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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a binding contract arise as a result of the behaviour of the parties?

Other than with respect to certain types of contracts (and provided that the common law requirements of contract formation, such as offer, acceptance, consideration, legal formalities and capacity are met), there is no general requirement under Hong Kong law that a sale of goods or services be evidenced by a formal contract (assuming "formal" means an agreement be in writing or evidenced in writing). As such, it is possible for a contract to arise solely from the behaviour of the seller and obligor in the absence of a written contract to the contrary.

An invoice, depending on the detail and nature of its terms, may be sufficient to evidence a contract between the obligor and the seller. In particular, an invoice may incorporate, by way of reference, the seller's standard terms and conditions. Furthermore, a court in Hong Kong may also imply further terms by examining the course of previous dealings between the obligor and the seller or imply terms which may arise by custom or trade usage within a particular industry.

1.2 Consumer Protections. Do your jurisdiction's laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Yes, there are Hong Kong laws that may limit the applicable rates of interest. The Money Lenders Ordinance (Cap. 163) operates to limit rates of interest in certain circumstances. In particular, any loan agreement that contains a provision requiring the payment of interest where:

(a) the rate of interest exceeds 48% – is deemed to be extortionate and the terms of such an agreement are susceptible to amendment by a Hong Kong court; or

(b) the rate of interest exceeds 60% – is rendered unenforceable (together with any security provided to support such loan) and is a criminal offence with a maximum penalty of HK$5,000,000 and 10 years' imprisonment.

In this context, the Money Lenders Ordinance does not apply to "authorized institutions" as lenders as defined in the Banking Ordinance (Cap. 155), nor does it apply to loans made to a company with paid up share capital of at least HK$1,000,000.

A provision in a contract which provides for the payment of an additional sum of money upon breach of the contract may amount to a penalty and be unenforceable under Hong Kong law if the sum stipulated to be paid for such a breach is not a genuine pre-estimate of the greatest conceivable loss likely to be suffered by the non-defaulting party.

There is no general consumer protection legislation in Hong Kong. However, there are specific regulations which are relevant in certain industries, such as insurance and structured products. In addition to the Money Lenders Ordinance, there are also several ordinances of general application which may provide rights to consumers, such as the Sale of Goods Ordinance (Cap. 26), the Control of Exemption Clauses Ordinance (Cap. 71), Supply of Services (Implied Terms) Ordinance (Cap. 457) and Unconscionable Contracts Ordinance (Cap. 458). Please see the response to question 8.4 below for further details.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Contracts entered into by the government or a governmental body are governed by ordinary principles of Hong Kong law, subject to, in the case of a governmental body, any limitations that may be set out in the statutory instrument that establishes such body.

Neither sovereign immunity nor crown immunity applies to the Hong Kong government and its entities. The Hong Kong government has effectively waived its immunity from legal proceedings under the Crown Proceedings Ordinance (Cap. 300).

However, care must be taken to distinguish contractual arrangements with the Hong Kong government and contractual arrangements with the mainland government of the People's Republic of China. The *Hua Tian Long (No. 3)* [2010] 3 HKC 557 decision confirmed that the mainland government of the PRC is entitled in certain circumstances to exercise crown immunity before the Hong Kong

courts unless waived. The essential test is whether the counterparty can be considered an instrumentality of the PRC government or any of its ministries and regional counterparts. Other factors include whether: (a) the board of directors are able to exercise independent discretion; (b) the entity is managed and/or established by a PRC state or government entity; (c) whether it has statutory powers conferred upon it or carried out the functions of a PRC state or government entity; and (d) whether it is required to seek approval for its day-to-day or commercial operations by any PRC state or governmental entity.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in your jurisdiction that will determine the governing law of the contract?

In the absence of a choice of law provision, the courts of Hong Kong would look to the jurisdiction which has the most real and substantial connection to the dispute.

2.2 Base Case. If the seller and the obligor are both resident in your jurisdiction, and the transactions giving rise to the receivables and the payment of the receivables take place in your jurisdiction, and the seller and the obligor choose the law of your jurisdiction to govern the receivables contract, is there any reason why a court in your jurisdiction would not give effect to their choice of law?

There is no reason.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in your jurisdiction but the obligor is not, or if the obligor is resident in your jurisdiction but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in your jurisdiction give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Hong Kong courts will generally give effect to the choice of foreign law, provided that such choice has been made *bona fide* and is not against public policy.

Notwithstanding the valid choice of a foreign law to govern the receivables contract, Hong Kong mandatory laws may nevertheless apply to certain aspects of any agreement between the obligor and the seller. For example, transfers of an interest in land would be governed by Hong Kong law, irrespective of the otherwise valid choice of a foreign law to govern the contract.

2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in your jurisdiction?

It is not clear whether the CISG applies in Hong Kong. The Hong Kong Department of Justice does not list the CISG as a treaty applicable to Hong Kong.

Furthermore, there is inconsistent international case law and commentary as to whether declarations made by the People's Republic of China have:

(a) by an affirmative declaration (as contemplated under article 93 of the CISG), excluded the CISG from applying to Hong Kong (being a territory of the PRC); or

(b) failed to make an affirmative declaration, with the result that (by operation of article 93(4) of the CISG) the CISG automatically applies to Hong Kong.

3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does your jurisdiction's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., your jurisdiction's laws or foreign laws)?

No, Hong Kong law does not require the sale of the receivables to be governed by the same governing law as the receivables themselves.

However, if the receivables contract is governed by Hong Kong law, the assignment of the receivables would be subject to perfection requirements as established under Hong Kong law. This is in addition to the issues set out above in the response to question 2.3 (i.e. Hong Kong mandatory laws).

3.2 Example 1: If (a) the seller and the obligor are located in your jurisdiction, (b) the receivable is governed by the law of your jurisdiction, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of your jurisdiction to govern the receivables purchase agreement, and (e) the sale complies with the requirements of your jurisdiction, will a court in your jurisdiction recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, a court in Hong Kong will recognise the sale as being effective against the seller, the obligor and third parties.

For this response and the responses below, we have assumed that "located in Hong Kong" means that the relevant party is (for a company) incorporated in Hong Kong, rather than a non-Hong Kong company that has an established place of business in Hong Kong and registered under Part 16 of the Companies Ordinance (Cap. 622). Whether the sale of the receivables is upheld as a "true sale" against the insolvent estate of a non-Hong Kong company depends on the insolvency laws of the jurisdiction of incorporation of that company.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside your jurisdiction, will a court in your jurisdiction recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

Yes, a court in Hong Kong will recognise the sale as being effective against the seller and third parties.

3.4 Example 3: If (a) the seller is located in your jurisdiction but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in your jurisdiction recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with your jurisdiction's own sale requirements?

In the event of enforcement against the seller before any insolvency proceeding in relation to it, it is likely that a Hong Kong court will recognise the sale as valid and enforceable against the seller (assuming of course the receivables purchase agreement is itself valid, binding and enforceable). As the relevant agreements in this scenario are governed by non-Hong Kong law, the situation envisaged here is enforcement post-foreign judgment against the seller. The response to this question therefore turns on whether a Hong Kong court would recognise and enforce a foreign judgment against the seller (for example, it may not be enforceable if it is against Hong Kong public policy).

However, notwithstanding that the transaction is recognised as a sale by the laws of the obligor's jurisdiction, in the event of insolvency proceedings commencing with respect to the seller, it is likely that a Hong Kong court would apply Hong Kong law true sale analysis to the transaction to determine whether it is treated as a true sale in accordance with the legal tests set out in the response to question 4.9 below.

3.5 Example 4: If (a) the obligor is located in your jurisdiction but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in your jurisdiction recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with your jurisdiction's own sale requirements?

There is no requirement in Hong Kong that the sale be in accordance with Hong Kong law for it to be enforceable against the obligor (subject to the limitations listed in the response to question 4.4 below). However, the question of whether the receivable is enforceable by the purchaser against a Hong Kong obligor depends on the nature of the receivable and the identity and characteristics of the obligor (for example, if the obligor is a consumer, he or she may have remedies available under Hong Kong law notwithstanding the location of the seller or purchaser or the governing law of the receivable – as further set out in the response to question 8.4 below).

3.6 Example 5: If (a) the seller is located in your jurisdiction (irrespective of the obligor's location), (b) the receivable is governed by the law of your jurisdiction, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in your jurisdiction recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in your jurisdiction and any third party creditor or insolvency administrator of any such obligor)?

As noted in the response to question 3.4 above, on the insolvency of the Hong Kong seller, a court in Hong Kong is likely to apply Hong Kong law true sale analysis to determine whether it is treated as a sale or a secured transaction.

For an obligor located in Hong Kong, the same considerations as set out in the response to question 3.5 apply. True sale analysis is not relevant with respect to the obligor, as its obligations under the receivables contract remain unchanged irrespective of whether the sale amounts to a sale or to a secured transaction between the seller and the purchaser.

4 Asset Sales

4.1 Sale Methods Generally. In your jurisdiction what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The customary method to sell receivables in Hong Kong is a legal or equitable assignment by way of sale. However, receivables may also be sold by way of novation or through a declaration of trust. The term "transfer" has no legal meaning under Hong Kong law but is typically synonymous with a legal or equitable assignment.

A legal assignment is an assignment which meets the criteria set out in Law Amendment and Reform (Consolidation) Ordinance (Cap. 23), being:

(a) an absolute assignment by way of sale of the assignor's entire legal interest in the receivables;

(b) in writing and signed by the assignor; and

(c) with express written notice of the assignment (in particular the date of assignment and the identity of the assignee) given to the obligor. The notice need not be in any particular form and may be given by any party.

An equitable assignment is an assignment which has not met all the required criteria necessary to create a legal assignment. Typically, an equitable assignment arises due to a commercial or practical decision to not provide notice to the obligor at the time of assignment and/or a transfer of a part (but not all) of a receivable. Nevertheless, courts of Hong Kong recognise an equitable assignment, but such an assignment has a number of practical and legal limitations (for example, priority is affected as set out in the response to question 4.2 below).

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The requirements to perfect the sale of receivables are, for an assignment by way of sale, set out in the criteria to establish a legal assignment in the response to question 4.1 above.

Perfection and priority against a subsequent good faith purchaser for value of the same receivables requires notice to be given to the obligor before the subsequent good faith purchaser has given its notice to the same obligor (unless the subsequent purchaser had knowledge of the earlier assignment at the time that they were assigned the same receivables).

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The sale of promissory notes is governed by the Bills of Exchange Ordinance (Cap. 19), which requires transfer by way of delivery or by way of endorsement and delivery.

For the sale of mortgage loans, the Conveyancing and Property Ordinance (Cap. 219) requires that the assignment of any equitable interest in land be created or disposed of by an instrument in writing and signed by the person creating or disposing of the equitable interest. The assignment of a mortgage loan must also be registered with the Land Registry pursuant to the Land Registration Ordinance (Cap. 128) within one month of the assignment in order to maintain priority over subsequent interests in the same land.

Marketable debt securities may either be in bearer form or registered form. By their very nature, bearer notes only require delivery of the relevant instrument from the seller to the purchaser in order to transfer title. The sale and transfer of ownership of registered notes requires an entry to be made to a register maintained by a registrar on behalf of the issuer of the registered notes. It is only when such register is updated that legal ownership in the notes is transferred from the seller to the purchaser. Please see the response to question 5.5 below for further information.

For consumer loans, please see the response to question 8.4 below.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Notification to the obligor is not mandatory in order for the sale of receivables to be effective against the obligor or creditors of the seller. However, as noted above in the response to question 4.1, there are a number of practical and legal difficulties that arise from an assignment without notice to the obligor (that is, an equitable assignment rather than a legal assignment). Therefore, unless notice is given, the following issues may arise:

(a) the obligor may discharge its liabilities by making payments solely to the seller, regardless of whether the seller must account to the purchaser for moneys received from the obligor;

(b) the obligor may claim set-off and raise equities and defences against the seller which it may not have been able to raise against the purchaser;

(c) as set out in the response to question 4.2 above, a subsequent purchaser of the same receivables may give notice to the obligor prior to the purchaser such that they gain priority;

(d) the purchaser must join the seller to any proceedings against the obligor; and

(e) the seller and the obligor may amend the relevant receivables contract without the consent or knowledge of the purchaser (although, as a matter of practice, the seller would usually covenant not to do so under any receivables purchase agreement).

Consent from the obligor is required where the underlying receivables contract prohibits assignment of the contract to a third party. A sale will not be enforceable against the obligor if the assignment is made in breach of such a prohibition.

The assignment of a contract, where such contract is silent as to the ability of a party to assign its rights, will generally be valid and effective, although Hong Kong law prohibits assignment for certain specific types of contracts or where it is against public policy to do so.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings have commenced against the obligor or the seller? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no specific legal requirements as to the form of notice to be given to the obligor. However, English case law decided prior to 30 June 1997 and which continues to apply in Hong Kong (as developed by the common law in Hong Kong), has emphasised that any notice of assignment must, at the very least, specify the relevant date of such assignment and clearly specify the identity of the assignee. It must also be sufficiently clear as to the receivables being assigned. Furthermore, such notice must be expressly provided to the obligor – it is not sufficient that notice to the obligor be inferred or implied in the circumstances.

Notice may be given after the obligor or seller has entered insolvency proceedings.

English case law also has held that notice of assignment of a future receivable is not valid if such receivable had not come into existence before such notice was given.

4.6 Restrictions on Assignment – General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)? Is the result the same if the restriction says "The obligations of the [seller] under this Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights)?

Restrictions on assignment are generally enforceable in Hong Kong as between the assignor and the assignee. It is not legally correct to state that an agreement is "assigned" or "transferred", but this is taken in layman's terms to mean the assignment of any rights arising under the relevant agreement. As such, whichever way the relevant clause is drafted, it is taken to be referring to the assignment of rights under the relevant agreement. The interpretation of assignment restriction clauses follows the English decision of *Linden Gardens Trust Limited v Lenesta Sludge Disposals Limited* [1994] 1 AC 85 (which has been considered by the courts of Hong Kong in *Zhang Qiyun v Shun Shing Construction & Engineering Co Ltd* [2010] HKCU 604), which held that such a clause will be effective as against the obligor and the purchaser, but will not affect relationships between the obligor and seller and the seller and purchaser (i.e. the assignor will remain liable to the assignee for the failed assignment).

It is not possible to "transfer" or "assign" an obligation under Hong Kong law, this must be completed by way of novation, which would require express consent and agreement of both the seller and obligor (together with the purchaser). This is the case even if the "transfer" is by way of book entry only (i.e. the debiting of account with the simultaneous crediting of another account) as this is considered under English law to be a novation rather than an assignment (*R v Preddy* [1996] AC 815).

The final formulation does not specifically prohibit the transfer of rights (with or without consent). Therefore, under the final formulation, it may be possible to assign certain rights without consent.

4.7 Restrictions on Assignment; Liability to Obligor. If any of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables or "seller's rights" under the receivables contract, are such restrictions generally enforceable in your jurisdiction? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If your jurisdiction recognises restrictions on sale or assignment of receivables and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or tort, or on any other basis?

Notwithstanding the general enforceability of a prohibition of assignment, the decision of *Don King (Productions) Inc v Warren (No 1)* [2000] Ch 291 affirmed that it is possible to establish a trust over the rights that the seller would have under the contract. Therefore, provided that there is no clear prohibition (which the *Barbados Trust Co Ltd v Bank of Zambia* [2007] EWCA Civ 148 decision confirmed could be enforceable and binding as against the seller) over establishing a trust over the rights of a contract, it is possible under Hong Kong law (assuming the Hong Kong courts follow the English common law position) to nevertheless replicate the commercial effect of assigning an interest in the receivables contract to the purchaser notwithstanding the existence of a prohibition of assignment clause.

If a seller sells a receivable in breach of contractual restriction of assignment, the seller may be liable to the obligor for breach of contract and the purchaser may be liable for the tort of inducing another (that is, the seller) to breach a contract.

4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must identify the receivables with such specificity such that they are capable of being ascertained, whether they are in existence or will come into existence in the future. Furthermore, a declaration of trust will not be validly established if there is a lack of certainty in the subject matter of the trust (being the receivables in this case).

There is no requirement that receivables share any objective characteristics.

It is sufficient to identify all receivables of the seller for the purposes of ascertaining which receivables are to be the subject of any receivable sale agreement.

4.9 Recharacterisation Risk. If the parties describe their transaction in the relevant documents as an outright sale and explicitly state their intention that it be treated as an outright sale, will this description and statement of intent automatically be respected or is there a risk that the transaction could be characterised by a court as a loan with (or without) security? If recharacterisation risk exists, what characteristics of the transaction might prevent the transfer from being treated as an outright sale? Among other things, to what extent may the seller retain any of the following without jeopardising treatment as an outright sale: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; (d) a right of repurchase/ redemption; (e) a right to the residual profits within the purchaser; or (f) any other term?

The label which parties give to a transaction is not determinative as to the true characterisation of that transaction. As such, the fact that the parties agree that the transaction be treated as a sale is one factor which a court in Hong Kong would consider when determining whether the transaction is a "true sale" or whether it should be characterised as another type of transaction (such as the granting of security or a secured loan).

The first step of any analysis is to examine whether the transaction is of a different legal nature than that which it purports to be. The Court of Appeal in *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 used a two-stage test to determine the answer to this first question. Firstly, is the arrangement a sham intended to hide the true agreement reached between the parties? Secondly, assuming that the transaction is not a sham, what is the legal characterisation of the transaction between the parties?

The English decision of *Re George Inglefield Ltd* [1933] Ch 1 (which has been applied by the Hong Kong courts in the decision of *Hallmark Cards Inc v Yun Choy Ltd* [2012] 1 HKLRD 396) illustrates a number of factors which the court would consider when determining the answer to the second step of the analysis, by looking at whether a particular transaction is a sale or whether it amounts to a transaction involving the granting of security. The non-exhaustive factors include the following:

(a) under a sale, the seller is not entitled to recover the property sold by returning the purchase money to the purchaser. In contrast, the provider of security is entitled to recover the property that is the subject of the transaction as a right called an "equity of redemption" upon return of the money (together with any interest or other amounts owed);

(b) under a sale, the purchaser is free to sell the property without having to account for any profit to the seller. In contrast, the provider of security is entitled to any surplus arising from the sale of the property (after discharge of any secured obligations) that was subject to the relevant security interest; and

(c) conversely, under a sale, if the purchaser sells the property at a loss, it cannot look to the seller to make good that loss, whereas under a secured transaction, the provider of security may be required to make good that loss to the security taker.

Notwithstanding the factors listed above, courts in Hong Kong (and England) have nevertheless found that a transaction amounts to a sale even though:

(a) the purchaser has recourse against the seller to recover the shortfall if the obligor fails to pay the debt in full;

(b) the purchaser may have to make adjustments and payments to the seller after the full amounts of the debts have been received from the obligor;

(c) the seller remains as servicer and responsible for collections from the obligors; and

(d) the seller assumes interest rate risk through the provision of any interest rate hedging arrangement.

Retaining control over collections will not, of itself, affect the true sale analysis. However, an unfettered right of the seller to repay the purchase price to repurchase all the receivables may undermine the true sale nature of the transaction.

4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner to continuous sales of receivables (i.e., sales of receivables as and when they arise)? Would such an agreement survive and continue to transfer receivables to the purchaser following the seller's insolvency?

Yes, under Hong Kong law the seller can agree to the continuous sale of receivables.

The sale of any receivable after the date of a winding-up petition (assuming that a winding-up order has been made by a Hong Kong court) is void without court approval.

4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to versus after the seller's insolvency?

Yes, under Hong Kong law the seller can agree to assign in equity receivables that come into existence after the date of the receivables purchase agreement. In such a case, the promise to transfer the receivables as they come into existence is enforced in equity so that the purchaser has a right to the receivables as soon as they come into existence. However, notice will still be required to the obligor in accordance with the Law Amendment and Reform (Consolidation) Ordinance to perfect such an assignment.

Note that the sale of any receivable after the date of a winding-up petition (assuming that a winding-up order has been made by a Hong Kong court) is void without court approval.

4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The response to the question depends on the nature of the asset to which the related security relates. For example, a transfer of a mortgage in Hong Kong would require registration with the Land Registry offices.

In the event that related security cannot be transferred completely, a security taker may be able to rely on an equitable interest rather than a legal interest.

4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

Hong Kong recognises a number of types of set-off. The effect of notice of a sale will depend on the type of set-off in question. For example, insolvency set-off is mandatory; however, the mutuality requirement for insolvency set-off will not survive the sale.

The purchaser of a receivables contract will take the assigned rights "subject to equities", being, in this context, any rights that the debtor has against the seller to set-off any amounts owing between the seller and the debtor that the debtor could have been able to set-off. Therefore, the purchaser has obtained a qualified right to the debt arising from the relevant receivable contract (*Tito v Waddell (No 2)* [1977] Ch 106). However, generally the right to set-off against the purchaser must have arisen before the relevant date of notice of assignment and must be in relation to the receivables contract itself (*Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 2 All ER 741) and the set-off amount must not exceed the sum due under the receivables contract to the purchaser (*Honour Finance Co Ltd v Chan Yan Pak* [1988] HKC 864).

Set-off rights that arise after the date of notice of assignment (and subject to the set-off provisions of the receivable contract) cannot be exercised by the debtor to set-off against payments due to the purchaser under the receivable contract unless the claims of the debtor and the purchaser are sufficiently closely connected. As between the debtor and the seller (and, again, subject to any set-off provision), the debtor may still nevertheless continue to assert set-off rights against the seller.

Subject to the terms of the relevant agreements between the parties, the mere operation of these principles is unlikely to give rise to liability for damages.

4.14 Profit Extraction. What methods are typically used in your jurisdiction to extract residual profits from the purchaser?

There are typically two ways to extract residual profits from the purchaser.

As a subscriber for the most subordinated tranche of notes, the seller can extract returns on these notes.

The seller can also extract fees by acting as servicer or manager.

5 Security Issues

5.1 Back-up Security. Is it customary in your jurisdiction to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that an outright sale is deemed by a court (for whatever reason) not to have occurred and have been perfected (see question 4.9 above)?

It is not customary in Hong Kong to take any form of security interest over the seller's ownership in the receivables. The reason being is that this may prejudice any true sale analysis as it may show an objective intention of the parties to treat the transaction as a security arrangement rather than a true sale of the receivables.

5.2 Seller Security. If it is customary to take back-up security, what are the formalities for the seller granting a security interest in receivables and related security under the laws of your jurisdiction, and for such security interest to be perfected?

Security created by way of charge over some assets must be registered in accordance with Section 335 of the Companies Ordinance (Cap. 622). Most relevant to the purchase of receivables is, among other things, the requirement to register charges over land and interests in land, charges over book debts of a company and floating charges over the property or undertaking of a company. "Company" in this context means a company incorporated in Hong Kong or a non-Hong Kong company registered under Part 16 of the Companies Ordinance (which must register the charges in accordance with section 336 of the Companies Ordinance (Cap. 622)).

Failure to register within one month after its creation renders the charge void as against any liquidator of the company and any third party creditor of the company. As such, registration is purely a perfection requirement against third parties and is not a condition to the validity of the charge as against the seller.

Perfection (with respect to priority over subsequent purchasers of the receivables) depends on whether the charge is fixed or floating. However, for practical reasons, it is unlikely that a fixed charge will be taken over receivables. Please see the response to question 5.3 below for further commentary on perfection and priority of security interests.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in your jurisdiction to grant and perfect a security interest in purchased receivables governed by the laws of your jurisdiction and the related security?

The formalities required to perfect security interests granted by the purchaser depends on the nature of the security interests granted over the purchased receivables.

For security interests granted by assignment by way of security, the legal assignment requirements as set out above in the response to question 4.1 apply.

Security interests may also be granted by way of mortgage, fixed charge or floating charge. Although other forms of consensual security exist under Hong Kong law (i.e. pledge and lien), it is most likely that such security is provided by way of charge or mortgage. In Hong Kong, financing is usually secured by means of taking a fixed charge (or mortgage) over real property owned by the purchaser and a floating charge over the assets and undertaking of the purchaser.

Registration is required for some fixed charges, and all floating charges, in accordance with the Companies Ordinance (Cap. 622) (being within one month of the date of creation of such charge). Failure to register in accordance with the Companies Ordinance will render the charge void as against the liquidator of the purchaser as well as its creditors.

Perfection (with respect to priority over subsequent purchasers or subsequent chargors of the same assets) depends on whether the charge is fixed or floating. Assuming that the third party purchaser is acquiring the receivables in good faith and for value, the question of whether such a third party purchaser acquires priority over the previous security taker turns on the question of what notice such a third party purchaser actually had or is deemed to have (constructive notice).

In the case of a fixed charge, the chargor has neither actual nor ostensible authority to deal with the assets free of the fixed charge. As such, provided that the third party purchaser has actual notice (irrespective of whether they had notice of the terms of the relevant charging document) or deemed constructive notice of the existence of a fixed charge, the third party purchaser for value will have priority over the first security taker.

However, the application of the doctrine of constructive notice in relation to the existence of a floating charge is not so straightforward, as a third party subsequent purchaser (or subsequent chargor) is entitled to assume that the seller has the freedom to dispose of the receivables without actual notice to the contrary. As such, without actual notice of the content of the relevant charging document, establishing notice of any negative pledge or other restriction on disposal of the relevant asset is more difficult to achieve.

In either case, when determining priority between competing interests, a party will be held to have constructive notice of the existence of the fixed or floating charge on the basis of whether it could reasonably have been expected to search the register. That means that, for example, a third party purchaser buying goods in the ordinary course of business is unlikely to search the register whereas a financial institution taking security is likely to have deemed constructive notice of the existence of the charge.

It is likely that a person with constructive notice of a charge registered with the Hong Kong Companies Registry will also have constructive notice of its terms (including any prohibition of disposal or negative pledge clauses therein), although there is no case law on point. With the implementation of the new Companies Ordinance (Cap. 622) in Hong Kong, certified copies of certain prescribed charge instruments must be registered with the Hong Kong Companies Registry, and as such, the terms of such charge will be publicly available through a search. This statutory development appears to reverse the legal position established in the Hong Kong case of *ABN Amro Bank NV v Chiyu Banking Corporation Ltd and Ors* [2000] 3 HKC 381 which limited the doctrine of constructive notice to the existence of a registered charge, but not of its terms.

To the extent that security relates to assets such as land, ships or aircraft, special registration requirements apply under Hong Kong law.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of your jurisdiction, and that security interest is valid and perfected under the laws of the purchaser's jurisdiction, will the security be treated as valid and perfected in your jurisdiction or must additional steps be taken in your jurisdiction?

If the purchaser is a non-Hong Kong company that is registered under Part 16 of the Companies Ordinance (Cap. 622), it will be required to register any security in accordance with Hong Kong law (for example, a floating charge will need to be registered in accordance with the Companies Ordinance (Cap. 622), notwithstanding that the security interest is valid and perfected under the laws of the purchaser's country).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security over insurance policies is typically achieved through assignment of the rights, title, interests and benefits in the insurance policy as well as an assignment of any proceeds received under such insurance policy to the secured party (or security trustee). An additional measure that is typically taken by secured parties is to have the secured party (or security trustee) recorded as a "loss payee" under the relevant insurance policy.

Security over promissory notes or marketable debt securities (in each case, where they are in definitive bearer form) is usually taken by way of a pledge – although definitive bearer instruments are very uncommon nowadays. Security over bearer instruments may also be made by such instruments being mortgaged by delivery.

Taking security over marketable debt securities is complex and depends on a number of factors. However, key points are summarised below:

(a) if the debt securities are not cleared – for a legal mortgage, the security taker's name and details would be entered on the register maintained by the registrar of the relevant issuer until such time as the obligations of the security provider are discharged. For an equitable mortgage or charge, the security provider completes all necessary transfer certificates but transfer by way of registration is not effected until enforcement steps are undertaken by the security taker;

(b) if the debt securities are cleared – for a legal mortgage, the security taker's name would be entered into the relevant securities account of an intermediary/custodian who itself holds an interest directly from the issuer or (as is most likely the case) from a higher-tier intermediary. Alternatively, security may be taken by way of an assignment of rights against the relevant intermediary together with an assignment of the rights, title and interests in or relating to the debt security; and

(c) security taken over mortgage loans would typically be required to be registered with the Land Registry in Hong Kong in accordance with the Land Registration Ordinance (Cap. 128) as it creates or transfers an interest in real property. Please see the response to question 4.3 above for further information.

5.6 Trusts. Does your jurisdiction recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets (so that they are not part of the seller's insolvency estate) until turned over to the purchaser?

Yes, trusts are recognised under Hong Kong law.

5.7 Bank Accounts. Does your jurisdiction recognise escrow accounts? Can security be taken over a bank account located in your jurisdiction? If so, what is the typical method? Would courts in your jurisdiction recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in your jurisdiction?

Yes, escrow accounts are recognised under Hong Kong law.

Security is typically taken over a bank account located in Hong Kong by the granting of either a fixed charge or a floating charge (which may crystallise (i.e. convert) into a fixed charge upon the occurrence of a default or other like circumstance under the relevant transaction documents).

A court in Hong Kong would generally recognise effective foreign law-governed security over a bank account in Hong Kong, although ideal practice would be to have security over a Hong Kong bank account governed by Hong Kong law to minimise delays or complications in enforcement.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

In general, a secured party would control all cash flowing in and out of a bank account during enforcement. The ability of the secured party to enforce the security would remain subject to the terms agreed in the relevant security document establishing a charge over the bank account and, in particular, whether a floating charge over the bank account has crystallised into a fixed charge.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes. The granting of a floating charge over the bank account provides for (prior to crystallisation) the chargor to access funds in accordance with the terms and conditions of the relevant security document.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will your jurisdiction's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? If so, what generally is the length of that stay of action? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Insolvency proceedings with respect to the seller will not affect the rights of the purchaser if the sale meets the requirements of a "true sale" or legal assignment under Hong Kong law.

The situation will be different if the sale was conducted as an equitable assignment (rather than a legal assignment or through novation). On the making of a winding-up order, or on the appointment of a provisional liquidator, with respect to the seller, it may not be possible to compel the seller to perform its obligations under the relevant transaction documents without leave of the court.

If a transaction, which was intended by the parties to be a sale, is subsequently recharacterised as a secured transaction under Hong Kong law, there is a risk that such a transaction would be held void against the liquidator of the seller as well as creditors of the seller due to lack of registration in accordance with the Companies Ordinance (Cap. 622).

There are no formal corporate rescue procedures in the present regime in Hong Kong.

With the introduction of the new Companies Ordinance (Cap. 622) on the 3 March 2014, all of the sections except for the prospectus regime and the winding-up and insolvency provisions are now regulated by the new Companies Ordinance. These remaining sections remain under the old Companies Ordinance which has been renamed as the Companies (Winding Up and Miscellaneous Provisions) Ordinance ("**CWUMPO**").

Various consultations by the government in Hong Kong over a number of years have outlined a proposal to introduce the concept of provisional supervision. The current proposals envisage such provisional supervision being initiated by filing a notice with the Companies Registry (without requiring court approval). This would then create a moratorium for, initially a 45-day period, where the provisional supervisor would prepare a voluntary agreement. Creditors will be able to extend the 45-day period up to a maximum of six months. A court will be able to extend the period for as long as it deems necessary. Discussions and further consultations regarding this arrangement and its exemptions are still taking place and are yet to be finalised.

Additionally, the government introduced the Financial Institutions (Resolution) Bill on 20 November 2015. Under the terms of the proposed bill, a range of general resolution powers will be provided to regulators to ensure stability in the financial markets in the event of any insolvency or restructuring of troubled financial institutions. Some of the proposed powers would allow regulators to: (a) temporarily prohibit the filing of a winding-up petition as against a troubled financial institution to the court; (b) temporarily suspend obligations of troubled financial institutions to pay certain creditors and impose a stay on creditor actions; and (c) operate and manage a troubled financial institution. These discretionary powers may affect the sale of receivables from a troubled financial institution to a third party.

6.2 Insolvency Official's Powers. If there is no stay of action, under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of its ownership rights over the receivables (by means of injunction, stay order or other action)?

Please see the response to question 6.3 below.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the seller's insolvency proceedings? What are the lengths of the "suspect" or "preference" periods in your jurisdiction for (a) transactions between unrelated parties, and (b) transactions between related parties? If the purchaser is majority owned or controlled by the seller or an affiliate of the seller, does that render sales by the seller to the purchaser "related party transactions" for purposes of determining the length of the suspect period? If a parent company of the seller guarantee's the performance by the seller of its obligations under contracts with the purchaser, does that render sales by the seller to the purchaser "related party transactions" for purposes of determining the length of the suspect period?

There are a number of circumstances where pre-insolvency transactions may be set aside:

(a) transaction at an undervalue and unfair preference (CWUMPO, sections 265D and 266);

a. transaction at an undervalue:

i. a company enters into a transaction with a person at an undervalue if (x) the company enters into a transaction with that person on terms that provide for the company to receive no consideration; or (y) the company enters into a transaction with that person for a consideration value of which is significantly less than the value of the consideration provided by the company;

ii. however, a Hong Kong court would not make an order for restoring the position if it is satisfied that: (x) the company entered into the transaction in good faith and for the purpose of carrying on its business; and (y) at the time the company did so, there were reasonable grounds for believing that the transaction would benefit the company;

b. unfair preference:

i. a company gives an unfair preference to a person if: (x) that person is one of the company's creditors; and (y) the company does anything which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position that person would have been in if that thing had not been done;

c. length of the "suspect" or "preference" period:

i. for a transaction at an undervalue, the relevant period is five years;

ii. for an unfair preference which is not a transaction at an undervalue and is given to a person who is connected with the company, the relevant period is two years;

iii. in any other case of an unfair preference which is not a transaction at an undervalue, the relevant period is six months; and

iv. the relevant periods above apply only if either of the following conditions is satisfied:

1. the company is unable to pay its debts at that time; or
2. the company becomes unable to pay its debts in consequence of the transaction or unfair preference;

(b) anti-deprivation rule – any agreement which, on insolvency, increases a creditor's claim or transfers assets to a particular creditor, is void. There is no preference or suspect period;

(c) invalidation of floating charges (CWUMPO, section 267) – any floating charge created within one year before the commencement of winding-up of a company may be set aside where the company was insolvent or became so as a result of the entering into the charge or associated transactions, except to the extent of the value of any consideration received by the company on or after the creation of such floating charge (i.e. the floating charge remains valid to the extent that it secured fresh funds);

(d) extortionate credit transactions (CWUMPO, section 264B) – a transaction entered into within three years of the commencement of winding-up of a company may be set aside where payments in relation to such a transaction are considered grossly exorbitant or the terms of the credit grossly contravene ordinary principles of fair dealing;

(e) transactions defrauding creditors (Conveyancing and Property Ordinance (Cap. 219), section 60) – any disposition of property made with the intent to defraud creditors may be voidable. There is no preference or suspect period. However, such a claim would need to be made by a person prejudiced by such a disposition and would be subject to normal limitation periods; and

(f) disclaiming of onerous property (CWUMPO, section 268) – the liquidator of a company may disclaim onerous property, which includes unprofitable contracts, effectively converting a counterparty's rights under the relevant agreement into an unsecured claim. Again, there is no preference or suspect period.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding? If the purchaser is owned by the seller or by an affiliate of the seller, does that affect the consolidation analysis?

There are limited circumstances under Hong Kong law where liabilities of a company may be imposed on another company. The typical circumstances are where the company was formed principally as a sham, to evade existing liabilities or to perpetrate a fraud.

Furthermore, there is no law in Hong Kong that provides for the pooling of assets. The pooling of assets and liabilities in Hong Kong is based on judicial discretion. Pooling is only allowed when it appears that it is the best or only method of distributing assets back to creditors. However, court sanction is required and the reasons for pooling assets must be clearly stated.

6.5 Effect of Insolvency on Receivables Sales. If insolvency proceedings are commenced against the seller in your jurisdiction, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

The commencement of insolvency proceedings would have no immediate legal effect on either the sale of receivables after such proceedings have commenced or the sale of receivables that have come into existence after such proceedings have commenced. The general rule is that insolvency does not terminate contracts nor extinguish rights, although remedies are restricted post-insolvency.

One example in particular of this restriction is that, in the event that a court has granted a winding-up order with respect to a party, any disposition of the assets of such a party from the date that the winding-up petition was presented is void (or deemed void) unless the court otherwise approves.

Notwithstanding this, if there has been a true sale of the future receivables (for example, such that legal assignment has been perfected by the purchaser giving notice to the obligors), then subject to the issues outlined in the response to question 6.3 above, the seller's insolvency would not affect the purchaser's rights in the relevant receivables.

6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

This issue recently arose for determination in the English decision of *ARM Asset Backed Securities S.A.* [2013] EWHC 3351 (Ch), where the court held that a Luxembourg company (with its centre of main interests determined to be in England) could be wound up where the court was satisfied that the company was unable to pay its debts, notwithstanding the inclusion of limited recourse wording (and "non-petition" wording – see our response to question 7.4 below) for the bonds which the company had issued. The court considered, among other things, the question of whether or not a company should be wound-up should be separate and unrelated from the question as to the quantum that creditors would receive from the liquidation of that company.

Such a question has not, to date, been considered by Hong Kong courts. Although persuasive, decisions of English courts are not binding on courts in Hong Kong. This case is unusual in that it was the directors of the issuer who petitioned the court rather than creditors of the issuer.

As a matter of market practice and drafting convention, documentation which contain limited recourse wording also invariably include non-petition clauses to limit the ability of creditors (but not directors) to seek to wind-up the relevant company. Therefore, it is unlikely that the opportunity will arise for a Hong Kong court to consider a limited recourse provision in isolation from a non-petition provision.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in your jurisdiction establishing a legal framework for securitisation transactions? If so, what are the basics?

There are no laws in Hong Kong specifically for securitisation.

7.2 Securitisation Entities. Does your jurisdiction have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no laws in Hong Kong specifically for the establishment of special purpose vehicles.

7.3 Limited-Recourse Clause. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

It is likely that a Hong Kong court would give effect to a limited-recourse clause, although there is no case law to date in Hong Kong which has considered its validity.

7.4 Non-Petition Clause. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

It is likely that a Hong Kong court would give effect to a non-petition clause, although there is no case law to date in Hong Kong which has considered its validity. However, enforcing such a clause to prevent a party from taking legal action would require a court to exercise its discretion as to whether to grant an injunction or not – injunctive relief is not a right *per se* available to a plaintiff under Hong Kong law.

Similarly, the court in Hong Kong retains the discretion under the Companies Ordinance (Cap. 622) to have a company wound up where it is, in the opinion of the court, just and equitable to do so. As such, although unlikely, it is possible that a court exercises such discretion to allow insolvency proceedings to commence against the purchaser or another person.

7.5 Priority of Payments "Waterfall". Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Waterfall or payment priority provisions are likely to be valid and enforceable under Hong Kong law for a Hong Kong law-governed document, although this has not been considered by any Hong Kong court to date. Assuming validity and enforceability under Hong Kong law, there is no reason why a court in Hong Kong would not give effect to such a clause with respect to a Hong Kong entity for a contract governed by a foreign law (subject to any foreign law-governed contract being void for public policy reasons or illegality in Hong Kong and payments mandatorily preferred by law).

Although not binding on a Hong Kong court, the English Court of Appeal decision of *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 has also affirmed the validity of "flip-clauses" which have the effect of altering the priority of payments upon an event of default (including insolvency) of a party to an agreement containing such a clause. As such, it is likely that a Hong Kong court would also uphold the validity of a "flip-clause" and, by necessary extension, the validity in general of priority of payment provisions.

7.6 Independent Director. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Provided that directors act in accordance with their fiduciary duties as directors and any requirements as set out in the Companies Ordinance and the Hong Kong listing rules (if applicable), there is no specific law which would prohibit contractual provisions or provisions in the company's memorandum and articles of association that prevent a director from acting or not acting in particular circumstances. Of course, such provisions (whether in a Hong Kong law-governed document or not) would remain subject to principles of general law, such as contracts being void for public policy reasons or illegality in Hong Kong.

7.7 Location of Purchaser. Is it typical to establish the purchaser in your jurisdiction or offshore? If in your jurisdiction, what are the advantages to locating the purchaser in your jurisdiction? If offshore, where are purchasers typically located for securitisations in your jurisdiction?

It is typical to establish the purchaser offshore. The purchasers are typically located in the Cayman Islands and the British Virgin Islands.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in your jurisdiction, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in your jurisdiction? Does the answer to the preceding question change if the purchaser does business with more than one seller in your jurisdiction?

Depending on the nature of the receivables, the purchaser may be required to obtain a particular licence or be subject to regulations. For example, the receivables may be relevant to business regulated by the Money Lenders Ordinance or the Banking Ordinance. If so, the purchaser will need to obtain the required licences or approvals before purchasing the relevant receivables.

A non-Hong Kong company must register in accordance with the Business Registration Ordinance (Cap. 310) if it is carrying on in Hong Kong "any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain". This is irrespective of whether it is required to register under Part 16 of the Companies Ordinance (see question 3.2 above). Please see the commentary below in question 9.6 as to whether mere

ownership of receivables may result in the purchaser "carrying on a business" under Hong Kong law.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

There are no specific requirements under Hong Kong law to collect and enforce receivables (other than any requirements specific to the industry or nature of receivables).

8.3 Data Protection. Does your jurisdiction have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes, in Hong Kong the Personal Data (Privacy) Ordinance (Cap. 486) ("**PDPO**") governs the collection, use and dissemination of personal data of living individuals. This does not apply to information with respect to enterprises.

The PDPO applies to anyone who collects or uses personal information which is capable of identifying an individual. In such circumstances, the "data user" must comply with a number of data protection principles that are set out in schedule 1 of the PDPO. In April 2013, criminal liability was introduced in respect of the new direct marketing provisions, which deal with unauthorised transfers of personal data the third parties for direct marketing purposes.

The Code of Banking Practice may also apply if the relevant entity is an "authorized institution" – please see the response to question 8.4 below. This imposes on such "authorized institutions" a duty to maintain privacy when handling information relating to individual customers.

Data about, or provided by, obligors may also be protected by more general Hong Kong legal and regulatory principles that require the protection of confidential information. Largely, these apply irrespective of the legal structure of the obligor, but their precise application depends on the circumstances.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your jurisdiction? Briefly, what is required?

Yes, a purchaser would be required to comply with certain consumer protection laws to the extent they apply with respect to the nature of the receivables and the identity and nature of the purchaser.

In particular (but not necessarily exhaustive):

(a) the Banking Ordinance (Cap. 155) and the Code of Banking Practice where the purchaser is an "authorized institution" as defined in the Banking Ordinance – "authorized institutions" are expected to act in accordance with the Code when dealing with individual customers (please also see paragraph (h) below);

(b) the Control of Exemption Clauses Ordinance (Cap. 71) – which limits the extent to which civil liability for breach of contract, or for negligence or other breach of duty, can be avoided by means of contract terms or otherwise;

(c) the Money Lenders Ordinance (Cap. 163) – as discussed in the response to question 1.2 above;

(d) the Sale of Goods Ordinance (Cap. 26) – which provides basic protections for sales of goods to consumers, such as requiring any goods sold to be of satisfactory quality, fit for purpose and for such goods to correspond with any description given in the packaging. Sellers who fail to meet the prescribed standards will be required to issue any consumer or purchaser a full refund;

(e) the Supply of Services (Implied Terms) Ordinance (Cap. 457) – which implies certain reasonableness qualifiers to terms of a consumer contract in the absence of express terms;

(f) the Unconscionable Contracts Ordinance (Cap. 458) – which grants to Hong Kong courts the power to determine that part or whole of a contract with a consumer may be unenforceable if found to be unconscionable;

(g) the Trade Descriptions Ordinance (Cap. 362) – which prohibits false trade descriptions, false, misleading or incomplete information, false marks and misstatements in respect of goods and services, and in respect of services, includes further offences for misleading omissions, aggressive commercial practices, bait advertising, bait-and-switch and wrongly accepting payment; and

(h) the various circulars and guidelines issued by the Securities and Futures Commission where the purchaser is licensed by the Securities and Futures Commission and by Hong Kong Monetary Authority where the purchaser is an "authorized institution" – which requires the purchaser in such circumstances to comply with such various circulars, codes and guidelines.

8.5 Currency Restrictions. Does your jurisdiction have laws restricting the exchange of your jurisdiction's currency for other currencies or the making of payments in your jurisdiction's currency to persons outside the country?

There are no currency exchange controls in Hong Kong. However, the flow of funds in and out of Hong Kong may be restricted or prohibited by laws such as the United Nations Sanctions Ordinance (Cap. 537), the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575), and related regulations.

The exchange of currencies is also generally confined to "authorized institutions" as defined in the Banking Ordinance and money changing service providers that are licensed under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in your jurisdiction? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest? If withholding taxes might apply, what are the typical methods for eliminating or reducing withholding taxes?

No, there is no withholding of taxes in Hong Kong. Whether any amount (such as a discount or deferred purchase price) is to be

treated as interest for profits tax purposes depends upon whether such amount satisfies sections 16(1) and 16(2) of the Inland Revenue Ordinance (Cap. 112) of Hong Kong ("**IRO**"). There are no specific provisions which deem a discount or deferred purchase price as being treated as interest for profits tax purposes, although the Inland Revenue Department in Hong Kong has stated that its position, at least with respect to initial discounting of securities, is that such discount may be deductible as interest (amortised over the life of such security) provided that the tests in sections 16(1) and 16(2) are also satisfied. This conclusion is not, however, directly relevant to discounted receivables, which are not thought of as lending or borrowing arrangements.

9.2 Seller Tax Accounting. Does your jurisdiction require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No, there is no specific accounting policy to be adopted for tax purposes in the context of securitisation. Hong Kong companies are required under the Companies Ordinance to prepare financial statements that give a true and fair view and are expected to prepare such statements under local GAAP (Hong Kong Financial Reporting Standards).

9.3 Stamp Duty, etc. Does your jurisdiction impose stamp duty or other transfer or documentary taxes on sales of receivables?

No, there is no stamp duty on the sale of receivables. There is, however, stamp duty imposed on the transfer of interests in land (including the transfer of mortgages – although the collector of stamps in Hong Kong has been willing to adjudicate that a mortgage transfer is not subject to stamp duty) as well as on certain transfers of stock.

On 23 February 2013, new stamp duty rates for the sale or transfer of immovable property were introduced, ranging from 1.5% up to 8.5%.

9.4 Value Added Taxes. Does your jurisdiction impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

There is no value added tax, sales tax or other similar taxes in Hong Kong.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

There are no such taxes applicable in the context of the sale of receivables.

However, under Hong Kong law, tax may be recovered from a third party if the taxpayer is in default of their taxation payment obligations. Such outstanding taxes may be recovered from any third party who (i) owes or is about to pay money to the taxpayer, (ii) holds money on account of another person for payment to the taxpayer, or (iii) has authority to pay money from some other person to the taxpayer. Failure to comply with a notice from the Commissioner of Inland Revenue may result in the third party becoming personally liable for the whole of the tax that was to be paid.

9.6 Doing Business. Assuming that the purchaser conducts no other business in your jurisdiction, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in your jurisdiction?

There is a profits tax payable by every person "carrying on a trade, profession or business in Hong Kong" in respect of profits "arising or derived from Hong Kong … from such trade, profession or business" (Inland Revenue Ordinance (Cap. 112)).

Whether a person is carrying on business is ultimately a question of fact having regard to the circumstances as a whole and determined by a number of indicia, with no single indicia being determinative. However, it is important to note that courts in England have considered that the passive receipt of share profits was held to be a business (*IRC v Korean Syndicate Ltd* (1921) 3 KB 258) as well as passive receipt of a fixed annuity (*South Behar Railway Co Ltd v IRC* (1925) AC 476).

9.7 Taxable Income. If a purchaser located in your jurisdiction receives debt relief as the result of a limited recourse clause (see question 7.3 above), is that debt relief liable to tax in your jurisdiction?

Section 15(1)(c) of the IRO deems "sums received by or accrued to a person by way of grant, subsidy or similar financial assistance in connection with the carrying on of a trade, profession or business in Hong Kong …" chargeable to profits tax. A debt relief is considered as a financial assistance to the purchaser by the Inland Revenue Department and, therefore, section 15(1)(c) of the IRO applies.

Moreover, where a deduction for the interest on the debt had previously been claimed and allowed as a trading expense, the amount relieved would be treated as a trading receipt under section 15(2) of the IRO at the time of the relief and is, therefore, liable to tax.

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