The suggested answers are published for the purpose of assisting students in their understanding of the possible principles, analysis or arguments that may be identified in each question.
CASE LIST FOR CANDIDATES’ REFERENCE

1. *AG Securities Limited v Vaughan* [1990] 1 AC 417
2. *Agnew v Commissioner of Inland Revenue* [2001] 2 BCLC 188
10. *Income Tax Special Purpose Commissioners v Pemsel* [1891] AC 531
11. *Kensington International Ltd. v Republic of the Congo* [2006] 2 BCLC 296
15. *Snook v London and West Riding Investments Limited* [1967] 2 QB 786
17. *Re Taiwa Land Investment Ltd* [1981] HKLR 197
19. *Re Yorkshire Woolcombers Association Ltd.* [1903] 2 Ch 284
SECTION A

1. A Ltd is listed on the main board of the Stock Exchange of Hong Kong. Last week the board of A Ltd received from B Ltd a letter indicating a firm intention to takeover A Ltd and a formal takeover offer (“the Offer”) which offered a 20% premium over the average market price of A Ltd’s shares over the last five trading days. The board of A Ltd was unanimous in the opinion that the Offer was not in the long-term interests of A Ltd even though the Offer price was too good for the board not to recommend that shareholders accept it. Although the board fully understood that the final fate of the takeover attempt was in the hands of the shareholders, the CEO of A Ltd reminded the board that B Ltd had previously breached a valuable contract with A Ltd and the two companies had not yet arrived at a settlement, so that starting a legal action against B Ltd could signal ‘you-are-not-welcome’ to B Ltd and at the same time get fair compensation for A Ltd. The board resolved to instruct the CEO to withdraw from the negotiation for settlement and prepare a legal action against B Ltd as soon as possible.

Wong was the company secretary of A Ltd. In the evening after the board meeting discussing the Offer, Wong told his wife that he probably could not come home for dinner for the whole week because “the board is considering a very big deal”. His wife shared this information with her father, an experienced stockbroker, who bought substantial shares in A Ltd the next day and made a handsome profit as a result of the surge in share price after the formal announcement of the Offer. Wong did not know what his wife and his father-in-law had done in relation to the Offer.

B Ltd acquired a total of 91% of the shares in A Ltd at the close of the Offer while Lee, the chairman of the board of directors of A Ltd, held the remaining 9%. Lee told B Ltd that he would only sell his shares if he could stay on the board after the takeover. B Ltd unequivocally replied to him that it was their plan to replace the whole board with more competent directors. B Ltd also told Lee that they had evidence proving that he had committed crimes in the US and they would make an application to the court for a disqualification order against him if he refused to sell.

REQUIRED:

1. (a) In relation to the resolution to take legal action against B Ltd, advise the directors of A Ltd on its legal implications under company law and the Code on Takeovers and Mergers.

Ans (a) As a fiduciary, a director owes several fiduciary duties to his company. The facts show that the directors of A Ltd genuinely formed the opinion that the takeover by B Ltd was not in the interests of A Ltd, indicating they formed that opinion in good faith in the interests of A Ltd. In relation to their decision to take legal action against B Ltd in order to discourage their takeover attempt, it is highly arguable that the directors have breached their
duty to exercise powers for proper purposes. Principle 2 of A Guide on Directors’ Duties (published by the Companies Registry in June 2009) accurately summarises the legal position stipulated in the landmark case in Hogg v Cramphorn [1967] Ch 254 and Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821: “A director of a company must exercise his powers for a proper purpose”. This means that he must not exercise his powers for purposes that are different from purposes for which they were conferred. The primary and substantial purpose of the exercise of a director’s powers must be for the benefit of the company. If the primary motive is found to be for some other reasons (e.g., to benefit one or more directors and to gain control of the company), the effects of his exercise of his power may be set aside. This duty can be breached even if he acted in good faith. In the present case, the directors of A Ltd have breached this duty as the major reason for taking legal action against B Ltd is to discourage their takeover attempt.

The directors of A Ltd should also note that under Rule 4 of the Code on Takeovers and Mergers, once a bona fide offer has been communicated to the board of an offeree company (or the board of an offeree company has reason to believe that a bona fide offer may be imminent), no action which could effectively result in an offer being frustrated, or in the shareholders of the offeree company being denied an opportunity to decide on the merits of an offer, shall be taken by the board of the offeree company in relation to the affairs of the company without the approval of the shareholders of the offeree company in general meeting. In view of the legal position under case law and the Code, the board of directors of A Ltd should first seek the approval of their shareholders before initiating legal action against B Ltd.

1. (b) Advise Wong of the legal implications regarding the actions by him, his wife and his father-in-law under the Securities and Futures Ordinance.

Ans (b) The major issue here is whether Wong, his wife, and his father-in-law had taken part in insider dealing in relation to the undisclosed information about the takeover bid by B Ltd.

Under the Securities and Futures Ordinance, insider dealing can take place when, inter alia, a person connected with a listed company who has relevant information in relation to that company (which he knows to be relevant information) deals or counsels or procures another to deal in the shares of that company, knowing or having reasonable cause to believe that such person would deal in them. A connected person is also liable if he discloses relevant information to another person, knowing or believing that that person will make use of the relevant information to deal or counsel or procure another person to deal. It can also take place if a person knowingly receives (directly or indirectly) relevant information from a person whom he knows is a connected person deals in the securities or counsels or procures another person to deal. Information is relevant if, inter alia, it is specific in respect of the company and is not generally known to other potential investors, but if known to them, it would materially affect the price.
of the shares of the company in question. Here it can be argued in favour of Wong and his family members that the message passed down from him to his wife and finally to his father-in-law was not specific enough and thus could not be said to be able to influence the share price materially if made known to the market. Under this premise, no insider dealing action could succeed because the information in question is at best a ‘big tip’ but not relevant information under the Securities and Futures Ordinance.

1. (c) Advise Lee whether he could prevent B Ltd’s attempt to takeover A Ltd.

Ans (c) Under s.168 and the Ninth Schedule of the Companies Ordinance, if B Ltd has, during the period of four months beginning on the date of the offer, acquired not less than 90% in value of the shares for which the offer is made (by virtue of acceptances of the offer or, if the shares are listed on a recognised stock market, by virtue of acceptances of the offer or otherwise), B Ltd may give notice to the holder of any shares to which the offer relates which it has not acquired that it wishes to acquire those shares. Any notice under the Ninth Schedule shall be given in the specified form and in the prescribed manner and not later than five months after the date of the offer; and where such a notice is given to the holder of any shares the transferee company is entitled and bound to acquire those shares on the terms of the offer. Where a notice is given under the Ninth Schedule to the holder of any shares the court may, on an application made by him within two months from the date on which the notice was given, order that the transferee company shall not be entitled and bound to acquire the shares or specify terms of acquisition different from those of the offer. The court may only order otherwise if it is satisfied that the bid is unfair to the general body of shareholders in the target company. The test is one of fairness to the body of shareholders as a whole and not to individual shareholders (Re Grierson, Oldham & Adams Ltd [1968] Ch 17).

1. (d) Advise Lee whether B Ltd could make out a good case for an application for a disqualification order against him.

Ans (d) On application by a member of a company, the court can, in its discretion, make a disqualification order against a director where he is convicted of an indictable offence in connection with the promotion, formation, management or liquidation of a company or in connection with the receivership or management of company’s property, or any other indictable offence his conviction for which necessarily involves a finding that he acted fraudulently or dishonestly (section 168E and section 168P of the Companies Ordinance). The provisions are drafted widely and cover not just actual management of the company provided the offence is committed in connection with its management. It has therefore held to include insider dealing (R v Goodman [1994] 1 BCLC 349). The maximum period of disqualification is 15 years or 10 years if the order is made by the Court of First Instance or the District Court respectively while the relevant period for an order made by a magistrate is 5 years. Since the facts do not indicate
the nature of the offences made by Lee in the United States, more information must be available before Lee can be advised whether B Ltd can make out a good case. Assuming that his criminal records are not indictable in nature but to a substantial degree indicate that Lee may not be fit as a director, B Ltd will not be able to submit an application based on unfitness against him because A Ltd is not in liquidation.
2. Avis plans to set up a charitable social enterprise to promote child care. According to her plan, the enterprise will be a separate entity which will run on business principles and hopefully will be able to make sufficient profit to sustain its operations in the long run. Since it is meant to be a charitable body, Avis hopes that its directors could be subject to fewer legal duties under company law and can claim tax exemptions. Since Avis does not expect this charitable body to break even in the first two to three years of its business, she would prefer not to disclose its accounts to the public because she thinks this may discourage possible donors and sponsors.

REQUIRED:

Advise Avis on what type of company could suit the proposed social enterprise and whether her requirements can be satisfied under Hong Kong law.

Ans

At present, there is no law in Hong Kong regulating the formation and management of charities or charitable organisations as such. A charity can be in the form of a trust or registered as a company under the Companies Ordinance or a society under the Societies Ordinance. Since Avis wants her proposed organisation to be a separate entity, the scope of your advice to her should be accordingly a limited company established under the Companies Ordinance. Avis should note that in Hong Kong many charitable organisations are companies limited by guarantee.

Where it is proved to the satisfaction of the Registrar that an association about to be formed as a limited company is to be formed for promoting commerce, art, science, religion, charity or any other useful object, and intends to apply its profits, if any, or other income in promoting its objects, and to prohibit the payment of any dividend to its members, the Registrar may by licence direct that the association may be registered as a company with limited liability, without the addition of, e.g., if the name of the association is in English, the word ‘Limited’ to its name, and the association may be registered accordingly and shall, on registration, enjoy all the privileges and be subject to all the obligations of limited companies (section 21 of the Companies Ordinance). A charity must be established for public benefit and for purposes which are exclusively charitable according to law.

According to the landmark case *Income Tax Special Purpose Commissioners v Pemsel* [1891] AC 531, charitable purposes are classified into four heads: (a) relief of poverty; (b) advancement of education; (c) advancement of religion; and (d) other purposes of a charitable nature beneficial to the Hong Kong community not falling under heads (a) to (c). Avis can argue that the promotion of child care falls under (d). To claim tax benefits under section 88 of the Inland Revenue Ordinance, (e.g. charitable institutions or trusts of a public character are exempt from tax under the Inland Revenue Ordinance), The Inland Revenue Department's A Tax Guide for Charitable Institutions and Trusts of a Public Character advises...
that the following clauses must be put into the articles of association of the proposed organisation:

a. clause stating precisely and clearly its objects;
b. clause limiting the application of its funds towards the attainment of its stated objects;
c. clause prohibiting distribution of its income and properties amongst its members;
d. clause prohibiting members of its governing body (e.g. directors, trustees, etc.) from receiving remuneration;
e. clause specifying how the assets should be dealt with upon its dissolution (the current practice is that the assets should normally be donated to other charities);
f. clause requiring the keeping of sufficient records of income and expenditure (including donation receipts), proper accounting books and compilation of annual financial statements; and
g. clause excluding the powers set forth in the Seventh Schedule to the Companies Ordinance.

The articles of association of a private company must (a) restrict the right to transfer its shares; and (b) limit the number of its members to 50, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have continued after the determination of that employment to be, members of the company; and (c) prohibit any invitation to the public to subscribe for any shares or debentures of the company. Avis may not be able to keep the accounts of the organization private if she sets it up as a company limited by guarantee which, by definition, is not a private company because the annual return submitted to the Companies Registry every year must contain (a) a copy, certified by a director or the manager or the secretary of the company to be a true copy, of every balance sheet laid before the company in general meeting during the period to which the return relates (including every document required by law to be annexed to the balance sheet); and (b) a copy, certified as aforesaid, of the report of the auditors on, and of the report of the directors accompanying, each such balance sheet (section 109 of the Companies Ordinance).
Alongside his brothers Benny and Calvin, Aaron has served as a director Z Ltd since its incorporation until recently. The three brothers and their mother are equal shareholders of the company. Aaron has fallen out with his brothers and as a result has resigned from the board of directors. Since then Aaron has found that the company’s business performance has deteriorated sharply due to his brothers’ incompetence. He is sure that a contract that the company is going to enter into next month will turn out to be a disaster. Aaron has convinced his mother to side with him not to re-elect Benny and Calvin to the board when they have to step down as required by the articles of association at the next AGM. His mother has also agreed to nominate and elect Aaron to be the sole director of the company. Benny and Calvin are angered by Aaron’s move and have indicated that they will not vote for Aaron. Therefore, it is highly likely that the company will have no director after the AGM.

REQUIRED:

3. (a) Advise Aaron whether he can seek a court order under the unfair prejudice remedy to stop the company from entering into the contract.

Ans (a) Under section 168A of the Companies Ordinance, any member of a company who complains that the affairs of the company are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members (including himself) may make an application to the court. If the court is satisfied that there is a case of unfair prejudice, in order to bring to an end the matters complained of the court may make an order restraining the commission of any such act or the continuance of such conduct (section 168A(2)(a)).

As a shareholder, Aaron may want to argue to the court that the effects of the recent decisions of the board, which are affairs of the company, were prejudicial to the shareholders’ interests, as evidenced by the dismal business results. Aaron should be advised that the existence of corporate affairs causing prejudice to shareholders’ interests, by themselves, is not sufficient to activate the court’s jurisdiction under section 168A because such affairs may not be unfair. In other words, prejudicial acts may not necessarily be unfair. As the court in Re Taiwa Land Investment Ltd [1981] HKLR 197 pointed out: "It seems clear that elements of both unfairness and prejudice must co-exist for the section to come into play. Conduct which is intrinsically prejudicial to the interests of a shareholder, without also being unfair, will not be enough; conversely the section cannot be relied upon if the conduct of which complaint is made is merely unfair."

In an appropriate case it is open to the court to find that serious mismanagement of a company’s business constitutes conduct that is unfairly prejudicial to the interests of minority shareholders (Re Macro (Ipswich) Ltd [1994] 2 BCLC 354). But as a general rule, the court will normally be very reluctant to accept that managerial decisions can amount
to prejudicial conduct, for two reasons. First, there will be cases where there is genuine disagreement between shareholders and directors as to whether a particular decision is commercially sound. The fact that the parties have taken different views is not of itself a proof of unfairness. Secondly, it is a fact that the company’s value will depend on the competence of management. Therefore, “short of a breach by a director of his duty of skill and care there is \textit{prima facie} no unfairness to a shareholder if the quality of the management turning out to be poor” (\textit{Re Elgindata Ltd} [1991] BCLC 959). Aaron will find it very difficult to base his claim only on the bad business result without alleging breach of duty of care by his brothers. Even if the court is convinced by Aaron, there is another technical difficulty that may deny him the injunction he wants to seek. As it is now, it is arguable that section 168A only applies to acts of the company but not its proposed acts. On this Aaron may want to argue that the contract is within the company’s ordinary course of business so that the making of that contract should be seen as part of the existing corporate affairs.

3. (b) Advise Aaron whether he has a case for winding up the company compulsorily if it turns out that no director is appointed at the next AGM.

Ans (b) The common law position is that the managerial power of the board should revert back to the shareholders should the board not be able to perform its functions. However, in this case no camp is able to secure any ordinary resolution as neither holds more than half of the issued shares. There is a clear management deadlock in both the board of directors and general meeting. Aaron may present a winding-up petition under section 177(1)(f) on the grounds that it is just and equitable to wind up the company. Management deadlock is a good ground for the court to exercise its jurisdiction. If the company is left with no directors, Aaron may also make an application to the court for the appointment of a provisional liquidator to take care of the company before the court grants a winding-up order. It is necessary for Aaron to show first that there is a good \textit{prima facie} case for the granting of a winding-up order at the hearing of the petition, and secondly that it is appropriate for a provisional liquidator to be appointed, having regard to the commercial realities, the degree of urgency and need established by the applicant and the balance of convenience in all the circumstances of the case (\textit{Re Five Lakes Investment Co. Ltd} [1985] HKLR 273). Candidates can reasonably conclude that the court should agree to appoint a provisional liquidator to a company without directors to maintain the status quo of the business and protect its assets before the court can make a decision.
Yesterday Dave filed a lawsuit against R Ltd in order to claim compensation on the ground that R Ltd had breached a contract with him. R Ltd is a wholly-owned subsidiary of H Ltd. Soon after the filing of the lawsuit, the board of R Ltd decided to sell all its valuable machines to H Ltd at a discounted value, claiming that the assets were largely obsolete and that R Ltd should switch to a new and more promising business. As an experienced business person in the same industry, Dave knows that these machines are still state of the art. Dave is very angry because R Ltd would have less money to pay him compensation as a result of the sale of the machines.

**REQUIRED:**

Advise Dave whether he can add H Ltd as a co-defendant in the lawsuit against R Ltd. (Base your answers on company law only and ignore any civil procedure implications.)

**Ans**

It is a fundamental principle that a company incorporated under the Companies Ordinance is a separate legal entity (Salomon v Salomon [1897] AC 22). This legal entity has the capacity and the rights, powers and privileges of a natural person (section 5A(1)). The members and the directors are treated as independent and separate from the company and are said to be managing the company in the board room and general meeting behind a corporate veil which the legislature and the courts would not pierce that veil in normal cases. However, the power to pierce the corporate veil can be exercised if the “sham” exception applies.

The court in Kensington International Ltd. v Republic of the Congo [2006] 2 BCLC 296 pointed out that: “The words or phrases which appear in the authorities where ‘piercing’ has taken place and which are used in the context of justifying the court's view, involve an element of impropriety and dishonesty... The decision of the House of Lords in AG Securities Limited v Vaughan [1990] 1 AC 417 establishes that ‘sham’ does have a meaning in law, namely an attempt to disguise the true character (of the agreement) which it was hoped would deceive the court. The classic definition of a ‘sham’ appears in Snook v London and West Riding Investments Limited [1967] 2 QB 786. There Diplock LJ said that, if the word had any meaning in law, it meant "acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create". For that purpose the parties to the acts or documents had to share a common intention that the actual documents were not to create the legal rights and obligations which they gave the appearance of creating."

It must be noted that the court should not pierce the veil to achieve justice. The decision in Creasy v Breachwood Ltd. [1993] BCLC 480 shows that the
power of the court to pierce corporate veil should be exercised to achieve justice was held to be wrong in *Ord v Belhaven Pubs Ltd.* [1998] 2 BCLC 447. The approach which looks to the economic unit, “to disregard the distinction between the legal entities that were involved and then to say: since the company cannot pay, the shareholders who are the people financially interested should be made to pay instead” is radically at odds with the doctrine of corporate personality as explained in *Salomon v Salomon* [1987] AC 22.

Recent cases indicate that *Creasy* should not be relied on to justify the proposition that justice is in itself a separate ground of lifting the corporate veil. The court in *China Ocean Shipping Co. v Mitrans Shipping Co. Ltd.* [1995] 3 HKC 123 held that achievement of justice is a result of the exercise of the power to lift the veil but it is not a separate ground. In deciding whether the power should be exercised, the court should see whether the case could be fitted into the established exceptions to the rule. The court in *China Ocean* declined to follow *Creasy* and stated that that case was not seeking to remove altogether the very narrow confines within which the courts have placed the power to lift the corporate veil.

The court in *The Tjaskemolen* [1997] 2 LLR 465 explained that it was only appropriate to pierce the corporate veil “where special circumstances existed indicating that it was a mere façade concealing the true facts.” While in principle there is no reason why a group could not arrange its corporate affairs in such a way as to minimise cross-liability in advance of such liability being incurred but the legal position may be different “where a group arranges its affairs in such a way as to divest a company within the group of its assets with the purpose and effect of ensuring that they would not be available to meet its existing liabilities, at any rate where the transfer is made to another member of the group at an undervalue. Depending upon the facts, such an agreement is likely to be held to be sham or façade, as those expressions are used in the cases.”

In this case, the company sold the valuable assets at an undervalue to its holding company apparently without good commercial reasons. Assuming that the board of directors of the holding company and that of the company had ‘the common intention’ as described by the court in Kensington, Dave would be able to argue that the transaction in question is an attempt to abuse creditors justifying the court applying the ‘sham’ exception. Therefore, the corporate veil is not just pierced to achieve justice only.
5. Bank A approved a loan to D Ltd which promised to provide a charge on all its present and future accounts receivable (the first charge). The debenture also provided that D Ltd must not sell or charge accounts receivable without consent of Bank A; and that it must deposit proceeds which it may receive in respect of the accounts receivable into a designated account with Bank A. The debenture also stated that D Ltd must not withdraw money from the designated account without the consent of Bank A.

The first charge was created on 1 March 2011 but it has not been registered yet. On 4 May 2011, D Ltd approached Bank B for another loan and offered its accounts receivable to Bank B to create a floating charge (the second charge). Bank B made a loan to D Ltd without knowledge of the first charge, and registered the second charge the next day.

REQUIRED:

5. (a) Explain whether the first charge is a fixed charge or a floating charge

Ans (a) According to Re Yorkshire Woolcombers Association Ltd. [1903] 2 Ch 284, a floating charge has the following three characteristics:

(i) it is a charge on a class of assets of a company, present and future;
(ii) which class is, in the ordinary course of the company’s business, changing from time to time; and
(iii) it is contemplated by the charge that, until crystallisation, the company may carry on business in the ordinary way with the class of assets charged. Until it becomes fixed, the company can without consent deal with the class of assets in the ordinary course of business.

On the above three characteristics, the Privy Council in Agnew v Commissioner of Inland Revenue [2001] 2 BCLC 188 explained that “the first two characteristics are typical of a floating charge but they are not distinctive of it, since they are not necessarily inconsistent with a fixed charge. It is the third characteristic which is the hallmark of a floating charge and serves to distinguish it from a fixed charge. Since the existence of a fixed charge would make it impossible for the company to carry on business in an ordinary way without the consent of the charge holder, it follows that its ability to do so without such consent is inconsistent with the fixed nature of the charge.” It is now clear that the fact that a charge is created over floating or future property does not of itself define it as a floating charge. The distinction between a fixed charge and a floating charge lies in the degree of control over the subject of the charge allowed by the chargee to the chargor. According to Re Spectrum Plus Limited (in liquidation) [2005] 2 AC 680, a debenture which (1) prohibits the company from selling or charging its book debts but also (2) requires that the proceeds from realisation of book debts be paid into the company’s account with the bank and cannot be withdrawn without bank’s consent would be able to create a fixed charge on book debts.
5. (b) Explain which charge would have a higher priority over D Ltd’s accounts receivable.

Ans (b) A company is obliged to deliver the prescribed particulars of the charge, together with the charge itself, to the Companies Registry for registration within five weeks after its creation, but the registration can be effected by the chargee at the company’s expense (sections 80 and 81). Every company must keep a register of charges (section 89). If a charge is not registered in the stipulated time period, the following two consequences will result: the company and every officer who is knowingly a party to the default is liable to a fine (section 81); and the charge is void against the liquidator and any creditor of the company, but without prejudice to the contract to repay the money secured, which becomes immediately payable. As a result, the charge holder effectively becomes an unsecured creditor (section 80). Under a rule of equity that “the first in should prevail”, the first charge should be entitled to a higher priority than the second charge. However, the first charge is void against Bank B as a result of its non-registration. Therefore, the second charge is the only valid charge in this case and is entitled to a higher priority over the loan given out by Bank A, which has become an unsecured loan under section 80.
The auditors of K Ltd advised the directors that the company was not able to continue its business as a going concern and they should consider ceasing business “as early as possible”. Based on this advice the directors agreed to wind the company up but they hoped to do that by way of members’ voluntary winding up as it would look a more dignified way of closing down the company and its business. At the same board meeting, the chairman of K Ltd, who was also the chairman of the holding company, proposed that the board should agree to upgrade an unsecured loan given by the holding company to K Ltd to a secured loan by providing a floating charge to the holding company “in order to ease the holding company’s concerns.”

REQUIRED:

Advise the directors of K Ltd on which mode of winding up is most compatible with the auditors’ advice, and also on the legal consequences of providing a floating charge to the holding company as proposed by the chairman.

Ans

A members’ voluntary winding up is initiated by the passing of a special resolution in general meeting (section 228 of the Companies Ordinance). Presumably this would be a more welcome procedure because in the general meeting members (some of them would be directors) can appoint their own choice as liquidators. Subject to the consent by shareholders in general meeting or the liquidator, all the powers of the directors shall cease on the appointment of a liquidator (section 235(2)). The directors (or the director in the case of a one-person company) must make a certificate of solvency (section 233(1)) that their inquiry into the company affairs shows that the company will be able to pay off all its debt in the next 12 months from the commencement of the winding up. This certificate must be made within five weeks preceding the special resolution (or on that date but before the passing of the members’ resolution) and lodged with the Companies Registry for registration not later than when the copy of the resolution is delivered (section 233(2)). In other words, members’ voluntary winding up is a procedure for solvent companies. If the directors cannot produce the certificate of solvency, the winding up process has to proceed in the mode of creditors’ voluntary winding up (section 233(4)).

Creditors voluntary winding up can commence if the directors, or the majority of them, consider that the company cannot continue its business because of its insolvency. The directors must (1) pass a board resolution to that effect at a director’s meeting, and (2) have it recorded in a winding-up statement (section 228A(1)). The following details must be stated in the winding-up statement (section 228A(1)):

(i) the company cannot continue its business by reason of its insolvency;
(ii) the directors consider it necessary that the company be wound up and that the winding up should commence under section 228A because,
with supporting reasons given, it is not reasonably practicable for the winding up to commence under another section of the Companies Ordinance, e.g. section 228; and

(iii) meetings of the company and of its creditors will be summoned for a date not later than 28 days after the delivery of the winding-up statement to the Companies Registry.

The winding-up statement must be signed by a director (section 228A(1)). A director who signs the statement without having reasonable grounds (a) for the opinion that the company is insolvent and thus cannot continue, or (b) to consider that the company should be liquidated under s.228A is liable to a fine and imprisonment (section 228A(4)). The winding-up statement must be delivered to the Companies Registry for registration within seven days after it is made (section 228A(3)). When the winding-up statement is delivered to the Companies Registry (section 228A(5)), the winding-up process commences and will proceed as a creditors’ voluntary winding up (see also section 228A(17)(b)). This way of putting the company into liquidation can ease the directors’ concerns that the company may be taking part in fraudulent trading and that they may be liable personally. The directors must forthwith (1) appoint a provisional liquidator, and (2) call a shareholders’ meeting and a creditors’ meeting within 28 days after the delivery of the winding-up statement.

According to section 267, if the company is eventually wound up, a charge which, when created, was a floating charge on the undertaking or property of the company and which was also created within 12 months of the commencement of the winding up will, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to the company at the time of or subsequent to the creation of, and in consideration for, the charge. Section 267 invalidates any floating charge created for no new consideration within a limited period before the commencement of the company’s liquidation unless it is proved that the company was solvent when the charge was created. Since K Ltd was seriously insolvent at the material time and that it would not receive any new loan or benefit from the holding company in connection with the provision of the floating charge, the proposed floating charge will be invalid under the Companies Ordinance.

END