C(WUMP)O on the backdrop of a winding up petition against the company having been filed and there is a risk of asset dissipation before the winding up hearing.

Once appointed, provisional liquidators may be granted powers to explore corporate rescue options, that are then implemented via a scheme of arrangement

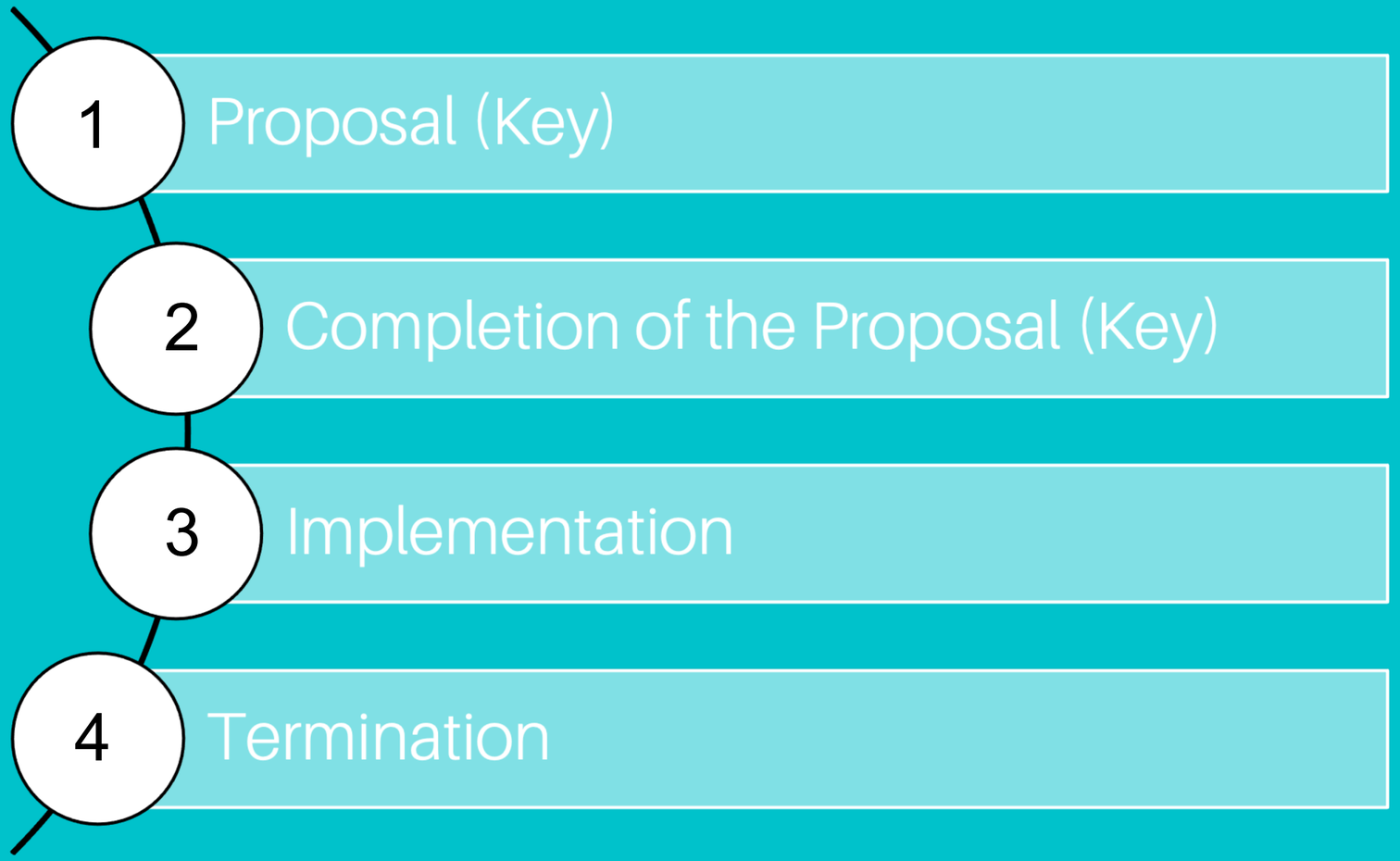
Schemes of Arrangement

Legal requirements and practical considerations:

- A statutory procedure where a company makes an arrangement with its members or creditors
- Unanimity of creditor support not required
- Binding on all creditors if voted on and accepted by all the various classes of the company's creditors
- Threshold: >50% in number and >75% in value of each class
- Court approval (i) to hold meeting (ii) to sanction scheme once voted by creditors

Schemes of Arrangement

4-stage process



Stage 1: Formulate Proposal

- With assistance of professional advisors (insolvency and legal practitioners), put together a proposal to be presented to its creditors and shareholders.

- The proposal should seek to compromise debts with a view to the business continuing to operate (often under new ownership)

- Creditors prepared to accept less than amount they are owed, in full and final settlement of their claim against the company, on the premise that the compromise would yield a better return than the alternative scenario of the company's liquidation.

Stage 2: Completing the Proposal

Proposal Document contains:

- Background of the company's affairs leading to current difficulties;
- Statutory information and accounting history of the company;
- Proposals for resolving its financial difficulties (including any change in control of the company);
- Terms and conditions governing the operation of the scheme, creditors' classes, issues relating to the meetings of creditors and shareholders, and distributions ie nuts and bolts of how the scheme will work.

Ie must properly and fairly explain the reasons and purposes behind the scheme and contains all the necessary provisions to enable the scheme to proceed.

Stage 2: Completing the Proposal

- Obtain agreement of the court on the Proposal Document and to hold meetings of the respective classes of creditors and shareholders
- Send Proposal Document to creditors and shareholders with the notices of meetings
- Present proposal to shareholders and creditors at **the approved class meetings** for voting. Threshold to approve: >50% in number and >75% in value at every class meeting

This process ensures that shareholders and creditors are provided with all the necessary information to enable them to make an informed decision on whether to accept or reject the proposal

Stage 2: Completing the Proposal

Principle of classes:

- Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings.
- Test: similarity or dissimilarity of legal rights against the company.
- The fact that individuals may hold divergent views based on their private interest not derived from their legal rights against the company is not a ground for calling separate meetings.

The question is whether the rights to be released/varied/given under the scheme are so different that the scheme must be treated as a compromise or arrangement with more than one class

Stage 2: Completing the Proposal

Sanction Hearing

- Not a rubber stamp
- Court considers whether the necessary statutory requirements have been met, in particular:
  - Whether classes of creditors properly construed;
  - Be satisfied that each class has been fairly represented and has voted bona fide in the genuine interests of the class (no coercion for members of a particular class to vote a particular way); and
  - That there were no irregularities at the scheme meeting.

Stage 3 and 4: Implementation and Termination

- File court order arising from the sanction hearing with the Registrar of Companies to achieve the final approval of the scheme
- Scheme administrator implements the provisions of the scheme
- Once the scheme is implemented and completed, the scheme administrator will file a notice with the Registrar of Companies stating that the scheme has been concluded

Schemes of Arrangement

Pros:

- Only statutory mechanism available to bind dissenting creditor

Cons:

- No moratorium (encourages strategic behaviour by small individual creditors against the best interests of the general body of creditors)
- Separate approval by each different classes of creditors – what is a class needs to be carefully defined (provoked considerable litigation in the past)
- Substantially court driven, takes several months and costly. (A company needs to be of a certain critical mass before it is cost effective to consider a scheme)



HK Companies: Use of Provisional Liquidation to Effect Corporate Rescue

Relationship between provisional liquidation and proposed restructuring:

- Section 186 of C(WUMP)O: no action or proceeding shall be proceeded with or commenced against the company once placed in provisional liquidation except by leave of the court
- It achieves a “de facto moratorium” to allow the company breathing space to formulate a restructuring proposal to present to creditors
- Prevents any individual creditor from acting against the interests of creditors as a whole



HK Companies: Use of Provisional Liquidation to Effect Corporate Rescue

Requirements and considerations:

- Winding up petition on foot (presented by creditor)
- Company is insolvent
- Degree of urgency
- Risk of dissipation of assets
- No winding-up order has been made

PLs cannot be appointed by the company solely for corporate rescue in HK. The sole purpose of contemplating a restructuring does not fall within the intention of s193 of C(WUMP)O

HK Companies: Use of Provisional Liquidation to Effect Corporate Rescue

Proposed legislative amendments to s193(1) of C(WUMP)O:

"The court may appoint a liquidator provisionally at any time after the presentation of a winding-up petition and before the making of a winding up order in respect of a company, on such grounds as the court thinks fit, **including on the grounds that the company intends to present a compromise or arrangement to its creditors**."

Further proposed: the court should be able to make a PL order upon an application by a company's directors

Offshore Companies: “Light-touch” Provisional Liquidator

Provisional liquidation as a tool for corporate rescue is explicitly allowed in offshore jurisdictions (Cayman Islands, Bermuda, etc.)

Reciprocal recognition in HK (Letter of Request)

Moratorium on creditor actions in place in both place of incorporation and HK

Offshore Companies: “Light-Touch” Provisional Liquidator

Process and Requirements:

- Application to the court in the relevant offshore jurisdiction by the company for light-touch PLs to be appointed
- Obtain recognition of the PLs’ appointment in HK via a Letter of Request from the offshore court. Decisions from the Hong Kong Court indicate that the court does have jurisdiction at common law to recognise the powers and assist the work of an offshore light-touch PL in HK

Powers and duties:

- Light-touch PLs are granted with limited powers necessary to contemplate a restructuring plan on appointment
- The directors remain in day-to-day control of the affairs of the company

Liquidation: Modes and Procedures

Solvent Companies – business having fulfilled its purpose (members control)

Option 1: Deregistration (Part 15, Div 2 of CO)

- Does not incur professional fees
- Criteria:
  - All members agree to the deregistration
  - Company has not carried on any business during the three months immediately before the application
  - Company's assets do not consist of any immovable property situate in HK
- Process:
  - Must wait for tax liability to be crystallised and settled from surplus cash
  - Distribute remaining cash amongst the shareholders
  - Application to the Companies Registrar in specified the form accompanied by the prescribed fee and tax clearance

  The Registrar may deregister the company if no objection to the deregistration is received within three months of Registrar's Gazette notice
- Time frame: approx. 9-12 months

Liquidation: Modes and Procedures

Solvent Companies – business having fulfilled its purpose (members control)

Option 2: Members' Voluntary Winding Up (Part V, Div 3, Subdivisions 4 of C(WUMP)O)

- Engage an independent professional (usually accountants or lawyers) to take on the role as a liquidator to wind up the affairs of the company
- Winding up and appointment of liquidators effected by the passing of a shareholder's resolution + directors' declaration of solvency
- Process—key tasks for liquidator to attend to:
  - Deal with any remaining assets
  - Call for creditors to come forward by claims bar date (usually 1 month), adjudicate and pay off any creditors with valid claims, including the IRD
  - Obtain tax clearance
  - Distribute any surplus assets to shareholders
  - Attend to various statutory filings with the Companies Registrar, including
- Professional fees and expenses of the liquidation: to be agreed with the company and paid as a fixed fee before commencement of liquidation
- Time frame: approx. 7-12 months

Liquidation: Modes and Procedures

Insolvent Companies (creditor control)

Option 1: Creditors' Voluntary Winding Up (Part V, Div 3, Subdiv 5 of C(WUMP)O)

- Winding up effected by the passing of a shareholders' resolution
- Appointment of liquidators to be approved by creditors at the first meeting (usually held on the same day but within 14 days of shareholders' resolution)
- Process: key tasks for liquidator to attend to:
  - Investigate, take control of and liquidate the company's assets
  - Call for creditors to come forward by claims bar date and adjudicate claims
  - Keep creditors abreast on the progress of the liquidation, including holding of creditors or creditor committee meetings
  - Distribute proceeds from asset realisations (net of liquidators' fees and expenses) in accordance with the statutory priority distributions as set out in section 265 of C(WUMP)O.
- Professional fees and expenses of the liquidation are to be paid out of the assets of the company in priority to all other claims (s256 of C(WUMP)O)
- Time frame: approx. 9-12+ months depending on size and complexity

Liquidation: Modes and Procedures

Insolvent Companies (creditor control)

Option 2: Court Liquidation (Part V, Div 2 of C(WUMP)O)

- Process to commence winding up:
  - Petition to the court by either the company, creditor or shareholder, under the circumstances as specified under s177, including the company being unable to pay its debts (definition per s178)
  - Should there be a risk of assets dissipation prior to the winding up hearing, the court may appoint a provisional liquidator with limited powers to preserve the company's assets until a liquidator is appointed (should the winding up application be approved and a winding up order made at the winding up hearing, s193)

Liquidation: Modes and Procedures

Insolvent Companies (creditor control)

Option 2: Court Liquidation (Part V, Div 2 of C(WUMP)O)

- Appointment of liquidator upon a winding up order being made at the winding up hearing (s194):
  - Unless a s193 PL has been appointed prior to the hearing, the Official Receiver automatically becomes the PL until such time she appoints another person as PL (assets < HK$200,000) or the liquidator is appointed
  - The PL shall then summon separate meetings of shareholders and creditors for the purpose of determining whether an application is to be made to the court for appointing a liquidator
  - If the creditors/shareholders do not pass a resolution or if there is a difference in determinations at the meetings, the court shall decide and make such order as the court may think fit
  - Where the official receiver is the liquidator, he may at any time apply to the court for the appointment of a person as a liquidator in his place

Where a winding-up order has been made or where a PL has been appointed, the liquidator/PL shall take into his custody and control, all property of the company (s197)

Liquidation: Modes and Procedures

Powers and duties of the liquidator (s199):

- Without court's sanction (Part 3 of Schedule 25), including:
  - Appoint an agent or solicitor to assist in performing his/her duties
  - Sell the real and personal property and things in action of the company, with power to transfer such property to any person or company
  - Do all other things as may be necessary for winding up the affairs of the company and distributing its assets
- Only with court's sanction (Part 1 and 2 of Schedule 25), includes:
  - Pay a class of creditors in full
  - Make a compromise or arrangement with creditors or persons having or alleging to have any claim against the company
  - Bring or defend any action or other legal proceedings in the name and on behalf of the company
  - Carry on the business of the company so far as may be necessary for its beneficial winding up

The liquidator shall have regard any directions that may be given by resolution of the creditors, members at any general meeting or by the committee of inspection, and may apply to the court for directions in relation to any particular matter arising under the winding up (s200)

Liquidation: Modes and Procedures

s256 and s265 Priority Distributions, broadly summarised as follows:

1.First, all costs, charges and expenses properly incurred in the winding up
2.Second, employees:

- Outstanding wages and salaries, including any payment from the Protection of Wages on Insolvency Fund (not exceeding HK$3,000 per employs)
- Severance payment payable under the Employment Ordinance (not exceeding HK$6,000 per employee)
- Long service leave payment payable under the EO (not exceeding HK$8,000 per employee)
- Employee compensation under the Employee's Compensation Ordinance accrued
- Wages in lieu of notice (not exceeding the lesser of one month's wages or HK$2,000 per employee)
- All accrued holiday remuneration payable on termination
- Any unpaid contributions (MPF)

3.Third, all statutory debts due to the Government