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**Bills Committee on Companies (Winding Up and Miscellaneous Provisions)
(Amendment) Bill 2015**

Background brief

Purpose

This paper provides background information on the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015, and summarizes the views and concerns expressed by Members on related issues at meetings of the Panel on Financial Affairs ("FA Panel") and the Establishment Subcommittee ("ESC") held from the 2011-2012 to 2013-2014 sessions.

Background

2. The statutory provisions relating to Hong Kong's corporate insolvency law regime are principally contained in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("C(WUMP)O")¹. In November 2011, the Government rolled out a legislative exercise to modernize the corporate insolvency law regime with the underlying objectives to facilitate more efficient administration of the winding-up process, increase protection of creditors through streamlining and rationalizing the company winding-up procedures and enhancing regulation of the winding-up process having regard to international experience.

3. From April to July 2013, the Government conducted a three-month public consultation on a package of 46 legislative proposals to improve the corporate insolvency and winding-up provisions. In terms of enhancing protection of creditors, the proposals include: (a) empowering the court to make

¹ When the new Companies Ordinance (Cap. 622) which contains provisions concerning the operation of live companies commenced operation on 3 March 2014, the old Companies Ordinance with the winding-up and insolvency provisions was re-titled as C(WUMP)O.

orders for restoring the position of a company to what it would have been if the company had not entered into a "transaction at an undervalue"² within a specified period before commencement of its winding-up; (b) introducing standalone provisions on "unfair preferences"³ to overcome existing problems arising from applying the relevant provisions in the Bankruptcy Ordinance (Cap. 6) ("BO") to the corporate insolvency context⁴; (c) modifying provisions on invalidation of floating charges to invalidate certain floating charges created by a company in favour of persons who are connected with the company within a specified period prior to winding-up; and (d) introducing additional safeguards to reduce the risk of abuse of the special procedure for voluntary winding-up by company directors set out in section 228A of C(WUMP)O ("the section 228A procedure")⁵.

4. In respect of streamlining the winding-up process, the proposals will: (a) rationalize the proceedings of the committee of inspection ("COI")⁶, such as enabling COI to function through written resolutions; (b) streamline the process for determining the bills of costs and charges of the agents employed by the liquidators by allowing the latter to seek the agreement of COI on those bills of costs and charges; and (c) allow communication by liquidators with creditors, contributories, members of COI and other interested parties through electronic means.

5. As regards enhancement in the integrity of the winding-up process, the proposals include: (a) expanding the list of persons disqualified for appointment as a liquidator/provisional liquidator to cover persons with potential conflict of interest; (b) introducing a statutory requirement for prospective liquidators/provisional liquidators to make a statement of relevant relationships before their appointment; and (c) introducing provisions to the effect that

² A transaction at an undervalue is a transaction entered into by a company prior to its winding-up that involves an outright gift given by the company to a party, or entered into by the company with a party on terms that provide for the company to receive no consideration or for a consideration which is significantly less than the value of the subject of the transaction.

³ Unfair preferences are transactions entered into by a company prior to its winding-up that put a particular creditor in a better position than other creditors in disregard of the priority position of preferential creditors and in breach of the *pari passu* principle of distribution among unsecured creditors.

⁴ For example, in the bankruptcy context, "debtor" refers to the bankrupt and "associate" covers the spouse and relatives of the bankrupt. However, in the company winding-up context, "debtor" can only be the debtor company and not a director of that company. The definition of "associate" therefore does not cover the spouse and relatives of a director of the debtor company. This situation is undesirable as such persons are likely recipients of unfair preferences.

⁵ Under the procedure, if the directors or a majority of the directors have formed the opinion that the company cannot by reason of its liabilities continue its business, they may resolve at a meeting of the directors that the company be wound up and deliver to the Registrar of Companies a winding-up statement. The procedure allows directors to commence a winding-up of the company voluntarily in the absence of a resolution of the members of the company.

⁶ A COI is a joint body formed by representatives of creditors and members of the company for supervising the liquidator, and may give directions to the liquidator during the winding-up.

liquidators will not be absolved from liabilities arising from their misfeasance or breach of duty notwithstanding their release by the court.

The Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015

6. The Administration published the consultation conclusions in May 2014. According to the Administration, all 46 legislative proposals set out in the consultation document were supported by a majority of respondents. In light of comments raised by respondents, refinements were made to some of the proposals. The Administration published in the Gazette the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 ("the Bill") on 2 October 2015. The Bill received its First Reading at the Legislative Council ("LegCo") meeting of 14 October 2015.

7. The Bill seeks to improve the corporate winding-up regime through the proposals described in paragraphs 3 to 6 above, and make related, consequential and minor technical amendments. The main provisions of the Bill are explained in paragraph 13 of the LegCo Brief (File Ref.: IB&W/2/1/5/4C issued on 30 September 2015) and paragraphs 4 to 11 of the Legal Service Division Report on the Bill (LC Paper No. LS1/15-16).

Members' views and concerns

8. FA Panel was briefed on the Administration's plan to modernize Hong Kong's corporate insolvency regime at the meeting on 7 November 2011. Panel Members discussed with the Administration the legislative proposals in the public consultation document, and were briefed on the outcome and conclusions of the public consultation at the meetings on 3 May 2013 and 7 July 2014 respectively. On 6 January 2014, the Government consulted FA Panel on a staffing proposal to retain two supernumerary directorate posts in the Financial Services and the Treasury Bureau to take forward legislative initiatives relating to, among others, corporate insolvency. The staffing proposal was considered at the meeting of ESC on 19 February 2014. The ensuing paragraphs summarize the major views and concerns raised by Members at the abovementioned meetings.

The section 228A procedure

9. At the FA meetings on 3 May 2013 and 7 July 2014, members expressed concerns about the section 228A procedure and sought elaboration on the proposed additional safeguards against abuse of the procedure. The Administration advised that it was proposed that the winding-up statement (to be submitted to the Registrar of Companies) must state that the directors had

already called the meeting as required under the procedure. This would ensure that members of the company would be made aware of the directors' initiation of the section 228A procedure at the earliest possible instance. Moreover, the winding-up statement would need to state the appointment of a provisional liquidator and such appointment would take effect upon delivery of the statement to the Registrar of Companies. There would also be restrictions on the powers of the provisional liquidator such that he/she might exercise powers conferred on a liquidator if and only if he/she had obtained the court's sanction, with the exception that the provisional liquidator might do things necessary for preserving the company's assets pending the appointment of the liquidator by the members and creditors of the company concerned.

10. Some Panel members enquired whether shareholders of a company could object or halt the section 228A procedure, and whether the Government would consider repealing the procedure given that it had been a subject of concern for the shareholders and employees. The Administration pointed out that allowing reversal of the section 228A procedure might give rise to complications in the restoration of the position of the company before the winding-up. Given that an overwhelming majority of respondents in the public consultation supported retaining the section 228A procedure as a means to be used by directors of a company to wind up the company as a last resort, the Government had no plan to repeal the procedure.

Employee protection and consultation with the labour sector

11. At the FA Panel meeting on 3 May 2013 and ESC meeting on 19 February 2014, some Members stressed the need for the Administration to gauge the views of the labour sector on certain issues, such as the order of priority for employees in the list of creditors and the current arrangement of using the accrued benefits of employers contributions to Mandatory Provident Fund ("MPF") schemes for offsetting Severance Payment or Long Service Payment ("SP/LSP offsetting arrangement") payable to employees, as these issues would affect the settlement of employees' outstanding entitlements by the insolvent company. The Administration advised that it had consulted various stakeholders, including the labour unions, during the public consultation. On the SP/LSP offsetting arrangement, the Administration considered that the matter should be dealt with separately in the context of improvement of the MPF system.

12. A Panel member suggested at the FA Panel meeting on 7 July 2014 that the current caps as set out in section 265 of C(WUMP)O on preferential payments to employees in a winding-up should be adjusted upward to bring them in line with the levels of the relevant maximum payments to employees from the Protection of Wages on Insolvency Fund ("PWIF"). The Administration explained that the caps on preferential payments under section 265 of C(WUMP)O only represented the maximum amounts which PWIF was

entitled to claim in a winding-up through subrogation to the rights of the employees. The caps did not affect the amount of payments to employees from PWIF. The purpose of the subrogation was to replenish PWIF. The Administration considered it inappropriate to introduce changes to the aforesaid caps without considering the views of other relevant stakeholders, such as creditors. The Administration would sound out the issue to the relevant stakeholders.

Transactions at an undervalue made in good faith

13. At the FA Panel meeting on 3 May 2013, members enquired whether undervalued transactions would be voided by an order of the court if it was proven that the party which had entered into such transactions with a company had done so in good faith and was unaware of the financial position of the company concerned. The Administration responded that under the existing C(WUMP)O, appropriate protection was given to persons who had, in good faith and for value, received benefits or acquired or derived interest in property from an unfair preference or undervalue transaction in the winding-up context. The said protection would be maintained in the new provisions on unfair preferences and transactions at an undervalue.

Consistency between corporate insolvency and personal bankruptcy provisions

14. At the FA Panel meeting on 3 May 2013, some members opined that the Administration should maintain the consistency between provisions in the corporate insolvency regime and those for personal bankruptcy proceedings under BO. The Administration advised that it had made reference to the personal bankruptcy provisions when developing similar provisions in the new corporate insolvency law. For example, the proposal to introduce new provisions on transactions at an undervalue was modelled on similar provisions in the existing personal bankruptcy regime. As regards transactions which were unfair preferences, both C(WUMP)O and BO had the relevant provisions. Currently, C(WUMP)O applied the provisions on unfair preferences in BO with modifications to winding-up cases by relying on cross-references to the relevant provisions of BO. It was proposed in the public consultation document that standalone unfair preferences provisions be introduced in C(WUMP)O to enhance their clarity and effectiveness.

Outsourcing of liquidation cases

15. In response to members' enquiry raised at the FA Panel meeting on 3 May 2013 about whether the Administration would consider introducing a licensing regime for liquidators, the Administration advised that at present, the Official Receiver's Office had been contracting out liquidation cases to the private sector and monitoring the performance of the participating firms to ensure the quality of the outsourced services. As the outsourcing regime had

been operating smoothly, and having regard to the relatively small size of the industry, the Administration did not have any plan to introduce a licensing regime for liquidators at the moment.

Timeframe for introducing a statutory corporate rescue procedure

16. During the discussions at the aforesaid meetings, some members urged the Administration to introduce a statutory corporate rescue procedure ("CRP")⁷ for companies as early as possible. These members noted that a statutory CRP for companies had merit over the winding-up procedure as it would minimize adverse impacts on the relevant parties (e.g. creditors and employees of a company), and there was general support from the business and the relevant professional sectors for the procedure.

17. The Administration advised at the FA Panel meeting on 7 July 2014 that it had been developing further the proposals on a new statutory CRP and the insolvent trading provisions having regard to the outcome of the public consultation exercise on the subject conducted in 2009-2010, and announced a package of relevant proposals in May 2014. Given the complexities of issues involved, the Administration would need more time to work out the detailed legislative provisions for further engagement with the relevant stakeholders and prepare the amendment bill⁸.

Latest development

18. At the House Committee meeting on 16 October 2015, Members agreed to form a Bills Committee to study the Bill.

Relevant papers

19. A list of relevant papers is in the **Appendix**.

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⁷ A statutory corporate rescue procedure aims to provide an opportunity for a company in short-term financial difficulty to turn around or restructure. The procedure involves proposals to put the troubled company under provisional supervision, impose a moratorium on legal actions against the company, and introduce insolvent trading provisions on the liability of directors of the company.

⁸ As pointed out in paragraph 20 of the LegCo Brief on the Bill (Ref: IB&W/2/1/5/4C), the Administration is preparing drafting instructions for the amendment bill on the statutory CRP and will engage stakeholders on the details in due course. The target is to introduce the relevant bill into LegCo in 2017-2018.

List of relevant papers

Date	Event	Paper/Minutes of meeting
7 November 2011	The Panel on Financial Affairs ("FA Panel") discussed the Administration's plan to modernize Hong Kong's corporate insolvency law	Administration's paper (LC Paper No. CB(1)237/11-12(05)) Minutes (LC Paper No. CB(1)614/11-12)
16 April 2013	Launch of a three-month public consultation on "Improvement of Corporate Insolvency Law Legislative Proposals"	Public consultation document (LC Paper No. CB(1)867/12-13(01)) Administration' paper on "Improvement of Corporate Insolvency Law" (LC Paper No. CB(1)876/12-13(01))
3 May 2013	FA Panel was briefed on the public consultation on the legislative proposals	Administration's paper (LC Paper No. CB(1)876/12-13(01)) Minutes (LC Paper No. CB(1)1789/12-13)
6 January 2014	FA Panel was brief on the Administration's proposal to retain two supernumerary posts in the Financial Services and the Treasury Bureau ("FSTB") to spearhead various legislative initiatives	Administration's paper (LC Paper No. CB(1)625/13-14(08)) Minutes (LC Paper No. CB(1)1310/13-14)
19 February 2014	Establishment Subcommittee deliberated on the proposal to retain two supernumerary posts in FSTB	Administration's paper (EC(2013-14)23) Minutes (LC Paper No. ESC43/13-14)

Date	Event	Paper/Minutes of meeting
7 July 2014	FA Panel discussed the consultation conclusions on the corporate insolvency law improvement exercise	Administration's paper (LC Paper No. CB(1)1536/13-14(01)) Minutes (LC Paper No. CB(1)1998/13-14)
14 October 2015	The Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 was introduced into the Legislative Council	The Bill Legislative Council Brief Legal Service Division Report (LC Paper No. LS1/15-16)