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Paper for the House Committee Meeting
of the Legislative Council
on 25 May 2000

Legal Service Division Report on
Companies (Corporate Rescue) Bill

Object of the Bill

To give effect to most of the recommendations contained in the Report on Corporate Rescue and Insolvent Trading issued by the Law Reform Commission (LRC) of Hong Kong.

LegCo Brief Reference

2. C2/1/12/1C(2001)IX issued by the Financial Services Bureau.

Date of First Reading

3. 23 May 2001.

Comments

4. The current legislative proposal was previously introduced into the Legislative Council as part of the Companies (Amendment) Bill 2000 (CA Bill). Due to the time constraints and the complexity of the issues involved, the then Bills Committee recommended that the relevant provisions be excised from the CA Bill and deferred for resubmission to the Council at a later stage. The Administration now resubmits the legislative proposal as a stand alone bill instead of as an amendment bill to the Companies Ordinance (Cap. 32). The rationale for taking this course of action is not explained in the LegCo Brief.

5. The Bill proposes to inaugurate the new regime of provisional supervision and voluntary arrangements. The central idea is to stay all proceedings (with some specified exceptions) against an insolvent company so as to enable an

independent professional appointed as a provisional supervisor to prepare a proposal which could salvage the company or part of its undertaking, or achieve the more advantageous realization of its assets or satisfaction of its debts and liabilities. The period of stay ("moratorium") would initially be 30 days which could be extended by the court up to six months upon application by the provisional supervisor. The new regime would not apply to -

(a) authorized institutions within the meaning of the Banking Ordinance (Cap. 155);

(b) authorized insurers within the meaning of the Insurance Companies Ordinance (Cap. 41);

(c) clearing houses, exchange companies or registered persons within the meaning of section 2(1) of the Securities and Futures Commission Ordinance (Cap. 24);

(d) recognized exchange controllers within the meaning of section 2(1) of the Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555); or

(e) licensed leveraged foreign exchange traders within the meaning of section 2(1) of the Leveraged Foreign Exchange Trading Ordinance (Cap. 451).

6. One of the pre-conditions for invoking the moratorium is that the company concerned has paid, or has sufficient funds in a trust account to settle, all amounts due to its employees and former employees under the Employment Ordinance (Cap. 57) before the commencement of the moratorium. Members of the Bills Committee on the CA Bill had suggested the provision of some flexibility to the requirement of settling all arrears due and owing by the company to its employees. The Administration had consulted the Labour Advisory Board (LAB) and the Protection of Wages on Insolvency Fund (PWIF) Board on this matter. Both objected to the flexibility proposal. Hence, the aforesaid requirement has remained wholly unchanged in the Bill.

7. Complementary to the new regime of moratorium is the introduction of the concept of "insolvent trade" (Clause 8 of Schedule 8). When a company is unable to pay its debts when they become due and the directors or manager of that company knowing that the company cannot avoid insolvency continue to incur debts, each of them could, upon the application of the liquidator in the subsequent liquidation of the company, be declared by the court to be liable for insolvent trading, and be ordered to pay such compensation to the company as the court may think proper in all the circumstances of the case. The Administration believes that this provision could encourage directors and senior management of a corporation to act on insolvency earlier rather than later.

8. Under the CA Bill, only the major secured creditor may object to the initiation of the provisional supervision. Minor secured creditors would be treated the same as unsecured creditors. Concern was expressed that such approach might change the existing practice of secured lending and cause confusion and uncertainty amongst the lending institutions and the business community. It is now expressly stipulated in clause 23(1) of the Bill 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.

9. The Bill now also protects the interests of the members of a company. 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)).

10. Clause 17 of the Bill permits the payment of reasonable costs to specified persons in connection with the provision of a statement of affairs of the company under provisional supervision, or the provision of documents or records relating to the company, and such information about the business, affairs, property or financial circumstances of the company as the provisional supervisor may reasonably require. The Bill has taken on board a suggestion of the Bills Committee on CA Bill by requiring the specified person to apply to the provisional supervisor for approval prior to the costs being incurred (clause 17(4)).

Public Consultation

11. According to the LegCo Brief, the Subcommittee on Insolvency of LRC carried out a public consultation on the concept of corporate rescue in 1995. The Financial Services Bureau conducted a consultation exercise on certain proposals of the LRC in 1998 amongst 26 major business/professional and employer/employee bodies. The results of the consultation were reported to the Panel on Financial Affairs in June 1999.

12. The Standing Committee on Companies Law Review supported the introduction of a statutory corporate rescue at one of its meetings in 1996 and expressed its view on the draft provisions on corporate rescue and insolvent trading in December 1999. It expressed concern over a possible conflict of interest that might arise if the provisional supervisor was allowed to become the liquidator in the winding up of the company if the creditors had so resolved. The Administration believes that such appointment makes commercial sense and would save time and money as the supervisor would be able to proceed quickly with the winding up on the basis of his knowledge of the affairs of the company.

Consultation with LegCo Panel

13. Members of the Panel on Financial Affairs were briefed at the meeting

on 5 February 2001 on the outcome of the consultation with LAB and PWIF Board as well as the proposed revisions to some of the provisions of the legislative proposal.

Recommendation

14. The Legal Service Division is still scrutinizing the legal and drafting aspects of the Bill. Since the Bill makes significant innovation in the regime of corporate rescue and changes the law governing personal liabilities of company directors and management, Members may wish to set up a Bills Committee to study the Bill in detail in view of the possible impact on the corporate business environment.

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