LC Paper No. CB(1)2027/00-01(19)

HONG KONG BAR ASSOCIATION'S COMMENTS ON

COMPANIES (CORPORATE RESCUE) BILL

1. There does not appear to be any criterion set out for the invocation of the statutory mechanism for the appointment of a provisional supervisor. S.6(1) simply sets out who may appoint a provisional supervisor; s.7(1) sets out the purpose of such appointment. Once the documents specified in Schedule 2 are filed the appointment takes effect: s.8. Those documents do not require the company to be in any particular condition except that it has a trust account containing sufficient money to pay employees' claims (s.6(2)(a) makes it clear that it is not necessary for the company to be insolvent). Thus, the directors and shareholders of the company are given very wide discretion to call into play the statutory procedure of provisional supervision, with the moratorium and other consequences that flow from it.

2. The moratorium which automatically comes into effect under s.11 pursuant to the appointment of the provisional supervisor prevents, inter alia, the presentation of a winding up petition against the company. There is therefore a danger that the moratorium will have the effect of delaying the application of avoidance provisions in our insolvency laws, e.g. provisions avoiding unfair preferences, which only apply to transactions within a certain period before winding up. The delay of a winding up petition by the moratorium may mean that certain transactions which would otherwise have been caught will fall outside such period. We note that s.11(4) attempts to discount the moratorium

for the calculation of time where time is limited for a "matter" to "proceed", but that provision as drafted is inapt to cover the avoidance provisions. It is true that the problem is to a significant extent addressed by s.22(5)(b) which deems the winding up consequent upon the rejection of the proposal by the relevant meeting of creditors to have commenced at the relevant date, upon the appointment of the provisional supervisor. However, the problem remains in the case where the provisional supervision is "nipped in the bud" by a major secured creditor under s.19 (even though the delay caused by the moratorium in such a case would be very limited).

3. A further effect of the moratorium is to prevent the commencement of proceedings against the company while the moratorium is in effect. Although we believe that the provisions of s.11(4) may be intended to prevent limitation periods from running during the period of the moratorium, we point out that the wording of s.11(4) may not be entirely apt to cover such a situation, since an uncommenced action could well be regarded as not being a "matter" which can "proceed", both those words tending to suggest that their subject matter is already in existence. It may be desirable to make it clear whether or not the moratorium is to have any effect on limitation periods generally.

4. In s.7(1)(b), it is to be noted that the purpose is the survival of the company <u>and</u> the whole or any part of its undertaking. Given the existence of the other purposes which are separately stated, it would appear that "and" is used conjunctively in this context. This may raise the question whether disposing of the entire undertaking of the company for cash assists will satisfy s.7(1)(b), since it may relate only to the

survival of the *company* as opposed to its *business*. It would probably not do so, on the existing wording. However, it may well be that such a course would be covered by one of the other purposes stated in s.7(1)(a) and s.7(1)(c).

5. It is not clear in s.7(1)(c) what yardstick is to be adopted in considering whether the proposal would achieve the "more advantageous" satisfaction of debts and liabilities. In comparison to what scenario and from whose point of view should this be "more advantageous"? If it is intended that the relevant comparison is the position in a winding up, then similar wording to that in s.7(1)(a) should be included. If not, the other comparison (whatever it may be) should be spelt out. While we assume that the point of view to be adopted is that of the creditors and not the company (which would be better off with a lower level of payments), it may be as well for this to be stated.

6. In s.14(1)(a), we think that reference should be made to exercise of powers and functions by the board of directors instead of or as well as by an individual director.

7. S.14(3) appears to deal only with the situation in which the director would have (but for the provisions of s.14(1)(a)) actual authority to deal with the third party on behalf of the company. It would not appear to affect the position where the director has no actual authority to do the act in question, but has previously been held out by the company as having such authority. In such a situation, the ordinary principles of agency relating to apparent or ostensible authority would appear to apply, subject to the additional factor that someone who is aware (or deemed to be

aware) of the provisional supervision will not be able to rely on any such apparent or ostensible authority. Again, this may be a matter which could be spelt out.

8. As to s.20(1)(a), we query why there should be a requirement that the application be made by not less than 50% in value of the creditors, when the application is for removal *for cause shown*. Presumably, if good cause is shown such as gross incompetence or bias, the provisional supervisor should not remain in office even if favoured by more than 50% in value of the creditors?

9. The word "and" appearing at the end of the first line of s.22(1)(a)(ii)(C), s.22(2)(b)(ii) and s.22(4)(b)(ii) appears to be superfluous.

10. It is unclear why reference is made to "subsection (1)(a)(ii)" in s.22(5) but to "subsection (1)(a)(ii)(A)" in s.22(6). We would have thought that the latter reference should not be so limited.

11. We note that under s.23(3) a *member* of the company may challenge a resolution of a relevant meeting of creditors. It is not clear why provision is made only for a member to make such a challenge. Under the equivalent provision in the UK (s.6(1) & (2) of the Insolvency Act 1986), a creditor, among other persons, may apply to the court to challenge. Further, such application under s.6 IA 1986 may be made not only on the ground that the arrangement unfairly prejudices his interests, but also where there has been some material irregularity at or in relation to the meetings.

12. An important question not addressed by the Bill is what is to happen if the voluntary arrangement fails to be implemented. Does the arrangement end according to its own terms or is the arrangement somehow treated as having been repudiated by the company? It appears that these are at least in part determined as questions of construction that arise upon the "statutory contract" represented by the voluntary arrangement: see Welsby v Brelec Installations Ltd [2000] 2 BCLC 576, and much therefore depends on the good draftsmanship of the provisional supervisor. Complex questions may arise in this respect, in particular where a winding up of the company is superimposed.

13. For example, if the voluntary arrangement in relation to a company provides for instalment repayments in 5 years of the debts of the creditors bound by the voluntary arrangement, and the company defaults after 2 years and the company is wound up upon the petition of a post-arrangement creditor, what are the relative rights of the creditors? Are there 2 groups of creditors (bound and not bound by the voluntary arrangement)? If certain assets or income have been earmarked for the purpose of repayment of the creditors bound by the arrangement, are there upon winding up 2 pools of assets, one subject to the arrangement and one not? Will the voluntary arrangement cease to have effect by virtue of s.26(2)?

14. These are but some of the difficult questions that have arisen in the UK in their implementation of not dissimilar legislation in the Insolvency Act 1986 and which have given rise to much litigation; we would refer to Re Arthur Rathbone Kitchens Ltd [1997] 2 BCLC 280; Re Excalibur Airways Ltd [1998] 1 BCLC 436 ("... all the difference in the world

between a case where the supervisor of a CVA on behalf of the CVA creditors presents a petition for a compulsory winding up order and a case ... where the petition is presented by the directors, or for that matter by a non-CVA creditor"); Welsby v Brelec Installations Ltd [2000] 2 BCLC 576; Re Kudos Glass Ltd [2001] 1 BCLC 390.

15. S.3(d)(i)(B) & 3(d)(ii) of Schedule 2 refer to "all debts and liabilities owing ... before the relevant date". It does not appear to cover debts and liabilities *which will accrue and become owing* because of the termination of the employment by reason of the company going into provisional supervision (perhaps because it will not be possible for the company to know the extent of such debts and liabilities, which will depend on the actions of the provisional supervisor). It is, however, unclear to us why former employees should include "those employees whose contracts of employment will be terminated on or after the relevant date" since such employees would appear to be existing employees whose position as to wages owing is expressly dealt with. Further, we note that former employees are to be protected in relation to all debts and liabilities owing by virtue of the Employment Ordinance, whereas existing employees are only to be protected in relation to wages (but not any other entitlements which may exist).

12th October 2001