

Panel on Financial Affairs

(Extract)

**Minutes of special meeting
held on Monday, 19 July 2010 at 10:45 am
in Conference Room A of the Legislative Council Building**

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II. Review of corporate rescue procedure legislative proposals

(LC Paper No. CB(1)2525/09-10(03) —Administration's paper on "Review of corporate rescue procedure legislative proposals consultation conclusions"

LC Paper No. CB(1)2523/09-10 —Background brief on review of corporate rescue procedure legislative proposals prepared by the Legislative Council Secretariat)

Briefing by the Administration

35. The Deputy Secretary for Financial Services and the Treasury (Financial Services)³ (DS(FS)³) briefed members on the feedback and conclusions of the public consultation on the corporate rescue procedure legislative proposals, by highlighting the salient points in the paper.

Insolvent trading

36. While pointing out that the legislative proposals had included measures to ensure the payment for employees' outstanding entitlements, Mr Andrew LEUNG said that the Hong Kong Federation of Industries had expressed strong views regarding the legislative proposals on insolvent trading. Mr LEUNG commented that a director would face a dilemma when a limited company became insolvent. If a director declared that his company was insolvent, banks would be reluctant to provide credit facility for the company. If the director did not disclose the insolvency of his company, he would be personally liable for insolvent trading. Mr LEUNG enquired why the Administration proposed to introduce the insolvent trading provisions.

Mr Albert HO shared Mr LEUNG's concern and said that the legislative proposals on insolvent trading needed to be carefully considered.

37. Mr Paul CHAN said that while he supported the introduction of the corporate rescue procedure and the proposed insolvent trading provisions with a view to protecting the interest of the creditors, extra care should be taken in drawing up the insolvent trading provisions.

38. DS(FS)3 responded that the insolvent trading provisions were proposed having regard to similar arrangements in other jurisdictions including Australia and the United Kingdom (UK). Directors of an insolvent company had a responsibility to protect the interests of shareholders and creditors. Apart from initiating the corporate rescue procedure, directors of a company facing financial difficulty might 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 (CO) (Cap. 32). Only if the directors continued the business of the company without taking steps to prevent insolvent trading, they would be liable, under civil proceedings, for the debts of the company incurred during the insolvent period. Taking into account the views of the respondents during public consultation, the standard in establishing liability had been modified by dropping the ground of "reasonable grounds for suspecting". Other defence factors for the directors might be considered during the drafting of the legislative provisions and great care would be taken in drawing up the provisions in order to strike a balance between the protection of the interests of the directors and the creditors/employees. The liquidator of a company would consider factors such as the cost involved and the repayment ability of the director(s) before making an application to the court to seek a declaration that a "responsible person" who failed to prevent the insolvent trading was personally liable for the debts. Based on the experience of other jurisdictions such as the UK, the number of directors being sued for insolvent trading was relatively small. DS(FS)3 added that the introduction of insolvent trading provisions would encourage directors to act on insolvency earlier and would enhance corporate governance. The Government would continue to explain the legislative proposals to the Hong Kong Federation of Industries and other stakeholders concerned, and was prepared, where necessary, to make minor amendments to the proposal.

39. In response to Mr Andrew LEUNG's and the Chairman's request, DS(FS)3 undertook to provide details of the views expressed by different parties on the insolvent trading proposals during the public consultation.

(Post-meeting note: The information provided by the Administration

was circulated to members vide LC Paper No. CB(1)2719/09-10 on 10 August 2010.)

Provisional supervision

40. The Deputy Chairman opined that some financially troubled companies might not be suitable to pursue the rescue procedure. He enquired whether a threshold would be set for a company to initiate the corporate rescue procedure, such as the need for seeking a court order. The Deputy Chairman also expressed concern whether the provisional supervision arrangement was adequate for protection of creditors' interests, as in the US, a trustee should be appointed to oversee the operation of the company when the corporate rescue procedure was pursued. Mr Albert HO expressed a similar concern and opined that apart from the support of secured creditors, consideration should be given to add the requirement of the support of non-secured creditors for the corporate rescue procedure to continue after initiation, as non-secured creditors would be most affected by the liquidation of the company concerned.

41. Mr Paul CHAN supported the imposition of personal liability on the provisional supervisors for any contracts they had entered into when performing their functions, similar to the relevant arrangement for liquidation of banks, and the arrangement would protect the interests of employees and creditors.

42. DS(FS)3 responded that the proposed corporate rescue procedure was based on the corporate rescue models in the UK and Australia, and the recommendations of the Law Reform Commission, with a view to minimizing court involvement so as to save cost and time. Based on a recommendation of the Law Reform Commission, the corporate rescue procedure could only be continued with the concurrence of the major secured creditors. A meeting of the creditors would be held ten days after the commencement of the corporate rescue procedure to consider the suitability of the appointment of the provisional supervisor. A provisional supervisor would be personally liable for debts and liabilities under certain conditions.

43. Mr Jeffrey LAM expressed concern about the high cost for appointment of the provisional supervisor which might render the corporate rescue procedure impracticable for the small and medium sized enterprises.

44. DS(FS)3 responded that the corporate rescue procedure provided an alternative arrangement to rescue insolvent companies, in addition to the existing non-statutory arrangements. The Government had no intention to set any restriction on the types of companies which might seek to initiate the

corporate rescue procedure, except those companies which were subject to other regulatory regimes, e.g. banks.

Employees' outstanding entitlements

45. Mr Albert HO asked whether the latest proposed arrangements for the treatment of employees' outstanding entitlements were supported by the labour associations. Mr Paul CHAN shared Mr HO's concern and said that, if necessary, further discussion on the corporate rescue procedure with the labour associations should be arranged.

46. DS(FS)3 responded that the Labour Advisory Board had been briefed on the latest corporate rescue procedure proposals. The labour associations supported in principle the proposals although some associations had expressed concern about the time taken for the insolvent company to pay back the employees' outstanding entitlements.

Liquidation

47. Mrs Regina IP was concerned that some multi-national corporations facing insolvency might arrange transfer of their capital out of Hong Kong before initiating the corporate rescue procedure.

48. The Official Receiver responded that there was legislation in Hong Kong and other jurisdictions to enable the liquidators to challenge the transfer of property to other overseas branch offices of an insolvent corporation before liquidation i.e. they were called anti-avoidance provisions. With regard to our proposal on insolvent trading, it was also important to have in place provisions to hold those who abused credit and the availability of credit to account. Insolvent trading provisions would assist in this regard..

Consultation

49. Mr Jeffrey LAM was of the view that the paper only provided a broad outline of the legislative proposals. The Government should proactively consult and hold more in-depth discussion with the business sector, the senior management of companies, and the labour associations on the legislative proposals, including the insolvent trading provisions, instead of passively waiting for the stakeholders' submissions.

50. DS(FS)3 responded that the consultation conclusions had been drawn up after extensive consultation with the stakeholders, including the business sector and the labour associations, and further discussion with the relevant parties would be held on the detailed legislative proposals.

Legislative work and timetable

51. The Chairman enquired about the timetable for legislating the corporate rescue procedure, and whether the Panel would be further consulted on the legislative proposals before the relevant Bill was introduced into the Legislative Council. The Chairman said that the Panel should be kept informed of the progress of the consultation and legislative timetable.

52. DS(FS)3 responded that the Administration was drawing up the drafting instructions for the relevant bill, and, subject to the scheduling of other legislative proposals to be put up by the FSTB, the most optimistic timeline was to introduce the bill into the Legislative Council by June/July 2011. Given the complexity of the bill, it might take the Legislative Council about one year to scrutinize the bill. The Administration would consider the need for consulting on the detailed draft provisions, and/or conducting a further consultation exercise on the legislative proposals.

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Council Business Division 1
Legislative Council Secretariat
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