

ITEM FOR FINANCE COMMITTEE

WRITE-OFF OF A DEBT OWED TO THE GOVERNMENT BY A CONTRACT AUCTIONEER

Members are invited to approve the write-off of an irrecoverable debt of \$17,025,082.44 owed to the Government by an auctioneer hired by the former Government Supplies Department (now the Government Logistics Department) for disposal of unserviceable or obsolete government stores and confiscated goods.

PROBLEM

A debt owed to the Government by a contract auctioneer has proven to be irrecoverable after all possible legal means to recover the debt have been exhausted.

PROPOSAL

2. In accordance with section 38 of the Public Finance Ordinance (Cap. 2) (PFO), the Director of Government Logistics, with the support of the Secretary for Financial Services and the Treasury, seeks the approval of the Finance Committee (FC) to write off the irrecoverable debt of \$17,025,082.44, inclusive of costs of action and interest, owed to the Government by the Hong Kong Auctioneers & Estate Agency Ltd. (HKAEAL) hired by the former Government Supplies Department (GSD) (now the Government Logistics Department (GLD)) for disposal of unserviceable or obsolete government stores and confiscated goods.

/JUSTIFICATION

JUSTIFICATION

The Debt Case

3. Since the 1970s until 31 August 1998, HKAEAL had been awarded with contracts through competitive bidding every two years to conduct auctions for the sale of unserviceable or obsolete government stores and confiscated goods and to collect the proceeds for the Government. The present debt case occurred in HKAEAL's last contract with the Government for the period from 1 April 1996 to 31 August 1998 (the 1996 Contract)¹. Under the 1996 Contract, the auctioneer was required to reimburse the Government the auction proceeds within 14 days of the auction date, and a late payment charge would be imposed on any overdue auction proceeds².

4. Except for some delays in payments of the auction proceeds to Government, HKAEAL's performance had been satisfactory under the contracts predating the 1996 Contract. Of the 58 auctions conducted during the contract period of the 1996 Contract, HKAEAL had only reimbursed the Government the proceeds from the first 43 auctions. The amount in default, inclusive of net sale proceeds and interest for late payments, was about \$15.8 million at the time. This problem, however, was not brought to the attention of GSD's senior management until after the 1996 Contract had expired.

5. In conjunction with the Department of Justice (D of J), GSD took immediate action to recover the debt. Eventually, after much negotiation and considerable efforts, a Deed of Settlement was concluded with HKAEAL's Managing Director in March 1999 with a schedule of payment for full settlement of the outstanding amount. Unfortunately, GSD only received several payments totalling \$6 million towards the debt, after which no further payments were received. GSD, through D of J, instituted legal proceedings against HKAEAL and the Managing Director for recovery of the remaining amount. In November 1999, the Court ordered that judgment be entered for the Government against HKAEAL and its Managing Director and that HKAEAL and the Managing Director should pay the Government the sum of \$10,742,838.17 plus interest from the date of judgment. The Court also awarded costs to the Government.

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¹ The 1996 Contract, originally expired on 31 March 1998, was subsequently extended for five months to end on 31 August 1998.

² The late payment charge was equal to an interest charge of 1% above the prime rate on outstanding auction proceeds which had not been paid to the Government within the 14-day deadline.

6. HKAEAL and the Managing Director failed to settle the judgment debt ordered by the Court. In June 2000, the Court made a winding-up order against HKAEAL. The Official Receiver (OR) was appointed liquidator. D of J filed in July 2000 a Proof of Debt with OR. As the Managing Director had left Hong Kong in February 2000, D of J, representing GSD, was unable to petition for bankruptcy against him at the time³. Upon the Managing Director's return to Hong Kong in April 2007, D of J took immediate legal action to recover the debt, including applying for examination of the Managing Director as to his assets and petitioning for bankruptcy against the Managing Director. At the hearing on the bankruptcy petition held on 5 September 2007, the Court granted a Bankruptcy Order with costs against the Managing Director. Subsequently, D of J filed Proofs of Debt with OR for the judgment debt plus costs of action and interest calculated up to 5 September 2007, and the said sums together with the costs of the bankruptcy proceedings amounted to \$17,025,082.44.

Remedial Actions Taken

7. To forestall recurrence of such incidents, GSD took various improvement measures to guard against late payments. Under the contract commencing from September 1998 with the new contractor, the auctioneer was required to advise the department of the gross auction proceeds within one working day after the auction day, based on which demand notes would immediately be issued to the auctioneer for the gross proceeds. Demand notes outstanding by the due dates, if any, would be reported to the senior management without delay and warning letters be issued to the auctioneer in the event of late payments which could lead to termination of contract. For the two-year contract commencing September 2000, tighter controls over the receipt of auction proceeds were introduced. The auctioneer was required to pay on the auction day half of gross auction proceeds into a designated bank account in trust of the Government solely for handling auction proceeds, while the balance after deducting the commission and advertising expenses should be deposited to the Government's account on the following day. There was no late payment by the auctioneer since September 1998.

8. To further strengthen controls, GSD (now GLD) has revamped the contract service mode since November 2002. The auctioneer is hired to provide the professional service of conducting the auction only, while GLD collects auction proceeds direct from successful bidders. Successful bidders are required to pay the

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³ D of J issued a statutory demand pursuant to section 6A(1)(a) of the Bankruptcy Ordinance (Cap. 6) against the Managing Director in March 2000. However, D of J was unable to serve the documents on the Managing Director personally. Investigations revealed that he had left Hong Kong since 4 February 2000. D of J was therefore unable to petition bankruptcy against the Managing Director at the time.

proceeds directly to the Government on the auction day. A release note for collecting the goods will only be issued to the successful bidders upon confirmation of receipt of the proceeds or upon clearance of the cheque. The arrangements have worked satisfactorily.

Investigations and Disciplinary Actions Taken

9. In parallel with the actions taken to recover the debt, GSD had conducted internal investigation into the case. The Independent Commission Against Corruption was also invited to look into the possibility of corruption. These investigations which were completed in June 2001 indicated that the case did not involve fraud or corruption but there were inadequacies in the performance of some staff in performing their duties.

10. Formal disciplinary proceedings were instituted against a Senior Accounting Officer. As the head of the Accounts Section, he was held primarily responsible for failure in monitoring the receipt of auction proceeds from HKAEAL and apprising the senior management of the late payment situation in accordance with prevailing government regulations. He was punished with a severe reprimand, together with a fine equivalent to reduction in salary by two increments for 12 months and a caution of removal from the service in the event of further misconduct. In addition, several other officers, namely one Accounting Officer I, one Principal Supplies Officer, two Chief Supplies Officers and one Senior Supplies Officer, were found to have failed to take proper action in enforcing due payment or in recovering outstanding payment from HKAEAL. They were given either verbal or written warnings having regard to the division of responsibilities and the degree of their involvement in the matter.

11. In the light of the advice of the Panel on Financial Affairs (the FA Panel) at its meeting in June 2005, GLD referred the case to the Police to establish whether other criminal offences might have been committed by HKAEAL or its Managing Director. The Police informed GLD in April 2007 that there was insufficient evidence to support a charge against any person. The Police re-examined the case after the Managing Director returned to Hong Kong. In July 2007 the Police confirmed that there was insufficient evidence to charge any person after serious consideration of the evidence obtained and that there would be no prosecution.

/Debt

Debt Recovery Actions Taken and Latest Position

12. When ordering a judgment be entered against HKAEAL and the Managing Director for the debt in November 1999 (please see paragraph 5 above), the Court also granted an order of inquiry to trace the auction proceeds. Based on the affirmation filed by the Managing Director with the Court in January 2000, there was no evidence showing that the auction proceeds were used to purchase any assets and no assets could be identified for the purpose of tracing.

13. Notwithstanding that D of J was unable to petition for bankruptcy against the Managing Director in early 2000 (please see paragraph 6 above), searches had been conducted on assets (e.g. landed properties) of the Managing Director and investigation agents engaged to conduct searches in 2000, 2001 and 2002 on the whereabouts of the Managing Director, and his assets in Hong Kong and the countries where he had previous connections. However, all these debt recovery attempts were futile.

14. With regard to the liquidation of HKAEAL, the company was wound up in June 2000. While OR has not yet applied to the Court for an order releasing him as the liquidator⁴, OR confirmed in October 2002 that there was zero balance in the estate of HKAEAL and that it was unlikely that there would be a dividend payment.

15. With regard to the Bankruptcy Order granted against the Managing Director in September 2007, OR confirmed in September 2011 that the Managing Director was discharged from bankruptcy in September 2011 and that there is no likelihood of dividend distribution to creditors, including the Government. According to the Bankruptcy Ordinance (Cap. 6) (BO), the discharge of a person from a Bankruptcy Order releases him from all bankruptcy debts. Thus the Managing Director is now released from all bankruptcy debts, including the judgment debt in question. The Administration cannot take any action to recover any proved debt after the said discharge. The Annual Statements of Earnings and Property Acquired of the Managing Director prepared in accordance with the BO during the four-year bankruptcy period did not show any income or property of the Managing Director that could satisfy the judgment debt or any part thereof.

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⁴ OR has not yet applied to the Court for release under section 205 of the Companies Ordinance (Cap. 32) because the liquidation process has not been completed. OR is still in the course of handling the consignment goods held by HKAEAL on behalf of their beneficial owners the identity of whom could not be found so far. OR may need to seek direction from the Court in handling such consignment goods. Until all the consignment goods are either returned to the respective owners or disposed of, the liquidation process cannot be finalised. Even if the consignment goods are sold, the sale proceeds will not form part of the assets of HKAEAL.

16. In light of the debt recovery actions taken and the latest developments, after consulting D of J, we consider that all possible legal means to recover the debt have been exhausted in this case. The tracing of the auction proceeds, the investigation of the Managing Director's local and overseas assets, as well as the separate processes of the liquidation of HKAEAL and the bankruptcy of the Managing Director in paragraphs 12-15 above have not led to any dividends that can be distributed to the Government. It is ascertained that the debt owed by HKAEAL and the Managing Director is irrecoverable and consideration could be given to writing off the debt.

Authority for Write-off

17. For cases not involving fraud or negligence, the Financial Secretary (FS) is empowered under section 38 of the PFO to write off losses of public moneys, stores, etc. without financial limit. For cases involving fraud or negligence, FS may only exercise his power of write-off subject to such conditions, exceptions and limitations FC may specify. If fraud or negligence is involved, the current limit of delegated authority is \$500,000 in each case, or in respect of any one cause. Since the current case involves negligence of some GSD staff as set out in paragraph 10 above and the amount exceeds the financial limit, FC's approval for writing off the debt is required.

FINANCIAL IMPLICATIONS

18. The total amount to be written off is \$17,025,082.44, broken down as follows :

(a) Judgment sum	\$10,742,838.17
(b) Costs of action and bankruptcy proceedings	\$244,315.55
(c) Interest calculated up to 5 September 2007	\$6,042,928.72
Less contract deposit retained	(\$5,000.00)
Total :	<u>\$17,025,082.44</u>

/PUBLIC

PUBLIC CONSULTATION

19. We briefed the FA Panel on the case on 6 June 2005 and 30 June 2008, and consulted the Panel on the current proposal on 7 November 2011.

20. At the meeting on 6 June 2005, the FA Panel raised questions on a number of areas, including whether other criminal elements were involved in the case, actions taken to recover the debt and forestall recurrence, and the responsibility of the senior management and officers involved in the case. We responded to the Panel in writing in July 2005 on the issues raised. The information in that written reply that is pertinent to the write-off application has been incorporated into this submission. At the Panel's suggestion, we reported the case to the Police after the Panel meeting. The investigation results are summarised in paragraph 11 above.

21. At the meeting on 30 June 2008, the Panel noted the latest position of the case and the Administration's intention to write off the debt after expiry of the Bankruptcy Order in September 2011 for prudence and in view of the amount of money involved. The Panel asked the Administration to keep track of the development and seek FC's agreement to write off the debt where appropriate.

22. At the Panel meeting on 7 November 2011, Members generally agreed that the debt could be written off and raised no objection to the Administration submitting the case to FC. Additional information requested by the Panel on areas such as the severity of the disciplinary actions against officers concerned and write-off applications processed by the Administration under delegated authority will be circulated to Members for reference.

BACKGROUND

23. GSD arranged sales of unserviceable or obsolete government stores and confiscated goods from bureaux/departments through auctions. Before November 2002, the service and the associated collection of proceeds were contracted out to auctioneering companies. Contracts were awarded to HKAEAL since 1970s until 1998 through competitive bidding. In the 1996 Contract, the company only reimbursed the Government part of the proceeds from the auctions.

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The amount in default, inclusive of net sale proceeds and interest for late payments, was about \$15.8 million at the time. The Government took legal action against HKAEAL and its Managing Director after their failure to repay the outstanding debt. However, all possible legal means to recover the debt have been in vain. Write-off of the outstanding amount is required.

Financial Services and the Treasury Bureau
November 2011