<table>
<thead>
<tr>
<th><strong>Title</strong></th>
<th>New Insolvency Law: Traps and Gaps; 新破產清盤法: 陷阱與漏洞</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Author(s)</strong></td>
<td>Smart, PSJ; Booth, CD</td>
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<tr>
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<tr>
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</tr>
</tbody>
</table>
New Insolvency Law: Traps and Gaps

Philip Smart and Charles D Booth argue that poor drafting in Hong Kong's new insolvency law leaves many issues open to challenge.

Corporate and insolvency law practitioners will be aware that on a number of occasions in recent years poor legislative drafting has resulted in defective amendments being made to the Companies Ordinance (Cap 32). This problem has recently reared its head again, most notably in Re Setaffa Investments Ltd [1998] 2 HCLR 236 (Le Pichon J). As in previous examples, the difficulties revealed in the Setaffa case were created because the draftsman, when in effect copying UK legislation, did not do a thorough enough job and failed to copy fully the UK legislation. As Le Pichon J noted (at 246), such an oversight would 'hardly be the first time that it will have occurred when Hong Kong legislation is modelled on UK legislation.' The purpose of this article is threefold: (1) to note the decision in Setaffa; (2) to identify a number of other areas in the new insolvency legislation where similar problems have occurred; and (3) to bring to practitioners' attention a practical difficulty concerning the extraterritoriality of the new avoidance powers that have recently been incorporated into the insolvency legislation.

Setaffa and Post-Liquidation Interest

Major amendments to Hong Kong's insolvency regime were made in the Bankruptcy (Amendment) Ordinance 1996 (Ord No 76 of 1996) (the BAO), which finally came into operation on 1 April 1998 (LN 158 of 1998). One issue dealt with in the BAO is interest on debts in a bankruptcy. However, reform of the law on interest on debts in relation to a solvent liquidation was introduced directly into the Companies Ordinance by the Companies (Amendment) Ordinance 1997 (the CAO), which came into operation on 10 February 1997 (Ord No 3 of 1997). The CAO introduced a new s 264A into the Companies Ordinance. This section deals inter alia with interest on debts, in the post-liquidation period, owed by a company that is not insolvent. Subsection (2) provides that '[a]ny surplus remaining after the payment of debts proved in a winding up of a company which is not an insolvent company:

... shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the period during which the debt has been outstanding, in the case of...

(b) a voluntary winding up, since the commencement of the winding up...

It goes without saying that s 264A will be applicable where the liquidation has commenced after 10 February 1997. The issue raised in Setaffa, however, was whether the section operated in relation to a winding up commenced prior to that date.

In Setaffa the winding up had begun many years previously (in fact as long ago as 1983), but there remained a substantial sum of money which had not been distributed at the time s 264A came into operation. It was argued that s 264A could be given a partially retrospective operation by applying it to distributions taking place after 10 February 1997. The reason why this argument, however unlikely it may appear, could even be advanced is because although s 264A(2) is taken almost verbatim from the Insolvency Act 1986 (UK) (s 189 thereof), the draftsman in Hong Kong failed to copy the relevant transitional provisions. These provisions, contained in the 1986 Act, Sch 11, para 4(1), provide:

'In relation to any winding up which has commenced, or is treated as having commenced, before the appointed day, the new law does not apply, and the former law continues to have effect...'

Clearly, some such transitional provision ought to have been made in the CAO. The failure to do so, which as Le Pichon J suggested (at 246) may have been 'attributable to sheer oversight', led to (what should have been) quite unnecessary litigation. On the facts in Setaffa, the court rejected the contention that s 264A had any retrospective effect. For in the absence of any express language or clear indication suggesting retroactivity, the section only applied to liquidations commenced after 10 February 1997.

Transitional Problems and Avoidance Powers

Under s 99 of the BAO (unlike the CAO) there is a general transitional provision which, in effect, provides that where a bankruptcy case had already commenced prior to the coming into effect of the BAO (ie 1 April 1998) the 'old law' will continue to apply to that case (subject to certain important exceptions in relation to the discharge of bankrupts). Thus, if we turn to the avoidance powers of a trustee in bankruptcy, there can be no doubt that if, for example, the bankruptcy commenced on 1 March 1998, then the old law on fraudulent preference will be applicable should the trustee seek to...
set aside a payment made by the bankrupt on 1 January 1998. In other words, as in Setaffa, the new law is not retrospective. But, one may ask, what of the situation where the bankruptcy is commenced after 1 April 1998 — so s 99 of the BAO is not applicable — but the transaction sought to be impeached was entered into prior to that date? The trap is to assume that, because the case commenced after 1 April 1998, the new provisions will apply.

The way this issue was specifically resolved in the Insolvency Act 1986 (UK) was to have a special transitional provision relating to avoidance powers (see para 17 in Sch 11 to the 1986 Act). That provision stated that a transaction occurring before the appointed day would only be avoided under the new statutory provisions to the extent that such a transaction could have been avoided under the old legislation. The advantage of this approach is that it puts the focus on the new provisions but, at the same time, prevents any unfairness by not allowing the new provisions to apply where the transaction was unimpeachable (under the old law) at the time it was entered into.

In Hong Kong, however, the draftsman has not copied para 17. As a result, as with the Setaffa case, there is no expressly applicable statutory provision in the amending legislation. Nevertheless, basic principles tell us that, in the absence of an express provision or a clear indication, the new avoidance powers cannot be regarded as applying to transactions taking place prior to 1 April 1998. If it were otherwise, a transaction that was perfectly valid and unimpeachable at the time it was entered into might subsequently become voidable. If, as suggested here, the new avoidance powers do not apply, then does the old law continue to operate in respect of such transactions? In light of s 23 of the Interpretation and General Clauses Ordinance (Cap 1), the answer is in the affirmative. Hence, the old avoidance provisions, even though they have been repealed by the BAO, must continue to be applied in relation to transactions occurring before 1 April 1998 despite the fact that the bankruptcy proceedings only commence after that date.

In summary, practitioners should be aware that the new avoidance powers in bankruptcy cases are not retrospective and, moreover, that the old provisions continue to apply to events and transactions occurring prior to 1 April 1998 even where the bankruptcy was only in fact commenced after 1 April 1998. Thus, practitioners had better keep copies of the old provisions for some years to come.

Our only observation is that the total non-discussion of this important topic by the appropriate law reform body is a peculiar way of conducting a law reform exercise.

Unfair Preferences under the Companies Ordinance
The BAO not only introduced new avoidance powers in bankruptcy, it also added a new unfair preference provision to the Companies Ordinance. Section 266B contains the following transitional provision:

‘(2) Where the winding up of a company commences before the amending Ordinance comes into operation, the provisions of the principal Ordinance [that is, the Bankruptcy Ordinance] as it existed before being amended by the amending Ordinance apply in respect of sections 266 and 266A of this Ordinance.’

Hence, s 266B(2) expressly provides that where a winding up commences on 1 April 1998, the new unfair preference provision does not apply. The effect, therefore, is that the old fraudulent preference provision (found in the old bankruptcy legislation) remains applicable. Section 266B(2) however does not address the situation where, for example, the winding up commenced on 1 May 1998 but the alleged preference occurred on 1 January 1998. Nevertheless, there can be no doubt that s 266B has no retrospective effect whatsoever: events taking place before 1 April 1998 continue to be governed by the old law on fraudulent preference.

Extraterritoriality: Amendment of Insolvency Rules Required
As has been noted, the new avoidance powers under the BAO are based largely on the equivalent English provisions (see ss 339 et seq of the Insolvency Act 1986). In recent years the English courts have consistently maintained that these English avoidance powers may operate extraterritorially (see Re Paramount Airways Ltd (in admin) [1993] Ch 223 and generally, P Smart, Cross-Border Insolvency (2nd Ed, 1998), pp 17-27. Note the same view is taken in England in relation to the public examination of a director of an insolvent company (see Re Seangull Manufacturing Co Ltd [1993] Ch 345). Having regard to the ancestry of the BAO provisions, it is very likely, if not inevitable, that the Court of First Instance would take the same approach in relation to the new Hong Kong avoidance powers. This would represent a change to the pre-April 1998 position, where avoidance powers were generally taken to be territorial in nature (see obiter in American Express International Banking Corp v Johnson [1984] HKLR 372).
Obviously, in light of the realities of global business, there is every reason to expect present-day avoidance powers to be construed as extraterritorial.

It is unfortunate that insolvency practitioners do not have the benefit of the views of the Hong Kong Law Reform Commission or its Insolvency Sub-Committee on the question of the extraterritoriality of the new avoidance powers. It is quite startling to realise that, despite the obvious significance of avoidance powers in bankruptcy, no discussion of avoidance powers is found in either of the two law reform documents relating to bankruptcy. The Law Reform Commission, and its Sub-Committee on Insolvency, simply did not address avoidance powers at all in these documents. Nevertheless, the UK provisions found their way into the Bankruptcy (Amendment) Bill 1996 and from there into the BAO. These commentators are happy to see new, more powerful avoidance powers conferred upon trustees and liquidators in Hong Kong insolvencies. Our only observation is that the total non-discussion of this important topic by the appropriate law reform body is a peculiar way of conducting a law reform exercise.

It is perhaps tempting to overlook the process followed and focus on the end result. Hong Kong trustees and liquidators now have stronger avoidance powers and these powers are, it seems, extraterritorial. However, if what the draftsman was trying to achieve (as one must assume) was to confer the same avoidance jurisdiction upon a Hong Kong trustee and the Hong Kong court as is possessed by their English counterparts, then that objective has not been met. For when the substantive law was changed in England in the mid-1980s, new procedural rules were introduced in the form of the Insolvency Rules 1986. Specifically, r 12.12(3) leaves it entirely to the discretion of the court as to the manner in which any process or order of the court in insolvency proceedings is to be served on any person who is not in England. Thus, the position in England is that: (1) the Insolvency Act 1986 avoidance powers are extraterritorial in scope; and (2) a person outside the jurisdiction can be served with process by reliance upon the express wording of r 12.12 of the Insolvency Rules 1986 (for a recent illustration involving insolvent trading, see Re Howard Holdings Inc [1998] BCC 549 and P Smart, supra pp 26-27). However, in Hong Kong, although the new avoidance powers are copied from the UK provisions, no equivalent to r 12.12 has been introduced into either the Companies (Winding-up) Rules or the Bankruptcy Rules (even though extensive amendments were made to the Bankruptcy Rules as from 1 April 1998 (Bankruptcy (Amendment) Rules 1998 (LN 77 of 1998)). The net result is that, although the new avoidance powers are extraterritorial, most practical benefits that might have flowed from extraterritoriality have evaporated because of what was presumably an oversight in not making appropriate procedural provision in the Bankruptcy Rules and the Companies (Winding-up) Rules.

Conclusion
The Setaffa decision puts to rest any suggestion that reference to this sort of legislative drafting error is mere quibbling. The failure to adequately copy UK legislation creates uncertainty and invites unnecessary litigation. To avoid similar confusion as to the operation of the new avoidance powers, it would be helpful if the Government Printer were to include copies of both the old and new provisions in the next edition of the inserts for the Bankruptcy and Companies Ordinances. Finally, it is also important that amendments be made to the subsidiary legislation as soon as possible to enable trustees and liquidators to benefit from the extraterritoriality of their new avoidance powers.

Philip Smart and Charles D Booth

教閱讀法的 Philip Smart 及 Charles D Booth 認為，香港新破產清盤法之擬制不佳，以致產生了很多爭議點。從事公司法與破產清盤法的律師們會注意，以往經常出現因立法草擬水平之不足以致《公司條例》（第 32 年）的修訂欠妥。類似問題最近再次出現，特別在 Setaffa Investments Ltd [1998] 2 HKLRD 236（主審法官為高等法院原高等法院法官黃英傑）一案中尤為明顯。一如以往，Setaffa 案揭示出問題的，其出現的原因，是草擬者把聯合王國法庭可以是實行普通法的時候，卻沒有徹底把該些法庭完全交過。正如英國法院指（見第 246 頁）：「關於香港法例乃仿效聯合王國法例，草擬者是這樣，很難說是首次出現。」本文之論述有三：（一）說明 Setaffa 案的判決；（二）提出新破產清盤法中曾出現類似問題的其他地方；及（三）讓讀者留意到有關最近被援引破產清盤法的新規定權力的境外法律效力在實務上的困難。

Setaffa 案破盤後的利息
增訂於《公司條例》。《公司法修訂條例》
把新的第 264A 條增訂在《公司條例》。第264A 條規定的事項之一，是規定有清償能力
之公司，在清償後所欠下的債券的抵償處理
方式。第 (1) 條規定，公司（非是無能力債
券）的，在清償後所欠的債券之後所剩
餘的任何債務除非

在用於任何其他目的之前，原用於支
付該等債券尚未清償的額度內該等債券
的抵償。如出現時自動清償，則該
期滿後開始清償之日（到期日起）。

第 264A 條規定適用於在 1997 年 2 月 10 日後
開始的清償案件。但 Setafa 案所提出的事
項是該條文在適用於在上述日期前開始的
清償案件。

在 Setafa 案中，香港的證券商在 1983 年
已開始，但直至第 264A 條生效時，仍有一
個可觀的金額尚未被償還。當中論點之一，為第 264A 條可能引致適用於在 1997 年 2 月 10
日之前進行的分拆，從而令該等債券應延遲
清償。這論點似乎不大可能，但亦可被提出
原因是在第 264A (2) 條幾乎是无法从德
士的有關規定的適用性

聯合國《1986 年破產清盤法令》特別
處理這個問題。方法是增加有關終止權力
的過渡性條文（見該法例第 17 條）。該
條例規定，一旦在指定日期前進行的交際，
只在該交易可按新條例作一般新條例之
條件下，該交易才可根據舊條例作廢止。這
條例的效果，是它把其重點放在新條例上，但
同時防止了不公平的情況。原因是它禁止新
條例被用於根據舊條例不能作廢止的交易
之上。

但香港的法律規定亦沒有抄錄上述第
17 條。結果是，在我們從 Setafa 案看到，
增訂條例中並沒有任何適用條文。但根據
基本原則，當缺乏明確條文或清晰的指引
時，新的終止權力不能被視為適用於在 1998
年 4 月 1 日前進行的交易，假若在進行時
間是有效及無瑕疵的交易關係可能會作予
可予廢止。若新的終止權力不適用（正如上
文提出），那麼舊有法律是否繼續適用於此
等交易呢？有關《釋義及通則條例》（第 1
卷）第 23 條，答案是肯定的。這是說，雖
舊有條例條文已被《破產法修訂條例》
廢止，但該等條文必須繼續適用於在 1998 年
4 月 1 日前出現的交易，縱使有關的破產程序
於該日後才開始。

總的來說，律師們應注意到，破產家產
中的某些終止權力並無適用，而舊有條文
則繼續適用於在 1998 年 4 月 1 日前發生的
事件及交易，縱使有關破產於該日後才開始。故
此，律師們最好顧及保存舊有的法律條
文。

破產案中的新

的終止權力並無適用於
在 1998 年 4 月 1 日前
發生的事件及交易

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此，律師們最好顧及保存舊有的法律條
文。

境內法律效力：《清盤規則》須修訂

正如上文提及，《破產法修訂條例》下的新
的終止權力，基本上是反映美國的法律例
條文（見《1986 年破產清盤法令》第 339
條）。近年來，英國法院均棄絕地承認這
些美國的終止權力具有境內法律效力（見
Re Paramount Airways Ltd (in admin) [1993]
Ch 223—案；及 P Smart 著《跨境破產清盤》
[第二版] 1993 年第 17 至 27 頁）。要注意
的是，英國對於有關公開公司無能力債券
公司董事的法律，抱著不同的觀點（見 R &
Seagull Manufacturing Co Ltd [1993] Ch
3 4 5 6），考慮到《破產法修訂條例》的來
源，香港原法律對於新的終止權力亦很可
能（若非勢在必行）採取相同的態度及立場。
與 1986 年 4 月 1 日後的情況（即一般認為終止
權力的權限在香港境內）：見 American Express
International Banking Corp v Johnson [1984]
HKL 372 (一樣的用意）比較，顯示了
極大的差異。明顯的是，在現時金融市場
的現狀環境下，我們需要充分考慮到新
的終止權力的權限具有境內法律效力。
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Contents Outline:
- Volume 1(1) Table of Cases Reported
- Volume 1(2) Table of Cases Referred To
- Volume 2 Subject Index and Table of Legislation Referred To

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