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Report of the Bills Committee on
Bankruptcy (Amendment) Bill 2004

Purpose

This paper reports on the deliberations of the Bills Committee on Bankruptcy (Amendment) Bill 2004.

Background

2. The Bankruptcy Ordinance (BO) (Cap. 6) provides that Official Receiver (OR) shall become the receiver of the bankrupt's property on the making of a bankruptcy order by the court. For bankruptcy cases where the value of the bankrupt's property is likely to exceed $200,000 (non-summary cases), the OR shall summon a meeting of creditors for the purpose of appointing a private-sector insolvency practitioner (PIP) as the trustee of the bankrupt's property. For cases where the value of the bankrupt's property is unlikely to exceed $200,000 (summary cases), no meeting of creditors is called and upon an order made by the court that the case be administered in a summary manner, the OR shall automatically be the trustee. Unlike the Companies Ordinance (Cap. 32) which allows the OR to outsource summary cases of liquidation to PIPs, the BO does not have similar provisions for summary cases of bankruptcy. The summary cases of bankruptcy, which account for over 90% of the total number of cases in 2003, are at present handled in-house by the OR's Office (ORO).

3. In 2001, in the light of the changing liquidation and bankruptcy landscape, the Administration commissioned a consultancy study to review the existing role of the ORO in the provision of insolvency administration services (the review). The Administration consulted the public in June-August 2002 and the Legislative Council (LegCo) Panel on Financial Affairs (FA Panel) at its meeting on 24 July 2002 on the recommendations of the review. One of the recommendations was the introduction of legislative amendments to allow the ORO to outsource bankruptcy cases to PIPs. Given the significant increase in the number of bankruptcy cases in recent years[1], the

[1] The number of bankruptcy orders made by the court has increased from 639 in 1997 to 9 151 in 2001, 25 328 in 2002, and 24 922 in 2003.

consultant considered that outsourcing offered potential for dealing with the expanding caseload in a more cost-effective and rapid manner.

4. The FA Panel was briefed at its meeting on 5 May 2003 on the outcome of the public consultation exercise. Members noted that most of the respondents agreed with the consultant's recommendation that legislative changes should be introduced to allow the ORO to outsource bankruptcy cases to PIPs. A few respondents considered it necessary for the Government to provide PIPs with subsidies and reduce the administration work involved. In mid-October 2003, the Administration provided the FA Panel with an information paper setting out the proposed legislative amendments and the Administration's intention to introduce the same into LegCo within the 2003-04 session.

5. In December 2003, the Administration introduced the Bankruptcy (Amendment) Bill 2003 into LegCo to effect the outsourcing proposal. While the House Committee decided on 12 December 2003 that a bills committee should be formed to study the Bill, the bills committee was placed on the waiting list because there was no vacant slot. Owing to the unavailability of a bills committee slot, the Bill lapsed at the end of the LegCo term on 30 September 2004.

6. On 13 October 2004, the Administration introduced the Bankruptcy (Amendment) Bill 2004 (the Bill) into LegCo. Apart from some textual amendments of minor nature, the Bill is the same in substance as the previous one introduced into LegCo in December 2003.

The Bill

7. The Bill seeks to amend the BO for the following main purposes:

(a) To empower the OR to outsource bankruptcy cases to PIPs in specified circumstances;

(b) To provide for the respective powers and duties of the OR, a provisional trustee and a trustee;

(c) To revise the priority of payment of costs and charges out of a bankrupt's assets as set out in section 37 of the BO to bring the section in line with the provisions of rule 179(1) of the Companies (Winding-up) Rules (Cap. 32, sub. leg. H); and

(d) To adapt certain provisions of the BO to bring them into conformity with the Basic Law and with the status of Hong Kong as a Special Administrative Region of the People's Republic of China.

The Bills Committee

8. The House Committee agreed at its meeting on 15 October 2004 to form a Bills Committee to study the Bill. The Bills Committee first met on 3 November 2004 and Hon TAM Heung-man was elected Chairman. The membership list of the Bills Committee is in **Appendix I**.

9. The Bills Committee held a total of 11 meetings. It received submissions from 17 organizations and met with three of them. The list of the organizations concerned is in **Appendix II**.

Deliberations of the Bills Committee

10. While the Bills Committee has no objection in principle to the Administration's proposal to outsource summary bankruptcy cases to PIPs, it stresses the importance for the Administration to ensure the quality of service to be provided by PIPs and that the outsourcing scheme is financially viable, cost-effective and transparent. In this connection, the Bills Committee has examined the Bill in detail, in particular the following issues:

(a) Scope and operation of the outsourcing scheme;

(b) Qualification criteria for appointment as provisional trustees;

(c) Duties of and powers conferred upon PIPs for handling bankruptcy cases, and remuneration of PIPs;

(d) Monitoring of the performance of PIPs;

(e) Priority of payment of costs and charges out of a bankrupt's assets; and

(f) Staffing implications of the outsourcing proposal.

Scope of the outsourcing scheme
(Clause 3 — proposed section 12(1A) of the BO)

11. The Bills Committee notes that the main proposal of the Bill is to empower the OR as the provisional trustee to appoint any person as provisional trustee in his place at any time when he considers that the value of the property of the bankrupt is unlikely to exceed $200,000. The Bills Committee is advised by the Administration that under the current proposal, outsourcing will be an option available to, but not mandatory on, the OR and it will be used only in debtor-petition cases[2]. The reason is

[2] A person who is unable to pay his debts, regardless of the amount, may present a bankruptcy petition. The deposit required is $8,650.

that the balance of the deposit in creditor-petition cases[3], after deduction of the OR's fees and expenses, must be re-paid to the creditor petitioners and will not be available as remuneration for the PIPs. Moreover, the number of creditor-petition cases is much smaller than that of debtor-petition cases[4].

12. Given the Administration's policy intent that the Bill will enable only the outsourcing of debtor-petition summary bankruptcy cases by the OR, the Bills Committee considers it necessary for the policy intent to be set out clearly in the Bill. The Administration accepts the Bills Committee's view and agrees to move a Committee Stage amendment (CSA) to clause 3 (proposed section 12(1A) of the BO) accordingly.

Operation of the outsourcing scheme

13. To ensure the transparency and fairness of the outsourcing scheme, the Bills Committee has requested the Administration to provide information on the operation of the scheme. The Bills Committee is advised that the ORO intends to outsource the debtor-petition summary bankruptcy cases to PIPs by way of open tender, and initially offer a one-year contract to the successful tenderers. The cases will be allocated in batches so that PIPs can achieve economies of scale. The Administration's preliminary thinking is that the size of a batch will be in the range of around 1 000 cases per year for successful tenderers. There will be a variation clause to stipulate that the number of cases may be varied by the ORO by say up to 30%, in order to cater for any fluctuation in the number of bankruptcy cases. In the Administration's view, the tender arrangements would help to ensure not only sufficient competition in the market, but also transparency and the adoption of best business practices in determining who should be awarded the tender.

Qualification criteria for appointment as provisional trustees

14. To ensure the quality of service to be provided by PIPs in the handling of outsourced summary bankruptcy cases, the Bills Committee considers that the assessment criteria for the tenders should include not only tender price but also other factors, such as the tenderers' manpower resources for undertaking the outsourced summary bankruptcy cases, past experience in insolvency work and track record in providing relevant services. The Bills Committee is advised by the Administration that PIPs must meet a number of pre-qualification criteria before they are able to qualify as a tenderer. The criteria will be similar to those adopted for the current scheme for outsourcing summary liquidation cases[5], including the criteria that they

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[3] A company or a person who is owed a sum of $10,000 or more by an individual or a firm may present a bankruptcy petition. The deposit required is $12,150.

[4] In the first 10 months of 2004, there were 9 238 debtor-petition cases and 1 152 creditor-petition cases.

[5] For summary liquidation (of company) cases, the current minimum requirements are: (i) 3 years of post-qualification experience; (ii) 300 chargeable hours of relevant insolvency work over last 3 years, with at least 150 hours related to insolvent liquidation/receiverships, and remaining hours may be on solvent liquidation of which the hours would be reduced by 50%; and (iii) having performed a minimum of 4 winding-up cases.

should have a certain number of years of post qualification experience and a minimum number of professional or chargeable hours in respect of insolvency work. The PIPs would need to be a member of the specified professional body – Hong Kong Institute of Certified Public Accountants, Law Society of Hong Kong (Law Society) or Hong Kong Institute of Company Secretaries (HKICS). Having met the pre-qualification requirements, tenders would be assessed primarily on the basis of tender prices, subject to other considerations such as the track record of the tenderers in providing the services.

15. On the concern whether it is appropriate to outsource summary bankruptcy cases to company secretaries, the Bills Committee is advised by the Administration that at present, persons who have passed the relevant parts of the Hong Kong Institute of Company Secretaries Examinations are eligible for applying to be the Insolvency Officers of the ORO. An integral part of the Insolvency Officers' work is to deal with summary bankruptcy cases. The proposal under the Bill is to outsource summary bankruptcy cases to competent professionals with necessary experience in handling insolvency cases. Lawyers, accountants and company secretaries are professionals who may possess the necessary and relevant experience in this regard. The ORO has not received any information indicating that the quality of services provided by company secretaries, vis-à-vis the other two professions, in the administration of insolvency cases is an area of concern. Moreover, in the outsourcing of summary liquidation cases, company secretaries, alongside with lawyers and accountants, are eligible to tender. The arrangement has been in place for years. The Administration therefore considers it appropriate to outsource to company secretaries (with the required experience) summary bankruptcy cases, which are generally less complicated than summary liquidation cases. The Administration also points out that in the review of the liquidation provisions under the Companies Ordinance (CO) in 1999, the Law Reform Commission accepted that members of the HKICS are qualified to carry out various kinds of insolvency work.

16. To ensure the quality of service of PIPs and enhance the transparency of the outsourcing scheme, some members suggest that the Administration should consider setting out in the legislation (principal ordinance or subsidiary legislation) the qualification criteria for appointment as provisional trustees for summary bankruptcy cases. In this connection, the Administration issued a consultation paper to 24 stakeholders, and reported to the Bills Committee on the outcome of the consultation, as follows:

(a) There is general agreement among the ten respondents that the detailed qualification criteria should be set out in the ORO's tender documents or a code of practice, and not in the legislation; and

(b) As to the need to set out in the legislation the basic criteria such as the professional qualifications, different views have been expressed. While some organizations do not think that the criteria need to be or should be set out in legislation, whether the BO or its subsidiary legislation, some do support including certain basic criteria such as

"fit and proper" in the legislation, on the ground that such inclusion can enhance transparency and preserve the quality of service of PIPs.

17. Taking into account the outcome of the consultation and the Administration's view, the Bills Committee considers that the detailed qualification criteria for appointment as provisional trustees for summary bankruptcy cases should be set out in the ORO's tender documents.

18. As regards the basic qualification criteria, the Bills Committee notes the Administration's view that there is no need to prescribe the basic criteria in the statutory provisions having regard to the fact that there are already checks to help safeguard the quality of services of PIPs and the much wider ramifications of setting out the criteria in the legislation. However, the Bills Committee considers that the basic qualification criteria should be set out in subsidiary legislation to ensure the quality of service of PIPs and enhance the transparency of the outsourcing scheme. Upon further consideration, the Administration accepts the Bills Committee's view and proposes the following CSAs:

(a) <u>CSAs to clause 3</u>

(i) To amend the proposed section 12(1A) of the BO to the effect that the OR may appoint any person to act as the provisional trustee of the property of the bankrupt in his place if he considers that the person has the qualifications prescribed in Schedule 3 of the BO; and

(ii) To add the new subsection (1C) to section 12 of the BO to provide that the Secretary for Financial Services and the Treasury (SFST) may, by notice published in the Gazette, amend Schedule 3.

(b) <u>CSA to add the new clause 46A</u>

To add the new Schedule 3 to the BO to provide that to qualify for appointment under section 12(1A), a person shall be (i) a certified public accountant within the meaning of section 2 of the Professional Accountants Ordinance (Cap. 50); (ii) a solicitor within the meaning of section 2(1) of the Legal Practitioners Ordinance (Cap. 159); or (iii) a current member of The Hong Kong Institute of Company Secretaries; and satisfy any reasonable conditions that the OR may impose and has made accessible to the public.

19. While members support the proposed CSAs mentioned above, they express concern about the scope of the term "reasonable conditions" referred to in the proposed new Schedule 3. They are advised by the Administration that the policy intent is that the "reasonable conditions" which the OR may impose on a person for appointment as a provisional trustee are those conditions to be set out in the tender document for outsourcing summary bankruptcy cases, including the conditions that the person should have a certain number of years of post-qualification experience and a minimum number of professional or chargeable hours in respect of insolvency work.

To address members' concern that the drafting of the proposed new Schedule 3 does not reflect this policy intent, the Administration undertakes that SFST will mention the policy intent to set out the "reasonable conditions" in the tender document in his speech when the Second Reading debate on the Bill is resumed.

20. As regards how the "reasonable conditions" will be made accessible to the public, the Bills Committee is advised by the Administration that the tender documents will be put on the website of the ORO and made available at the ORO, and also disseminated to the relevant professional bodies.

21. The Bills Committee is also advised by the Administration that it has considered some organizations' suggestion of stipulating in the BO the basic criterion of "fit and proper", which was modelled on the relevant provisions of the United Kingdom (UK) Insolvency Act 1986. However, given that the criterion is related to the licensing system for PIPs in UK and Australia and there is no plan to implement such a system in Hong Kong, the Administration does not consider it appropriate to stipulate the criterion in the BO.

Duties of and powers conferred upon PIPs for handling bankruptcy cases

22. On members' concern about the duties of PIPs in handling bankruptcy cases, the Bills Committee is advised by the Administration that in general, PIPs as fiduciaries and officers of the court should deal with all matters relating to administration of the estate of the bankrupt and undertake any duties and obligations in accordance with the provisions of the BO and the contract with the ORO. After appointment as a provisional trustee, the PIP should first take steps to take into his custody all the property of the bankrupt (sections 53 and 54 of the BO), interview the bankrupt and ascertain the earnings and property of the bankrupt. Thereafter, he should consider the financial contributions, if any, to be made by the bankrupt. He should also ascertain the value of the assets and, in cases where the assets is unlikely to exceed $200,000, apply to court for a summary procedure order (section 112A of the BO). After such an order is made by the court, the provisional trustee himself would become the trustee.

23. The Administration also points out that in administering the bankrupt's estate, the PIP should realize all the assets of the bankrupt and review periodically the financial contributions to be made by the bankrupt. The PIP would receive the proof of debts in respect of the bankrupt's estate (Rules 109 and 113 of the Bankruptcy Rules) and if there were sufficient assets, the PIP would take steps to arrange for distribution of dividend (section 67 of the BO). At the time for consideration of discharge, the PIP should review the case to determine whether there are grounds for objection to discharge (e.g. failure to provide an annual statement of earnings and acquisition) (section 30A of the BO). It shall also be the duty of the PIP to investigate the conduct of the bankrupt and to immediately report to the ORO where there is reason to believe that the bankrupt has committed any offence under the BO (section 86A). Moreover, PIPs are required to comply with the relevant provisions of the BO

including the time limits stipulated in the Ordinance and the codes of conduct of their profession in undertaking their duties.

24. As regards the powers conferred upon PIPs, the Bills Committee notes that under the proposed section 60(2) of the BO, a provisional trustee has the power to take into his custody or control all the property of the bankrupt, sell or dispose of perishable goods and do such things as are necessary to protect or preserve the bankrupt's property. Moreover, a trustee is empowered under section 60(1) of the BO to sell the property of the bankrupt, prove, rank, claim and draw a dividend in respect of any debts due to the bankrupt and exercise all powers vested in the trustee under the BO and do all things as may be necessary for administering the bankrupt's estate and distributing the assets (if any).

Monitoring of the performance of PIPs

25. Given the duties of PIPs and the powers conferred upon them for handling bankruptcy cases, the Bills Committee considers it essential for the Administration to put in place appropriate measures to ensure that PIPs will perform their duties and exercise their powers in a reasonable and consistent manner. The Bills Committee is advised by the Administration that statutory and non-statutory measures are in place for this purpose. On statutory measures, PIPs will be subject to the statutory control in the BO, as follows –

(a) A bankrupt, creditor or any other aggrieved person may appeal to the court against the act or decision of the trustee (section 83);

(b) The court shall take cognizance of the conduct of trustees. In the event of any PIP not faithfully performing his duties and duly observing all the requirements of the BO, any creditor, the OR, the bankrupt or any other person may refer the matter for consideration by the court (section 84);

(c) PIPs are required to provide statement of proceedings to the OR through which the OR will be able to monitor the progress of the proceedings (section 89);

(d) The OR may at any time require the PIPs to provide the accounts of the bankrupt's estate (proposed section 93(1A)), and may cause the accounts to be audited (section 93(3A)); and

(e) In appropriate cases, the OR may make application to the court for removal of the trustee (section 96(2)).

26. As regards non-statutory measures, the Administration points out that the contract of appointment will include the work specification of PIPs. The contract will provide that PIPs are required to perform with professionally acceptable standards all the duties as may be required of a trustee in bankruptcy under the BO and all the duties

as may be imposed on them under the contract of appointment. PIPs may also be required under the contract of appointment to submit a report to the ORO if they do not complete certain work within the specified time frame. The ORO will closely monitor the performance of the PIPs under the terms of the contract and in accordance with the provisions of the BO. Moreover, PIPs are professionals. They may be subject to disciplinary action for breaching professional rules or codes of conduct of the professional bodies of which they are members, including the committal of professional misconduct in the course of acting as trustee-in-bankruptcy.

27. The Bills Committee is concerned whether guidelines will be provided to PIPs to facilitate their handling of summary bankruptcy cases. In this connection, the Bills Committee is advised by the Administration that successful tenderers will be briefed by the ORO and their duties and obligations will be specified in the BO and in the contract of appointment. It is planned that the ORO would provide the appointed PIPs with the ORO's relevant Forms and Guidelines to facilitate the latter's consideration of the financial contribution to be made by the bankrupt.

28. The Bills Committee is also concerned whether measures are in place for dealing with a situation where a PIP sits on an outsourced bankruptcy case or commits other acts of misconduct. The Bills Committee is assured by the Administration that the ORO will conduct investigation into the matter. In an appropriate case, the ORO may terminate the contract of appointment and arrange for other PIPs to take up the unallocated cases. If there are grounds for removal under section 96(2) of the BO, the ORO may apply to the court for the removal of the PIP and appointment of another PIP in his place in respect of those cases where the PIP is already appointed as trustee in bankruptcy. If the application is approved by the court, the removed PIP must deliver to the new trustee all books and documents and accounts in his possession under Rule 194 of the Bankruptcy Rules. The property of the bankrupt vests automatically in the new trustee under section 58(3) of the BO. If the PIP is removed by the court, then subject to the order of the court no remuneration should be payable to him under the terms of the contract. This is considered appropriate as the PIP has not fulfilled all his duties under the contract and is in breach of the terms of the contract.

29. As a whole, the Bills Committee urges the Administration to closely monitor the performance of PIPs in handling outsourced summary bankruptcy cases. In this connection, members suggest that the Administration should strengthen monitoring of the work of PIPs and conduct random audit on a fixed percentage of the outsourced cases. Members also suggest that it should be specified in the outsourced contract that PIPs, in handling outsourced summary bankruptcy cases, are required to observe the statutory and non-statutory requirements, including the requirements that they should avoid conflict of interests with, and should not accept advantages from, the bankrupt. The Administration accepts members' suggestions and members' request that these undertakings will be included in SFST's speech when the Second Reading debate on the Bill is resumed.

Remuneration of PIPs
(Clause 27 — proposed new section 85A of the BO)

30. The Bills Committee notes that under the proposed new section 85A(1) of the BO, the remuneration of PIPs acting as provisional trustees and first trustees for summary bankruptcy cases shall be fixed by the OR in accordance with a scale of fees or on such other basis as the OR may from time to time approve in writing. Members and some of the organizations which have submitted views on the Bill are concerned how the OR would fix the remuneration. The Administration points out that the scale/basis of fees will be fixed by the ORO and agreed with the provisional trustee at the time of the appointment. The wording of the proposed new section 85A(1) generally follows that of the existing section 196(1A) of the CO for the remuneration of a provisional liquidator appointed in a summary liquidation case. Section 196(1A) of the CO has been put in place for a number of years and has worked well.

31. The Bills Committee is concerned that the proposed new section 85A(1) would give rise to uncertainty of the level of remuneration of PIPs. In this connection, the Bills Committee notes that the Law Society has expressed reservation on whether the proposed system is likely to attract solicitors to accept the appointment as provisional trustees. Members therefore request the Administration to consider setting a fixed level of remuneration for provisional trustees or trustees so as to encourage competent PIPs to participate in the outsourcing scheme. The Administration however does not consider it appropriate to set any fixed level of remuneration for all PIPs, as there are no comparable benchmarks. This option may also hinder market competition, thus undermining the benefits of outsourcing.

32. On some organizations' suggestion of introducing contingency fee arrangement as the basis of PIPs' remuneration, the Bills Committee notes the Administration's view that whether contingency fees should be charged carries much wider policy implications that are yet to be studied and considered. In any case, given that the great majority of bankrupts have limited assets, the proposal of contingency fee may not be practicable.

Priority of payment of costs and charges out of a bankrupt's assets
(Clause 11 — proposed section 37(1) of the BO)

33. The existing section 37 of the BO provides for the order of priority for payments to be made from the assets of a bankrupt. It applies to all bankruptcy cases, including both summary and non-summary cases. Under this section, expenses properly incurred in preserving, getting in or realizing any of the assets of the bankrupt would first be paid off. The remaining balance would be used to cover payments according to the order of priority set out in section 37(1). It is proposed under the Bill that the order of priority in section 37(1) be amended to follow the order in the existing Rule 179 of the Companies (Winding Up) Rules for payments in liquidation cases.

34. The Bills Committee notes that among the nine items in the proposed section 37(1), "the remuneration of, fees, commissions, percentages and charges

payable to, and costs, charges and expenses incurred or authorized by, the OR" are accorded the highest priority for payment, while the remuneration and necessary disbursements of PIPs acting as provisional trustees or trustees are accorded almost the lowest priority. The Bills Committee and some of the organizations which have submitted views on the Bill express concern that this proposed arrangement gives little incentive for PIPs to take up the outsourced bankruptcy cases. The Administration explains that there are mainly two reasons for this proposed arrangement. First, the proposed arrangement is consistent with the existing arrangement under Rule 179 of the Companies (Winding Up) Rules for payments in liquidation cases, which is applicable to both summary and non-summary cases (whether outsourced or not). This Rule has been operating smoothly and is considered to have struck a proper balance among the interests of relevant stakeholders. The Administration considers it appropriate to adopt the same approach for bankruptcy cases. Second, the proposed arrangement is made in recognition of the ORO's multiple roles and duties under the BO. The ORO has a supervisory role and another role of administering the bankrupt's estate while acting as trustee in bankruptcy. The ORO also has many duties under the BO for which PIPs do not have. Unlike PIPs, the ORO also acts as the trustee in bankruptcy of the last resort, in order to ensure the smooth running of the insolvency regime. In view of these multiple roles and duties of the ORO, the Administration considers it appropriate to accord a higher priority to the ORO's fees and expenses, etc.

35. At the request of the Bills Committee, the Administration provides the justifications for the order of priority set out in the proposed section 37(1), as follows:

(a) Apart from the ORO's fees and expenses, etc (proposed section 37(1)(a)), the taxed costs of petition is given the next priority because the petition must come before any bankruptcy, let alone processes such as the appointment of PIPs as provisional trustees or trustees (proposed section 37(1)(b));

(b) Next in line are the remuneration and fees, disbursements and expenses properly incurred by the special manager (proposed section 37(1)(c)). As the term of appointment of the special manager will last until there is a provisional trustee or trustee, it means that the special manager will be appointed prior to the appointment of provisional trustee or trustee (proposed section 15(4)(a) and (b) of the BO). It is logical for his remuneration and disbursements, etc to come before those of the PIP acting as a provisional trustee or trustee;

(c) Next in line are the costs and expenses of any person who makes the bankrupts' statement of affairs (proposed section 37(1)(d)). The statement of affairs is an essential document for the administration of the estate of the bankrupt. It is also one required at the very early stage of the bankruptcy proceedings;

(d) Next in line are the taxed charges of a shorthand writer appointed to take an examination under the BO (proposed section 37(1)(e)). The higher priority is appropriate as the shorthand writer is appointed by the court to perform the important function of taking down the records of the proceedings of the examination; and

(e) Next in line are the necessary disbursements, the costs of any person properly employed by and the remuneration of PIPs acting as provisional trustees or trustees (proposed section 37(1)(f), (g) and (h)), to be followed by the actual out-of-pocket expenses necessarily incurred by the creditors' committee subject to the approval of the trustee (proposed section 37(1)(i)).

36. Given that in the great majority of self-petition bankruptcy cases, the bankrupts have very limited assets and incomes, or no assets and no income at all, the Bills Committee notes that the debtor-deposit of $8,650 may be the only sum of money available for payment of the costs and charges under the proposed section 37(1). The Bills Committee and some organizations are concerned that under the proposed order of priority of payment, there is little chance for PIPs to be paid their remuneration and recover their necessary disbursements for handling the outsourced summary bankruptcy cases. This may discourage competent PIPs from participating in the outsourcing scheme or result in a situation where the quality of service provided by PIPs in handling the outsourced cases would be compromised because of insufficient funding. In this connection, the Bills Committee requests the Administration to provide information on the mechanism for the allocation of the debtor-deposit, the amount of fees and expenses to be incurred by the ORO, the amount of necessary disbursements of PIPs, and the range of remuneration of PIPs for handling the outsourced cases.

37. On the mechanism for the allocation of the debtor-deposit, the Bills Committee is advised by the Administration that under rule 52 of the Bankruptcy Rules, the ORO will deduct from the deposit the fees and expenses to be incurred by the ORO, for example, expenses for the gazettal of bankruptcy order. The balance of the deposit will then be used to pay for other payments according to the order of priority in section 37(1) of the BO. Any balance remaining after the payments under section 37(1), plus any additional assets realized from the bankrupt will be distributed in accordance with the priorities set out under section 38(1) of the BO. In short, outstanding wages of the employees (or ex-employees) [6] or benefits such as severance payment payable by the bankrupt have the highest priority, followed by statutory debts owed by the bankrupt to the Government.

38. On the amount of fees and expenses to be incurred by the ORO, the Bills Committee notes the Administration's estimate that the fees and expenses to be incurred by the ORO in a typical bankruptcy case would amount to $2,000 to $3,000, and the chance of great fluctuation is very remote. A balance in the range of $5,650

[6] Or payments made by the Protection of Wages on Insolvency Fund to the relevant employees or ex-employees.

($8,650 - $3,000) to $6,650 ($8,650 - $2,000), plus any further net asset realized from the bankrupt and any net contribution made by him/her during the bankruptcy period, would therefore be available to cover the disbursements, relevant costs and the remuneration of the PIP. In the Administration's view, it is extremely unlikely that the total amount of the fees and expenses incurred by the ORO would exceed the debtor-deposit of $8,650. As far as the Administration can trace so far, no such cases have happened in the past 10 years. As regards members' suggestion of capping the fees and expenses incurred by the ORO for each summary bankruptcy case, the Administration points out that Rule 52 of the Bankruptcy Rules provides that the fees and expenses incurred by the ORO shall be paid from the deposit made by the petitioner. The ORO is not at liberty to cap the fees and expenses.

39. On the amount of necessary disbursements of PIPs, the Administration points out that the amount (except expenses properly incurred in preserving, getting in or realizing the assets of the bankrupt) will depend on the actual amount incurred in a particular case. Assuming a typical case with no more than 10 creditors and where no assets were recovered, it is estimated that the total amount of disbursements of the PIP will be between $900 and $1,500. Members note that the Administration's estimate is made on the basis that PIPs, who will be awarded summary bankruptcy cases in batches, will be able to achieve economies of scale. For example, PIPs should be able to arrange consolidated gazetting to minimize costs.

40. As illustrated in the calculations set out above, there would be between $4,150 ($8,650 - $3,000 - $1,500) and $5,750 ($8,650 - $2,000 - $900) left for payment of other items set out in the proposed section 37(1). In this connection, the Bills Committee is advised by the Administration that some of the items in the proposed section 37(1) would not or would rarely be applicable in summary debtor-petition bankruptcy cases, such as the taxation cost of the petition (as the costs of a debtor-petition is paid by the bankrupt himself), the expenses incurred by a special manager (as it is virtually impossible that there would be a special manager in summary bankruptcy cases), or the taxed charges of any shorthand writer appointed to take an examination under the BO (as it is unlikely that a shorthand writer would be appointed in summary bankruptcy cases). The Administration is therefore of the view that between $4,150 and $5,750 would be available for payment of the PIP's remuneration and the costs of the person properly employed by the PIP, even without additional asset realized and without income contribution made by the bankrupt. It believes that there would be sufficient interest from PIPs in participating in the outsourcing scheme.

41. The Bills Committee considers that the Administration's estimate may be too optimistic. Given that some of the items in the proposed section 37(1) would not or would rarely be applicable in summary debtor-petition bankruptcy cases, and that bankruptcy cases and company liquidation cases are different in nature, the Bills Committee requests the Administration to review whether it is appropriate to maintain its original proposal of bringing the order of priority of payment of costs and charges out of a bankrupt's assets as set out in section 37 of the BO in line with rule 179(1) of the Companies (Winding-up) Rules. Upon review, the Administration considers that

its original proposal should be maintained for ensuring a consistent approach in the whole insolvency regime.

42. The Bills Committee nevertheless requests the Administration to consider elevating the priority of payment of the necessary disbursements, costs and remuneration of PIPs for summary bankruptcy cases. The Administration considers it not justified to do so for three reasons. First, any change would lead to continued inconsistency in the relevant arrangements in company winding-up cases vis-à-vis that in bankruptcy cases. Secondly, while some of the costs and charges referred to in the proposed section 37(1)(a) to (e) would unlikely arise in a debtor-petition summary bankruptcy case, as a matter of principle this should not be a reason for changes. In fact, there are specific justifications for the ranking of each of the items. Moreover, the order of priority under the proposed section 37(1) applies to both summary and non-summary cases as well as debtor-petitions and creditor-petitions[7]. Thirdly, the Administration does not see a need for such change in the light of actual operating experience. The proposed order of priority has been in operation smoothly for years in companies winding up, including summary and non-summary cases. Thus, the disbursement and remuneration of PIPs acting as liquidators for companies winding up (including outsourced cases) already rank lower than other items such as the taxed costs of the petitioner and the remuneration and expenses of the special manager. The Administration also reiterates the following points –

(a) As some of the costs and charges referred to in the proposed section 37(1)(a) to (e) would unlikely arise in a typical outsourced case, the necessary disbursements and remuneration of the PIP appointed to handle the case would likely rank next in line to the ORO's fees and charges;

(b) Unlike the ORO who has to act as the trustee of the last resort, PIPs are free to decide whether or not to accept the appointment as a provisional trustee. It is also up to a PIP to take into account the relevant arrangements, including the proposed section 37(1), in determining his/her tender price; and

(c) The order of priority under section 37(1) is subject to any order of the court. Thus, if a PIP considers that, say, the expenses incurred by the ORO in an outsourced case are unreasonable, he/she may seek an order of the court. This can serve as a safeguard of the last resort.

43. To address the Bills Committee's concern, however, the Administration proposes to amend the proposed new section 85A(3) of the BO to the effect that in an outsourced bankruptcy case, where the PIP concerned "acts without remuneration", he or the OR may make an application to the court and the court may approve the necessary disbursements incurred by the PIP in the course of the administration of the

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[7] Having different orders of priority for summary and non-summary cases would lead to problems. Other than causing inconsistency, it would lead to problems when, say, a summary case becomes non-summary during the bankruptcy period.

estate to be paid out of the bankrupt's estate. In this case, the order of priority set out in section 37(1) would be subject to any court order in this regard. Where the OR acts as the applicant, it is unlikely that PIPs would need to incur any additional cost. In this regard, the OR would take into account the relevant circumstances of a case in determining whether or not to act as the applicant. While members have no objection to the Administration's proposal, they are concerned that the proposed formulation "acts without remuneration" in the proposed new section 85A(3) is unclear and may be subject to different interpretation by the court. The Administration accepts members' suggestion of replacing the proposed formulation by "has not received any remuneration".

44. The Bills Committee also suggests that the proposed section 37(1)(a) be amended to cover only the necessary fees and charges incurred by the ORO in handling outsourced summary bankruptcy cases. In this connection, the Bills Committee is advised by the Administration that the existing section 114 of the BO provides that the Chief Justice may, with the approval of LegCo, by order prescribe a scale of fees and percentages to be charged for or in respect of the proceedings under the BO. Under section 114, the Chief Justice has made the Bankruptcy (Fees and Percentages) Order (the Order) which sets out all the fees and percentages to be charged for the proceedings in bankruptcy. "Remuneration of, fees, commissions, percentages and charges payable to" the OR referred to in the proposed section 37(1)(a) means those fees, charges and percentages set out in the Order and payable to the OR, and their levels are generally set on the basis of full cost-recovery. To avoid any ambiguity, the Bills Committee considers that such policy intent should be set out clearly in the proposed section 37(1)(a). The Administration accepts the Bills Committee's view and proposes a CSA accordingly.

Staffing implications of the outsourcing proposal

45. The Bills Committee has examined the staffing implications of the outsourcing proposal and whether the staff in the ORO has been consulted on the proposal. The Bills Committee is advised by the Administration that at present, there are some 70 posts for the administration of bankruptcy cases. After the implementation of the outsourcing proposal, there would be up to 45 posts for possible re-deployment or deletion. Out of the 45 posts, 17 are planned for deletion. While some staff will be re-deployed to take up the role of monitoring the PIPs in the outsourced cases, some will be re-deployed to deal with other duties, such as enhancing the role of the ORO as a regulator in the insolvency regime. As the ORO will need to continue to follow up on existing bankruptcy cases before the discharge of the bankrupts, it is expected that the re-deployed staff will continue to deal with the administration of existing bankruptcy cases for some time. To facilitate the re-deployment plan, the ORO will provide necessary training for the staff concerned.

46. The Bills Committee is also advised by the Administration that staff in the ORO has been informed about the outsourcing proposal. The OR has met with the

Association of Insolvency Officers[8] to brief the Association on the outsourcing proposal, and the Association welcomed the proposal.

Miscellaneous amendments

Definition of trustee
(Clause 2 — section 2 of the BO)

47. For the sake of clarity, the Bills Committee considers that the definition of "trustee" in section 2 of the BO should make reference to the new subsection (1B) of section 58 which provides that save in certain sections, the provisional trustee shall, unless the context otherwise requires, be regarded as the trustee for the purposes of BO. The Administration accepts the Bills Committee's view and agrees to move a CSA accordingly.

Powers of provisional trustee and trustee to deal with the property of the bankrupt
(Clause 17 — proposed section 60 of the BO)

48. In response to the suggestion of the Bills Committee, the Administration agrees to recast the proposed section 60(1) to provide the OR when acting as provisional trustee with the power to take into his custody or control the property of the bankrupt as provided to other provisional trustees in the proposed section 60(2)(a).

49. The Bills Committee has no objection to the Administration's proposal to amend the proposed section 60(2) to set out clearly that a provisional trustee may exercise all the powers vested in him under the BO, and subject to section 61, do all such other things as may be necessary for administering the estate pending the appointment of a trustee.

Duties of trustee as regards the bankrupt's conduct
(Clause 28 — proposed new section 86A of the BO)

50. The proposed new section 86A of the BO, as set out in the Bill, provides that it shall be the duty of a trustee to:

(a) report to the court on any conduct of the bankrupt that justifies the court in refusing, suspending or qualifying an order for the bankrupt's discharge; and

(b) investigate the conduct of a bankrupt, and to submit a report to the court (if the trustee is the OR) or the OR (if the trustee is a person other than OR), stating whether there is reason to believe that the bankrupt has committed any act that constitutes an indictable offence under the BO.

[8] Insolvency Officers are the departmental grade of the ORO.

51. On the duty mentioned in item (a) above, the Bills Committee has no objection to the Administration's proposal to move a CSA to clarify that the trustee should also investigate the conduct of the bankrupt. As regards the duty mentioned in item (b) above, the existing arrangement is that whenever there is any report of an offence (whether indictable or not) under the BO, the OR will initiate the prosecution action, where appropriate. In view of this, the Administration now considers it not necessary to impose a reporting duty on the OR in relation to any conduct which constitutes an indictable offence under the BO. Furthermore, the scope of the reporting duty imposed on a trustee (other than the OR) should be expanded to cover both indictable and summary (not indictable) offences. The Bills Committee has no objection to the Administration's proposal to amend the proposed new section 86A to give effect to these changes.

Administration's undertakings

52. At the request of the Bills Committee, the Administration undertakes that the following points will be highlighted in the speech to be delivered by SFST when the Second Reading debate on the Bill is resumed:

(a) It is the Administration's policy intent that the "reasonable conditions" which the Official Receiver may impose on a person for appointment as a provisional trustee are those conditions to be set out in the tender document for outsourcing summary bankruptcy cases, including the detailed qualification criteria that the person should have a certain number of years of post-qualification experience and a minimum number of professional or chargeable hours in respect of insolvency work;

(b) The Administration undertakes that it will strengthen monitoring of the work of PIPs in handling outsourced summary bankruptcy cases, and conduct random audit on a fixed percentage of the outsourced cases;

(c) The Administration undertakes that it will be specified in the outsourced contract that PIPs, in handling outsourced summary bankruptcy cases, are required to observe the statutory and non-statutory requirements, including the requirements that they should avoid conflict of interests with, and should not accept advantages from, the bankrupt; and

(d) The Administration undertakes that it will review the scheme for outsourcing summary bankruptcy cases after implementation of the scheme and report the outcome of the review to LegCo.

53. On items (b) and (d) above, the Administration will specify in SFST's speech the expected percentage of the outsourced cases in respect of which random

audit is to be conducted and when the review of the outsourcing scheme will be conducted.

Committee Stage amendments

54. The Bills Committee supports the CSAs proposed by the Administration. The Bills Committee has not proposed any CSAs.

Recommendation

55. The Bills Committee supports the Administration's proposal that the Second Reading debate on the Bill be resumed on 6 July 2005.

Consultation with the House Committee

56. The House Committee, at its meeting on 17 June 2005, supported the recommendation of the Bills Committee in paragraph 55 above.

Council Business Division 1
Legislative Council Secretariat
24 June 2005

附錄I
Appendix I

《2004年破產(修訂)條例草案》委員會
Bills Committee on Bankruptcy (Amendment) Bill 2004

委員名單
Membership List

主席 **Chairman**	譚香文議員	Hon TAM Heung-man
委員 **Members**	何俊仁議員	Hon Albert HO Chun-yan
	呂明華議員, JP	Dr Hon LUI Ming-wah, JP
	陳鑑林議員, JP	Hon CHAN Kam-lam, JP
	劉健儀議員, GBS, JP	Hon Miriam LAU Kin-yee, GBS, JP
	余若薇議員, SC, JP	Hon Audrey EU Yuet-mee, SC, JP
	李國英議員, MH	Hon LI Kwok-ying, MH
	湯家驊議員, SC	Hon Ronny TONG Ka-wah, SC
	鄺志堅議員	Hon KWONG Chi-kin
	(總數：9位委員) (Total : 9 members)	
秘書 **Clerk**	陳美卿小姐	Miss Salumi CHAN
法律顧問 **Legal Adviser**	顧建華先生	Mr KAU Kin-wah
日期 **Date**	2004年11月3日 3 November 2004	

Appendix II

Bills Committee on
Bankruptcy (Amendment) Bill 2004

List of organizations submitted views on the Bill

*	1.	Yip, Tse & Tang Solicitors
*	2.	Grant Thornton
	3.	The Chinese General Chamber of Commerce
	4.	Consumer Council
	5.	Hong Kong Monetary Authority
	6.	The Hong Kong Association of Banks
	7.	The Standing Committee on Company Law Reform
	8.	Joseph S C Chan & Co
	9.	The Hong Kong Institute of Company Secretaries
	10.	The Association of Chartered Certified Accountants (Hong Kong)
	11.	The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies
	12.	The British Chamber of Commerce in Hong Kong
	13.	Kenny Tam & Co
	14.	The Society of Chinese Accountants and Auditors
*	15.	Hong Kong Institute of Certified Public Accountants
	16.	Insolvency Law Committee of the Law Society of Hong Kong
	17.	Hong Kong Bar Association

Remark:

"*" denotes those organizations the representatives of which have attended a Bills Committee meeting.