Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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By fax and by post
(2537 1425)

1 April 2005

The Hon. Tam Heung-man
Chairman of the Bills Committee
on Bankruptcy (Amendment) Bill
Room 425, West Wing
Central Government Offices
11 Ice House Street
Hong Kong

Dear Ms. Tam,

Bankruptcy (Amendment) Bill 2004

We refer to our submission dated 10 December 2004 and the response from the Administration under the heading "Written Submissions on the Bankruptcy (Amendment) Bill 2004". The comments of the Hong Kong Institute of Certified Public Accountants (the "Institute"/"HKICPA") on the Administration's response are as set out below.

The Framework

1. In response to our concerns regarding the possibility of private sector trustees undertaking significant work simply to realise sufficient funds to meet, for example, the costs and expenses incurred or authorised by the Official Receiver ("OR"), and "where applicable", the costs of the solicitors acting for the petitioning creditor, the Administration indicates that the Official Receiver's Office (ORO) plans to outsource debtor-petition cases only.

   However, the wording in the Bill does not limit the scope to debtor-petition cases and certain provisions, e.g., the proposed new section 86B(1)(f), appear to be relevant to both debtor- and creditor-petitioned cases. The concerns raised in the Institute's previous submission should be considered and addressed in that light. The comments below are made on the basis that the provisions of the Bill will apply to both debtor-petition and creditor-petition cases where appropriate.

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The Institute has previously pointed out that most bankruptcies are non-remunerative, and that the proposed framework should ensure that there would be sufficient funds available for suitably qualified and experienced private sector insolvency practitioners ("PIPs") acting as trustees to be remunerated at reasonable level for work properly undertaken. In response the Administration has indicated that bankruptcy cases will be outsourced in batches so that PIPs can achieve economies of scale.

However, as each case differs on its facts and circumstances and there are minimum standards of professionalism and good practice to be observed by PIPs, as members of regulated professional bodies and as officers of the court, there will be a limit on the extent to which economies of scale can be achieved in practice.

The Specific Provisions

2. *Clause 3 (Re. section 12, BO) – Effect of bankruptcy order*

We note that the proposed new section 12(1A) was intended to facilitate the OR to appoint a PIP as provisional trustee in his place under the tendering arrangement only in summary cases i.e., where the Official Receiver considers that the value of the property of the bankrupt is unlikely to exceed $200,000. The idea is that such cases will require less efforts and skills and therefore by being outsourced in batches, PIPs can achieve economies of scale (see our comment in 1 above). The concept is similar to the OR's current practice under section 194(1A) of the Companies Ordinance ("CO") in relation to corporate insolvency.

We note from the Administration's response that where the ORO has formed the view that the assets are likely to exceed $200,000, an appointment of provisional trustee under proposed section 12(1A) of the BO (i.e. under the tendering scheme) will not be made. Instead, the ORO will summon the creditors meeting for appointment of trustee under section 17A as is presently done.

According to some practitioners, while the ORO is required under section CO 194(1A) to form the opinion that the value of the property of the company is unlikely to exceed HK$200,000 before appointing someone as provisional liquidator in his place, in some cases the onus has in fact shifted to creditors to prove that the company has assets of more than HK$200,000. There have been cases in the past involving property exceeding HK$200,000 in value but were outsourced under section 194(1A). As the provisions are intended to help to ensure that those who undertake the work outsourced are suitably qualified and experienced, it is therefore important that the OR should have reasonable due processes in place to ensure adherence to the requirements

of both section 194(1A) of the CO and the proposed new section 12(1A) of the BO.

3. *Clause 4 (Re. section 13) – Power to appoint interim trustee*

The Institute has previously made the observation that the proposed amendment to section 13 of the BO merely changes the title of the appointee, from "interim receiver" to "interim trustee". This section does not provide for any person other than the OR to be appointed as interim trustee. This may be contrasted with the position under section 193(2), CO, which provides that the "Official Receiver or any other fit person" can be appointed as provisional liquidator.

We continue to believe that it would be sensible at least to allow for the possibility of appointing PIPs as interim trustee under the BO, even though such appointments are not likely to be frequent. Notwithstanding the Administration's contention that there has been only one such appointment in the past ten years, the main purpose of the bill is to facilitate the contracting out of bankruptcy work to the private sector. It is not clear, therefore, how relevant past experience is to the point in question.

We reiterate, therefore, our view that the BO should be amended to converge more closely with the equivalent provisions in the CO, i.e. section 193 and section 194(1)(aa) and that provision similar to Rule 28(3) of the Companies (Winding-up) Rules should also be incorporated into the Bankruptcy Rules to allow the interim trustee to be paid his remuneration out of the assets of the estate in the event that a bankruptcy order is not ultimately made.

4. *Clause 11 (Re. section 37) – Priority of costs and charges*

In its previous submission, the Institute pointed out that given that the intention of the proposed legislation is to facilitate contracting out more work to PIPs, consideration should be given to increasing the priority of the trustee's remuneration, which under the bill ranks very low. We believe that this would provide a greater incentive for the trustee to pursue claims that were worth pursuing but which might not result in immediate recoveries. In its response, the Administration has indicated that the proposed priority of the items set out in section 37(1) by and large follows that provided under rule 179(1) of the Companies (Winding-up) Rules, which has been applied for many years in the case of company liquidation.

We do not agree that it is necessary or appropriate to follow the priority of items as provided under rule 179(1) of the Companies (Winding-up) Rules, which itself provides a questionable model. Although it may be in line with the practice in some jurisdictions, these jurisdictions do not have in place a

system under which the whole or a substantial portion of the liquidation caseload is contracted out to PIPs.

In response to the Institute's request for clarification as to how much is likely to be made available to private sector trustees out of the petitioners' deposit, the Administration has indicated that, "as a rough estimate", the amount to be deducted as the OR's fees and expenses, from the deposit for a debtor-petition case of $8,650, will be in the range of $2,500 to $3,000. In view of the concerns previously raised by the Institute as to the availability of sufficient funds for suitably qualified and experienced PIPs acting as trustees to be remunerated at reasonable level for work properly undertaken, we would request the Administration to clarify whether the remainder of the deposit after deducting the figure referred to above, would in principle be available the cover the costs, expenses and remuneration of the trustee, subject to the priorities listed in clause 11, and discussed above.

5. *Clause 15 (Re. section 58, BO) – Vesting and transfer of property*

The Bill seeks to replace the existing section 58(1). The proposed new section 58(1B) provides that save in certain specifically named sections, "the provisional trustee shall, unless the context otherwise requires, be regarded as the trustee for the purposes of this Ordinance".

The Institute would like to reiterate that this is an important definitional provision, of general application, and does not seem to be appropriate, therefore, to secrete it in a section dealing primarily with the vesting and transfer of property. In its response the Administration indicates that the proposed section 58(1B) "is like an interpretation provision". As such, in our view it should either be included in the "interpretation" section or incorporated as a stand-alone section in the bill.

6. *Clause 27 – Section added*

Clause 27 proposes to introduce a new 85A. Section 85A(1) proposes that the remuneration of the provisional trustee and the first trustee constituted under section 112A(1) is to be fixed by the OR in accordance with a scale of fees or "on such other basis as the Official Receiver may from time to time approve in writing". Although this provision appears to be based on section 196, CO, we believe that the wording is too open-ended and could create uncertainty. It seems to be reasonable that a PIP should not be left in any doubt about the basis on which he will be remunerated before taking on a case. In practice, similar ambiguity in the CO and Companies Winding-up Rules and their application has given rise to uncertainty, as yet unresolved, in relation to the basis of liquidators' remuneration in summary winding-up cases. The judiciary has indicated to the OR and some practitioners that

liquidators' remuneration in summary winding-up cases can only be charged on a percentage basis, rather than on a time-cost basis. However, as suggested in the Institute's submission to the OR dated 22 December 2004, it would not be equitable and, from a commercial point of view, it would certainly be less viable, if the basis for fixing remuneration were not to provide a reasonable degree of certainty and fair reward for work properly undertaken, which, generally, the imposition of the percentage basis in summary cases would not do. We believe, therefore, that the opportunity should be taken to ensure greater clarity from the outset under the Bill.

We would reiterate that clause 27 should specify the grounds on which the court may, on the OR's application for review under the proposed section 85A(2), confirm, increase or reduce the remuneration of the trustee.

7. *Clause 28 – Section added*

Notwithstanding the response of the Administration, we still do not see it as a duty of the trustee "to raise money in any case where in the interests of the creditors it appears necessary so to do", as prescribed in the proposed new section 86B(1)(a). It is not a prescribed duty of a liquidator to do so in a winding-up. It is potentially an onerous duty where there are only a few thousand dollars to fund all the costs of the bankruptcy (see the discussion under "clause 11" above) and we do not understand the purpose for which money is to be raised or indeed, more generally, the purpose of including such a provision in the bill.

The Institute has previously commented that the provisions of paragraph (f), i.e. to assist the bankrupt in preparing his statement of affairs in case the bankrupt has no solicitor acting for him and is unable properly to prepare it himself…", is not a duty of the liquidator under the corresponding provisions of the CO, and could be onerous, given the lack of available assets in most bankruptcies. In its response, the Administration does not see this as an onerous duty on the PIPs because of the underlying obligation of the bankrupt in debtor-petition cases to submit a sworn statement of affairs.

However, depending on the background of the bankrupts concerned, more input is required from the trustee in some cases in relation to the preparation of the statement of affairs. While the statement of affairs may have been sworn and filed with the bankruptcy petition in debtor-petition cases, input may also be required from the trustee in relation to any amendments that are required to be made. Furthermore, the bill does not limit this proposed duty to debtor-petition cases, so the response does not remove the concern. We would also add that this is an illustration of the point made above under "The Framework" that the scope of the bill is not confined to debtor-petition cases, even though it may be the present intention of the OR only to contract out such cases. The Institute needs to consider the bill in the form in which it is

drafted and, this being the case, we find the proposed duties in sections 86(1)(a) and (f) to be potentially onerous and, therefore, we, object to their inclusion.

8. *Clause 30 (Re. section 88) – Trustee to provide statements of accounts*

The Administration has indicated that it is considering the Institute's suggestion that, in amending s.88, BO, clause 30 should include a provision similar to that contained in the proposed section 19(4A) (Clause 9 - *Public examination of bankrupt*), empowering the trustee to require a creditor to pay a deposit as a pre-condition to taking the action requested.

The Institute would be grateful for the Administration's feedback on the matter.

9. *Clause 31 (Re. section 89) – Annual statement of proceedings*

The Institute repeats the comment made in its December 2004 submission that it would seem appropriate to take the opportunity to review the format of accounts with a view to simplify them to facilitate compilation, and to make them more meaningful to creditors. This could also apply to the Form 137, produced by the trustee in his application for release.

10. *Unfair preferences*

We note that the Administration's preliminary view is that a review of the unfair preference provisions is outside the scope of the present amendment exercise. We should like to know whether this remains the Administration's position, as we continue to believe that the bill provides a good opportunity to update these ineffective insolvency provisions. There are no regular amendments made to the Bankruptcy Ordinance and if this opportunity is not taken, it is not at all clear when the matter will be addressed in future. As we pointed out previously, there are significant deficiencies in the provisions on unfair preferences under the BO (section 50, section 51B, etc.) and, as some of the provisions of the BO are imported into the CO, by virtue of section 266 and section 266B of the CO, there are also significant deficiencies in the unfair preference provisions as applied to company liquidations. For example, unfair preferences given to fellow subsidiaries or holding companies are not caught by the provision, due to the limited definition of "associate" under section 51B of the BO.

I hope that you find our comments above constructive. If you have any questions in respect of the comments, please feel free to contact our Peter Tisman, Director, Faculties & Advocacy at peter@hkicpa.org.hk or at 2287 7084, or John Tang, Assistant Director, Faculties & Advocacy at johntang@hkicpa.org.hk or at 2287 7006.

Yours sincerely,

Winnie C.W. Cheung
Chief Executive & Registrar

WCC/JT/ay

c.c. Mr. Alan Lo, Financial Services and the Treasury Bureau
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