

Principal  
Slotine Maëva Lucile

In association with  
 UGCCAVOCATS

Unit 2102, 21/F, Keen Hung  
Commercial Building  
80-86 Queen's Road East  
Wanchai, Hong Kong

T. (+852) 2483 3818  
F. (+852) 2483 3518  
[www.slotine.hk](http://www.slotine.hk)

## Compulsory winding-up: what to expect once a creditor has petitioned

The term “winding-up” refers to the sale of a company’s assets to settle its debts and distribute the surplus (if any) to its shareholders. Once this process is complete, the company is dissolved.

There are two main types of winding-up procedures in Hong Kong: compulsory winding-up before the High Court, and voluntary winding-up without a court order. This article debunks the myths surrounding court-sanctioned winding-up, which is commonly initiated by a creditor who is owed a debt of HK\$10,000 or more. There are other circumstances in which a company may be wound up by the Court, but these are beyond the scope of this article.

The steps laid out in this article are by no means exhaustive, but simply serve to bring clarity to the process of compulsory winding-up.

*Other articles outlining the steps and stakeholders of **members’ voluntary winding-up and deregistration** (when the company is solvent) and **creditors and directors’ voluntary winding-up** (when the company is insolvent). Visit our website for more information [www.slotine.hk](http://www.slotine.hk).*

## The steps involved in compulsory winding-up

### Statutory demand

A creditor who is owed HK\$10,000 or more serves a statutory demand requiring the debtor to pay. If the debt remains unpaid for 3 weeks, the company is deemed insolvent.

### Court hearing

*About 3 months after the petition is filed*

In the absence of opposition and if the Court is satisfied that all the conditions are met, a winding-up order is made and the provisional liquidator is appointed. If there is a *bona fide* dispute of the debt, the creditor may be ordered to bear the debtor's costs.

### Creditors and contributories' meetings

*Within 3 months of the winding-up order*

The provisional liquidator meets with creditors and contributories to appoint a liquidator and possibly also a committee of inspection to assist and supervise the liquidator. To have the right to vote, each creditor must submit a proof of debt to the provisional liquidator, who may accept or reject it at their discretion.

### Realisation of assets

The process of realising the company's assets and paying the creditors usually lasts 2 to 3 years. When the liquidator asserts that there are no more realisable assets, if the liquidator is a private practitioner, he/she applies to the Court for release as liquidator. If the liquidator is the Official Receiver, he/she files a certificate to the Companies Registry.

### Winding-up petition

A winding-up petition is filed with the Court of First Instance. In most cases, a solicitor is instructed by the creditor due to the strict statutory deadlines and advertising requirements. The Court may appoint a provisional liquidator at any time between the filing of the petition and the winding-up order if it is necessary to protect the company's assets.

### Statement of affairs

*Within 28 days of the winding-up order*

Directors deliver a preliminary examination (with information regarding the company's officers, assets, legal proceedings, cessation of business, etc.), a statement of affairs (equivalent to a balance sheet as of the date of the winding-up order), and the company's assets, books and records to the provisional liquidator. If the total asset value is less than HK\$200,000, the provisional liquidator may apply to the Court for an order of a summary winding-up procedure.

### Appointment order

*Within 3 months of creditors and contributories' meeting*

The nomination of the liquidator is approved by the Court by appointment order. If no agreement can be reached between the creditors and contributories or the Official Receiver has doubts about the suitability of the nominated liquidator, the Official Receiver will offer the name of the next available insolvent practitioner on the roster of the Panel.

### Dissolution

*About 2 years after winding-up petition is filed*  
The company is dissolved.



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## What happens after the compulsory winding-up process has begun

The winding-up process is deemed to have commenced on the date the winding-up petition is presented by the petitioning creditor. From that date onwards:

- any disposition of the company's assets, including any transfer of the company's shares or payment made to the company's creditors after the winding-up petition is presented is void, unless the Court otherwise orders;
- the powers of the directors to manage the company's affairs cease;
- the provisional liquidator takes control of the company's assets, books and accounting records;
- all documents issued by the company must have the words 'in liquidation' after the company's name;
- the company's employees are automatically dismissed, unless the Court orders otherwise;
- no action or proceedings shall be commenced or continued against the company except with the leave of the Court.



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## The stakeholders: roles and responsibilities

- Before winding-up: maintain proper accounting records, have financial statements prepared and lay them before the company timely (among more general statutory and fiduciary duties).
- Prepare and submit the statement of affairs and the directors' preliminary examination to the provisional liquidator.
- Deliver the company's assets, books, records and seal to the provisional liquidator.
- Attend an interview with the provisional liquidator to provide information about the company.
- Attend meetings with the creditors and contributories if requested to do so by the provisional liquidator.
- Potential liability under the CO and the CWUMPO.

### DIRECTORS

- Serve a statutory demand on the debtor and, if it remains unpaid for three weeks, file a winding-up petition with the Court.
- Submit proof of debt and documents substantiating their debts to the provisional liquidator.
- Attend creditors' meetings provided that their proof of debt has been accepted by the provisional liquidator.
- Vote at creditors' meetings by a majority in value of claims.
- Appoint the liquidator and determine his remuneration.
- Appoint a committee of inspection comprising 2-5 creditors (optional).
- Receive payment from the liquidator in accordance with their order of priority.

### CREDITORS

- Vote at shareholders' meetings to appoint the liquidator (the creditors' choice usually prevails) and determine his remuneration.
- Appoint a committee of inspection comprising 2-5 creditors or shareholders to assist and supervise the liquidator.
- Liable to contribute to the assets of the company only in respect of any amount unpaid on their shares.
- Receive any surplus available after payment of all the creditors, according to their respective shareholding, if the proceeds of the winding-up are sufficient.

### SHAREHOLDERS

- Discretionarily accept or reject the proof of debt submitted by the creditors.
- Call meetings of directors and contributories.
- Realise the company's assets and distribute the proceeds to the creditors according to their order of priority.
- Investigate the affairs of the company and its directors.
- Report to the Official Receiver if they become aware of any conduct of a director that makes him/her unfit to be involved in the management of a company.
- Apply to Court for a restoration order in case of transaction at an undervalue or unfair preference; for personal contribution by directors in case of fraudulent trading or misfeasance; or for a disqualification order against a director.

### LIQUIDATORS



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## In focus: directors' duties and liabilities in case of financial distress

The directors have statutory duties of care, skill and diligence under the Companies Ordinance (Cap. 622) (CO) and the fiduciary duty to act in good faith in the best interest of the company. While the directors owe their duties to the company and its shareholders as a whole while the company is solvent, their obligations shift towards ensuring fair treatment of the creditors once the company is in financial distress. Insolvency is assessed based on the cash flow test (the company's inability to pay its debts as they fall due) and the balance sheet test (the company's liabilities exceeding its realisable assets).

If the company is in financial distress, the directors must be prudent and act primarily in the interest of the creditors as a whole with a view to minimising their potential loss. Particular attention must be paid to the conduct of the company's business during the twilight period, i.e. the period when the company transitions from being a going concern to being insolvent.

Most directors' duties apply regardless of whether the company is solvent or not. Apart from statutory and fiduciary duties, directors are responsible for:

- maintaining proper accounting books and records that give a true and fair view of the financial position of the company;
- preparing annual financial statements in accordance with the provisions of the CO; and laying the audited financial statements before the shareholders in annual general meetings.

Without such documents, one cannot assess whether a company is solvent or insolvent, so the directors may be removed and the shareholders may apply to Court for an order requiring the company to disclose its records or documents. The CO serves severe sanctions upon conviction.

In addition, specific potential liabilities arise for directors under the CO and the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (CWUMPO) where the company is in wound-up.

- Transactions at an undervalue, i.e., transactions that provide for the company to receive no consideration or a consideration which is significantly less than the consideration provided by the company, entered into by the company within the five-year period preceding the presentation of a winding-up petition may be invalidated by the Court.
- Unfair preference schemes, i.e., payments made to a person within the six-month period preceding the presentation of a winding-up petition (two years if the recipient is a person connected to the company) that put such person in a better position than other creditors when the liquidation starts, may be invalidated by the Court.
- Any director who was knowingly party to fraudulent trading, i.e., carrying on the company's business with the intent to defraud creditors or for any fraudulent purpose, may be personally liable to contribute to the company's assets.
- Any director who has misapplied or retained the company's assets and used them for his/her own purposes may also be personally liable to contribute to the company's assets (i.e., in practice, the director must repay the company from his/her own funds).



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- A director may be disqualified from acting as a director of any company for up to 15 years in case of (i) fraudulent trading, fraud or breach of duty in the course of winding-up and (ii) conduct of an insolvent company that makes the director unfit to be concerned in company management. The director's unfitness is considered based on several factors, notably the existence of any unfair preference, the incurring of credit during the twilight period without proper consideration of the prospects of repayment in full, the failure to keep proper books and records, the failure to deliver the company's property to the liquidator, the failure to submit the statement of affairs, etc. The Official Receiver has released a non-exhaustive checklist of questions to be answered by a provisional liquidator or liquidator when considering whether to report the conduct of a director. The questionnaire is available from the Official Receiver's website: <https://www.oro.gov.hk/eng/publications/pdf/ORO%20Circular%20No.2-2020.pdf>
- A floating charge created within the 12-month period preceding the presentation of a winding-up petition (two years if the recipient is a person connected to the company) without any money being advanced to the company may be invalidated by the Court.
- A director who has made a gift, transferred or created a charge on the company's property within the two-month period preceding any judgment or order for payment against the company with the intent to defraud creditors may be criminally liable for fraud.

In addition, a company shall not hire new employees if the directors do not believe on reasonable grounds that the company will be able to pay all wages due under the employment contract as they fall due. Otherwise, the directors are liable to a criminal offence under the Employment Ordinance (Cap. 57).

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### **Definitions**

- *Contributories: the shareholders of the company being wound up.*
  - *Official Receiver: Hong Kong Official Receiver's Office ([www.oro.gov.hk](http://www.oro.gov.hk)).*
  - *Panel: the Administrative Panel of Insolvency Practitioners for Court Winding-Up (Panel A for cases where the company's assets are likely to exceed HK\$200,000 in value, and Panel T for cases where the company's assets are not likely to exceed HK\$200,000 in value).*
  - *Provisional liquidator: the Official Receiver or an insolvency practitioner (a solicitor or certified public accountant) from the Panel appointed by the Court to protect and safeguard the assets of the company.*
  - *Committee of inspection: representative body appointed by the shareholders and creditors comprising between two and five creditors (sometimes shareholders too) in charge of assisting and advising the liquidator.*
  - *Liquidator: an insolvency practitioner (a solicitor or certified public accountant) appointed by the creditors and contributories, usually from the Panel, to realise the company's assets and distribute the proceeds to the creditors.*
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*The law in this respect is complex. The information provided in this article does not, and is not intended to, constitute legal advice and should not be relied upon as such.*

*For professional legal advice, please do not hesitate to contact us.*