Bills Committee on Companies Corporate Rescue Bill

Introduction

This paper updates Members on the outcome of the consultation on the proposals relating to the trust account arrangement under the Companies (Corporate Rescue) Bill (the Bill).

Background

2. The Bill provides for a corporate rescue procedure for a company in financial difficulty, and, in relation to the introduction of the corporate rescue procedure, to make directors and senior management personally liable for the debts of their company which traded while insolvent (i.e. insolvent trading). When the Bills Committee invited comments on the Bill from concerned parties, business and professional bodies raised concerns about the then proposed trust account arrangement under the corporate rescue procedure, which set no limit to the amount of employees' entitlements despite the financial difficulty of the company. They argued that a company in financial difficulty would be very unlikely to have sufficient means to set up such kind of trust account; and employees would enjoy a more favourable treatment under the trust account arrangement than in the case of winding up of the company.

Proposed Changes

3. In view of the above concerns, whilst keeping the trust account requirement, we propose to cap the sum payable under the trust account to each employee in respect of his entitlements accrued before the start of the corporate rescue procedure to what would have been payable to that employee by the Protection of Wages on Insolvency Fund (PWIF) had the company been wound up at the time of initiating the corporate rescue procedure[1]. In working out the details, we aim to ensure that the

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[1] Ex-gratia payment can only be made from the PWIF in respect of –

(a) wages not exceeding $36,000 for services rendered not more than four months prior to the applicant's last day of service and for which an application is made not more than six months after the last day of service;

(b) wages in lieu of notice not exceeding one month's wages or $22,500, whichever is the lesser, which became due not more than six months prior to the date of application; and

(c) severance payment not exceeding $50,000 plus 50% of any excess entitlement which arose not more than six months prior to the date of application (the maximum (as at September 2003) being $210,000).

employees of the company would generally be treated no worse off than would have been the case had the company gone into insolvent liquidation (instead of initiating the corporate rescue procedure). Furthermore, the employees could be better off as they may keep their jobs and a chance to recover the full amount of their entitlements, viz. those not covered by the cap, within 12 months of the approval of a voluntary arrangement proposal for the company if the corporate rescue is successful. A summary of the proposals is set out as follows –

Category	**Cap**
Former employees (i.e. whose employment is terminated before the corporate rescue procedure starts) where there are amounts outstanding	Sub-cap of $36,000 (for wages for services rendered not more than four months prior to the last day of service); Sub-cap of $22,500 or one month's wages, whichever is the lesser (for wages in lieu of notice); Sub-cap of $50,000 plus 50% of any entitlement in excess of $50,000, subject to a maximum of $210,000 (for severance payment). The overall cap of $268,500 is calculated in accordance with the provisions under the Protection of Wages on Insolvency Ordinance and the Employment Ordinance (as at September 2003). As the maximum amount of severance payment reckoned under the Employment Ordinance will be adjusted according to the relevant date of termination of employment, the overall cap will also be adjusted accordingly.
Continuing employees (i.e. who are retained by the company after the corporate rescue procedure starts)	$36,000 in respect of wages for services rendered not more than four months prior to the commencement of the corporate rescue procedure. (Note: Wages in lieu of notice and

	severance payments are not relevant here.)

4. We then issued a paper (Appendix A) to seek comments from all relevant parties (including all those who had made submissions to the Bills Committee such as Labour Advisory Board (LAB), PWIF Board) on the proposals in late September 2003.

Views on the proposals

5. We received a total of 18 submissions from various parties such as LAB, PWIF Board, Hong Kong Society of Accountant, Hong Kong Association of Banks, academic institutions, and chambers of commerce etc. The list of the respondents is at Appendix B. Of them, eleven (including the LAB and PWIF Board) gave their general support to the proposal of capping the sum payable to each employee under the trust account; six did not have any comment or express any preference; and one was against the proposal because they considered it as a significant impediment to the viability of corporate rescue and would affect the interests of other creditors should the corporate rescue fail. However, we consider that the capping proposal has already struck a proper balance of interests of employees and companies.

Way forward

6. In view of the majority support for the proposals relating to the trust account arrangement, we are working on the possible changes to the Bill to put in place the proposals. Given the complexity of the proposals involved, and other issues in the Bill on both the corporate rescue part and insolvent trading part, we expect that a tremendous amount of work would need to be done. It is highly unlikely that the scrutiny of the Bill can be completed within the current Legislative Council (LegCo) session. Hence, we would not propose that the Bills Committee be reactivated to continue its scrutiny of the Bill. We will, however, make use of this opportunity to review, in the light of the developments in other jurisdictions on the corporate rescue and insolvent trading matters, the need for the proposed corporate rescue and insolvent trading provisions and, if so, how best they should be taken forward in the next LegCo session.

Financial Services Branch
Financial Services and the Treasury Bureau
June 2004

Consultation Paper on Proposals relating to the Trust Account Arrangement under the Companies (Corporate Rescue) Bill

Purpose

This paper aims to seek the views of all the relevant parties on proposed changes to the trust account arrangement under the Companies (Corporate Rescue) Bill (the Bill).

Background

2. The Bill was introduced into the Legislative Council (LegCo) in May 2001 to provide for a corporate rescue procedure for a company in financial difficulty. The background and main purposes of the Bill are set out in the Legislative Council Brief at **Annex A**. The Bills Committee set up in July 2001 to scrutinise the Bill invited comments on the Bill from concerned parties. In this regard, business and professional bodies raised concerns about the then proposed trust account arrangement, which set no limit to the amount of employees' entitlements despite the financial difficulty of the company. They argued that a company in financial difficulty would be very unlikely to have sufficient means to set up such kind of trust account; and employees would enjoy a more favourable treatment under the trust account arrangement than in the case of winding up the company. In brief, the trust account arrangement which sets no limit for individual employee's claims would make it more difficult for the corporate rescue procedure to be initiated, thereby defeating the purpose of the Bill. Some Members of the Bills Committee shared these concerns.

3. In view of the concerns, we consider it worthwhile to explore the feasibility of capping the amount payable to each employee of a company in financial difficulty. With such capping, the company may be more likely to be able to comply with the trust account requirement and to initiate the corporate rescue procedure. In working out the details, we aim to ensure that the employees of the company would generally be treated no worse off than would have been the case had the company gone into insolvent liquidation (instead of initiating the corporate rescue procedure). Furthermore, the employees could be better off as they may keep their jobs and a chance to recover the full amount of their entitlements, viz. those not covered by the cap, within 12 months of the approval of a voluntary arrangement proposal for the company if the corporate rescue is successful.

Proposed Changes

4. Companies which would be subject to the corporate rescue process would either be on the verge of or already in liquidation. Employees of such companies would not be worse off than without the corporate rescue process as they get protection similar to those under the Protection of Wages on Insolvency Ordinance. Whilst keeping the trust account requirement, we propose to cap the sum payable under the trust account to each employee in respect of his entitlements accrued before the start of the corporate rescue procedure to what would have been payable to that employee by the Protection of Wages on Insolvency Fund (PWIF) had the company been wound up at the time of initiating the corporate rescue procedure[1], as follows –

Category	Cap
Former employees (i.e. whose employment is terminated before the corporate rescue procedure starts) where there are amounts outstanding	Sub-cap of $36,000 (for wages for services rendered not more than four months prior to the last day of service); Sub-cap of $22,500 or one month's wages, whichever is the lesser (for wages in lieu of notice); Sub-cap of $50,000 plus 50% of any entitlement in excess of $50,000, subject to a maximum of $210,000 (for severance payment). The overall cap of $268,500 is calculated in accordance with the existing provisions under the Protection of Wages on Insolvency Ordinance and the Employment Ordinance. As the maximum amount of severance payment reckoned under the Employment Ordinance will be adjusted

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(a) wages not exceeding $36,000 for services rendered not more than four months prior to the applicant's last day of service and for which an application is made not more than six months after the last day of service;

(b) wages in lieu of notice not exceeding one month's wages or $22,500, whichever is the lesser, which became due not more than six months prior to the date of application; and

(c) severance payment not exceeding $50,000 plus 50% of any excess entitlement which arose not more than six months prior to the date of application (the prevailing maximum being $210,000).

	according to the relevant date of termination of employment, the overall cap will be $278,500 if employment is terminated on or after 1 October 2003.
Continuing employees (i.e. who are retained by the company after the corporate rescue procedure starts)	$36,000 in respect of wages for services rendered not more than four months prior to the commencement of the corporate rescue procedure. (Note: Wages in lieu of notice and severance payments are not relevant here.)

5. We propose that before the appointment of the provisional supervisor takes effect, the company should file a notice in the form of an affidavit with the Official Receiver, the Registrar of Companies and the High Court Registry, confirming that –

(a) it has paid each of its employees the outstanding amount, or an amount up to the respective cap; or

(b) it has set aside sufficient money in the trust account, the exclusive purpose of which is to pay each of its employees an amount up to the respective cap. In cases in which an employee's entitlements are in dispute, the amount set aside should be sufficient to pay the employee an amount up to the cap applicable to the entitlements in question.

The details of the trust account (such as the amount of money in the trust account, the employees' claims and whether such claims are in dispute) should be set out in the notice.

6. Once appointed, the provisional supervisor will pay each employee from the trust account an amount to meet the outstanding liabilities up to the respective cap as soon as practicable after he assumes office and except in circumstances where there are good and sufficient reasons, before the relevant meeting of creditors. In practice, it means the first meeting of creditors at which the provisional supervisor presents a voluntary arrangement proposal or reports that there is no chance for a voluntary arrangement proposal for the company in question. An employee (if he is also a creditor) aggrieved by the act of a provisional supervisor may make an application to the court with a view to redressing the situation.

7. The employee will be regarded as an ordinary creditor in respect of any amount not covered by the cap and owed by the company. If this happens, he will be entitled to participate in and vote at the relevant

meetings of creditors on matters such as how and when their debts should be paid by the company, whether the moratorium imposed during the provisional supervision of the company should be extended further to that already approved by the court[2].

8. We also propose that a voluntary arrangement proposal (i.e. the proposal to rescue the company) must contain a term requiring the company to pay its employees the outstanding amounts mentioned in paragraph 7 above in full and within 12 months of the approval of the proposal. An employee (if he is also a creditor) aggrieved by the act of the supervisor of the voluntary arrangement may make an application to the court with a view to redressing the situation.

9. Where a corporate rescue procedure fails and the company has to be wound up, the employees may petition to wind up the company (if no other party has already done so) if the company has outstanding liabilities towards them. As the former employees of the company are paid from the trust account in the same manner as they would have been from the PWIF had the company been wound up (see paragraph 4 above), they should not receive any additional ex-gratia payment from the PWIF. The continuing employees may, however, apply to the PWIF for ex-gratia payment in respect of wages (only those accrued outstanding since the start of the corporate rescue procedure), wages in lieu of notice and severance payment.

10. If the company is eventually wound up, the continuing employees' wages and any other entitlements (accrued since the start of the corporate rescue procedure) are treated as qualifying liabilities. They should be charged on and paid out of the property of the company (except any such property subject to a fixed charge) in priority to other debts (such as preferential payments or ordinary debts), but excluding fees, costs and charges incurred by the provisional liquidator or liquidator whose appointment is terminated by the initiation of the corporate rescue procedure.

11. The employees may still be entitled to preferential payments under section 265 of the Companies Ordinance in respect of any item not covered by the PWIO, the respective caps or the qualifying liabilities mentioned in paragraph 10 above. They may also be able to claim the company in the capacity as ordinary creditors in respect of any other amount owed by the company.

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[2] The court may grant an extension of the moratorium of not more than 6 months from the commencement of the corporate rescue procedure under certain circumstances.

12. With the trust account arrangement which adopts the cap similar to that of the PWIFO, the entitlements of former employees would be preserved to a large extent and their position would not be worse off than the company being wound up. Continuing employees of a company (if their contracts of employment are accepted by the provisional supervisor) which undergoes the corporate rescue process would likely be better off than having the company wound up because they have retained their jobs and under section 16 of the Bill, in addition to the company, the provisional supervisor would be personally liable for their wages, salaries and other entitlements accrued after the commencement of the corporate rescue procedure.

13. The implications of the proposals are set out in **Annex B**.

Way Forward

14. We would be grateful for the views of all concerned parties on the proposals with a view to deciding whether and, if so, how the trust account arrangement should be amended.

Financial Services Branch
Financial Services and the Treasury Bureau
9 September 2003

File Ref : C2/1/12/1C(2001)I

LEGISLATIVE COUNCIL BRIEF

COMPANIES (CORPORATE RESCUE) BILL

INTRODUCTION

At the meeting of the Executive Council on 15 May 2001, the Council **ADVISED** and the Chief Executive **ORDERED** that the Companies (Corporate Rescue) Bill at Annex A, should be introduced into the Legislative Council.

BACKGROUND AND ARGUMENT

Need for Corporate Rescue Procedure

2. At present, companies liable to be wound up under the Companies Ordinance (the Ordinance) may agree to an arrangement with their creditors in a non-statutory manner or pursuant to section 166 of the Ordinance, which provides for the manner in which a company may do so, subject to the sanction of the court. However, the section does not protect the company from its creditors' actions to wind up the company, which may terminate an arrangement being formulated.

3. To address this, the Law Reform Commission (LRC) has recommended a corporate rescue procedure for companies in financial difficulty. The recommendation aims to impose a moratorium during which a company is protected from creditors' action and put under the control of a provisional supervisor (an independent professional third party) whose task is to formulate an arrangement for agreement with its creditors. A summary of the LRC's recommendation is at Annex B.

4. The corporate rescue procedure, if introduced, would give companies in financial difficulty an opportunity to try to turn around. Employment that would otherwise disappear might be preserved, at least to some extent. The legislative proposals to implement this recommendation formed part of the Companies (Amendment) Bill 2000, which was

introduced into the Legislative Council on 19 January 2000.

5. During the Bills Committee stage, the Bills Committee, having regard to time constraints and the complexity of the legislative proposals, recommended that these proposals be excised from the Bill and deferred for re-submission to the Legislative Council at a later stage. The Bills Committee was generally supportive of a corporate rescue procedure. However, some of its Members expressed doubts on the requirement placed upon a financially troubled company to set aside sufficient funds to settle all arrears of wages, severance pay and other statutory entitlements of its employees as if it were a going concern. They were concerned that the Bill did not provide the flexibility to allow employees to trade in their claims for, say, shares of the company.

6. As suggested by the Bills Committee, the Administration has consulted the Labour Advisory Board (LAB) on its proposal to provide some flexibility to the requirement to settle all arrears due and owing by the company to its employees. We have also consulted the Protection of Wages on Insolvency Fund (PWIF) Board on this matter. Having regard to the objection by the LAB and the PWIF Board, we have decided not to pursue the flexibility proposal put forward by the Bills Committee. We have revised the legislative proposals in the light of their views and those from the professional bodies and trade organisations received after the publication of the Bill in 2000.

Main Features of Corporate Rescue Procedure

Application

7. The corporate rescue procedure which may be initiated by a company or its directors or liquidators will apply to local and oversea companies formed/registered under the Ordinance, except –

(a) as recommended by the LRC, the authorized institutions regulated by the Hong Kong Monetary Authority under the Banking Ordinance; and

(b) insurance companies and registered entities in the securities and futures industry regulated by law which empowers the regulator to assume control of the regulated entity or oblige the entity to act in a certain manner in case the entity has financial difficulty.

Moratorium

8. The moratorium starts as soon as the appointment of the provisional supervisor comes into effect (i.e. the provisional supervision starts). The moratorium period is 30 days initially and may be extended for up to six months by the court upon the provisional supervisor's application. Any further extensions must be approved by creditors at a relevant meeting (and the court's approval is not required).

9. During the moratorium, there will be a stay of all proceedings (such as an application to the court to wind up the company, appointment of a receiver of the assets of the company) against the company. The only exceptions are the proceedings of the Insider Dealing Tribunal and the Securities and Futures Commission in the exercise of its regulatory powers under the relevant provisions of the Securities and Futures Commission Ordinance and Leveraged Foreign Exchange Trading Ordinance.

Exemptions from Application of Moratorium

10. The moratorium should not apply to eligible financial contracts (for example, currency or interest rate swap agreements, or agreements to buy or sell securities). These dealings occur in certain closed markets, such as the central clearing and settlement system of the Stock Exchange. To impose a moratorium on such contracts could involve unravelling innumerable other contracts which would cause chaos in the market concerned.

11. Nor should the moratorium apply to debts and liabilities incurred by the company after the initiation of the corporate rescue procedure so that the company can continue with its normal business during the provisional supervision by maintaining the necessary credit facilities with its business partners. Any resumptions by Government pursuant to a Government lease or otherwise should also be exempted from the moratorium.

Provisional Supervisor

12. Once appointed, the provisional supervisor will effectively take charge of the company. To inspire confidence, he must be independent, acting with integrity and possess the necessary expertise. He will be selected from a panel of practitioners to be operated by the Official Receiver (OR) and comprising solicitors and professional accountants. The OR may also approve other suitably qualified independent persons as provisional

supervisors.

13. The provisional supervisor will manage and control the company, acting as the agent of the company when exercising his powers. He may retain or dismiss directors of the company, make alternative arrangements for any creditor and exclude such creditor from the moratorium, and will be personally liable for any contract he enters into when performing his functions. He will be indemnified out of the assets of the company.

14. In response to the views from the professional bodies (see paragraph 6 above), we agree that the provisional supervisor should have the power to investigate voidable transactions made prior to the start of the corporate rescue procedure. The provisional supervisor will be required to report the outcome of such investigation to a meeting of creditors so as to help the creditors to reach an informed decision on whether to proceed with a voluntary arrangement or a creditor's voluntary winding up.

Provisional Supervision

15. Unless objected to by a major secured creditor of a company (in which case the provisional supervision would cease), the provisional supervisor would ascertain the financial position of the company and decide whether a proposal can be made for a voluntary arrangement. If so, he will call a meeting of creditors to consider it and upon the creditors' approval of the proposal, the provisional supervision will cease and the voluntary arrangement take effect immediately thereafter. If not, he will report it to the meeting of creditors which should resolve to terminate the provisional supervision and that the company be wound up as a creditors' voluntary winding up.

16. The original approach as recommended by the LRC was that a company had to notify its major secured creditor of the proposed corporate rescue. The latter had the right to object to the initiation of the procedure and upon receipt of such objection by the provisional supervisor, the provisional supervision would end. The LRC has not proposed to accord the same treatment to minor secured creditors, who will be bound by the terms of the voluntary arrangement that may eventually be drawn up at the end of the procedure.

17. We have received views from the professional bodies and trade organisations that this approach represents a major departure from the long established and respected secured lending practice, i.e. secured creditors, be

they large or small, cannot be forced to accept any "hair-cut" of debts without their consent. We are mindful of the impact of such approach on the existing secured lending practice, the lending institutions and the business community, and consider it necessary to modify the approach to provide that the rights of all secured creditors may not be affected by the voluntary arrangement except with their consent. If a proposal is not acceptable to a secured creditor (be he major or minor), he may choose to opt out of the voluntary arrangement and rely on his own security.

18. We have also modified the approach to provide that a member of a company who claims substantial prejudice may apply to the court for a determination on the resolution of the creditors on a proposal for a voluntary arrangement. Such modification aims to protect the interest of the member in view of the binding effect of the terms of the voluntary arrangement on the member.

Insolvent Trading

19. In relation to the introduction of a corporate rescue procedure and in order to encourage directors and senior management to act on insolvency earlier rather than later, they should be made personally liable for the debts of a company which traded while insolvent. This will encourage them to face the fact that a company was slipping into insolvency at an early date and to address the situation.

Outstanding Wages and Other Entitlements Owed to Employees who are Laid Off by a Company in Provisional Supervision

20. The treatment of outstanding wages and other entitlements owed to employees has been a sensitive subject. As mentioned in paragraph 6 above, the Bills Committee in considering the Companies (Amendment) Bill 2000 has suggested that the Administration should consult the LAB on its proposal to provide some flexibility to the requirement to settle all arrears due and owing by the company to its employees. Flexibility could be in the form of a deferral of payment or payment in lieu of cash (e.g. shares under a trade-in agreement) in respect of the wages and other entitlements accrued owing immediately prior to the commencement of the corporate rescue procedure.

21. In late 2000, we consulted the PWIF Board and the LAB on these forms of flexibility. While both bodies supported in principle the introduction of the corporate rescue procedure, they firmly objected to the

flexibility proposal. They held the view that such a proposal would erode the protection accorded to employees under the existing labour legislation, and alter fundamentally the nature and policy intent of the PWIF in that it would amount to using the PWIF to bail out companies in financial difficulties. They also pointed out that the proposal would have financial implications on the PWIF. The two bodies asked the Administration to adhere to the original proposal on settlement of arrears in wages as set out in the Companies (Amendment) Bill 2000. A summary of the outcome of our consultation with the two bodies is at Annex C.

22. We recognise that any statutory corporate rescue procedure must be workable, bearing in mind the needs of the company in difficulty, interests of creditors, and rights of employees. Having regard to the views of the PWIF Board and the LAB, we intend to adopt a pragmatic approach as originally designed, balancing the interests of all the relevant parties.

THE BILL

23. Clause 3 specifies the companies to which the Bill will apply. Clauses 4 and 5 empowers the OR to appoint a panel of professional accountants and solicitors eligible for appointment as provisional supervisors. The persons that may appoint a provisional supervisor are specified under clause 6.

24. The filing and notification requirements in respect of the notice of appointment of the provisional supervisor are set out in clauses 8 and 9. The notice has to include a 'consent to act' form duly signed by the provisional supervisor. The form will be prescribed by the OR who will require, amongst other matters, the level of remuneration of the provisional supervisor to be displayed prominently in the notice form for creditors to be so informed in the first instance. In addition, the notice will require the company to confirm that it has set aside sufficient money to settle the statutory liabilities owed to its former employees and any wages owed to its existing employees under the Employment Ordinance before the company goes into provisional supervision.

25. The effects of moratorium and the exemptions to it are set out in clause 11. The length, cessation and extension of the moratorium are governed by clauses 12 and 13. The duties and powers of the provisional supervisor are set out in Schedule 4. Powers of directors are to be suspended under clause 14 and the provisional supervisor will act as an

agent of the company.

26. Clauses 15 and 16 specify the liability of the provisional supervisor vis-à-vis contracts of goods and services and contracts of employment entered into before and after the rescue. Where the provisional supervisor accepts a pre-existing contract of employment, or enters into a new contract of employment, the wages and salaries thereby payable have priority over the provisional supervisor's remuneration. The provisional supervisor is indemnified out of the property of the company under Schedule 4 Part 4 for all debts for which he is liable.

27. Under Schedule 4 Part 5, the provisional supervisor is remunerated in accordance with a scale of fees approved by the OR. The court, on the application of the provisional supervisor, may vary the scale. Creditors may also object if they consider the fees to be excessive.

28. The provisional supervisor shall require specified persons to prepare a statement of affairs of the company as soon as practicable under clause 17. The procedures for the removal and resignation of the provisional supervisor are set out in clause 20.

29. The creation of "super" priority debt is in clause 18. Borrowings made by the company in provisional supervision will receive priority over all existing debts, with the exception of fixed charges. This is necessary because in all likelihood, a company under rescue would need to raise capital to fund its operations during the provisional supervision period.

30. Clause 19 sets out the procedures for major secured creditors of the company to decide whether or not the provisional supervisor may proceed to prepare the proposal. If the major secured refuses, the moratorium ceases and the provisional supervisor vacates his office. If the major secured creditor agrees to the drawing up of a proposal but the proposal is eventually rejected by the creditors, the company may either be wound up as a creditors' voluntary winding up, or if it was previously under court winding-up procedures, the stayed procedures would be re-activated.

31. The requirements and procedures for the creditors' meetings to consider the proposal by the provisional supervisor are in clauses 21 to 24. Clause 23 provides that a proposal approved by a meeting of creditors may not affect the right of a secured creditor of the company except with his consent. Where a proposal is approved by the creditors, a voluntary arrangement will follow and the procedures for such an arrangement are in

clauses 25 to 29. Clause 34 and Schedule 8 make consequential amendments, in particular to the Companies Ordinance.

32. Clause 8 of Schedule 8 adds new sections 295A to 295G to the Ordinance to implement the proposals on insolvent trading. Section 295B empowers the liquidator of a company to make an application to the court to seek declaration that a "responsible person", i.e. a director or a member of senior management, is liable for insolvent trading. The grounds on which the court may declare a responsible person liable for insolvent trading are set out in new section 295C. New section 295E provides that where the court makes a declaration of insolvent trading in respect of a responsible person or former responsible person, it may order that person to pay compensation to the company.

PUBLIC CONSULTATION

33. The LRC Sub-Committee on Insolvency carried out a public consultation on the concept of corporate rescue in 1995. A consultation exercise on certain proposals of the LRC (in relation to the treatment of outstanding wages and other entitlements owed to employees) was conducted by Financial Services Bureau in 1998 with 26 major business/professional and employer/employee bodies. The consultation exercise and the results were reported on two occasions to the Legislative Council Panel on Financial Affairs in February and June 1999 respectively.

34. The Standing Committee on Company Law Reform (SCCLR) expressed support for the introduction of a statutory corporate rescue at one of its meetings in 1996. Subsequently, at the meeting on 14 December 1999, the SCCLR examined the draft provisions on corporate rescue and insolvent trading. Concern was expressed over a possible conflict of interest that might arise if a provisional supervisor is allowed to become the liquidator of the company should creditors resolve to wind up that company. However, we believe it makes commercial sense to leave the choice of liquidator to the creditors themselves if they consider that the provisional supervisor is the most appropriate person to become the liquidator of the company in the circumstances. A provisional supervisor turned liquidator would save time and money as he would by then have grasped a fair amount of knowledge of the affairs of the company to quickly proceed with the winding up.

35. We consulted the LAB and the PWIF Board in late 2000 on the

Bills Committee's suggestion that flexibility should be added to the trust account arrangement. The outcome of such consultation was reported to the Legislative Council Panel on Financial Affairs in February 2001.

BASIC LAW IMPLICATIONS

36. The Department of Justice advises that the Bill is consistent with those provisions of the Basic Law carrying no human rights implications.

HUMAN RIGHTS IMPLICATIONS

37. The Department of Justice advises that the Bill is consistent with the human rights provisions of the Basic Law.

BINDING EFFECT OF THE LEGISLATION

38. The Hong Kong Special Administrative Region Government will be bound by the moratorium when it is acting in its capacity as creditor of the company.

FINANCIAL AND STAFFING IMPLICATIONS

39. With the introduction of the new statutory corporate rescue procedure, the Official Receiver's Office will need to maintain a panel of provisional supervisors which may generate additional workload to the department. Any additional resources required will be absorbed by the OR through internal re-deployment and from within the global allocation of the Secretary for Financial Services. Other proposals in the Bill have no financial or staffing implications for Government.

ECONOMIC IMPLICATIONS

40. The corporate rescue procedure would help financially ailing but potentially viable business to survive as a going concern, in whole or in part. It would be beneficial to the company's shareholders and creditors who might in due course get a better return from the success of the rescue than from the outcome of a winding up. It would also be beneficial to the

company's employees as well as suppliers and contractors for that portion of employment and purchases that might be retained by the rescue. The procedure should be particularly helpful in reducing the stress to the economy when a greater number of companies with viable business for the longer term face more immediate, but probably relatively short term, financial difficulties in a cyclical economic downturn.

LEGISLATIVE TIMETABLE

41. The legislative timetable is as follows –

Publication in the Gazette	18 May 2001
First Reading and commencement of Second Reading debate	23 May 2001
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

PUBLICITY

42. A press release will be issued on 17 May 2001 and a spokesman will be available to handle media enquiries.

ENQUIRIES

43. For enquiries, please call Mr L W TING, Assistant Secretary for Financial Services (Companies) at 2527 5543.

Financial Services Bureau
Ref: C2/1/12/1C(2001)IX

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Implications of Proposals in respect of the Trust Account Arrangement under the Companies (Corporate Rescue) Bill

Employment Ordinance
(A) Resignation of employees

Under the Employment Ordinance, an employee who resigns from employment is entitled to –

(a) outstanding wages;

(b) payment in lieu of any untaken annual leave and pro rata annual leave pay for the current leave year (if he has no less than three months' continuous service in the current leave year);

(c) any outstanding sum of end of year payment (if his employment contract provides for end of year payment and he has served a complete payment period); and

(d) long service payment (if he has been employed under a continuous contract for not less than five years and resigns on ground of ill health or old age after reaching the age of 65).

2. However, he is not entitled to other termination payments under the Employment Ordinance such as wages in lieu of notice, pro rata end of year payment for the current incomplete payment period, severance payment and remedies for employment protection.

3. An employer shall effect all the payments mentioned in paragraph 1 above to an employee as soon as practicable and in any case not later than seven days after the date of termination of contract. If an employer fails to pay wages to the employees within the seven days, he is required to pay interest on the outstanding amount of wages to the employees.

4. The implications of the proposals in respect of the trust account arrangement under the Companies (Corporate Rescue) Bill for the statutory entitlements and rights of the employees described in paragraph 1 above under the Employment Ordinance are as follows –

(i) If the employees resign before the commencement of the corporate rescue process

5. The employees may get from the trust account an amount not more than the cap of $36,000 in respect of any outstanding wages for services rendered not more than four months prior to last day of service. This treatment is generally no worse than what they would have been treated had the company been wound up at that point in time.

6. However, they cannot take or continue any legal action to recover any amount not covered by the cap and owed by the company e.g. long service payment while the company is subject to a moratorium under the corporate rescue process. They will be regarded as creditors in respect of such amount, and will be entitled to participate in and vote at the relevant meetings of creditors. If the corporate rescue is successful, the amount will be paid in full and within 12 months of the approval of a voluntary arrangement proposal for the company. If the corporate rescue fails and the company is wound up, the employees will not be entitled to any payment from the PWIF. They will be entitled to preferential payments under section 265 of the Companies Ordinance in respect of any item not covered by the cap if they meet the requirements (as in the case of winding-up). They may still be able to claim the company in the capacity as ordinary creditors in respect of any amount still owed by the company that is more than the total amount of payments under the trust account and preferential payments under the Companies Ordinance.

7. While payments from the trust account may not be made within the timeframes specified in the Employment Ordinance (e.g. for severance payment, not later than two months upon the receipt of a notice of claim from an employee; for wages and other termination benefits, not later than seven days after the date of termination), the difference in the time when the payments are made when compared with what would have been should a company be wound up should, in most cases, not be more than 18 months[1].

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[1] In general, a moratorium shall cease upon the expiration of 30 days since the commencement of the corporate rescue procedure. Where the provisional supervisor of the company is unable to complete the voluntary arrangement proposal within the 30 days, he may apply to the court for an extension and the court may grant an extension of not more than 6 months from the commencement of the corporate rescue procedure if it is satisfied that certain conditions are met. Furthermore, the proposal is required to contain a term to the effect that any amount not covered by the cap and owed by the company should be paid in full and within 12 months of the approval of the proposal. Therefore, the difference in time when the payments are made when compared with what would have been should a company be wound up should, in most cases, not be more than 18 months.

8. There could be concern that the amount of assets available for distribution to employees when the corporate rescue fails and the company is wound up would be less than what it would have been should the company be wound up in the first place. It is, however, useful to note that the Companies (Corporate Rescue) Bill provides that the provisional supervisor has a duty to do all things necessary to protect the property of the company and to manage the business, property and affairs of the company for the primary purpose of preserving the property of the company for its creditors. Any employee (if he is also a creditor) aggrieved by the act of a provisional supervisor may apply to the court with a view to redressing the situation.

9. It should also be noted that the amount of assets available for distribution to former employees could be reduced in some cases because continuing employees' wages and any other entitlements (accrued since the commencement of the corporate rescue procedure) are paid in priority to other debts (excluding fees, costs and charges incurred by the provisional liquidator or liquidator whose appointment is terminated by the initiation of the corporate rescue procedure).

(ii) If the employees resign in the course of the corporate rescue process

10. The implications discussed under (i) above will apply in respect of wages accrued prior to the commencement of the corporate rescue process. If the company fails to pay the employees wages or any other entitlements accrued since the commencement of the corporate rescue process, -

(a) the provisional supervisor will be personally liable for wages and any other entitlements of the employees if the provisional supervisor accepts in writing the employees' contracts (existing immediately before the commencement of the corporate rescue procedure) within 14 days[2] immediately following the commencement of the corporate rescue procedure or enters into the contracts since the commencement of the corporate rescue procedure;

(b) the employees may petition to wind up the company (because the moratorium does not apply to any debt or other liability of the company incurred since the commencement of the

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[2] If a continuing employee's contract is not accepted in writing by the provisional supervisor within the 14 days, the contract will be deemed to be terminated upon expiration of that period.

corporate rescue procedure);

(c) the employees may apply to the PWIF for ex-gratia payment in respect of wages that are accrued outstanding since the commencement of the corporate rescue process; and

(d) the employees' wages and any other entitlements (accrued since the commencement of the corporate rescue procedure) are treated as qualifying liabilities and paid out of the property of the company (except any such property subject to a fixed charge) in priority to other debts (but excluding fees, costs and charges incurred by the provisional liquidator or liquidator whose appointment is terminated by the initiation of the corporate rescue procedure).

(B) Termination of employment by employees under section 10A of the Employment Ordinance

11. At present, under section 10A of the Employment Ordinance, where any wages are not paid to an employee within one month after they become due, the employee may terminate the contract. In such case, the contract will be deemed to be terminated by the employer without notice and the employee will be entitled to the following termination payments -

(a) outstanding wages;

(b) wages in lieu of notice;

(c) payment in lieu of untaken annual leave and pro rata annual leave pay for the current leave year;

(d) any outstanding sum of end of year payment and pro rata end of year payment for the current payment period; and

(e) severance payment, where an employee has been employed under a continuous contract for not less than 24 months and is dismissed by reason of redundancy; or long service payment, where an employee has been employed under a continuous contract for not less than five years and is dismissed (except for summary dismissal due to the employee's serious misconduct or dismissal by reason of redundancy).

12. An employer is required by law to make the above payments, except for severance payment, to the employee as soon as practicable and in

any case not later than seven days after the date of termination of contract. For severance payment, an employer shall make payment not later than two months from the receipt of a notice of claim from an employee, unless the severance payment has been made the subject of a claim filed with the Registrar of the Minor Employment Claims Adjudication Board or the Registrar of the Labour Tribunal. If an employer fails to pay wages to the employee within the seven days, he is required to pay interest on the outstanding amount of wages to the employees.

13. The implications of the proposals for the statutory entitlements and rights of employees described in paragraph 11 above under the Employment Ordinance are as follows -

(i) If the termination of employment takes place before the commencement of the corporate rescue process

14. Where the employees are owed outstanding amounts, they may get from the trust account -

(a) an amount not more than the cap of $36,000 in respect of any outstanding wages for services rendered not more than four months prior to last day of service ;

(b) an amount not more than the cap of $22,500 or one month's wages, whichever is the lesser, in respect of any outstanding wages in lieu of notice; and

(c) an amount not more than the cap of $50,000 plus 50% of entitlement in excess of $50,000 for the severance payment in respect of any outstanding severance payment.

15. This treatment is generally no worse than what they would have been treated had the company been wound up at that point in time. The analysis as set out in paragraphs 6 to 9 above applies here.

(ii) If the termination of employment takes place after the commencement of the corporate rescue process

16. The implications as discussed in (i) above will apply in respect of wages accrued prior to the commencement of the corporate rescue process. If the company fails to pay the employees outstanding wages or any other entitlements including severance payments or wages in lieu of notice accrued since the commencement of the corporate rescue process, the analysis as set out in paragraph 10 above applies here.

(C) Dismissal by Employers

17. At present, under the Employment Ordinance, if an employee is dismissed by the employer (except in case of summary dismissal due to the employee's serious misconduct), he will be entitled to the same termination payments and receive such payments within the same statutory time limit as set out in paragraphs 11 and 12 above. The implications of the proposals for the statutory entitlements and rights of these employees are the same as those set out in paragraphs 14 to 16 above.

(D) Reduction in Salary

18. At present, under the Employment Ordinance, an employee's statutory entitlements to holiday pay, annual leave pay, maternity leave pay, sickness allowance, and wages in lieu of notice are calculated on the basis of the latest wages of the employee. An employee's entitlement to severance payment or long service payment upon termination of employment is also based on his last month's wages or, at the election of the employee, his average wages over the last 12 months. Hence, if an employee accepts a wage reduction at the request of the employer, his statutory entitlements under the Employment Ordinance will also be reduced. The implications of the proposals for the statutory entitlements and rights of these employees under the Employment Ordinance are the same as those set out in paragraphs 5 to 10 and 14 to 16 above, depending on the circumstances of the employees concerned, except that their statutory entitlements are reduced as a result of the wage reduction.

Protection of Wages on Insolvency Ordinance

19. Under the PWIO, the PWIF would provide prompt relief in the form of ex-gratia payment to employees who are owed wages, wages in lieu of notice and severance payment by insolvent companies, subject to the statutory payment ceilings and time limits. If an employee accepts a wage reduction at the request of the employer, ex-gratia payment on outstanding wages and wages in lieu of notice payable under the PWIO would also be calculated on the basis of the reduced wage rate. If the employer has undertaken before the wage reduction to calculate any severance payment due on the basis of an employee's wage level before the reduction or a wage level in between the employee's reduced wages and his pre-reduction wages, the amount of ex-gratia severance payment would also be calculated on this basis, provided that the wage reduction takes place within 12 months immediately before the date of termination of employment. It should also be noted that the presentation of a bankruptcy or winding-up petition against the employer is a pre-condition for an employee to receive an ex-gratia

payment from the PWIF[3].

20. The implications of the proposals for employees' statutory entitlements and rights under the PWIO and hence the PWIF are two-pronged if the corporate rescue fails and the company is wound up. On the one hand, the former employees of the company will not be entitled to any ex-gratia payment from the PWIF as their wages, wages in lieu of notice and severance payments have been paid from the trust account up to the respective caps and this should relieve the financial burden on the PWIF. On the other hand, the continuing employees of the company may apply to the PWIF for ex-gratia payment in respect of wages (only those accrued outstanding since the commencement of the corporate rescue procedure), wages in lieu of notice and severance payment and these liabilities could be more than what they would have been had the company be wound up in the first place because of their longer service period.

21. It should, however, be noted that such ex-gratia payment will be treated as a qualifying liability owed to the PWIF by virtue of subrogation of employees' rights, which, together with other qualifying liabilities, would be charged on and paid out of the property of the company (except any such property subject to a fixed charge) in priority to other debts e.g. preferential payments (but excluding fees, costs and charges incurred by the provisional liquidator or liquidator whose appointment is terminated by the initiation of the corporate rescue procedure).

Employees' Compensation Ordinance

22. The entitlements and rights of an injured employee under the Employees' Compensation Ordinance will not be affected by his employment status with the employer after the work-related injury is sustained. The employer concerned is still liable to make payment of compensation, such as periodical payments for sick leave arising from the work injury and compensation for permanent incapacity, if any, even if the employment of the employee has been terminated for whatever reason. The Employees' Compensation Ordinance requires employers to have a valid insurance policy to cover their liabilities for work-related injuries in

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[3] Under section 18 of the PWIO, Commissioner for Labour may waive the requirement for a petition if the employment size of the insolvent employer is less than 20, sufficient evidence exists to support the presentation of a winding-up/bankruptcy petition, and it is unreasonable or uneconomic to present the petition. However, companies which undergo the corporate rescue procedures should normally be established concerns with 20 employees or more. Hence, it is quite unlikely that the petition requirement could be waived for such cases.

respect of their employees. Hence, there does not appear to be a need to set aside funds in the trust account to cover such liabilities. In the interest of protecting the entitlements and rights of an injured employee, we consider that a company wishing to undergo corporate rescue procedure should be required to confirm before the commencement of the corporate rescue procedure that it has in place a valid insurance policy to cover its employee compensation liabilities, including liabilities in respect of any work accidents happened before the commencement of the corporate rescue procedure.

Appendix B

List of Respondents

1.	Protection of Wages on Insolvency Fund Board
2.	The Hong Kong Federation of Insurers
3.	Securities and Futures Commission
4.	Labour Advisory Board
5.	Employers' Federation of Hong Kong
6.	The Chinese Manufacturers' Association of Hong Kong
7.	The Chinese Gold & Silver Exchange Society
8.	The DTC Association
9.	Two Associate Professors from the Faculty of Law of the University of Hong Kong
10.	The Hong Kong Association of Banks
11.	The Hong Institute of Company Secretaries
12.	Lingnan University
13.	Ernest & Young
14.	The Hong Kong Exporters' Association
15.	Hong Kong Bar Association
16.	The Chinese General Chamber of Commerce
17.	CCIF Corporate Advisory Services Ltd
18.	Hong Kong Society of Accountants