

***Review of Corporate Rescue Procedure  
Legislative Proposals***

***Public Consultation***

December 2009

Financial Services and the Treasury Bureau  
[www.fstb.gov.hk](http://www.fstb.gov.hk)

# Background

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- ❑ Law Reform Commission (LRC) submitted the Report on Corporate Rescue and Insolvent Trading in 1996
- ❑ Bills introduced into the LegCo twice in 2000 and 2001
  - Companies (Amendment) Bill 2000
  - Companies (Corporate Rescue) Bill 2001 (2001 Bill)
- ❑ Proposals not enacted due to diverse views among stakeholders (particularly on how to deal with employees' outstanding entitlements)
- ❑ Originally scheduled to be reviewed as part of the second phase of the rewrite of the Companies Ordinance (CO)
- ❑ In late January 2009, the Government adopted the recommendation made by the Task Force on Economic Challenges to advance its review of the introduction of a corporate rescue procedure

# Shortcomings of existing options for companies to restructure debts

Existing options	Shortcomings
Non-statutory arrangement	<ul style="list-style-type: none"><li>❑ lack of a moratorium creates uncertainty</li><li>❑ depends entirely on voluntary cooperation</li><li>❑ the “Hong Kong Approach to Corporate Difficulties”, while generally effective, only applies to participating banks</li></ul>
Compromise or arrangement under <b>section 166</b> of the CO	<ul style="list-style-type: none"><li>❑ lack of a moratorium creates uncertainty</li><li>❑ complex process and requires heavy court involvement</li></ul>
Restructuring by a provisional liquidator appointed under <b>section 193</b> of the CO	<ul style="list-style-type: none"><li>❑ provisional liquidators cannot be appointed solely for the purpose of facilitating a corporate rescue</li><li>❑ provisional liquidators appointed on the basis that the company was insolvent and the company’s assets were in jeopardy</li></ul>

# ***“Provisional supervision”:***

## ***Key points***

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- ❑ Provide a statutory moratorium for companies in financial difficulty
- ❑ A stay of general civil proceedings against the company during the moratorium
- ❑ Company taken over by a “provisional supervisor”, an independent third party (usually a professional), who will prepare a voluntary arrangement proposal
- ❑ Voluntary arrangement proposal to be considered and approved at a meeting of creditors
- ❑ Insolvent trading provisions as a “stick” applicable to all companies: during liquidation, directors could be made personally liable for the debts of a company which traded while insolvent

# *Principles of the review*

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- ❑ **Building on the consensus already reached** during the earlier legislative attempts and resolving the concerns raised by the public
- ❑ “Provisional supervision” should **complement, and not replace, existing restructuring arrangements** under the CO and non-statutory arrangements
- ❑ **Court involvement should be minimised** so as to save costs and time
- ❑ **Employees** should generally be **no worse off than** in the case of **insolvent liquidation**
- ❑ **Allowing greater involvement of creditors** in the rescue process

# *Why not adopt Chapter 11 of US Bankruptcy Code?*

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- Chapter 11 of the US Bankruptcy Code
  - “debtor in possession” (i.e. the existing management continues to control the company) under court supervision
  
- LRC rejected the Chapter 11 model in its 1996 Report
  - creditors in Hong Kong concerned that a company under “debtor in possession” could easily avoid or delay its obligations to creditors
  
- Costly because of court’s close involvement

# *What companies will use provision supervision?*

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- Applicable to both local and non-Hong Kong companies formed or registered under the CO, except for certain regulated institutions (banks, insurance companies and entities in the securities and futures industries)
  
- Generally certain conditions exist, e.g.:
  - the company has a long-term sustainable or viable business model
  - major secured creditors and most creditors support the rescue
  - capital can be raised during the moratorium
  
- SMEs are relatively less likely to benefit

# *Major Changes*

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- ❑ Employees' outstanding entitlements
- ❑ Insolvent trading
- ❑ Qualification, remuneration and appointment of provisional supervisor (PS)



# *Employees' outstanding entitlements*

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- **2001 Bill** provides that, before initiating provisional supervision, a company should:
  - clear all arrears of wages, severance payments and other statutory entitlements owed under the Employment Ordinance; or
  - set up a dedicated trust account for paying all arrears of wages, severance payments and other statutory entitlements owed under the Employment Ordinance.
  
- **Concerns:**
  - too onerous for financially-distressed companies
  - act as a major obstacle to using provisional supervision
  - employees better off than in the case of liquidation

# *Employees' outstanding entitlements*

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## □ **2003 Proposal:**

- cap the trust account amount to mirror that of the Protection of Wages on Insolvency Fund (PWIF)
- any outstanding amounts above the cap to be paid within 12 months of the approval of the voluntary arrangement

# *Employees' outstanding entitlements*

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## □ **Alternative A:**

- exempt employees who are owed wages or other entitlements from the moratorium
- preserve their right to petition to the court to wind up the company during the moratorium

# *Employees' outstanding entitlements*

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## □ **Alternative B:**

- amounts owed to employees (subject to PWIF caps) paid on or before the rescue plan is effected, or 60 days after the commencement of the moratorium at the latest
- the remaining employees' debts to be paid within 12 months of the approval of the voluntary arrangement

# *Insolvent trading*

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## □ 2001 Bill:

- Liquidator empowered to make an application to the court to seek a declaration that a “responsible person” (including directors, shadow directors and senior management) is liable for insolvent trading if he:
  - (1) (a) **knew or ought reasonably to have known** the company was insolvent or **knew or ought reasonably to have known** that there was no reasonable prospect that the company could avoid becoming insolvent; or
    - (b) there were **reasonable grounds for suspecting** that the company was insolvent or there was no reasonable prospect that the company could avoid becoming insolvent; and
  - (2) failed to take any steps to prevent the insolvent trading.

## □ Concerns:

- Would discourage directors and senior management from taking risks

# *Insolvent trading*

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- **Consultation paper** proposes that insolvent trading provision is needed:
  - to encourage directors to act on insolvency earlier rather than later
  - to prevent further erosion of the distressed company's assets at the detriment of creditors
  
- Two adjustments to address business sector's concerns:
  - excluding senior management from being liable under insolvent trading
    - Reasons:**
      - difficult in defining "senior manager"
      - similar provisions in Australia and UK only impose liabilities on directors (including shadow directors)
  - dropping "reasonable grounds for suspecting"
    - Reasons:**
      - raising the threshold for directors to be found liable

# *Qualification, remuneration and appointment of provisional supervisor (PS)*

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- ❑ **2001 Bill** provided that PS should be:
  - a member from a panel comprising solicitors and professional accountants to be operated by Official Receiver; or
  - (for non-panel members) a person whom the Official Receiver is satisfied has suitable skills and is fit and proper
  - remunerated in accordance with a scale of fees approved by Official Receiver
  
- ❑ The court may terminate the appointment of PS upon creditors' application
  
- ❑ **Concerns:**
  - considerable time and resources for setting up the panel system
  - dangers of a closed shop and high fees if criteria for appointment are strict
  - cf. Australia, creditors have a say in the choice and remuneration of PS

## ***Qualification, remuneration and appointment of provisional supervisor (PS)***

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- ❑ **Consultation paper** proposes:
  - PS only needs to be a practising solicitor or a registered professional accountant unconnected with the company
  - consult the public on whether other persons without the above qualifications could also be appointed as provisional supervisors on a case-by-case basis
  
- ❑ At the 1<sup>st</sup> meeting of creditors (to be held within 10 working days from the commencement of provisional supervision), creditors approve the remuneration of PS and may replace the PS



## *Other procedural or technical amendments*

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- ❑ Procedures for initiating provisional supervision
- ❑ Moratorium
- ❑ Personal liability of provisional supervisor (PS)

# *Procedures for initiating provisional supervision*

<b>2001 Bill</b>	<b>Proposals in the Consultation Paper</b>
<ul style="list-style-type: none"><li>❑ Filing a notice of appointment of PS together with relevant documents with the Registrar of Companies, the Official Receiver and the High Court</li></ul>	<ul style="list-style-type: none"><li>❑ Filing the notice of appointment of PS together with relevant documents with the Registrar of Companies</li><li>❑ Confirm before the commencement of provisional supervision that it has in place a valid insurance policy to protect the entitlements and rights of any injured employees under the Employees' Compensation Ordinance</li><li>❑ In case of initiation by directors, the statement of affairs of the company should be submitted at the directors' meeting that decides to appoint a PS. PS will have the power to request additional information after commencement</li></ul>

# Moratorium

<b>2001 Bill</b>	<b>Proposals in the Consultation Paper</b>
<ul style="list-style-type: none"><li>❑ Initial moratorium: 30 days</li><li>❑ Extension up to six months in total must be approved by the court</li></ul>	<ul style="list-style-type: none"><li>❑ Initial moratorium: 45 days</li><li>❑ Extension up to six months in total must be approved at a meeting of creditors</li></ul>
<ul style="list-style-type: none"><li>❑ Any extension beyond six months must be approved at a meeting of creditors</li><li>❑ No limit to the period of such extension</li></ul>	<ul style="list-style-type: none"><li>❑ Any extension beyond six months must be approved by the court</li><li>❑ Moratorium cannot exceed a maximum of 12 months from the commencement of provisional supervision</li></ul>

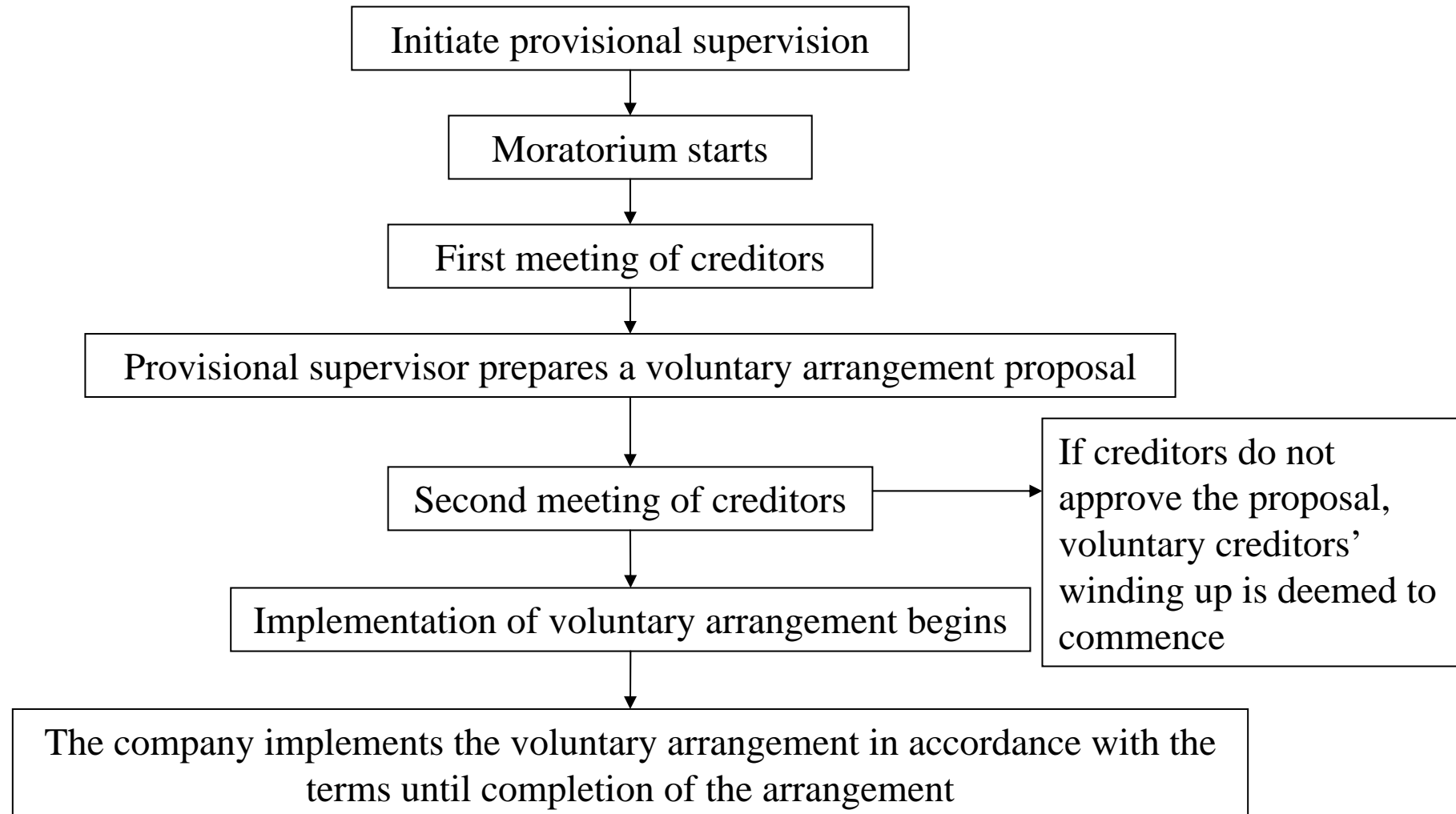
# *Personal liability of provisional supervisor (PS)*

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<b>2001 Bill</b>	<b>Proposals in the Consultation Paper</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> PS personally liable for any contracts they had entered into when performing their functions</li></ul>	<ul style="list-style-type: none"><li><input type="checkbox"/> Same as 2001 Bill</li></ul>
<ul style="list-style-type: none"><li><input type="checkbox"/> The period for the provisional supervisor to decide whether to accept pre-existing employment contracts was 14 days after the commencement of provisional supervision</li></ul>	<ul style="list-style-type: none"><li><input type="checkbox"/> To extend the period for provisional supervisor to decide whether to accept pre-existing employment contracts to 16 working days after the commencement of provisional supervision</li></ul>

# *Simplified flowchart on operation of provisional supervision*

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# *Timeline*

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## □ 29 October – 28 January 2010

- Consultation Period
- Will organise a consultation forum / focus group discussion and meet with stakeholders

## □ Mid-2010

- Issue consultation conclusions

## □ 2010-11

- Introduce draft legislation into the LegCo

**Thank you**