HCCW000058/1998

HCCW58/98 and HCMP1746/99

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

COMPANIES WINDING-UP NO.58 OF 1998

AND

MISCELLANEOUS PROCEEDINGS NO.1746 OF 1999

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IN THE MATTER OF SHARP BRAVE COMPANY LIMITED (IN LIQUIDATION)

and

IN THE MATTER OF THE COMPANIES ORDINANCE CAP.32

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Coram : The Hon Mrs Justice Le Pichon in Court

Dates of Hearing : 20 and 22 July 1999

Date of Judgment : 22 July 1999

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J U D G M E N T

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There are two matters before me : the first is a petition seeking the court's sanction under section 166 of the *Companies Ordinance* to a Scheme of Arrangement ("the Scheme") between Sharp Brave Company Limited (In Liquidation) ("Sharp Brave") and the Scheme Creditors as defined in the Scheme annexed to the petition; the second is an application for a stay of all further proceedings in the winding-up of Sharp Brave.

*The petition*

Sharp Brave is a wholly owned subsidiary of Northern International Holdings Limited ("Northern"), a company listed on the Stock Exchange of Hong Kong Limited. On 26 January 1998, Leung Kee Holdings Ltd. ("Leung Kee") petitioned for the winding-up of Sharp Brave based on an unpaid debt of over $9 million. A winding-up order was made on 30 June 1998. At that date, Sharp Brave had debts in excess of $132 million. Of these, approximately $72 million or 54.4% was to companies within the Group.

Shortly after the making of the winding-up order, Northern wrote to all the creditors of Sharp Brave other than Leung Kee for their in-principle approval to accept part payment of the amounts owed by Sharp Brave together with the shares in Northern in full and final settlement of their claims. In view of the positive response, Northern decided to fund and support the Scheme because it was detrimental to the business of Northern and the Group to have one of its subsidiaries in liquidation and that fact also made it difficult for Northern to approach the market for further investment. Northern entered into discussions with the Official Receiver culminating in the appointment of Simon Richard Blade and Stephen Peter Stuart Weatherseed as Special Managers by order dated 11 December 1998. The Special Managers were empowered specifically to promote the Scheme proposed by Northern and for the stay of the winding-up of Sharp Brave if the Scheme should be sanctioned by the court.

The Special Managers have filed an affidavit in which they opined that the projected return ranged from a low of 0.5 cent to a high of 9 cents in the dollar. The Special Managers explained that the estimates of realizations and dividend forecasts took into account the fact that a substantial portion of Sharp Brave's assets and the parties against which Sharp Brave may have claims are situated in the PRC and recovery of assets and enforcement of claims might involve significant professional costs with uncertain results for the creditors. The Special Managers have also drawn attention to a number of potentially questionable transactions which a liquidator would investigate further. They relate to three specific areas summarized below.

*(i) Inter-company reorganization*

Immediately before the winding-up order, the board of Sharp Brave resolved to execute a memorandum relating to the reorganization of inter-company balances. The result was that Sharp Brave had set off $139 million of debts due to it from Group companies against amounts owed to it by Group companies. The result is that the Group companies obtained full payment for $139 million of liabilities for which they would otherwise have ranked *pari passu* in the liquidation of Sharp Brave. These transactions are believed to be void pursuant to section 182 or would be attacked as unfair preferences. If the reorganization were held void, Sharp Brave would have a claim of $151 million against certain of the Group companies. However, it would appear that only three of such companies (which are PRC companies) have any significant assets and a further result in voiding the reorganization would be to reduce the non-Group creditors' claims from 46% to 22% as a proportion of the total amount claimed.

*(ii) Post-winding-up petition payments*

Payments totalling approximately $6 million of which nearly $3 million relate to Group companies have been identified as payments which may be found void pursuant to section 182 of *Cap.32,* having been made during the five-month period between the date of the petition and the winding-up order.

*(iii) Cash book review*

Payments totalling $102 million have been identified as potentially open to attack as antecedent transactions. These were payments made to former directors, businesses associated with them and fellow Group companies and another business.

All these matters are set out in considerable detail in the explanatory statement accompanying the Scheme sent to the creditors of Sharp Brave.

*The Scheme*

In essence, non-Group creditors are offered 9 cents together with 7.15 shares in Northern. Group creditors will receive 5.6 cents only. As Northern shares are trading at approximately 5 cents, Northern's overall offer to Sharp Brave's non-Group creditors is worth approximately 45 cents in the dollar.

Pursuant to the order dated 25 May 1999, a court convened meeting was held on 4 June 1999. Directions were given by the court for the sending out of notices to convene the court meeting, enclosing a copy of the Scheme Documents to be sent by prepaid mail or air courier as appropriate. The directions given by the court have not been fully complied with in that the notice and enclosures to be sent to the overseas creditor was sent by airmail and facsimile rather than air courier. At the hearing on 20 July, counsel explained that the reason was that the creditor had a representative based in Hong Kong who was also provided with a copy of the notice and enclosures. After the hearing on 20 July, a supplemental affidavit was filed to verify this fact. In view of the explanation given, the court is prepared to waive the technical non-compliance with the directions. That there is power so to do is clear : see **Re Anglo-Spanish Tartar Refineries Limited** [1924] WN 222 applied in **Re Kansa General International Insurance Co. Ltd.** [1999] 1 HKC 254 at 262A-B/C. The statutory meeting was held and over 99% in number and value of the creditors who voted were in favour of the Scheme. Under the Scheme, only non-Group creditors could vote.

Whilst it is the exception rather than the norm that a scheme of arrangement should be promoted after the Company has been wound-up (and it would appear that there is no case law on the point), section 166(1) itself contemplates a scheme being put forward when the company is being wound-up. An application by a liquidator is certainly envisaged. Perforce the company must by that time already be in liquidation.

I am satisfied that the statutory conditions have been complied with, the Scheme was properly explained in the explanatory statement, the meeting was duly convened and the resolution passed by the requisite majority. As the Group creditors abstained from voting, it laid to rest any possible doubt as to the proper constitution of the class in that it cannot possibly be contended that the wishes of the Group creditors overrode those of the non-Group creditors.

In considering whether the court should exercise its discretion to sanction the Scheme, the relevant test is whether the Scheme is one which, as an intelligent and honest man, a member of the class concerned in acting in respect of his interest might reasonably approve of : see *Buckley on the Companies Act* (13th Edn.) 1957, page 409, cited with approval by Ploughman J in **In re National Bank Ltd.** [1966] 1 WLR 819 at 829. Applying that test, I have little doubt that the Scheme is one which the court should sanction in the exercise of its discretion.

*Stay of winding-up proceedings*

The second matter before me is whether I should accede to the application for a stay. The effect of such a stay would be to bring the winding-up to an end.

Counsel for the Special Managers relied on the following passage in McPherson & O'Donovan on *The Law of Company Liquidation*, 3rd Edn. at page 443 :

"A company which is put into liquidation undergoes a change of status...Because these changes are the result of statutory enactment, they cannot be displaced by any act whereby the company of its own motion reverts to its former state. This can only be achieved by obtaining an order of the court staying the proceedings in the winding-up."

She also referred to *Halsbury's Laws of Hong Kong* Vol.6 [95.1340] at page 961 :

"The court may, at any time after the order for winding up, make an order staying the proceedings, either altogether or for a limited time on such conditions as it thinks fit, on the application of either the liquidator or the Official Receiver or of any creditor or contributory...A stay is often applied for in pursuance of a scheme of arrangement sanctioned by the court."

It would appear from the decision of Buckley J in **In re Telescriptor Syndicate Limited** [1903] 2 Ch 174 at 180 that :

"...in the exercise of its jurisdiction with reference to staying proceedings under an order for the winding-up of a company, the court ... refuses to act upon the mere assent of the creditors in the matter and considers not only whether what is proposed is for the benefit of the creditors, but also whether the rescission or annulment will be conducive or detrimental to commercial morality and to the interests of the public at large."

At the hearing on 20 July, the court enquired whether the present management had been involved with any of the three areas of questionable transactions to which reference has already been made. An adjournment was granted for further evidence to be filed. Also, it appeared to the court that whilst special managers have been appointed, the Official Receiver may well wish to appear and assist the court.

At the adjourned hearing on 22 July, a further affidavit was filed by Mr Blade. In that affidavit Mr Blade sets out his understanding gained from discussions with Northern which is that Northern does not intend that Sharp Brave should resume trading.

Of course the consequence of staying the winding-up proceedings will be that the two directors who have been involved in one or more of the questionable transactions would automatically resume their responsibilities. The Official Receiver is of the view that it would not be in the public interest for such directors to continue to act as directors having regard to their involvement in the questionable transactions.

The court is firmly of the view that a stay which would enable these two directors to resume responsibilities for the running of this Company is not in the public interest, albeit it is not the present intention that the Company should be involved actively in business once the stay is granted. Nevertheless, it is possible that at some future date, it may be thought appropriate for the Company to become active again. In the circumstances, counsel was invited to consider whether a stay could be made on the basis that the two directors no longer act. In the result, the two directors concerned are content to resign from the board.

On this basis, I will order a stay of the winding-up proceedings, such stay to take effect upon the resignation of the two directors from the board of Sharp Brave.

(Doreen Le Pichon)
Judge of the Court of First Instance
High Court

Representation:

Miss Mairead Rattigan, inst'd by M/s Cameron McKenna, for the Special Managers

Miss Angel Li for the Official Receiver