By fax (2869 6794) and by hand

Your ref : CB1/BC/12/00

11th September, 2001

Clerk to Bills Committee on Companies (Corporate Rescue) Bill
Legislative Council Secretariat
3rd floor, Citibank Tower
3 Garden Road
Hong Kong

Attn : Mr. S.C. Tsang

Dear Sir,

Re : Bills Committee on Companies (Corporate Rescue) Bill

Thank you for your letter dated 13th July, 2001.

I am enclosing a copy of my letter 11th February 2000 and for completeness sake, a copy of the Official Receiver's reply to my letter dated 29th February 2000.

I am enclosing these two letters because the relevant parts of the legislation that my first letter was concerned with have not changed.

I would like to expand on the areas that I commented on earlier, which are Insolvent Trading, Section 295 (a) and its effect on responsible people as defined.

The definition of Insolvent trading is "unable to pay its debts as when they become due and owing".

There are some 260 overseas banks operating in Hong Kong. At anyone time a number of these banks are withdrawing facilities because of the market in Hong Kong or the market in their home country and that they need to consolidate their position. As soon as the bank sends out a demand letter and the company is unable to pay it's debt, it is insolvent.

The proposed legislation has the effect that on any day within 12 months period immediately proceeding the day of the commencement of the winding up. It will be presumed, unless the contrary is shown that the company remain insolvent from the mentioned date to the date of liquidation.

An example would be as follows :-

Within the period of 365 days, a company became insolvent on the day 10 due to a demand from one of its minor banks. However, the company continue to trade and on the day 30, is able to secure additional finance and it pays the minor bank. On day 359, its major customer in the U.S. became insolvent and the company in Hong Kong went into provisional supervision or liquidation on day 360.

If we assume that provisional supervision after six months is not successful then the Directors and senior managers, under the proposed legislation, would be liable from day 10 up to day 360 (Schedule 7 Section 18).

The proposed legislation assumes the presumption of continue insolvency, (Section 295 (d)).

It is the Directors and senior managers' responsibility to convince the court that the contrary was the case and the company was solvent up to day 359.

It is normally the case that people assumed to be innocent of something until they are proved guilty. I am not sure whether this legislation will infringe the Bill of Rights or not, over the presumption of Insolvent Trading.

In the Official Receiver's letter, he states that honest Directors need not fear this legislation. However, the honest Director will have to prove that that company was solvent. Which means that the honest Director who stays behind to try to save the company, may be faced with the problem of proving that he did his best for the company, which may involve expensive litigation.

The practical result of this type of legislation is to stop Directors and this means all Directors including Independent Non-executive Directors from taking on any personal risk. Any sensible professional adviser will advise the Directors not to do so. This will undoubtedly drive more companies into liquidation and provisional supervision.

The definition of Responsible Person defined under this legislation is as follows :-

"a manager of the company who is involved to a substantial or material degree in directing the company's business or affairs and who knows, or ought reasonably to know, the company's solvency position;"

This definition will undoubtedly in practical terms involved the Chief Financial Officer or the Financial Controller of the company. Although these two people are not Directors of the company, they will find themselves personally liable, as the company slips into insolvency and they do not take advantage of the legislation to write a letter to the Board of Directors warning them.

From my experience in Hong Kong, this would mean that these people will leave the company as soon as there is whiff of any insolvency. Why would they want to stay behind and risk any form of personal liability ?

This legislation involving senior managers is unique in the world. These senior managers would be the individuals that the provisional supervisor will need in order to successfully carry on running the company operations.

This legislation was designed to stop managers who are running company in Hong Kong into insolvency where the Directors are overseas, and are not aware of what's happening. If this is the purpose of the legislation, why not defined specific legislation for this problem of overseas Directors.

It is Directors in Hong Kong and elsewhere in the world who are usually held responsible for the operations of the company and reporting to shareholders. For some reason, we seemed to want to involve senior managers in the fiduciary duty and responsibilities of Directors.

As I have mentioned in my earlier submission, I am in favour generally of some form of legalised formal restructuring for companies.

There are still at present some 70 public companies who are undergoing some form of restructuring in Hong Kong where their shares are not suspended. The impact of this legislation will be to suspend their shares, which may be the right course of action and it may be the right course of action to place more public companies and private companies immediately into liquidation or provisional supervision.

However, the impact on the economy in Hong Kong at this moment in time may be quite negative. Therefore this legislation may have the opposite intention in not actually saving companies, but putting more companies into liquidation.

Yours faithfully,

Signed by Jim Wardell

Jim Wardell
FCA FHKIoD FHKSA FABRP MAE MHKSI ACIArb MMSCPA
Managing Director

Encl.

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11 February 2000

By fax and by Hand
(2537 1851)

Mr. Jimmy Yuen
Public Information Division
Legislative Council
8 Jackson Road
Central
Hong Kong

Dear Sir,

COMPANIES (AMENDMENT) BILL 2000

I am writing with regard to the various proposed amendments contained in the Companies (Amendment) Bill 2000 gazetted on 7 January 2000.

I have for the last 18 years practiced as an insolvency practitioner in Hong Kong and on balance welcome the introduction of provisions that are aimed at encouraging troubled companies to start forming debt restructuring plans at an early stage. It is encouraging that the introduction of provisional supervision and the availability of a moratorium will provide a formal platform from which restructuring plans can be implemented.

In reality though, debt restructuring has always been the preferred recovery mechanism in Hong Kong. This is because of the unique make up of Hong Kong. The majority of Hong Kong businesses are either property related, trading or manufacturing and because of Hong Kong's import/export role most companies unsecured debts are with banks. As a result, the banks have always taken a proactive role in recovering their money, because they realise the benefits of debt restructuring rather than liquidation and they also agree to standstill, rather like a moratorium.

In Hong Kong many large companies have at some time in the past been insolvent but have successfully traded out of this situation with the support of their banks. To illustrate this point, there are thought to be some 70 publicly listed companies in Hong Kong currently undergoing some form of debt restructuring.

My concerns with the proposed introduction of the insolvent trading provisions in section 295, are that instead of promoting debt restructuring plans at an early stage they may in fact have the reverse effect and cause further insolvencies. Section 295D deals with the presumption of continued insolvency in certain circumstances where a liquidator can demonstrate that the company being wound up was insolvent at any point within twelve months prior to its

winding up. If demonstrated, it is presumed that the company was insolvent for the entire twelve-month period prior to it being been wound up (unless the contrary can be proven) and the court may decide, under section 295C(1), that the company's directors and senior managers may be liable for the debts during that period.

Any responsible person, whether executive directors, non-executive directors or senior managers would not wish to run the risk of becoming personally liable under section 295C by trading out of the first point of insolvency if the presumption is, should he ultimately fail, that the company remained insolvent from the first point of insolvency throughout until the company's eventual winding-up.

This surely is contradictory to the overall purpose of the proposed amendments.

The effect of these amendments may be too overbearing on directors and senior management and exert too much pressure on them at a financially critical time. If the presumption is that directors and senior management may end up being personally liable for the Company's debts during the relevant time period then the net result may be that these responsible persons may opt for liquidation and or provisional supervision rather than take any personal risk.

The likely hood is that professional advisors to directors will advise them to place the company immediately into provisional supervision rather than take any chance of personal risk. Which director or non-executive director of a public company will be willing to take the risk?

Finally, the broadening of the scope of who is a responsible person, section 295A, to senior managers is harsh and there is a danger that it will further exacerbate the problem highlighted above. As far as I am aware senior management are not held out as responsible people in any other jurisdiction and therefore Hong Kong would be setting a precedent.

I hope that my representations are not too late for the sub-committee in its deliberations in considering the proposed amendment bill.

Yours sincerely,

Jim Wardell
FCA, FHKIoD, FHKSA, MAE, MHKSI, MSPI, ACIArb, MMSCPA
Managing Director

c.c. Miss Julina Chan - Financial Services Bureau

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29 February 2000

Mr Jim Wardell
Rutledge Group Limited
Room 1602, One Hysan Avenue
Causeway Bay
Hong Kong

BY FAX ONLY
(2972 2742)

Dear Mr Wardell,

Companies (Amendment) Bill

I refer to your letter dated 11th February to the Legislative Council in which you raise a number of concerns regarding the Insolvent Trading provisions in the Companies (Amendment) Bill. I have been asked by the Secretary for Financial Services to respond. Before I comment in detail on those concerns, could I make a number of general observations on the 2nd, 3rd and 4th paragraphs of your letter.

Apart from section 166 of the Companies Ordinance which allows for compromises between a company and its creditors, debt restructuring for companies in financial difficulties in HK has always been the favoured option. I must stress, however, that corporate rescue and provisional supervision does not seek to replace debt restructuring but rather to complement it. Indeed, the debt restructuring process may actually benefit from having a corporate rescue and moratorium procedure in place because creditors will know that a company could seek a moratorium under provisional supervision in the event that settlement negotiations were e.g. protracted and difficult. It would also help to avoid the problems normally associated with informal corporate workouts of the smaller creditors holding out for a much better deal than otherwise would be the case from the larger creditors. In addition, informal workouts can prove to be quite lengthy which the corporate rescue provisions seek to address by imposing time limits.

With regard to your observation that HK banks have always taken a proactive role in recovering their money, I certainly hope that will continue. Such banks will still be able to consider, in conjunction with their customers, whether informal restructuring or provisional supervision would be their best option. Again the draft legislation seeks to provide the commercial community with more options, not less, when debt restructuring problems arise.

The aim of the Insolvent Trading provisions is to encourage directors and senior management to face up to the fact sooner rather than later that a company may be slipping into insolvency and to address the situation before it is too late. This is to be welcomed. At the moment, the tendency is for directors to keep such companies trading, usually in the hope rather than the expectation, of a financial turn around. These new draft provisions will lead to greater accountability on the part of directors and senior management. You will appreciate directorship of a company is a serious matter. Statutory defences are provided in the Bill. So long as directors and senior management have carried out their duties conscientiously and diligently and have taken every step to minimise potential losses for the company's creditors, they will have a defence to a claim for Insolvent Trading. In addition, senior management which is unhappy with the decision of a company to continue trading whilst insolvent can protect themselves by a notice under section 295C(2)(a)(ii).

The Law Reform Commission studied the position in the UK, Australia and locally before it finally concluded that senior management should also be responsible for 'Insolvent Trading'. Under section 295A of the Bill, the definition of Senior Management is confined to those who are involved to a "substantial or material degree in directing the company's business or affairs" and this most certainly will not include every manager of a company. Given their position, it is on balance right that senior management too should also shoulder responsibility for Insolvent Trading when it arises.

In summary, the honest and conscientious director has nothing to fear from the Insolvent Trading provisions, whilst the dishonest and unscrupulous director most certainly does. These provisions are a modest addition to the statute book and will, we hope, go a little way in promoting honesty, accountability and transparency by directors when they find that their companies are in financial difficulty. If there are no reasonable prospects of saving a company which is in a financial difficulty, the directors should cause it to cease trading and to put into liquidation as soon as practicable.

Thank you for taking the time and trouble of writing to us to express your concerns. I do hope the above explanation goes some way to allay those fears.

Yours sincerely,

(E T O'Connell)
Acting Official Receiver

ETO/ll