COMPANIES (CORPORATE RESCUE) BILL (the "Bill")

Consultation Paper response

section 2(2)	*It is hereby declared that the power under section 6(1) or 20(4)(d) to appoint a qualified person as the provisional supervisor of a company may be exercised in such a way as to appoint 2 or more qualified persons to be the provisional supervisor of the company and, in any such case, the provisions of this Ordinance shall be read and have effect with such modifications as are necessary to take into account such an appointment.* We understand that the costs of the provisional supervisor will be paid out from the property of the company and the qualified persons eligible to be appointed provisional supervisor will be those approved practitioners from the panel of members to be operated by the Official Receiver. To such extent, we consider the chance to require 2 or more provisional supervisors for a company to be practically remote due to the fact that the qualified persons eligible for appointment are professionals approved by the Official Receiver. In the case where such appointment should be required, it is our opinion that it should be conditional upon the approval by the relevant creditors or, as the case may be, by the court.
section 6(1)	*Subject to sections 7 and 8, the persons who may appoint a qualified person to be the provisional supervisor of the company for the purpose of the provisional supervisor examining whether a proposal can be made to the creditors of the company for a voluntary arrangement in respect of the company and, if so, making the proposal are:* *(a) before the commencement of a winding up:* *(i) the directors of the company by means of a resolution passed by the majority of them for the purpose; or* *(ii) the members of the company by means of an ordinary resolution passed at a meeting of the company convened for the purpose;* *(b) a provisional liquidator of the company who has the approval of the court to do so; or* *(c) the liquidator of the company who has the approval of the court to do so.*
section 6(2)(a)	*It is hereby declared that the appointment of a qualified person to be the provisional supervisor of the company may be made whether or not the company is able to pay its debts*

We understand that the purpose of the statutory corporate rescue procedure is to enable the provisional supervisor to formulate, if possible, a proposal for a voluntary arrangement for the purpose of protecting the interests of the creditors. If the company is able to fulfil its debts and liabilities, the appointment of the provisional supervisor, which may bring extra costs to the company, may perhaps be unnecessary, notwithstanding the negative impact which the provisional supervision may have on the company in terms of its business reputation and creditability.

Nevertheless, there may be possibilities that directors or members of the company, who are able to appoint the provisional supervisor by virtue of the Bill, may abuse such power. Thus, we believe that such provision can be modified to cater for circumstances where the appointment of the provisional supervisor is made by the directors or members of the company, they should be required to demonstrate that there were reasonable grounds to believe that despite the fact the company is able to pay its debts at the time of the appointment, the company will be insolvent or there is no reasonable prospect that the company could avoid becoming insolvent.

section 7(3) *The following matters shall amongst other terms of the voluntary arrangement be stated or otherwise dealt with in the proposal:*
(g) the duties, powers and liabilities of the supervisor

We note that the supervisor of a voluntary arrangement should only be capable of appointment from the Official Receiver's panel and in most cases he would probably be the provisional supervisor. To such extent, we believe that in order to promote independence and confidence, statutory requirements or guidelines should be laid down for the rate of charge of the supervisor of a voluntary arrangement as well as their duties, powers and liabilities, as in the case of the provisional supervisor which has been set out in the Bill.

section 13(5) *Subject to any order of the court under the provisions of Schedule 7, the court shall not under subsection (2) extend the moratorium for any period beyond the period of 6 months immediately following the relevant date in respect of the company.*

Based on our experience, a company that is insolvent usually requires an extensive period of time in coming to terms with its creditors under a voluntary arrangement. The extensive period of time will be required for, inter alia, numerous negotiations, preparation and presentation of debt restructuring proposals, possible introduction of new equity and even standstill arrangements. To this extent, we consider that the period of the moratorium should be left for determination by and agreed between the company, the provisional supervisors and the relevant creditors.

section 14(3)

Where a director of the company deals with a person and thereby contravenes subsection (1)(a), then, and notwithstanding that contravention, the director, the provisional supervisor of the company and the company are bound by that dealing if, but only if, that person acted in good faith and for good consideration in relation to that dealing and changed his position or acted to his detriment based on that dealing.

We understand that pursuant to section 14 of the Bill, a director of the company shall not discharge a duty or exercise a power imposed or conferred on him in his capacity as such a director. Furthermore, under Schedule 4 Part 1 of the Bill, the provisional supervisor has the power to remove any director or officer of the company.

Thus, the possible liability of the provisional supervisor and the company under this provision may effectively encourage the provisional supervisor to remove directors of the company, who in reality, may be critical in the business of the company or its subsequent survival. We therefore recommend that the provisional supervisor's power to remove directors or officers to be made conditional upon the approval of the creditors and that the reasons for doing so can be demonstrated.

section 19(2)(a)

Where a major secured creditor decides that he does not agree with the provisional supervisor of the company proceeding to prepare the proposal, then the moratorium shall cease immediately the provisional supervisor receives the 2nd notice concerned at the address referred to in subsection (1)(c).

Since the costs of appointing the provisional supervisor is to be borne by the company, we consider that in the case where there is a major secured creditor of the company, the consent from the major secured creditor of the company should be obtained prior to the appointment of the provisional supervisor, thereby minimising the costs for the company in the case where the major secured creditor of the company disagrees with the preparation of the proposal.

section 26(1)

While the voluntary arrangement is in effect in respect of the company:

(a) no creditor bound by the arrangement may commence or continue any winding up proceedings against the company;

(b) no resolution may be passed or made by the members or directors of the company for winding up of the company;

(c) no receiver of the company may be appointed by a creditor bound by the arrangement or, if already appointed, no receiver may exercise any powers incidental to the office;

(d) no creditor bound by the arrangement may take any step to enforce or continue to enforce any security over the company's property or to repossess goods in the company's possession; and

(e) no creditor bound by the arrangement may commence any proceedings, execution, distress or other legal process against the company.

Whilst we agree that the above-mentioned provisions will enable the voluntary arrangement to be implemented without any interference while in effect, we consider that there should be provisions in the Bill to allow the parties to be bound by the voluntary arrangement to apply to the court for exemption under the provision as stated above upon the occurrence of certain events such as the change in circumstances from the date of the approval of the voluntary arrangement and the date of the application.

Schedule 4 Part 2

Powers of the provisional supervisor:

1. *power to appoint any agent or employ any person to do any business and to dismiss the agent or employee*
2. *power to appoint a solicitor, professional accountant or other professionally qualified person to assist in the discharge of duties and the exercise of powers and to dismiss the solicitor, professional accountant or other professionally qualified person.*

As stated above, the costs of the provisional supervisor, including those for the appointment of any of its agents, will be borne by the company. To such extent, we consider it appropriate to require the provisional supervisor to demonstrate the reasons for and benefits of appointing such agents or employees and the approval from the relevant creditors should also be obtained prior to such appointment as the ultimate purpose of the provisional supervisor is to preserve the property of the company for the creditors of the company as a whole. The introduction of a general mandate for provisional supervisor to act within a predetermined amount can also facilitate such procedures and provide for a compromise between the provisional supervisor and the relevant creditors.

Schedule 4 Part 4(1) *The provisional supervisor of the company shall be entitled to be indemnified out of the property of the company for:*

a. all contracts, debts and liabilities for which he is liable as the provisional supervisor in the discharge of his duties and the exercise of his powers as the provisional supervisor; and

b. his remuneration and all reasonable fees, costs and charges, to the extent that such contracts, debts and other liabilities, and such remuneration and reasonable fees, costs and charges, are not attributable to misconduct or negligence on the part of the provisional supervisor.

Schedule 4 Part 4(2) *Notwithstanding any other law (including any other provision of this Ordinance except under section 11(8)(b) or 16 of this Ordinance), the indemnification given to the provisional supervisor of the company under section 1 shall;*

a. have priority to all other claims, whether secured or unsecured, against the company except claims which are secured by a fixed charge; and

b. be secured by a lien over the property of the company except such property subject to a fixed charge.

We note from the Bill that apart from the provisional liquidator or the liquidator of the company, directors and members of the company can also appoint qualified person to be the provisional supervisor of the company, whose ultimate goal is to preserve the company's property for the benefit of the creditors.

By giving the indemnity of the provisional supervisor priority over the claims by secured or unsecured creditors, we consider that the Bill should provide for circumstances where the appointment of the provisional supervisor is initiated by the directors or members of the company, the consent from the creditors should be obtained as the costs of the provisional supervisor will ultimately affect the property of the company available for repayment to its creditors.

Schedule 4 Part 6(3) *Where a person deals with the provisional supervisor of the company in good faith and for good consideration and thereby changes his position or acts to his detriment based on the dealing, the provisional supervisor and the company shall be bound by the provisional supervisor's actions whether or not the provisional supervisor was acting within his powers.*

The ultimate goal of the provisional supervisor is to preserve the property of the company for the benefit of the creditors of the company. Thus, we consider that the above provision exposes the company to possible liabilities for the acts of the provisional supervisor, whether or not it relates to the discharge of his duties as the provisional supervisor.

We therefore recommend that such provision to be modified to cover only those actions taken by the provisional supervisor in his capacity as the provisional supervisor and in discharging his duty or exercising such power as the provisional supervisor, as well as actions that are not attributable to misconduct or negligence on the part of the provisional supervisor.

section 295C(1)

The court shall declare a responsible person or former responsible person liable for insolvent trading if, but only if, it is satisfied that:

a. the company engaged in the insolvent trading on or after the date on which this section came into operation;

b. the responsible person or former responsible person was a responsible person at the time that the insolvent trading occurred; and

c. either:

i. the responsible person;

(A) knew or ought reasonably to have known the company was insolvent; or

(B) knew or ought reasonably to have known that there was no reasonable prospect that the company could avoid becoming insolvent; or

ii. there were reasonable grounds for suspecting that:

(A) the company was insolvent; or

(B) there was no reasonable prospect that the company could avoid becoming insolvent,

and the responsible person failed to take any steps to prevent the insolvent trading.

section 295D(1)

Subject to subsection(2), where in any proceedings under section 295C it is shown to the satisfaction of the court that the company, on any date within the 12 months immediately preceding the date of commencement of the winding up of the company:

(a) was insolvent; or

(b) contravened section 121(1) or (3A)(and whether or not any person was convicted of an offence in respect of the contravention),

then it shall be presumed in those proceedings, unless the contrary is shown, that the company remained insolvent form the first-mentioned date to and including the second-mentioned date.

We understand that the purpose of the amendments to section 295C is to ensure that the interests of the creditors be protected against any further liabilities which the company may enter into when it is already insolvent. Nevertheless, combining the effect of sections 295C and section 295D as proposed, we note that if the company is insolvent at any time within the 12 months preceding the date of the commencement of the winding up of the company, the responsible person or former responsible person will be deemed liable for insolvent trading and thus for compensation to the company at an amount to be determined by the court.

To this extent, we believe that these provisions will discourage the directors and senior management of the company to try to rescue the company at the edge of the company being insolvent by continue trading because if the effort turned out to be unsuccessful, they may potentially be deemed liable if winding up proceedings against the company is to commence within 12 months. Instead, directors and senior management may be more willing to appoint a provisional supervisor and put the company under provisional supervision despite the fact that the situation may be due to an exceptional and temporary downturn in the market and there may be possibilities that such effort may perhaps pay off in getting the business back on track.

Furthermore, in order to improve solvency of the company, the directors and senior management of a company may utilise various means to reduce cashflow pressure such as laying off the company's staff which will defeat the purpose of the preservation of jobs which we understand, is one of the primary purposes of the introduction of the Bill.

We therefore consider it appropriate to limit the scope of the provision in section 295D to apply only if the company was insolvent at any time within 12 months preceding the date of commencement of the winding of the company and remain insolvent throughout that period, thereby reducing the directors' and senior management's reluctance in implementing any intermediary measures to rescue the company, or justify the effort if a turnaround in the business of the company did occur after such effort but eventually did not sustain.

In addition to the specific comments on the Bill which we have raised above, we also have certain views on the introduction of the Bill and its actual impact upon application.

Whilst we understand that the purpose of the Bill is to introduce a statutory framework in handling circumstances where a company may be or will eventually be insolvent and provide protection to the employees and its creditors, we are a bit concerned as to whether the Bill, once passed, will be perceived as government intervention in the business environment in Hong Kong which, among other countries, has been praised for the freedom of its business environment with minimal intervention by the government. By "defining" what is "insolvency" and the consequential liabilities of the directors and senior management for insolvent trading, the Bill effectively poses boundaries for the actions of business operators.

Furthermore, we believe that despite the fact that the qualified person will either be a professional accountant or a solicitor, it is technically difficult to require or expect the provisional supervisor to "step in" the company and assume absolute control over its business, property and affairs. This may be due to the specific technical knowledge, skills or experiences required in that particular industry or when business relationships and networking play an important role in that particular industry. Whilst we concur to the view that an independent third party should be appointed to the company during provisional supervision, the role of such provisional supervisor should perhaps be of a control and monitoring nature rather than an operator of the business.

Moreover, the current market practice allows for voluntary arrangement between a company which is insolvent and its creditors to be reached by the will of the parties involved, with the assistance of professional parties such as professional accountants, solicitors and registered investment advisers. On the other hand, companies with situations which cannot be rectified will be put under liquidation. The introduction of the Bill will effectively change this market-driven process as it was previously mentioned, the combined effect of the amended sections 295C and 295D will pose great pressure on directors and senior management of the company in terms of whether any rescue effort should be made when trading must be maintained.

We are also concerned that the Bill might lead to the frequent or even premature appointment of provisional supervisors by the directors and senior management so as to "cover" themselves in the situation when there is no assurance that the rescue effort, if it requires maintaining the operation of the company, will be successful. As mentioned above, upon the passing of the Bill, companies may perhaps be more willing and prepared to lay off employees when there is a slight indication that solvency of the company may become an issue, so as to improve its cashflow position. The consequence of this abusive use of the legislation may eventually create a lack of business confidence as news of companies being put under provisional supervision and redundancy of employees continue to emerge in the market.

Other common ways to rescue a company, be it a public company or a private one which includes, inter alia, introduction of new equity by means of placing of new shares or rights issue, or even the introduction of a new controlling shareholder (the "white knight") through subscription of new shares which in the case of a listed company, to be accompanied by an application for a whitewash waiver to comply with The Hong Kong Codes on Takeovers and Mergers, may lose ground in light of the time involved as well as the uncertainty of whether such effort can guarantee the company to remain solvent for 12 months or more. These are all serious considerations that must be addressed by the business community, market practitioners as well as the Legislative Council.