羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor Prince's Building
Central Hong Kong
Telephone (852) 2289 8888
Facsimile (852) 2810 9888

Clerk to Bills Committee on Companies (Corporate Rescue) Bill
Legislative Council Secretariat
3rd Floor, Citibank Tower
3 Garden Road
Central
HONG KONG

For the attention of SC Tsang

7 September 2001

Our Ref: DRH/RJH

COMPANIES (CORPORATE RESCUE) BILL

Dear Sir

I refer to the submission made by PricewaterhouseCoopers on the Companies (Amendment) Bill 2000 and thank the Bills Committee for the opportunity to make a further submission on the Companies (Corporate Rescue) Bill.

We are pleased to see that some of our previous submissions, such as the protection of secured creditors rights, have been implemented in the revised Bill. Rather than repeat many of the submissions made previously, it is the intention of this letter to concentrate on the only remaining area of prime concern – payment of employees entitlements.

In summary, as you know, the Bill proposes that the company undergoing corporate rescue must be responsible for clearing all arrears of wages, severance pay and other statutory entitlements of its employees as if it were a going concern. This can be done by payment in full or establishment of a trust fund. Before directors appoint a Provisional Supervisor they must sign an affidavit stating that they have met employees liabilities in full.

The arguments against such treatment of employees are:

- How can a company in such dire financial difficulties that it has to appoint a provisional supervisor find the money to meet employee liabilities, especially if the amount owing to employees is significant or there are many employees? Every insolvency practitioner has been faced with the unfortunate case where a company does not seek advice until they cannot meet the next wages bill. This does not mean those companies are not capable of being restructured, but if the company had to meet all outstanding employee payments, it would be impossible for it to be restructured.
- Where the company has a large number of staff or a number of highly paid staff, the requirement to meet employee liabilities in full will greatly restrict the ability of a company to implement the procedure. Surely it is not the intention of the legislation to restrict the use of Provisional Supervision to companies with a small number of staff?
- It is unlikely that a bank would be willing to lend a company cash if it was contemplating Provisional Supervision because the funds would go straight to the employees, not to restructure the ailing firm.
- It should also be noted that where the company is insolvent, realistically the only source of funding of payments to employees is likely to be the extending of further credit (unknowingly) by the company's ordinary unsecured creditors or realisation of assets that could otherwise be used to pay ordinary unsecured creditors. Thus it would appear that the proposed provisions will encourage directors to prejudice the position of unsecured creditors by taking more credit from them in order to give employees a greater priority than they may otherwise have on insolvency.
- Generally an employee's primary concern is to keep their job, hopefully with a financially stable employer. The requirement for employers to meet all outstanding employee liabilities in full at such a critical time seems to work against this most important goal. If Provisional Supervision is made unworkable in most cases, the employee's ultimate goal of keeping their job, is likely to be lost.

- Of course the fair treatment of employees is rightly a major concern of the Hong Kong government and unions. However, there is a major inconsistency between the treatment of employees under Provisional Supervision and any other form of insolvency. Under winding up, employees may look to the Protection of Wages on Insolvency Fund for payment of entitlements up to specified amounts. Also, in a winding up employees are afforded some priority over ordinary unsecured creditors, although this is limited to HK$18,000[1]. The balance of the claim ranks as an ordinary unsecured creditor. Under Provisional Supervision the proposed legislation requires employee liabilities to be met by their employers in full immediately, which if the company were subsequently placed in liquidation would be nothing more than a legalised form of preference.

Annex C of the Legislative Brief provided with your letter dated 13 July 2001 provides helpful feedback on your consultation with the PWIF Board and the LAB. We would like to provide our comments on that feedback, using the same numbering system as Annex C:

21 (b) *The PWIF has been set up to provide prompt relief in the form of ex-gratia payment to employees of insolvent employers and not to bail out financially troubled companies. The proposal would alter fundamentally the nature and policy intent of the PWIF. The mandate of the PWIF should not be changed to accommodate the proposal.*

PWIF, as its name suggests, exists to provide protection to employees of insolvent companies. One may argue that Provisional Supervision can be used by non-insolvent, or merely 'financially troubled' companies. I'm sure the Bills Committee will see that the vast majority of companies contemplating Provisional Supervision in the future will be insolvent. Concerns appear to arise about possible abuse of the PWIF by employers. If the PWIF paid employees claim, the PWIF, as a creditor stepping into the shoes of employees, would have a vote in the proposed Voluntary Arrangement put forth by the company in Provisional Supervision. It makes no rational sense for a company to go through the expense, possible business interruption and effect on credit worthiness for the sake of payment of employees that it will have to pay under the Voluntary Arrangement anyway.

[1] S.265 of the *Companies Ordinance (Cap32)*

Whilst I disagree that this would fundamentally alter the nature and policy intent of the PWIF, if that is what is needed, then so be it. Further, I would respectfully submit that it is up to the government to set policy and the PWIF merely to administer that policy.

21 (c) *The proposal would have financial implications on the PWIF. Given the continued depletion of the PWIF due to the upsurge of insolvency cases in recent years, the PWIF should not take on liabilities that would further increase its financial burden.*

If a company is 'financially troubled' or insolvent, it is likely to be placed in liquidation in any case and the PWIF will have to pay out in due course. Therefore, Provisional Supervision has little extra in the way of financial implications for the PWIF. Further, studies in Australia have shown that companies entering into Voluntary Administration (similar to Provisional Supervision) pay returns considerably higher than those expected were the company to be placed in liquidation. The same result is expected for Provisional Supervision (otherwise why would creditors accept such an arrangement?). Therefore, the PWIF should actually be better off for paying out employee claims in Provisional Supervision.

The financial demands on the PWIF are cyclical, as the economic conditions deteriorate and then improve. Any short term funding deficit could presumably be met with a small increase in the company levy which currently provides funding. An extra HK$50 or HK$100 per company in Hong Kong is unlikely to entail serious financial hardship.

21(d) *The outstanding wages and other entitlements owed to the employees usually constitute only a small proportion of the total amount of debts of the companies concerned. Hence, in most cases a company undergoing corporate rescue should be able to set aside sufficient funds for clearing its debts to the employees.*

In my experience, whilst employee entitlements are usually a small proportion of the total amount of the debts of the companies concerned, they are not a small proportion of the available cash on hand of those companies. There is no doubt that the requirement to pay employee costs in full would mean many companies would not be able to use the corporate rescue procedures and would be placed in liquidation (where the PWIF would have to pay employees in any case).

By way of comparison, the Australian version of the PWIF, the Employee Entitlements Support Scheme ("EESS") pays out during the Australian version of Provisional Supervision (Voluntary Arrangements). However, the EESS also states that:

"…the principles are clear: taxpayers' money should be recouped where possible; and employers would be deluding themselves if they were to think they could use EESS to remove their obligation to pay their entitlements. EESS will not and cannot be used as an incentive for an employer to become insolvent and terminate employees without paying their entitlements[2].

An enthusiastic attitude to recoveries of payouts may be what Hong Kong needs, rather than a reluctance or statutory inability to pay out.

Should you require any further information, please do not hesitate to contact me on 2289 8822.

Yours faithfully

David Hague
Partner

[2] From "Employee Entitlements Support Scheme: Year One Activity Report" January 2001, by the Department of Employment, Workplace Relations and Small Business available at http://www.dewrsb.gov.au/workplaceRelations/employeeEntitlements/default.asp, accessed 14/4/01.