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Legislative Council

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(These minutes have been seen by the Administration and cleared with the Chairman)

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Bills Committee on
Companies (Amendment) Bill 2000

Minutes of meeting
held on Monday, 10 April 2000, at 10:45 am
in Conference Room B of the Legislative Council Building

Members present	**:**	Hon Ronald ARCULLI, JP (Chairman) Hon James TIEN Pei-chun, JP Hon Albert HO Chun-yan Hon Eric LI Ka-cheung, JP Hon HUI Cheung-ching Hon CHAN Kwok-keung
Members absent	**:**	Hon HO Sai-chu, SBS, JP Hon LEE Cheuk-yan Hon Margaret NG Hon CHAN Yuen-han Hon SIN Chung-kai Hon Mrs Miriam LAU Kin-yee, JP
Public officers attending	**:**	**Financial Services Bureau** Miss Julina CHAN Principal Assistant Secretary for Financial Services Mr L W TING Assistant Secretary for Financial Services

Official Receiver's Office

Mr E T O'CONNEL
Official Receiver (Ag)

Mr Edward LAU
Assistant Principal Solicitor

Mr Jeremy GLEN
Assistant Principal Solicitor

Department of Justice

Mr Geoffrey FOX
Senior Assistant Law Draftsman

Miss Shandy LIU
Senior Government Counsel

Clerk in attendance : Mr Andy LAU
Chief Assistant Secretary (1)2

Staff in attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Miss Irene MAN
Senior Assistant Secretary (1)9

I Meeting with the Administration

Repeal of section 228A

Two submissions from the Law Society of Hong Kong (LS) and the Hong Kong Society of Accountants (HKSA) on the repeal of section 228A of the Companies Ordinance (Cap.32) were tabled at the meeting respectively.

(*Post-meeting note*: The two submissions were circulated to members vide LC Paper Nos.CB(1)1355/99-00(01) and (02) respectively for retention.)

2. Noting the proposed amendment of HKSA to section 228A to the effect that the filing of the director's statutory declaration would enable the directors to forthwith appoint a person to be provisional liquidator but that the company was not in liquidation until a contributories' resolution for winding up the company was passed,

the Chairman enquired about the status of the company at that stage.

3. The Official Receiver (OR/Atg) advised that under section 228A(3)(a), the winding up of the company shall commence at the time of the delivery of the directors' declaration.

4. Members noted that HKSA and LS had reservation on the proposed repeal of section 228A. OR/Atg. advised that the Administration had already set out the detailed justifications for the proposal at previous meetings. He added that there was an average time lag of about eight weeks between the filing and the hearing of the winding up petition. It was desirable to plug any possibility of abuse of the winding-up provisions.

5. Referring to the second paragraph of HKSA's submission, Mr James TIEN enquired whether the Administration was aware of any first hand knowledge of abuse of section 228A. OR/Atg advised that the OR's Office was not aware of any complaints made by aggrieved party about the procedure in section 228A. The Chairman remarked that although the LRC was concerned about the possible abuse of the provision, there had not been any concrete evidence of abuse.

6. Mr Albert HO said that the 228A procedure seemed to be an effective channel for efficient winding up of certain defunct insolvent companies. Since both LS and HKSA were not aware of any examples of abuse of the section, he took the view that the provision should be retained. At the same time, he also found HKSA's proposal of giving creditors a chance to air their view sensible. As such, he opined that section 228A should be amended so that the directors might be obliged to summon a creditors' meeting for passing of the resolution before they made use of the 228A route.

7. The Chairman expressed reservation about HKSA's proposal. He pointed out that when directors made a statutory declaration stating that the company was unable to carry on its business in order to kick the 228A procedure into operation, the creditors, being unable to recover their debts, might become difficult by not passing the directors' resolution which would thus create a deadlock. He also considered that the proposal might create difficulty regarding the legal status of the matter because once the directors convened a meeting on the basis that the company was unable to carry on its business, it was almost impossible for creditors to hold contradictory views. Moreover, if directors took the 228A route notwithstanding the corporate rescue provisions, this would imply that they considered the corporate rescue procedure not an option. For these reasons, the Chairman held the view that the HKSA's proposal was difficult to implement. OR/Atg agreed and added that if HKSA's suggestion was adopted, there would be no difference from the existing provision under section 241 about creditors' voluntary winding ups and it would only add another layer of complexity unnecessarily. Since there was no concrete reason to repeal the section, the Chairman said that the rationale of LRC needed to be considered first before taking the matter further.

Trust account requirement

8. The Chairman sought the Administration's view on the suggestion of providing more flexibility in respect of the requirement on a company to provide a trust account for all the arrears it owed to its employees by virtue of the Employment Ordinance (Cap. 57), before initiating the corporate rescue procedure. The Principal Assistant Secretary for Financial Services (PAS for FS) advised that comments from the Labour Advisory Board (LAB) would have to be sought regarding the proposed opting out of the trust account requirement. The Administration might work out proposal(s) for circulation among the Board members to seek their views or request the Board to hold a special meeting to discuss the proposal(s) if necessary.

Classes of employees and classes of meetings

9. In response to the Chairman, the Assistant Principal Solicitor of the Official Receiver's Office advised that if classes of employees were to be introduced, the provisional supervisor would have to come up with a proposal for all types of creditors so that each class would need a separate meeting to vote on the proposal. Addressing the Chairman's concern about the classes of creditors, OR/Atg referred to paragraphs 16.5 and 16.9 of the LRC Report on Corporate Rescue and Insolvent Trading and advised that apart from employees, all other creditors belonged to one single class only excluding the major creditors holding at least 1/3 of liabilities as secured creditors. In other words, small secured creditors under the proposal were grouped together with the unsecured creditors to form one single class of creditors taking on a one-person-one-vote system.

10. Mr James TIEN doubted whether a certain creditor would be aware of being a small or major secured creditor without knowing the total assets of the company. Besides, even a creditor was known to be a small secured creditor at an early stage, his status might have changed after years when the company continued to develop. Apart from the Hong Kong Association of Banks (HKAB), Mr TIEN asked if small banks were consulted.

11. OR/Atg advised that HKAB had been consulted by the LRC. Besides, secured creditors were always registered and they would know their rank in terms of securities. However, Mr James TIEN held the view that the secured creditors should be acknowledged once their rank changed. While the Chairman considered that it was up to the secured creditor to protect himself by extracting a negative covenant from the borrowing company to ensure his creditor status, Mr TIEN stressed that it would not do good for the convenience of business. The banks, in that circumstance, would all seek the negative covenant disregarding the amount lent, which might in turn restrain the company from business development.

12. Nevertheless, Mr Eric LI pointed out that the situation was not as bad as Mr TIEN had thought at the very beginning. The provisional supervisor would have to give a full business plan to the court and explain what was to be done in a month's time.

Besides, if the company was going to lose out, not only the small creditors but also the major creditors would lose out, so the interest of the small creditors would not be jeopardized.

13. On the issue of class meeting, the Chairman said that since the management of a company would be working closely with the provisional supervisor to work out a rescue package, they should not be entitled to cast a vote. OR/Atg advised that if managerial and non-managerial staff were divided and the former was not given the right to vote, it would run contrary to the fundamental purpose of the draft legislation where those having a financial stake in the outcome should have a vote. However, the Chairman pointed out that the concern was that the value of the management would outweigh the value of the supporting staff. OR/Atg said that the issue was very complicated and difficult and would require very careful consideration. Mr James TIEN agreed that the issue was very complicated because under the Employment Ordinance, there was neither class voting nor the definition of managerial and non-managerial staff, but employees were defined in value by using a cap. In that case, the Chairman was of the view that the voting side on value could also be subject to that cap and be consistent with the Employment Ordinance.

Arrangement of the trust fund upon liquidation

14. As the trust account would look after the liabilities of the company up to the appointment of the provisional supervisor, the Chairman enquired if the provisional supervisor failed to come up with a proposal, whether the employees would be able to draw from the trust account or whether the fund would be available to the general creditors. PAS for FS clarified that if the company wound up in the end, the normal winding up procedure would apply and the fund would go into the general assets of the company. The fund would only go to employees when the corporate rescue procedures were in place. OR/Atg supplemented that when a company went into liquidation, its assets would be subject to the statutory regime provided by the Companies Ordinance (Cap.32). Since the trust account was set up for the purpose of protecting employees in relation to the provisional supervision, once the supervision failed, the company would go into liquidation and the fund in the trust account would go back into the company's account. In the case of liquidation, the Senior Assistant Law Draftsman (SALD) added that the provisional supervisor might be asked to draw out the fund in the trust account as soon as possible for payment of employee benefits and there would hardly be anything left in the account.

15. OR/Atg advised that there were two different classes of employees. The first class was not retained by the provisional supervisor, and they would get their payments straight away; the second class was retained by the provisional supervisor, and if these employees had any arrears of wages as at the date of commencement of the provisional supervision, they should receive those arrears of wages first; if they kept on working for the company after the procedure started, the fund in the trust account would remain being held up. Mr Eric LI pointed out that the employees would not have access to the funds in the trust account until there were good reasons, such as any

arrears of payment and severance payment arose. Therefore, the provisional supervisor would keep the fund in the trust account until the company was wound up; otherwise, the fund in the trust account would be released to the company itself.

16. The Assistant Principal Solicitor of the Official Receiver's Office (APS/ORO) further clarified that the idea of setting up a trust account had had regard to two different types of employees. The first type was those sacked by the company before the relevant date to whom the severance payment would have to be made. The other type was those continuing to work with the company, and only if there was any arrears of wages, the trust account would be of assistance and the trust account would not cover the contingent liabilities arising out of termination of contract of employment. SALD added that severance payment would not arise until an employee was dismissed.

17. Citing a scenario where a company had 1,000 employees with 200 terminated before the provisional supervision procedure, 300 terminated by the provisional supervisor after the procedure had commenced and 500 continued working with the company, the Chairman enquired whether the trust account would provide for the each of the three categories of employees. APS/ORO clarified that the trust account would only provide for the first category of the 200 employees terminated before the relevant date. The second category of the 300 employees terminated by the provisional supervisor after the relevant date would become the liabilities of the provisional supervisor and would not be covered by the trust account.

18. Mr James TIEN doubted why the trust account should cater for the first category of employees who were terminated before the provisional supervision commenced as they should have been paid already. Mr Albert HO shared the view and said that the liabilities for this category of employees should be immediate. In response, SALD explained that the setting up of a trust account was a prerequisite for entering into the provisional supervision. The company would have to be in a position to pay all the liabilities due and owing to employees and ex-employees up to the date of the provisional supervision, and this would be done through a trust account before the procedure commenced where sufficient money was guaranteed to settle the liabilities. The accrued payments for employees terminated after the provisional supervision had commenced were not covered in the trust account, because it would become a continued liability arising after the supervision to be taken care of by the provisional supervisor.

19. The Chairman enquired whether a trust account would be necessary if no one was terminated upon the appointment of the provisional supervisor. PAS for FS advised that if there was no outstanding liability as at the date of the provisional supervision, the trust account would not be necessary. SALD added that when the company had settled all debts and liabilities or owed nothing by virtue of the Employment Ordinance to the employees before the relevant date, there was no need to have a trust account even after terminating all the employees.

Purpose of the trust account

20. Mr James TIEN pointed out that in considering the request of an employer or a provisional supervisor to help out the company for the six months during the moratorium, the employees would be most concerned about their entitlements, not only the current but also those at the subsequent stages. Thus, he considered that the trust fund should provide for those who were willing to continue helping out the company during the rescue procedure. Without such protection, the employees might not be willing to take the risk to help out the company lest in the end, if the company could not be turned around, they could only seek assistance from the Protection of Wages on Insolvency Fund (PWIF) where there was a cap limiting the compensation.

21. PAS for FS advised that if a company started the corporate rescue procedure, the whole concept of setting up a trust account was to make the company settle all outstanding liabilities, including wages and severance payments to employees, because once the rescue procedure started, a moratorium would take effect and creditors would not be able to petition to wind up the company. Likewise, laid off employees who were owed wages and other entitlement also would not be able to seek assistance from the PWIF. That explained why the company was requested to clear all outstanding wages and severance payments before the rescue procedure started. On the other hand, debts arising after the rescue would not be subject to the moratorium. If employees' wages were owed after the commencement of the rescue procedures, employees' right to petition to wind up the company was not affected.

22. The Chairman doubted whether the trust account was needed since all debts and liabilities should have been paid according to section 168ZA(c)(iv)(B). He enquired how long the fund would be deposited in the trust account. SALD advised that if the company had paid the debts or owed no debts or liabilities of employment, the trust account would not be necessary. The Chairman queried why the trust account was necessary at all for as soon as there was fund, it would have been paid out immediately. He considered that the funds in the trust account should be held in abeyance for use in a specific way in future instead of as a present mechanism for payment.

LAB's understanding of the trust account

23. Mr James TIEN doubted why the employers and employees in the LAB would agree on the arrangement for the trust account. PAS for FS clarified that the LAB had not examined the Bill at the time of consultation but the Administration had reported to it the result of the consultation and the Administration's preferred option. The Board was aware that once a moratorium was in place, employees who were owed wages could not petition to wind up the company and employees' right to make an application to PWIF might be impaired. The result of the consultation clearly indicated that both employers and employees insisted on maintaining the functions and scope of PWIF. In other words, employees who were owed arrears of payments due to the rescue procedure should not be allowed to seek assistance from PWIF. Taking this as the principle of reviewing the recommendation made by the LRC, the

Administration concluded that immediately before the rescue procedure commenced, all arrears of payments to employees should be cleared because the employees could no longer seek assistance from PWIF once provisional supervision started. Therefore, a trust account would have to be established for the purpose of clearing the arrears of payments owed to employees before the rescue procedure started. However, for those continued to be hired and there were no arrears of payments, the company would only be required to settle all of their severance payments at the time they were terminated. In short, the trust account was purely to settle the arrears of payments owed to employees immediately before the commencement of rescue procedure. Any arrears of payments arose after the rescue procedure or the employees who were terminated by the provisional supervisor were known as qualifying liabilities which would not be covered by the trust account. Since the debts arising after the commencement of the procedure would not be affected by the moratorium, the employees could still have the right to petition to the court for winding up of the company. Thus, the LAB understood that the Administration's proposed option was that the draft legislation would provide for a statutory corporate rescue with a condition that the company undergoing corporate rescue was obliged to clear all arrears of wages, severance pay and other statutory entitlement of its employees as if it was a going concern.

24. Having noted that employees could still petition for winding up of the company even the rescue had started, the Chairman enquired how the provisional supervisor could carry on the rescue procedure on a parallel basis. PAS for FS clarified that not only the employee debts but all liabilities arising after the moratorium would not be subject to the moratorium. In other words, once the rescue procedure started, the company should have sufficient funds to settle all debts and liabilities incurred by the company after the initiation of the corporate rescue procedure. If employers had difficulty in settling certain employee debts, they could retain them for the time being since termination of employees would involve heavier costs. However, Mr Albert HO pointed out that in certain circumstances, termination of employment contracts might be necessary in carrying out the rescue procedure.

25. Mr James TIEN sought clarification on whether the employees continuing working in the company after the commencement of the rescue procedure would be excluded from the trust account, and whether the flexibility introduced into the trust account requirement would be applicable to this category of employees. PAS for FS explained that in some circumstances, for example, the employer had been paying 80% of wages to employees who were then retained and continued to be employed by the provisional supervisor. In such cases, the trust account should have provisions to cater for the wages owed immediately before the commencement of the rescue procedure. The Chairman said that the flexibility so suggested could be applied to all circumstances. However, PAS for FS pointed out that the proposed flexibility in the trust account would deviate from the principle made known to the LAB before and the Board's views had yet to be sought.

The way forward

26. The Chairman advised members that the work of the Committee would have to be completed latest by the third week of May 2000 should the Second Reading debate on the Bill be resumed in mid June 2000. However, the Committee had yet to examine the detailed provisions of the corporate rescue package and the representations put forward by various organizations the deadline of which was 15 April 2000. Given the need to consult LAB, the time constraint would even be tighter, bearing in mind it took time for the Administration to work out a proposal if an alternative for employees regarding the trust account requirement was put forward, including the provision of such an alternative to different classes of employees and whether there should be different classes of meetings. Further, unlike other jurisdictions where there was a social security safety net for employees, there was no similar security in Hong Kong and the trust account was unique in itself. He therefore suggested the Bills Committee not to proceed with the examination of the corporate rescue and insolvent trading proposals within the limited time available before the end of the current term and invited members' view on the suggestion.

27. Mr James TIEN considered that although the LAB could hold special meetings to discuss the trust account requirement, it would not be able to reach a conclusion easily given the complexity of the issues involved. Besides, the employer representatives would probably have to spend time consulting organizations such as the Hong Kong General Chamber of Commerce and it would be difficult to complete the scrutiny of the Bill by May 2000. Mr Eric LI remarked that employees in Hong Kong were already better protected than those elsewhere for they would be fully protected by the trust account and in case of an insolvency, they would be protected by the PWIF. The accounting profession welcomed any initiative to introduce flexibility and improve the chance of using the proposed legislation but acknowledged the complexity of the legal issue involved.

28. Mr Albert HO considered that given the extensive consultation underway, the consultation might not be completed before the end of the current LegCo term. Besides, the Administration would have to prepare concrete proposals before consulting the LAB. He stressed that whatever changes were to be introduced into the Bill, the Administration should retain the simplicity and efficiency of the scheme. Any complicated and costly procedures would only defeat the purpose. He suggested two ways of handling the Bill, namely either by putting aside the part on the flexibility of the trust account requirement subject to the Administration's undertaking of an immediate review after passing the Bill in its present form, or by passing all the miscellaneous provisions in the Bill and leaving the part on corporate rescue to be considered in the next LegCo term. SALD advised that it was not unusual for legislators to pass an ordinance first on the basis of conducting an immediate review afterwards by means of an undertaking.

29. However, the Chairman expressed reservation on the idea because practically speaking, if the Bill were passed first leaving aside the flexibility of the trust account requirement for subsequent review, and if in the meantime, a corporate rescue exercise was defeated all because the employees were not given the flexibility in the trust

account requirement, serious criticism might be laid against the Council for passing a Bill which had room for improvement at the outset. Moreover, once the Bill was passed, parties involved, including the LAB, would hesitate to review it for there was no evidence of any problems with the scheme. Since some members had pointed out that the scheme would only be used on rare occasions, delaying it might not do much harm to the concept of corporate rescue. Furthermore, the union representatives, having secured the protection of the trust account, might not be willing to consider the flexibility anymore.

30. OR/Atg advised that the new rescue procedure was actually in addition to what was already in place under section 166 of the Companies Ordinance for there were plenty of informal corporate workouts taking place in Hong Kong. SALD added that criticism might also be raised even if the Bill was passed without commencing the relevant provisions on corporate rescue, because a company having no problem with the trust fund might allege that it could have been saved if the commencement of the rescue procedure was in place.

31. PAS for FS appreciated the concept of providing flexibility in respect of the trust account requirement but since many complicated issues would be involved, including whether such flexibility would be in breach of the Employment Ordinance, who would put forward and enforce the proposal for employees to opt out and the introduction of class voting among employees etc, the Administration would have to examine all these carefully. If the flexibility option was to be considered, the Administration would need to seek comments from the LAB.

32. The Chairman said that in view of the complexity of the subject matter, it was not practically possible to complete the scrutiny of the entire Bill within the limited time available. He therefore suggested curtailing the examination of the corporate rescue and insolvent trading proposals in the Bill. SALD advised that if the scrutiny of the Bill could not be completed in the current session, Committee Stage amendments (CSAs) would have to be moved to take out both the provisions on provisional supervision and insolvent trading as well as their consequential amendments.

33. Mr Eric LI said that since the concept of corporate rescue had long been discussed by the LRC and LAB, it might be advisable to invite the Chairmen of the relevant organizations to have a meeting with the Committee before deciding whether or not to drop the part on corporate rescue in the Bill. If these organizations undertook to consider the issues proposed, he held the view that the part on corporate rescue should not be proceeded until they reverted to LegCo. On the other hand, if they expressed strong objection to providing more flexibility in respect of the requirement on a company to provide a trust account for all the arrears it owed to its employees, before initiating the corporate rescue procedure at such an initial stage, he considered that the Bill should be passed first given the limited time for consultation.

34. While the LAB had also been consulted on the Bill and its response being

awaited, the Chairman expressed objection to Mr Eric LI's suggestion. He also pointed out that the Chairmen of the respective organizations might not even have a consensus on the issues. Mr James TIEN supplemented that the Chairman of the LAB was indeed the Commissioner for Labour who was also a government official, and it would not mean much to call a meeting of this kind.

35. The Chairman said that Mrs Miriam LAU and Miss Margaret NG, though not present, had substantial reservation about the passing of the Bill judging from the legal aspect, not to mention the proposed flexibility in the trust account requirement. They also expressed concern about the complexity and the rare applicability of the Bill. Moreover, since the Committee and the LAB were so different in understanding certain aspects of the Bill, he considered that it would be appropriate to take the matter back to the LAB for further comments. Besides, views from the organizations had yet to be gathered for reference. He estimated that it would take approximately 14 more meetings to complete the scrutiny of the entire Bill within the current term, because the corporate rescue package was a completely new idea in Hong Kong, there were still many uncertainties about the Bill, and the parts on insolvent trading and all the schedules had not been studied yet.

36. Mr Eric LI said that he was ready to hold as many meetings as necessary to study the Bill but he was worried whether the LAB could be convinced to accept the proposal of flexibility because the employees, under the present arrangement in the Bill, could recover all their arrears of wages instantly. Unless the LAB had very strong interest in the flexibility option, which was less likely, he would support, on behalf of the accounting profession, passing the Bill in the current session.

37. Mr CHAN Kwok-keung considered that since the corporate rescue package was a rather new idea and carried no urgency, there should not be any problem if that part was left out for the time being and was to be implemented only after more detailed examination by all parties. Mr James TIEN preferred taking out the corporate rescue part because a lot of problems had still not been resolved in the Bill. Mr HUI Cheung-ching considered that the part on employees' interest might not be resolved easily despite more meetings were to be held within the coming two months. Mr Albert HO held the view that 14 more meetings would be sufficient to finish studying the Bill only in its present form but not if new proposals arose. However, since there was practical difficulty in finding time slots for the meetings as numerous bills committee meetings were coming up, he suggested taking out the part on corporate rescue for future examination.

38. Whilst appreciating the Administration's enthusiasm in passing the Bill in the current term since the LRC had spent several years on the rescue package, members considered that there was practically insufficient time for the Committee to scrutinize the Bill. Having gathered the views from members, the Chairman advised that the parts on corporate rescue and insolvent trading should be excised from the present Bill.

39. Having conducted two rounds of large-scale consultation exercise and

balanced the opinions of different parties, PAS for FS said that the Administration aimed at passing the provisions on corporate rescue procedure in the current LegCo term. Notwithstanding, she appreciated the complexities involved and took note of the Committee's decision to take out the part on corporate rescue and insolvent trading. She would report the matter to the Secretary for Financial Services (S for FS) accordingly.

40. The Chairman advised that a further meeting would be held pending the decision from the S for FS and the CSAs concerned. Meanwhile, members should examine the issues arising from section 228A and propose amendments if necessary.

(*Post-meeting note*: The CSAs moved by the Administration and by the Chairman of the Committee were circulated to members vide LC Paper Nos. CB(1)1538/99-00 and 1607/99-00(01) respectively.)

41. There being no other business, the meeting ended at 12:45 p.m.

Legislative Council Secretariat
16 August 2000