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**Panel on Financial Affairs
Meeting on 7 December 2009**

**Background brief on
Review of corporate rescue procedure legislative proposals**

Purpose

This paper sets out the background of the review of corporate rescue procedure legislative proposals and summarizes Members' views and concerns expressed on the subject during the scrutiny of the Companies (Amendment) Bill 2000 and the Companies (Corporate Rescue) Bill in 2001.

Background

2. At present, Hong Kong companies facing financial difficulty may try to come to an arrangement with their creditors by means of non-statutory voluntary workouts or restructuring arrangements under section 166 of the Companies Ordinance (the Ordinance) (Cap. 32). Neither of those methods provides for a moratorium that can bind creditors while an arrangement proposal is being formulated, thereby lacking certainty. There have also been complaints that schemes of arrangement are complex and require too much court involvement.

3. To address this, the Law Reform Commission (LRC) recommended in 1996 the introduction of a statutory corporate rescue procedure in the form of "provisional supervision" whereby a moratorium on legal action would be provided to a company in financial difficulty. LRC recommended the appointment of an independent professional third party, the provisional supervisor, to take effective control of the company during the provisional supervision period and to formulate a voluntary arrangement proposal for creditors within a specified timeframe. In addition, LRC also recommended introducing "insolvent trading" provisions to encourage directors and senior management to act on insolvency earlier rather than later by making them personally liable for debts of a company which traded while insolvent.

Members' views and concerns expressed during the scrutiny of the relevant bills

The Companies (Amendment) Bill 2000

4. The legislative proposals to implement LRC's recommendation on corporate rescue procedure were part of the Companies (Amendment) Bill 2000, which was introduced into the Legislative Council (LegCo) on 19 January 2000. Members of that Bills Committee were generally in support of the rationale behind the corporate rescue and insolvency trading proposals. However, some Members expressed doubts on the requirement placed upon a financially troubled company to set aside sufficient funds to settle all arrears of wages, severance pay and other statutory entitlements of its employees as if it were a going concern. These Members were concerned that the Bill did not provide flexibility in this regard. They pointed out that even if the employees concerned were willing to assist the company to turn round by trading in their claims for, say, shares of the company, they would not be permitted to do so under the draft provisions.

5. The Bills Committee suggested that the Administration should consult the Labour Advisory Board (LAB) on the proposal to provide some flexibility to the requirement to settle all arrears due and owing by the company to its employees. Having regard to time constraints and complexity of the legislative proposals, the Bills Committee recommended that the corporate rescue proposals be excised from the Bill and deferred for re-submission to LegCo at a later stage.

The Companies (Corporate Rescue) Bill in 2001

6. After consulting LAB and the Protection of Wages on Insolvency Fund (PWIF) Board, the Administration proposed in February 2001 to maintain the original proposal of requiring a company to settle all outstanding arrears that it owed to its employees before starting a statutory corporate rescue operation as set out in the Companies (Amendment) Bill 2000. The Administration also proposed that certain provisions in the legislative proposal be amended to take into account the views expressed in submissions of the various professional bodies and trade organizations made to the Bills Committee on Companies (Amendment) Bill 2000. To take forward the legislative proposals, the Administration introduced the Companies (Corporate Rescue) Bill on 18 May 2001.

7. Members of the Bills Committee on the Companies (Corporate Rescue) Bill supported the concept of corporate rescue, but expressed doubts about the proposed requirement that before the commencement of the corporate rescue procedure, either all outstanding wages and liabilities of employees had to be paid, or sufficient funds must be provided for in a trust account for the purpose. Members were concerned that as there was no ceiling for such amounts, it was unlikely that a company in financial difficulty would have sufficient money to fulfill the requirement. This proposed requirement might therefore create a substantial obstacle to the commencement of corporate rescue procedure, thus defeating the purpose of the Bill.

8. To address Members' concern, the Administration had proposed that the sum payable to each employee would be capped, and it would consult the relevant parties on the new proposal. The Administration was also requested to review whether it was appropriate to hold the directors and senior management of a company liable for insolvent trading. Some Members considered that this provision would create practical difficulties and discourage people from being directors and responsible persons of companies. The Bills Committee decided that the scrutiny of the Bill should be held in abeyance to allow time for the Administration to conduct consultation on, and work out the details of, a new proposal. Due to the complexity of the legislative proposals and diverse views among stakeholders, the Bill had not been enacted and lapsed at the end of the second term of LegCo ending 2004.

Recent developments

9. In January 2009, the Administration adopted the recommendation of the Task Force on Economic Challenges¹ to advance its review of the corporate rescue procedure, ahead of the schedule of the Phase II rewrite exercise which will deal with the winding-up related provisions in the Ordinance. The Administration advised Members of the latest development during the briefing on the progress of the rewrite exercise of the Ordinance at the meeting of the Panel on Financial Affairs (FA Panel) on 26 February 2009.

10. At the Council meeting on 13 May 2009, Hon Paul CHAN asked a question on corporate rescue procedure, following the Administration's announcement that it would advance the review of the relevant legislative proposal.

11. On 29 October 2009, the Administration launched a three-month public consultation on the review of corporate rescue procedure legislative proposals, and issued an information note on the subject to Members. Subject to the outcome of the consultation, the Administration plans to prepare draft legislation for introduction into LegCo in 2010-2011.

Latest position

12. The Administration will brief the FA Panel on the review of corporate rescue procedure legislative proposals at the meeting on 7 December 2009.

¹ The Chief Executive (CE) appointed individuals from different sectors to form a Task Force on Economic Challenges in late 2008 to give views on measures to address issues arising from the financial tsunami. The Task Force, chaired by CE, held a number of meetings during November 2008 to June 2009. Members of the Task Force recommended at the meeting on 22 January 2009 that the Administration should revisit the proposals for corporate rescue procedure to help corporations running into financial difficulties as a result of financial tsunami.

Relevant papers

13. Relevant papers are available at the following links:

Information note on introduction of statutory corporate rescue procedure in Hong Kong — report on consultation on the proposed flexibility on the settlement of outstanding wages and other entitlements

<http://www.legco.gov.hk/yr00-01/english/panels/fa/papers/a522e03.pdf>

LegCo Brief on Companies (Corporate Rescue) Bill

http://www.legco.gov.hk/yr00-01/english/bc/bc12/general/b40_brf.pdf

Minutes of House Committee meeting on 7 December 2001 (paragraphs 45 to 48)

<http://www.legco.gov.hk/yr01-02/english/hc/minutes/hc011207.pdf>

Minutes of FA Panel meeting on 26 February 2009 (paragraphs 47 and 55)

<http://www.legco.gov.hk/yr08-09/english/panels/fa/minutes/fa20090226.pdf>

Hon Paul CHAN's question on corporate rescue procedure

<http://www.info.gov.hk/gia/general/200905/13/P200905130151.htm>

Information note on public consultation on the review of corporate rescue procedure legislative proposals

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/facb1-191-1-e.pdf>

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