<table>
<thead>
<tr>
<th>Title</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>Author(s)</td>
<td>Smart, PSJ; Booth, CD</td>
</tr>
<tr>
<td>Issued Date</td>
<td>1999</td>
</tr>
<tr>
<td>URL</td>
<td><a href="http://hdl.handle.net/10722/44888">http://hdl.handle.net/10722/44888</a></td>
</tr>
<tr>
<td>Rights</td>
<td>This work is licensed under a Creative Commons Attribution-NonCommercial-NoDerivatives 4.0 International License.</td>
</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 HKLRD 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 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(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 before 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 Seagull 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 edition of the supplements 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 teach insolvency law at the University of Hong Kong

新破產清盤法：陷阱與漏洞

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到，以往經常出現因立法草率水準之不佳以致《公司條例》（第 32 章）的修訂欠妥。現時問題再次出現，特別在 Re Setaffa Investments Ltd [1998] 2 HKLRD 236（主審法官為高等法院原書法庭法官蘇英超）一案中尤為明顯。一如以往，Setaffa案揭示的問題，其出現的原因，是草率者把複合王國法例可以說是無所不包，但沒有徹底把複合法例完全納入。正如訴訟法法官指出（見第246頁）：「當香港法院採取有效聯合王國法例，草率者有這樣的典範，很難說是首次出現。」本文之論旨有三：（一）說明 Setaffa案的結論；（二）指新破產清盤法中出現類似問題的其他地方；及（三）讓律師留意到有關最近被納入破產清盤法的新程序的權力的境外法律效力在實務上的困難。

Setaffa案與清盤後的利息
破產案中的新嘗試：廢止權力並無追選適用，而舊有條文將繼續適用於在1998年4月1日前發生的事件及交易

聯合國《1986年破產清盤法令》特別處理這類問題，方法是廢除有關廢止權力的過渡性條文（見該法令第11條）。該條文規定，只在指定期限前進行的交易，只可在廢除權力繼續適用的情況下，該宗交易才可根據新條例被廢止。這做法的動機是，它既定焦點放在新條文上，但同時防止了不公平的現象。廢除權力被用於廢除原有法律不能從廢止的交易之上。但香港的法律專家亦沒有抄襲上述第17條的作法，香港在廢除權力後亦有脫離適用於在1998年4月1日前進行的交易。香港在廢除權力後亦有脫離適用於在1998年4月1日前進行的交易。

過渡期問題及廢止權力

《公司法修訂條例》不同的是，該例第99條包括了過渡性條文。其實質上規定，對於在《破產法修訂條例》生效日期（即1998年4月1日）前已開始的破產案件而言，「舊有條文」將繼續適用（除了一些有關豁免破產的重要例外情況）。故此，破產案受託人的廢止權力而已，而舊有條文仍在破產法院根據在1998年4月1日前出現的事件，及適用於在1998年4月1日前發生的事件。
法律改革委员会及其破產清盤附屬委員會對廢止權力的影響并不大。另一方面，《1996年破產（修訂）條例草案》以及《破產法修訂條例》中均包括了聯合國法例的條文。香港的破產受託人及清盤人能夠更有效地監察更有效的廢止權力對此我們感到非常高興。我們唯一的意見是，有關的法律改革組織在推行改革時對此重要項目竟然完全不作討論，這是比較奇怪的。

有關的附屬法例必須儘快被修訂，使破產受託人及清盤人可真正從新的廢止權力的境外法律效力中獲益。


總結
Setoff案的裁決，顯示了對於此類法例草案範例的評論，絕非吹毛求疵。有關草案者未有充分把聯合國法例條文抄過去，這不但產生了灰色地帶，而且更引致了不必要的爭議。為了避免在新的廢止權力的選項上出現類似的混亂，政府財政局長應考慮在《破產規則》及《公司條例》下一期的修訂中同時包括新舊兩類條文。最後，有關的廢止權力必須儘快被修訂，使破產受託人及清盤人可真正從新的廢止權力的境外法律效力中獲益。

Philip Smart及Charles D Booth

在香港大學教授破產清盤法

---

**At Issue**

---

**Use the Consolidated Index to All Reported Hong Kong Decisions**

This is a complete consolidated index of the Hong Kong Law Reports and Hong Kong Cases and also 20 other series of law reports worldwide, in which Hong Kong decisions have been reported.

**Law reports covered from Hong Kong include:**
- Hong Kong Law Reports
- Hong Kong Cases
- Hong Kong Criminal Law Reports
- Hong Kong District Court Law Reports
- Hong Kong Lands Trubunal Law Reports
- Hong Kong Public Law Reports
- Hong Kong Tax Cases
- Hong Kong Conveyancing and Property Reports

**Other series include:**
- All England Law Reports
- Weekly Law Reports
- Fleet Street Reports
- Lloyd's Law Reports

**From 1999, the consolidated Index volumes will be kept up-to-date by way of a bi-monthly looseleaf service.**

**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

For more information please contact: Bryan Barrington • Edmond Cheuk • Tony Tham • Rosa Lee

Butterworths

19/F Eight Commercial Tower, 8 Sun Yip Street, Chai Wan, Hong Kong
Tel: (852) 2965 1400 Fax: (852) 2976 0840