

12 November 2001

The Honourable Margaret Ng,
Chairman of the Bills Committee on Companies (Corporate Rescue) Bill,
Legislative Council,
Legislative Council Building,
8 Jackson Road,
Central,
Hong Kong
By fax: 2869 6794

Dear Madam,

Companies (Corporate Rescue) Bill

We would like to reiterate that the Association remains supportive of the Government's effort in developing legislation to assist companies in financial distress, and believes that such legislation should be an integral part of maintaining Hong Kong's position as a good place to do business. We therefore thank the Bills Committee for the opportunity of allowing the Association to put forward its views on the trust account arrangement in respect of unpaid employee wages and other entitlements.

Putting your request into context, at the outset we should state that we are concerned that the debate over the merits of the Companies (Corporate Rescue) Bill (the "**Bill**"), both following the presentations by delegations which the Association attended on 22 October 2001, and now within this follow up request, appears to be focusing on the issue of employee wage entitlements. As stated below, the issue of employee wage entitlements, whilst important, is but one part of the Bill, and it is vital that other deficiencies of the Bill also receive attention. Furthermore, leaving aside the debate on the Bill's treatment of employee wages for the moment, we question whether the whole issue of employee entitlements would be better addressed within dedicated legislation rather than trying to address any perceived inadequacies within a Bill that is primarily not intended to address such issues.

Regarding your request specifically, on 22 October 2001 the Association submitted that the requirement contained in the Bill that settlement of wage claims (or the provision for such claims), was a significant impediment to the viability of the operation of Provisional Supervision. Such a requirement detracts from the purpose of the Bill to deal with companies where they are in a position that they cannot satisfy creditors' claims. The elevation of full payment to one creditor class (that is, employees) above all others does not fit comfortably with a corporate rescue philosophy.

Employees have protection at the present time (above other unsecured creditors). They are afforded priority over claims of other creditors in respect of some of their entitlements in the winding up of an insolvent company. Furthermore, they are afforded protection by virtue of the Protection of Wages on Insolvency Fund. To propose another level of protection in a bill that is not designed for that purpose appears inappropriate and would seem to frustrate the purpose of the Bill and have unwanted and harmful consequences.

The long term viability of a restructured company, the effect of which protects continuation of employment, should be the primary focus of the Bill. The requirement to fully satisfy employee wages may well represent an insurmountable obstacle to allowing a company to enter Provisional Supervision, and given the insolvent trading provisions of the Bill, force directors to opt for liquidation.

Even if a company were able to settle employee wages, the requirement will make creditors less amenable in agreeing to support a restructuring, and full settlement of wages due to directors, who were, at least in part, responsible for putting the company into its position would be unacceptable. At present, the Companies Ordinance provides for employees to have priority in their claim up to a specified maximum amount which is augmented by the Protection of Wages on Insolvency Fund. This constitutes a policy decision that recognizes that certain creditors should have priority but that such claims should not necessarily exhaust all the assets of the insolvent company. Equally other creditors have an entitlement to expect their claims will at least be partially satisfied from the company's assets once those limited preferential claims are met. The Bill in proposing to meet in full employees' wage claims appears to be in part sacrificing its corporate rescue focus in an attempt to address labour law issues. Even then this secondary aim is unlikely to be achieved as it will reduce the likelihood of companies entering a rescue via Provisional

Supervision, and increase the likelihood of liquidation due to insolvent trading provisions. The effect of this is obviously harmful to trade creditors which have, to now, legitimately expected partial, or even full repayment from trading the indebted company out of its problems under a rescue/corporate restructuring. The affected group will include Small to Medium Sized Enterprises (“SME’s”) whose own viability may well be compromised by the resulting irrecoverable receivable. If workers’ entitlements in the event of corporate insolvency are to be addressed, we would respectfully suggest this be done through dedicated legislation.

At the presentations by delegations on the 22 October 2001 you were keen to find out whether we thought the intended legislation would be damaging in any way. As stated above, while full payment of employees’ wage claims is only required to enter Provisional Supervision, and therefore can be avoided if Provisional Supervision is not chosen, in combination with provisions relating to insolvent trading, we believe that this will reduce the likelihood of a rescue being undertaken, the corollary being an increased likelihood of liquidation.

Furthermore, while not related to employee wages, the failure of the Bill to adequately protect the rights of secured creditors will also be damaging, as it will compromise a bank’s ability to mitigate lending risk by taking appropriate security which is by all means inconsistent with international lending practice. This in turn will reduce the ability of banks to lend money, particularly into growing companies. Our concerns in this regard were detailed in our 22 October 2001 presentation, but for ease of reference are:

1. A secured creditor holding security over all or substantially all of the company’s assets should be entitled to act under powers conferred by their security immediately on the appointment of the Provisional Supervisor. At present, there is a notice procedure, and until receipt of formal notice, the relevant secured creditor cannot act. This creates a hiatus, permitting claims that otherwise would not have priority (such as the Provisional Supervisor’s fees and expenses) to enjoy a priority out of the floating charge component. This is unacceptable.
2. Security held by a lender not in the form of a fixed charge will be subject to priority claims by employees and the Provisional Supervisor on account of their fees and expenses. Lenders often take other types of security (or obtain rights of security by operation of law). Pledges and

liens are two common types of such security. Our view is that such security obtained in this manner under the Bill will be subject to priority claimants as mentioned above. Once again this is unacceptable.

3. We do not consider that the draftsman has fully considered the complicated implication on long-standing and well understood rights which remain unclear under the Bill. Such rights include the right to retain control of documents of title, bills of lading, effect combination of accounts or right of set off. Such rights should remain consistent with current practice and remain unaffected by the Bill. Once again this does not appear to be the situation.

We again reiterate that the Association is committed to working with Government and the Legislature to foster an environment that promotes Hong Kong as a commercial centre attracting investment into the SAR for sound commercial and community reasons and an environment that continues to encourage the development of the SME sector. This is particularly important at a time of global economic uncertainties. While again we would state that we would support all initiatives to promote a corporate rescue culture, including provision for a short, non-extendable moratorium, the Association is not able to support the Bill for the reasons expressed above, and for the reasons contained in its earlier submissions.

We once again thank the Bills Committee for the opportunity to make further submission on the Bill.

Yours faithfully,

David Wan
Secretary

c.c. David Carse, Deputy Chief Executive, Hong Kong Monetary Authority
Antony Leung, Financial Secretary
Susie Ho, Deputy Secretary for Financial Services