

**Paper for the Bills Committee
on the Companies (Corporate Rescue) Bill**

**Briefing by the Legal Service Division
on Legal Aspects of the Companies (Corporate Rescue) Bill**

**I. Major Differences between the Companies (Corporate Rescue) Bill
and the relevant provisions of the Companies (Amendment) Bill
2000**

- The Companies (Corporate Rescue) Bill (the new Bill) is a stand alone bill. Under the Companies (Amendment) Bill 2000 (the old Bill), the provisions relating to corporate rescue scheme were introduced as part of the amendments to the Companies Ordinance (Cap. 32) (the Ordinance). The difference does not by itself cause any change in the effect of the provisions.
- The more significant new provisions not found in the old Bill are set out in the Appendix.
- *Relationship with the Companies Ordinance*
Although the new Bill is not a part of the Ordinance, they are closely related. Apart from the exceptions stated in clause 3(1)(b), the Bill applies to all companies incorporated under the Ordinance as well as overseas companies registered under Part XI of the Ordinance. Under clause 2(5), the interpretation section (section 2) of the Ordinance would apply in the interpretation of the provisions of the Bill. Further, in the definition of the "report to creditors" in clause 21(5), references are made to sections 264B, 266, 266B, 275, 276, 295A to 295G of the Ordinance. However, as the Bill is legislation governing a corporate insolvent situation, it does not affect the operation of the Ordinance except in relation to proceedings brought under the Ordinance against the Company and the operation some of the provisions of the Ordinance applicable to creditors' voluntary winding-up.

II. More Significant Legal Issues

- *Human Rights considerations:*

Clause 32(3) stipulates that an answer given by a person to a question put to him in exercise of powers conferred by rules made under this clause may be used in evidence against him. This appears to have abrogated the right against self-incrimination. The existing section 296(2A) of the Ordinance has the same wording. Perhaps section 296(2A) is meant to cover rules such as Rule 59 of the Companies (Winding-up) Rules (Cap. 32 sub. leg.). Rule 59 provides that verified notes of public examination of a person named in an order pursuant to section 222 of the Ordinance shall be used and subject to all just exceptions to admissibility in evidence, be admissible in evidence against that person. It is not immediately clear whether similar provision in the context of a corporate rescue scheme is necessary or conducive to the purposes of the scheme.
- *Clause 11(3) and Schedule 5:*

Clause 11(2) imposes the moratorium. Clause 11(3)(d) provides exceptions to the moratorium for the contracts described in Schedule 5. Those contracts relate to financial products and instruments. Since products traded on recognized exchanges are settled on continuous net settlement basis, the need to exclude the application of clause 11(2) to contracts cleared through the recognized clearing houses is understood. It is also accepted that it is generally desirable for the development of financial markets to allow netting irrespective of the insolvency of a counter-party. Provisions should therefore be in place to cater for the needs of the clearing houses and for the purposes of netting. What clause 11(3)(d) and Schedule 5 have achieved is, however, the wholesale exclusion of the contracts relating to financial products and instruments. It means that purposes of a moratorium could be defeated if any creditor has a claim under any contract within Schedule 5 could sue the company. Perhaps the alternative is to restrict the exclusion to netting and the obligations relating to clearing houses.
- *Employer's contribution under Mandatory Provident Fund Schemes Ordinance (Cap. 485)*

Clause 3(d)(i) of Schedule 2 requires a company to pay all debts and

liabilities owing to employees under the Employment Ordinance (Cap. 57). Employer's contributions under Mandatory Provident Fund Schemes Ordinance do not appear to be covered.

- *Company liable to third party for directors' unauthorized acts*
Clause 14(3) provides for circumstances under which a company in provisional supervision may be liable to a person who deals with a director of the company. The general rule appears to be that the director is liable to the person with whom he has dealt. It is not clear whether it is necessary to make the company also liable. It seems to be not justifiable to make a company liable to a person who has notice of the fact that the company is in provisional supervision.

- *"As soon as reasonably practicable"*
In various provisions relating to the giving of notices and the vacation of office, the new Bill employs the expression of "as soon as reasonably practicable". The expression would allow the actual circumstances of the person concerned to be taken into account. Hence, a person who has much to do may be justified to take a longer time to give notice. Similarly, a busy Provisional Supervisor (PS) may be allowed more time to tidy up things before he vacates the office of PS. It may be desirable to set a minimum time within which the notice must be given or the office must be vacated subject to the power of the courts to grant extension.

- *Deemed commencement of voluntary winding-up*
Under Clause 22(5)(b), the commencement of a creditors' voluntary winding-up pursuant to a resolution of a creditor's meeting held in compliance with clause 21 would be deemed to be the date of the commencement of the moratorium. Consequently, as provided in clause 22(5)(c), other provisions of the Ordinance shall apply with necessary modification. This need for modification is uncertain in scope and content. A simple example is section 231 of the Ordinance which stipulates that a company shall cease to carry on its business from the commencement of a voluntary winding-up. The fact is that the company during the moratorium may still have carried on business but the deeming of the commencement of the voluntary winding-up makes such carrying on contrary to the statutory provision. Should

we therefore change section 231 to have effect from the date of the resolution of the creditors' meeting, which contradicts the effect of clause 22(5)(b)? Another example is section 232 which stipulates that all transfer of shares after the commencement without the sanction of the liquidator shall be void. Should we declare any transfer of shares during the moratorium void? If not, what should the law be? Further, it is unclear how sections 241 to 243 would apply.

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APPENDIX

- Clause 2 (1)
 - Definition of "daily penalty"
 - Definition of "notice"
 - Definition of "published in the prescribed manner"
 - Paragraph (b) in the definition of "relevant creditors"

- Clause 2(4) provides notice published in prescribed manner to be constructive notice to all creditors.

- Clause 2(5) applies the interpretation section of the Ordinance.

- Clause 3(1)(b)(iv) excludes the recognized exchange controller from the application of the enacted Bill.

- Clause 3(2) stipulates that the enacted Bill would bind the Government as a creditor of a company.

- Clause 7(2) requires the PS to specify in the proposal which purpose is achievable and explain why a voluntary arrangement is desirable.

- Clause 7(3) prescribes the matters that must be stated in a proposal.

- Clause 12(2)(c) provides for cessation of moratorium when there is no PS of the company upon the expiration of specified periods of time.

- Clause 16 (7) excludes debts and liabilities to be satisfied by a trust account of the company established under Schedule 2.

- Clause 17(4) requires the specified person to apply to the PS for approval prior to the costs being incurred. This takes on board a suggestion of the Bills Committee on the old Bill.

- Clause 20(9) requires the persons who have appointed the PS to give notice after the cessation of the moratorium of the cessation.

- Paragraph (b) is added to the definition of "report to creditors" in Clause 21(5).
- Clause 23
 - Under the old Bill, secured creditors other than major secured creditor would be treated the same as unsecured creditors. It is now expressly stipulated in clause 23(1) that no proposal or modification that affects the right of a secured creditor of the company shall be approved without the consent in writing of the creditor concerned.
 - A member who is aggrieved by a resolution passed by a relevant meeting of creditors in relation to the company may apply to the court on the ground that the resolution substantially prejudices his rights as such a member (clause 23(3)).
- Clause 33 provides for amendment of the schedules.
- Schedule 2 clause 3(d)(i)(C) and (ii)

The affidavit should state all wages owing by virtue of the Employment Ordinance to the existing employees of the company have been paid up to the relevant date and no such wages is owed to existing employees up to the relevant date.
- In Schedule 4 Part 1, clause 8 is added and consequential amendment to clause 7.
- In Schedule 4 Part 2, clause 12 is added to give the PS power to dispose of property of a company in ordinary course of the company's business for its benefit.
- In Schedule 4 Part 3, clause 2(a) is added.
- In Schedule 4 Part 5, clause 6 is added to allow PS to accept remuneration at a scale of fees lower than the approved scale.

- In Schedule 7:
 - clause 14 is added to allow a secured creditor to vote on the unsecured portion of the debt of the company owed to him.
 - clause 23 is added to stipulate that a resolution is invalid if 50% in value of the creditors unconnected with the company votes against it.
 - Clause 24 is added to apply clauses 20, 21 and 22 to an appeal under clause 23 of the Bill.
 - clause 25 is added to explain the meaning of "a person connected with a company" for the purposes of clause 23.

- In Schedule 8 (consequential amendments):
 - In the proposed section 295A, a definition of "insolvency" is added and "insolvent trading" is defined with reference to insolvency.
 - An item is added to the Schedule to the Administrative Appeals Board Ordinance to include an appeal under section 4 against the decision of the Official Receiver.