Corporate Rescue: The Need for Legislation in Hong Kong

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There are no corporate rescue provisions in Hong Kong, except those which allow a scheme of arrangement[1]. Unfortunately, there is no moratorium on the company's debts while a company explores such a scheme, and seeks the court's sanction for it.

It had been thought that the courts could overcome this difficulty, by utilising the procedure for the appointment of a provisional liquidator as a vehicle for corporate rescue. A provisional liquidator can only be appointed once a winding up petition has been presented[2] – the presentation of which results in a statutory moratorium[3]. This would, it was thought, facilitate a rescue, by allowing provisional liquidators to work out rescue proposals, with a view to dismissing the petition once the proposals had been agreed[4].

A recent Court of Appeal case, *Legend International Resorts Ltd*[5], has, however, rejected such thinking in Hong Kong. While the decision is disappointing, it would be preferable if legislation could be introduced to address the issue[6]. This could easily be modelled on the procedure for administration orders in England & Wales. That allows for the rehabilitation of a company (but not an insurance company), with the benefit of a moratorium.

Provisional Liquidators

Although not stipulated in the legislation, courts have traditionally held that a provisional liquidator may be appointed if the assets of a company are in jeopardy or those in control are misappropriating or wasting them. As explained below, that approach has evolved in England.

Appointing a Provisional Liquidator – the Position in England

In England, the potential for provisional liquidation to be used as a vehicle for corporate rescue has been explored and endorsed. Palmer mentions *"the relative speed with which the procedure can be initiated, combined with the benefits of an automatic moratorium..., [which] can in certain cases be utilised to facilitate the rescue of a financially troubled company, where such alternatives as administration or administrative receivership may not be available..."*[7]. In England, those alternatives are not available for insurance companies. In Hong Kong, they are not available for any type of company, *"whatever the nature of their business"*[8]. Palmer continues, *"If [the provisional liquidators] are successful in restoring the company to viability, the order of appointment can be discharged, and no winding up need take place. The courts have been supportive of such creative use of the procedure, and have been prepared to adapt other principles of insolvency law to meet the needs of emerging practice"*[9].

> *"In Hong Kong, the appointment of provisional liquidators is restricted to cases where the company is insolvent and its assets are in jeopardy, and is not to be used 'solely' to enable a corporate rescue."*

Palmer cites *Smith -v- UIC Insurance*[10]. The head note mentions *"the newly emerging process of resolving the affairs of insolvent companies by an imaginative use of provisional liquidators (the use of administration not being available to insurance companies) and there was no good reason why those principles should not apply in the particular facts of this case"*[11]. The emphasis is on *"resolving the affairs of insolvent companies"*, where *"the use of administration [was] not...available"*; and not upon insurance companies.

In *Smith*, the court cited the relevant legislation, that *"the court may, at any time after the presentation of a winding up petition, appoint a liquidator provisionally"*[12], and recognised that appointments had, historically, only been made *"by way of a temporary and often an urgent appointment, for the purpose of preserving the assets...pending the completion of the winding up proceedings"*[13]. That did not, however, preclude that which Palmer has since described as the *"creative use of the procedure"*, in what the court in *Smith* called a *"novel"* situation[14]. In that case, the petitioners had *"no present intention to seek a formal winding up order at any stage"*[15]. While none had then been drafted, the provisional liquidators intended to prepare and seek approval for a scheme of arrangement, and, if it was implemented and approved, then to apply to court to dismiss the petition[16].

Gore-Browne also cites *Smith*, when stating that *"There may be other circumstances justifying the appointment of a provisional liquidator [besides preserving the status quo pending the hearing of the petition by the court], and the court's power is not limited"*[17].

Appointing a Provisional Liquidator - Rejection as a Panacea to Corporate Rescue in Hong Kong

It is disappointing that the Court of Appeal in *Legend* considered that there were limits on its powers, and rejected

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1 *Companies Ordinance, Section 166. Unless indicated otherwise, references in this article to any section(s) are to section(s) in the Hong Kong Companies Ordinance*

2 *Sections 192 and 193 refer*

3 *Once a provisional liquidator has been appointed, section 186 states that "no action or proceeding shall be proceeded with or commenced against the company except by leave of the court and subject to such terms as the court may impose".*

4 *See, for example, Legend International Resorts Ltd [2006] 2 HKLRD 192, paragraph 32 – rejecting the first instance judgment that "it is within the jurisdiction of the Court to appoint provisional liquidators to explore, formulate and pursue a corporate rescue".*

5 *Ibid*

6 *The Court of Appeal referred to Law Reform Commission Recommendations dating back to 1996, that recommended the introduction of a law to enable corporate rescues to take place, but said "whether a law should be introduced remains a matter of policy for the administration and the legislature" (paragraphs 33 and 34, ibid)*

7 *Palmer's Company Law, paragraph 15.240.1.*

8 *Re HIH Insurance (Asia) Ltd (HCCW 337-340/2001, 21 December 2001, unreported), paragraph 23*

9 *Palmer's Company Law, paragraph 15.240.1.*

10 *[2001] BCC 11*

11 *Ibid, page 12B and se page 20H et seq*

12 *Ibid, page 20B, and Insolvency Act, 1986 section 135*

13 *Ibid, page 20E*

14 *Ibid, page 22G*

15 *Ibid, page 13C*

16 *Ibid, page 13C*

17 *Gore-Browne on Companies, paragraph 56[17]*

the proposition that the procedure for the appointment of provisional liquidators could be used as a vehicle for corporate rescue. The court concluded that there was no clear statutory authority to allow it so to act in Hong Kong, and stated that "*it is not the function of the court to legislate*"[18].

The court referred, inter alia, to Section 192. This states:

> *"For the purpose of conducting the proceedings in winding up a company ... the court may appoint a liquidator or liquidators, provisionally or otherwise... ".*

The court also referred to section 193(1) – "*the court can appoint a liquidator provisionally at any time after the presentation of a petition*"[19]. This is similar to the legislation cited in *Smith*.

The court noted the "*traditional basis*"[20] for the appointment of provisional liquidators (insolvent, assets in jeopardy). It also referred to the "*practice [that has developed] in England that provisional liquidators could be appointed in respect of insurance companies even if it could not be shown that there was jeopardy to the assets*"[21].

While it did not refer, directly, to *Smith* (or to Palmer and Gore-Browne), the court said "*the reason for the development of that practice lay in the fact that the insurance policies themselves might have otherwise lapsed*"[22]. Unfortunately, it did not consider that the jurisdiction arises because "*administration or administrative receivership may not be available*" – then to be exercised for the reasons given, on the merits of the particular application. This had been addressed by the judge at first instance[23]. She referred to the *HIH* case, where that "*practice*" had been applied in relation to an insurance company in Hong Kong, and concluded that other types of company could also benefit from such an approach[24].

The court did not suggest that the English courts lacked jurisdiction to develop this practice, or criticise it per se. In any event, there is no distinction in the legislation, in relation to the appointment of provisional liquidators, in respect of insurance companies and any other type of company, or between the interests of policy holders and creditors of an insolvent company. In such circumstances, it is difficult to see why insurance companies should be treated any differently to other companies. It is disappointing that the court did not consider this particular aspect of the matter further.

The court nevertheless reviewed a number of earlier Hong Kong cases, including *Re Luen Cheong Tai International Holdings Ltd*[25]. In that case, the Court of Appeal held:

> *"Once it has been established that grounds for the appointment of provisional liquidators exist on the basis that it is likely that a winding-up order would be made, and that circumstances exist which justify the making of the appointment on the basis of the protection of assets, the fact that the applicant for the appointment wishes that the provisional liquidators be granted powers to facilitate a restructuring of the company can be no bar to the appointment and is not intrinsically objectionable"*[26].

Expanding on this, the court concluded that[27]:

> *"The court should not attempt to extend the statutory law, albeit for expediency. The appointment of provisional liquidators is a statutory power given to the court. It is not a common law power which can be extended, as in the case of the development of the law in relation to Mareva injunctions and Anton Piller orders".*

Yet, in *Mareva*[28], Lord Denning had held that the power to grant a freezing injunction was derived from "*the Judicature Act*". There was, therefore, a statutory jurisdiction – albeit one which might not have generally been recognised before that judgement.

Gee also observes that extensions to the Mareva jurisdiction were "*put beyond doubt*" in the Supreme Court Act 1981, and that the jurisdiction to make an Anton Piller order can be justified under statutory provisions[29].

By comparison, in *Legend*, the court held[30] that:

> *"The law on the appointment of provisional liquidators is contained in Section 192...and it is clear on the wording...that the appointment of a provisional liquidator must be for the purposes of the winding-up. Provided that those purposes exist, there is no objection to extra powers being given to the provisional liquidator(s), for example those that would enable the presentation of an application...[for a scheme of arrangement]. There is nevertheless a significant difference between the appointment of provisional liquidators on the basis that the company is insolvent and the assets are in jeopardy and the appointment of the provisional liquidators solely for the purpose of enabling a corporate rescue to take place."*

This may be a difficult line to draw in practice. The court itself recognised that "*the difference may, in most cases, be merely a matter of emphasis*"[31].

The difficulty may be compounded by the fact that the court referred to "*the appointment of a provisional liquidator...for the purposes of* ***the winding-up***", as opposed to the wording in the section, which discusses an appointment *"for the purpose of* ***conducting the proceedings in winding up*** *a company*" (our emphasis):

(a) If a company is insolvent (as in *Smith*[32] and as in *Legend*[33]), and needs a corporate rescue to avoid being wound up, it is difficult to see why that is not something done "*for the purposes of*" resolving the conduct of "*proceedings in winding-up*" – albeit on terms that those proceedings are ultimately dismissed. This protects the creditors' interests; who would presumably get more money.

(b) By contrast, a rescue is not done "*for the purposes of the winding-up*", but, rather, "*for the purposes of avoiding the winding up*"[34]. If that is the case, and a provisional liquidator can only be appointed "*for the purposes of the winding-up*", it is difficult to see, logically, how even "*extra powers*" could ever be given to him to explore rescue proposals. That seems to be more a matter of principle, than of emphasis.

Comment

In Hong Kong, the appointment of provisional liquidators is restricted to cases where the company is insolvent, and its assets are in jeopardy; and is not to be used "*solely*" to enable a corporate rescue.

It would be preferable if the legislature in Hong Kong could address this issue, by introducing a procedure for administration orders (and also considering the position of insurance companies).

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18 *Legend, paragraph 33*
19 *Legend Paragraph 26*
20 *Legend Paragraphs 27-29*
21 *Legend Paragraph 28*
22 *Legend Paragraph 28*
23 *[2005] 3 HKLRD 16, paragraph 77*
24 *[2005] 3 HKLRD 16, paragraphs 77 and 92, and HIH, supra*
25 *[2003] 2 HKLRD 290*
26 *Legend Paragraph 31*
27 *Legend Paragraph 33*
28 *[1975] 2 Lloyd's Law Reports 509*
29 *Steven Gee QC, "Commercial Injunctions", 5th Edition, paragraphs 1.014, 1.019 and 1.039.*
30 *Legend Paragraph 35*
31 *Legend Paragraph 35*
32 *The insurance company had "substantial assets", but was "insolvent in the sense that its outstanding liabilities exceed the amount of those assets - see [2001] BCC 11, 13D*
33 *Legend Paragraph 51*
34 *Legend Paragraph 35*