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Risks for Transactions and Directors in Financially Distressed Businesses (Hong Kong)

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A Practice Note addressing the legal and practical considerations in Hong Kong for a company director where that company is in financial distress and may subsequently enter insolvency proceedings. This Note also outlines the types of claims that an official appointed to oversee the insolvency proceedings or represent the creditors' interests, or both, may bring against the company's former directors, or to unwind transactions that took place before any insolvency proceedings.

When a company is in financial distress and enters into insolvency proceedings, there are a variety of legal and practical issues to consider. Before the distressed company goes into insolvency proceedings the directors may need advice on what they need to do to fulfil their duties to the company, its creditors and shareholders, and will need to consider the status of any ongoing transactions the company may be engaged in. Once the company has gone into insolvency proceedings, the pre-insolvency actions of the directors will be scrutinised by insolvency officials attempting to achieve the greatest return for the company's creditors.

This Note considers the legal and practical issues involved in the law of Hong Kong and addresses:

- The duties that directors owe to their company, its shareholders and its creditors, and how these may change according to the company's financial situation.
- The investigation of the pre-insolvency actions of the directors by insolvency officials.
- The powers of the insolvency officials to unwind any ongoing transactions and general powers of recovery in their aim to achieve the greatest possible return for the company's creditors and other applicable aims.
- The potential for any claims against the company's directors, and whether the directors can be personally pursued because of certain conduct even if ordinarily they would not be liable for the insolvent company's debts.

Directors' Duties

In Hong Kong, the duties of directors are generally classified into two broad categories:

- Fiduciary duties under common law (see Common Law Duties).
- Statutory duties of care, skill, and diligence codified in the Companies Ordinance (Cap. 622) (CO) (see Statutory Duties).

Common Law Duties

Fiduciary duties that directors owe to the company are derived from common law. The key duties in the insolvency context include:

- The duty to act in good faith in the interests of the company.
- The duty to exercise powers for proper purposes.
- The duty to refrain from fettering their own discretion.
- The duty to avoid conflicts of duty and interest.
- The duty not to compete with the company.
- The duty not to make secret profits.

When a company is solvent, directors owe the above duties to the company itself. Directors must act in good faith to promote the success of the company for the benefit of its shareholders as a whole. They can pursue business opportunities, even risky ones, with a view to increase profits, if these actions do not risk the solvency of the company.

The duty to consider creditors' interests is not triggered at this stage if the company is not (or is not likely to become) insolvent.

Statutory Duties

Section 465 of the CO requires directors to exercise reasonable care, skill, and diligence when performing their duties. In determining whether a director has breached this duty, courts adopt a mixed objective and subjective test and consider:

- The reasonable care, skill, and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill, and experience that may reasonably be expected of a person carrying out the functions of the director towards the company (the objective test).
- The general knowledge, skill, and experience that the director in question actually has (the subjective test).

Shift of Directors' Duties to Creditors When a Company has Entered the Insolvency Zone

When a company is insolvent or near insolvency, the interests of shareholders are no longer paramount. The company is, in essence, trading with the creditors' monies. Therefore, the creditors' interests are at stake. While directors still owe duties to the company, common law requires that they also consider, and not prejudice, the creditors' interests (see *Tradepower (Holdings) Ltd. (In Liquidation) v. Tradepower (H.K.) Ltd. & Others* (2009) 12 HKCFAR 417). Therefore, directors' duties shift from maximising shareholders' return (when the company is solvent) to preserving the company's assets to distribute them to all creditors (when the company is insolvent or nearing insolvency).

Freestanding Duty May Not be Owed Directly to the Creditors

The duty to consider creditors' interests is not a standalone duty that directors owe directly to the creditors (see *Moulin Glob. Eyecare Holdings Ltd. (In Liquidation) v. Olivia Lee Sin Mei* [2013] 1 HKLRD 744). It forms part of the directors' duty to act in the best interests of the company. Therefore, creditors cannot bring claims directly against the directors for their failure to regard creditors' interests without the assistance of the company or the liquidators.

Directors must also regard the interests of creditors as a whole, rather than any particular classes of creditors. Therefore, directors can breach their duties if their actions seek to advance the interests of any particular classes of creditors (but harm the interests of the general body of creditors).

How Directors' Duties Change in the Pre-Insolvency Period

When Directors' Duties to Consider Creditors' Interests are Triggered

It is generally accepted that directors' duties to consider creditors' interests are triggered when the company is in fact insolvent. Whether a company is insolvent at a particular time is a question of fact which must be determined objectively (see *Wing Hong Constr. Ltd. V. Hui Chi Yung & Others* [2020] HKCFI 2985). When determining a company's insolvency, both of the following tests apply:

- The cash flow test, under which the company is insolvent if it cannot pay debts when they fall due.
- The balance sheet test, under which the company is insolvent if its liabilities exceed its assets.

Things are less straightforward where a company is in a troubled financial state, but not yet insolvent. Historically, there have been different versions of the test where the court held that directors' duties are triggered when the company is "doubtfully solvent" (see *Brady v Brady* [1987] 3 B.C.C. 535), "on the verge of insolvency" (see *Colin Gwyer & Assocs. Ltd v London Wharf (Limehouse) Ltd* [2003] B.C.C. 885) or "there is a real and not remote risk of insolvency " (see *Kalls Enters. Pty Ltd v Baloglow* [2007] NSWCA 191 cited in *Re HLC Env't Projects Ltd* [2014] B.C.C. 337). However, as confirmed in *Cyberworks Audio Video Technology Ltd. (in Compulsory Liquidation) v. Mei Ah (HK) Co. Ltd*. [2020] HKCFI 398, the correct test in Hong Kong is whether the directors knew (or should have known) that the company was insolvent, or was likely to become (even when not actually) insolvent.

The duty to regard creditors' interests may also arise during the pre-insolvency period when a proposed transaction involves significant transfer of assets or payment of monies such that the directors should have known that the action might put the company into liquidation.

Although it is not always possible to pinpoint a particular time from which the company is likely to become insolvent, directors must always be mindful of the company's financial situation, and look out for any signs of approaching insolvency. The presence of these warning signs triggers their duties to consider the interests of creditors.

Duty to Consider Creditors' Interests May Work on a Sliding-Scale Basis

Under the doctrine of *stare decisis*, the decision of a higher court within the same jurisdiction acts as binding

authority on a lower court within that same jurisdiction. Before the 1997 handover, Hong Kong courts were bound by decisions of the higher English Courts. English cases after 1997 are only persuasive precedents.

In the recent English case *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25, the UK Supreme Court reaffirmed that the duty to consider creditors' interests is triggered when the directors know (or should know) that the company is insolvent (or bordering on insolvency), or that an insolvent liquidation or administration is probable. However, the judge did not agree that once the duty to consider creditors' interests is triggered, then the creditors' interests would become paramount, to the exclusion of the shareholders' interests.

The court explained that the directors' duty to consider creditors' interests works on a sliding-scale, rather than a bright-line, basis: directors must balance the interests of creditors and shareholders. A sliding-scale approach means that, as the company's financial difficulties increase, the more the interests of creditors will predominate and the greater the weight that directors should give to creditors' interests. From the point when insolvent liquidation becomes inevitable, creditors' interests become paramount. The Hong Kong Court has not yet considered the sliding scale approach and it remains to be seen whether the court will adopt this approach in future cases.

However, in practice, directors' judgment calls remain difficult when they must assess where on the sliding scale of insolvency the company is positioned to determine where the balance of competing interests between the shareholders and creditors should lie. Whether a company is insolvent or close to insolvency is highly fact sensitive and directors must exercise careful commercial judgment and take legal advice if necessary.

A Director May Not Have a Legal Obligation to File for Specific Types of Insolvency Proceedings Even When the Financial Condition of the Company is Declining

Unlike some other common law jurisdictions, Hong Kong currently has no "wrongful trading" or "insolvent trading" provisions which would allow liquidators to bring claims against directors who continue to trade when they know, or should know, that there is no reasonable prospect for the company to avoid insolvency.

Therefore, unless the directors have violated other common law or statutory duties or provisions (for example involving fraudulent trading or misfeasance (see Fraudulent Trading and Misfeasance)), it might be difficult to hold directors accountable for not placing the company into liquidation when the company's financial condition is declining.

Deciding on a Subjective or Objective Test to Determine Whether the Directors have Breached their Duties Towards the Interests of Creditors

In *Cyberworks Audio Video Technology Ltd (in Compulsory Liquidation) v. Mei Ah (HK) Co. Ltd.* [2020] HKCFI 398, the Hong Kong court clarified that the test for determining whether a director has breached the duty to consider creditors' interests is a subjective one. The proper inquiry is whether the director honestly believed that their act or omission was in the interests of the company and would not be prejudicial to creditors. It is the state of mind of the director concerned that is relevant.

However, the subjective test is only applicable where evidence shows that the director has actually considered the best interests of the company. In the absence of this consideration, the court will apply the objective test in *Charterbridge Corp. Ltd. v. Lloyds Bank Ltd.* [1970] Ch 62. This test asks whether an intelligent and honest person, in the position of the director in question, would have reasonably believed that the transaction was for the benefit of the company or creditors.

Directors should consider that if their acts or omissions result in substantial detriment to the company or creditors, it will be more difficult to persuade the court that they honestly believed them to be in the company's (or the creditors') interests (see *Cyberworks Audio Video Tech. Ltd. (in Compulsory Liquidation) v. Mei Ah (HK) Co Ltd.* [2020] HKCFI 398).

Examination of Directors' Pre-Insolvency Actions During Insolvency Proceedings

Legal Basis for Liquidators to Investigate Pre-Insolvency Actions

It is well settled that liquidators are empowered to investigate the company's affairs, including investigating the causes of the company's failure and the company management's conduct for public interest purposes (see *Re Pantmaenog Timber Co. Ltd.* [2004] 1 AC 158). Liquidators must report:

- The cause of the company's failure to the court.
- Any directors' misconduct to the Official Receiver.

Legal Basis for Liquidators to Bring Proceedings Against Former Directors

Liquidators are also empowered to bring or defend proceedings in the name and on behalf of the company under Item 1, Part 2, Schedule 25 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO). For a compulsory winding up, liquidators can only exercise this power with the approval of the court or the committee of inspection (a creditors'/shareholders' committee). Liquidators must obtain approval from the committee of inspection first. If the approval is refused, or granted with unreasonable conditions, then the liquidators must apply for approval from the court. Liquidators in a voluntary winding up can exercise this power without obtaining any approval.

Conducting Investigations by Seeking Documents and Conducting Examinations

During the investigation, liquidators may face difficulties in obtaining documents or information concerning the affairs of the company or collecting properties of the company from the directors or other persons taking part in the management of the company. Liquidators may require the relevant persons to deliver the documents, information, or property of the company (see Power to Request Delivery of Property). They may also make court applications to compel these persons to attend private or public examinations, to provide the requested information or documents (see Public Examination and Private Examination).

Liquidators' Obligation to Report on the Conduct of the Former Directors

Where the liquidators of an insolvent company believe that the conduct of a current or former director makes them unfit to participate in the management of a company, the liquidators should report the matter to the Official Receiver by completing a statutory Form D1. This form can be found in the Schedule of the Companies (Reports on Conduct of Directors) Regulation (Cap. 32J). In addition to Form D1, liquidators must also complete a questionnaire in the form of a checklist. The purpose of the questionnaire is to provide supporting information and documents of the case to the Official Receiver. On receiving this report, the Official Receiver may apply to the court under section 168I of the CWUMPO for a disqualification order against that former director. This would bar that former director from acting as a director of any company in Hong Kong for a period up to 15 years, if the court considers that it would be in the public interest to do so.

For a compulsory winding up, after receiving the statement of affairs from the directors (or when the court orders that this statement should not be made), the liquidators should submit a preliminary report to the court without delay (section 191(1), CWUMPO). The preliminary report must include information on the amount of capital issued, subscribed, and paid up, and the estimated amount of the company's assets and liabilities. Furthermore, the liquidator's report may also include information regarding the pre-insolvency actions of the former directors and officers, such as:

- Whether they engaged in any misconduct.
- Whether they breached any of their fiduciary duties to the company.
- The reasons for the company's failure (if applicable).

This report may be used as a basis for bringing proceedings against former directors and officers for their misconduct or breach of duties.

Liquidators also have a duty to report any criminal activities or misconduct they discover during their investigation to the relevant authorities, such as:

- The Hong Kong Police.
- The Securities and Futures Commission (SFC).
- The Hong Kong Monetary Authority (HKMA).

This duty arises from common law and applicable legislation, as well as from the professional standards and guidelines that govern the conduct of liquidators in Hong Kong. For example, the Securities and Futures (Client Money) Rules provide for the segregation and protection of client money held by licensed intermediaries. If a licensed intermediary becomes insolvent, the liquidator must investigate the conduct of the intermediary's directors and officers and report their findings to the SFC.

Potential Claims Against Former Directors

Directors are generally not liable for the company's debts, save for special circumstances (such as the director entering into personal guarantees of those obligations). However, when the company is in financial difficulty or has become insolvent, directors may be held personally liable for the company's losses if their actions or omissions have worsened the creditors' position. The types of claims which liquidators may bring against the former directors and the extent of the directors' liabilities under these causes of actions are discussed below.

Fraudulent Trading

Section 275 of the CWUMPO provides that if the business of the company has been carried on with intent to defraud creditors of the company, or for any fraudulent purpose, all persons who were "knowingly parties" to the continuation of trading in that manner may be held personally liable for all or any of the company's debts or liabilities. In addition to directors, persons who take a more active role in the management of the company, such as company secretary or other officers, can be subject to this provision.

In addition to civil liability, any person who is a party to fraudulent trading may also be held criminally liable and subject to both:

- A fine (without limit).
- Imprisoned for a maximum period of five years.

The Official Receiver, liquidators, or any creditors or contributories of the company can make a claim under section 275. A contributory means every person liable to contribute to the assets of a company in the event of its being wound up, and includes shareholders of the company.

The Hong Kong court in *Aktieselskabet Dansk Skibsfinansiering (Body Corporate) v. Robert John Francis Brothers* [2000] 1 HKLRD 568 clarified that the test for determining fraudulent intention is a subjective one. This test requires that the person in question was personally dishonest; it is not sufficient that others would view the conduct as objectively dishonest. If a director honestly thought that the company could trade through the financial difficulties and return to prosperity, but failed in the end, they could continue trading without breaching their duties. This is so even if the director's belief was not reasonably held.

However, directors should note that the further they depart from objective standards, the more likely the court may find that they are dishonest. Whether a person carrying on the business is dishonest is highly fact-sensitive, and the court must consider all relevant facts to make a determination. If the facts suggest that the directors have an honest intention, the court will not infer dishonesty.

In practice, liquidators rarely invoke section 275 due to the difficulties in proving an individual's state of mind and actual intention.

Misfeasance

Section 276 of the CWUMPO states that where a "specified person," in the course of winding up, has misapplied, retained, become liable or accountable for any money or property of the company (or has been guilty of any misfeasance, breach of duty, or breach of fiduciary duty in relation to the insolvent company), the court may:

- Examine the conduct of that specified person.
- Compel that specified person to repay or restore the money or property with interest, or make compensation to the company, as the court thinks just.

The CWUMPO broadly defines a "specified person" to include any of the company's:

- Present and past officers (including directors).
- Provisional liquidators.
- Liquidators.
- Receivers.
- Managers.

Directors owe fiduciary duties to act in the best interests of the company at all times. When the company is in financial distress, these duties require directors to have proper regard for the creditors' interests. Directors must be careful not to enter into any improper transactions, which would prejudice the interests of creditors.

Similar to fraudulent trading (see Fraudulent Trading), the Official Receiver, liquidators, or any creditors or contributories of the company can make an application under section 276.

Section 276 itself does not create any new obligations or cause of action. It simply provides a summary procedure allowing liquidators to enforce existing rights of the company without having to commence a separate civil action outside the winding-up proceedings.

Directors may also be found liable for misfeasance if, due to their involvement as company officers, certain transactions of the company are set aside by the court.

Breach of Fiduciary Duties

In addition to the statutory provisions, the company or the liquidators may rely on common law rules and equitable principles to bring claims against the former directors for breaches of fiduciary duties. A range of remedies under the common law including damages, an account of profits, and restitution are available to the company, subject to circumstances of the case.

Failure to Keep Proper Books and Records

Under section 373 of the CO, a company must keep sufficient accounting reports to show and disclose, with reasonable accuracy, the company's financial position and financial performance. These reports should also

explain the company's transactions. Directors failing to take reasonable steps to ensure that the accounting records are kept and preserved according to section 373 are criminally liable and may be subject to both:

- A maximum fine of HK$300,000.
- Imprisonment up to a maximum of one year.

Non-Payment of Wages

Under Hong Kong law, employees are preferential creditors and therefore they are entitled to:

- Payment of wages out of the assets of the company before payments to unsecured creditors.
- Wages in lieu of notice.
- Severance payments.
- Payment in lieu of accrued but untaken annual leave.

Under section 23 of the Employment Ordinance (Cap. 57) (EO), wages are payable on the expiry of the last day of the wage period, and in any event no later than seven days thereafter. Wilfully violating section 23 without reasonable excuse constitutes an offence. Officers of the company (including the directors) may be guilty of the same offence under section 64B of the EO if they consent to, connive in, or are negligent about the non-payment of wages. Courts do not consider insolvency or financial difficulties of the company as reasonable excuses for non-payment of wages.

The punishment is a fine of up to HK$350,000 and imprisonment for up to three years.

Disqualification Order

In addition to civil and criminal liabilities, liquidators may apply to the court for a disqualification order against any director of a company in liquidation, if the director's conduct makes them unfit to manage a company. A court may make a disqualification order:

- Where the director has:
  - been convicted of an indictable offence;
  - been involved in fraudulent trading or any fraud; or
  - breached directors' duties.
- For any other reasons making them unfit to participate in the management of a company.

The court may make a disqualification order forbidding a person to act as a director of any Hong Kong company for up to 15 years.

Company Transactions that Can be Challenged and Unwound if the Company Becomes Insolvent

Unfair Preference

Sections 266, 266A, and 266B of the CWUMPO govern unfair preference. Generally, an unfair preference arises where the company does anything (or suffers anything to be done) which has the effect of putting a creditor, guarantor, or surety in a better position than they otherwise would be in, if the company liquidates.

If the company gives the unfair preference to a person within six months before the start of its liquidation (or two years, if it gives the unfair preference to a person connected to the company), the transaction becomes voidable. The court may set it aside to restore the company's position to what it would have been before it gave the unfair preference. A person is connected to the company if that person is:

- An associate of a company director or shadow director (meaning those persons in accordance with whose directions or instructions the directors, or a majority of the directors, of the company are accustomed to act).
- An associate of the company.

(Section 265A(3), CWUMPO.)

The CWUMPO defines associates of a company to include:

- Directors.
- Shadow directors.
- Other officers of the company.

(Section 265C(2), CWUMPO.)

Employees are not regarded as associates. A person's associates include:

- The spouse or cohabitant of that person.
- A relative of that person or of that person's spouse or cohabitant.
- The spouse or cohabitant of that relative.

(Section 265B(1), CWUMPO.)

To establish a claim of unfair preference, the company must have a desire to place that person into a better position. A court will presume this desire to prefer if the company gave the unfair preference to an associate connected to the company, unless it provides contrary evidence.

If a director of an insolvent company repays a debt or gives security to a creditor, to put that creditor in a better position than the remaining creditors, the court may hold the director liable for unfair preference and order them to compensate the company. However, if other factors motivated the director, such as commercial pressure put onto the company by the creditor, then this would not amount to an unfair preference.

Transactions at an Undervalue

Sections 265D and 265E of the CWUMPO govern transactions at an undervalue. A transaction at an undervalue occurs when the company either:

- Makes a gift to someone for no consideration in return.
- Enters into a transaction with a person from which the company receives no value, or significantly less value than the consideration paid by the company.

The court may grant an order to void the transaction, to restore the company's position to what it would have been before it entered into the undervalued transaction, if both of the following conditions are met:

- The undervalued transaction was entered into within five years immediately before the commencement of the winding up.
- The transaction was made when the company was insolvent or caused the company to become insolvent as a result.

Extortionate Credit Transactions

Under section 264B(3) of the CWUMPO, a credit transaction is regarded as extortionate if, taking into account the risks accepted by the lender, credit is provided for grossly exorbitant payments or if the transaction grossly violates the principles of fair dealing.

Liquidators may apply to the court for orders to amend the terms of the relevant transaction, or to void part or all of the obligations created by the transaction, in connection with these extortionate credit transactions. This is if they took place three years before either:

- The resolution for winding up (in the case of voluntary liquidation, or if the company had entered into compulsory winding up with a special resolution).
- The date of the winding-up order (if the company was compulsorily wound up without any resolution).

Floating Charge Created Within 12 Months Before the Commencement of Winding Up

Under sections 267 and 267A(2) of the CWUMPO, any floating charge (including a charge that was initially created as "floating charge," but has subsequently crystallised as a fixed charge) created within 12 months of commencement of the company's winding up is invalid. Fixed and floating charges give creditors security over a debtor's assets. Unlike assets covered by fixed charge which cannot be sold or transferred, a floating charge allows the chargor to continue to deal with the charged assets in its ordinary course of business until the charge crystallised into a fixed charge over the assets. Exceptions apply:

- If the company was solvent immediately after creation of the floating charge.
- To the extent of cash paid to the company at the time, or after the creation of the charge, in consideration for the charge (and any interest payable on this amount).

Where the floating charge was created in favour of a person connected with the company, the relevant time is extended to 24 months before commencement of the winding up. There is no need to establish that the company was insolvent when the charge was created, or became insolvent as a result (section 267A(1), CWUMPO).

This provision is intended to prevent an insolvent company from preferring certain creditors by creating floating charges to secure old monies, that is past debts or liabilities. Genuine credit transactions, where floating charges are supported with new consideration paid to the company, are not invalidated.

For more information on floating charges, see Practice Note, Lending and Taking Security in Hong Kong: Overview: Tangible Movable Property: Common Forms of Security.

Void Disposition in a Compulsory Liquidation

Any disposition of properties made after the commencement of a compulsory liquidation (the date on which the winding-up petition is filed with the court) is void, unless the court grants leave (section 182, CWUMPO).

Fraudulent Conveyance

A court can set aside a disposition of property under section 60 of the Conveyancing and Property Ordinance (Cap. 219) if the company made it with the intent to defraud its creditors. If a company transfers a property without receiving any consideration in return, with the deliberate intention to put this property beyond reach of its creditors, it is likely that it had intent to defraud.

Similar to the fraudulent trading provisions (see Fraudulent Trading), the transferor's state of mind

must be proved. Therefore, liquidators have rarely used section 60 due to the difficulty of establishing the transferor's intent to defraud.

Powers of Insolvency Officials or Office Holders to Investigate Pre-Insolvency Transactions and Director Conduct

Liquidators play an important role in the winding-up process. Their main functions are to wind up the business of the company properly, and ensure fair distribution of the company's assets to the creditors and contributories (if available), according to statutory rules.

Liquidators of an insolvent company must carry out statutory investigation of the affairs of a company wound up by the court. These investigations determine the assets and liabilities of the company, and review the directors' conduct, decisions and actions. Liquidators must consider whether they should take any appropriate actions if, during these investigations, they discover that either:

- The company's assets have been misappropriated.
- The directors have breached their duties, or were involved in any unlawful conduct leading to losses of the company,

In discharging their duties, liquidators stand in a fiduciary position and owe various fiduciary duties to the company and its creditors, including:

- The duty to act honestly with due care and diligence and in good faith.
- The duty to regard the interests of the creditors.
- The duty to preserve the company's assets.
- The duty to avoid conflicts of interest.
- The duty not to make secret profit.
- The duty to act impartially.

(See *Chinese Strategic Holdings Ltd. & Another v. James Wardell & Another* [2019] HKCFI 1236.) They must perform their duties with a high standard of care, skill, and diligence attributable to a professional insolvency practitioner.

Failure to discharge these duties can result in serious consequences, including removal from office (see *Chinese Strategic Holdings Ltd & Another v James Wardell & Another* [2019] HKCFI 1236) and personal liability for any losses incurred by the company or its creditors (section 276, CWUMPO). The court has the power to remove a liquidator in both voluntary liquidations (section 252, CWUMPO) and compulsory winding up (section 196(1), CWUMPO) if liquidators have failed to fulfil their obligations or have acted improperly.

Court-appointed liquidators are court officers, and have an obligation to promote justice and uphold the law. They must act honestly, impartially, and fairly and to exercise their powers for the bona fide purpose for which they are appointed. They should be truthful to the court and not conceal information which is material to the winding up of the company.

If the liquidators are aware that any potential offence may have been committed by the directors or other persons connected with the company, they should report it to the Secretary for Justice in a voluntary liquidation (section 277(2), CWUMPO) or to the Official Receiver in a compulsory winding up by the court (section 277(1), CWUMPO). Where appropriate, they should also provide information about these potential offences to other relevant authorities, such as the Securities and Futures Commission (SFC), Independent Commission Against Corruption (ICAC), and the Commercial Crime Bureau (CCB).

Powers of Insolvency Officials or Office Holders to Require the Production of Information, Documents, or Assets when Investigating

Directors have statutory duties to cooperate with the liquidators after the company is wound up. After the liquidators are appointed, they normally start their investigation by questioning or interviewing the relevant directors and officers. This is the quickest and most straightforward way to obtain information about the company if the directors are cooperative. Liquidators also typically obtain the company's statutory and minute books and accounting records together with the associated documents from the directors to investigate how the business of the company was conducted.

However, if the directors refuse to cooperate voluntarily or the liquidators suspect that some of the relevant information, documents, or assets have not been delivered to them, the liquidators may consider invoking the following provisions under the CWUMPO to facilitate their investigation:

- Section 211 of the CWUMPO (see Power to Request Delivery of Property).
- Section 286A of the CWUMPO (see Public Examination)

Power to Request Delivery of Property

If directors refuse to deliver the company's documents or properties to the liquidators, liquidators can make an application under section 211 of the CWUMPO. Under section 211, the court may, at any time after making a winding-up order, request any contributory, trustee, receiver, banker, agent, or officer (including directors) to pay, deliver, convey, surrender, or transfer to the liquidators any money, property, or books and papers on hand to which the company is prima facie entitled.

However, the summary procedure under section 211 is not available where there is a dispute about the company's ownership or entitlement to the property in question.

Public Examination

Under section 286A of the CWUMPO, after the court has made a winding-up order against a company, it may order a person to attend a public examination by the court:

- If the official receiver or liquidator reports that in their opinion any person has committed a fraud in relation to the company's affairs.
- On application of the official receiver or the liquidator of the company.

The purpose of a public examination is to gather more information on the affairs of the company being wound up and on the conduct or dealings of the examinee in relation to the company for facilitating the administration of the winding-up case. Section 286A only applies to compulsory winding up.

The examination is a public one. The official receiver or liquidator who made the report or applies for the public examination attends the public examination to ask questions. Creditors of the company can also ask questions at the examination.

Persons who may be called to attend a public examination include the company's:

- Past or present officers.
- Provisional liquidators or liquidators.
- Receivers.
- Managers.
- Any person who participated in the promotion or formation of the company.

Private Examination

Sections 286B and 286C of the CWUMPO empower the court to require certain categories of persons to attend court to be privately examined or to produce documents. They include any:

- Officers of the company (including directors).
- Person concerned with the company's properties.
- Debtor of the company.
- Person "capable of giving information concerning the promotion, formation, trade, dealings, affairs, or property of the company."

Private examination is a powerful tool which assists liquidators in obtaining necessary information or documents for conducting their investigation. However, the court does not order this lightly. When deciding whether it should order private examination, the court must balance the liquidators' reasonable requests with the oppressiveness of compelling the examinee to provide the information or documents. Therefore, liquidators only use this application as a last resort, as the court expects the liquidators to have taken all reasonable steps to obtain the information/documents voluntarily before making the court application.

Conclusion

When a company is in financial difficulty and falling behind on payments, the stress levels of directors can be overwhelming. The immense pressure to prevent the business from going under can impair the ability of a director to make sound business judgments in compliance with the law.

Directors must always be clear on the company's financial situation. If the company displays any warning signs indicating the likelihood of insolvency, directors should take precautions to ensure that they comply with their common law and statutory duties to protect the company's and creditors' interests, and minimise their exposure to potential personal liabilities. If in doubt, directors should seek professional legal advice about their specific concerns.