Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (bc_01_15@legco.gov.hk) and by hand

26 November 2015

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Hon. Wong Ting-kwong, SBS, JP
Chairman,
Bills Committee on Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015,
Legislative Council Complex,
1 Legislative Council Road,
Hong Kong

Dear Mr Wong,

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

Thank you for inviting the views of the Hong Kong Institute of Certified Public Accountants ("the Institute") on the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015. The Institute's Restructuring and Insolvency Faculty has considered the bill. We are in support of updating the corporate insolvency law in Hong Kong and there are a number of necessary and welcome changes included in the bill, such as the new provisions on transactions at an undervalue and unfair preferences. However, at the same time, we have concerns about certain provisions as drafted and our views on these set out below. Our comments focus on the primary legislation and, at this stage, do not touch on the proposed amendments to the Companies (Winding-up) Rules and other subsidiary legislation.

1. Clause 42

The proposed section 206(5) states that a committee of inspection ("COI") must consist of both creditors and contributories, albeit, under subsections (5)(a) and (b), this is qualified by the provision that this be in a proportion agreed on by the meetings of creditors and contributories and, in the event of a difference between the two, in a proportion determined by the court.

It is worth noting that in practice, contributories will not always have an interest to participate in a COI. In addition, in the case of smaller companies, the contributories are often also former directors who may be the target of liquidators' investigations or recovery actions. Having them in the COI would not be conducive to effective liquidation work. In practice, therefore, COIs often comprise creditors only.

For this reason, we query the requirement that COIs "must consist of both creditors and contributories". This could be interpreted to mean that the COI must contain at least one contributory, as it is debatable whether a proportion that includes no contributories would be in compliance with this section. Therefore, we suggest that

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any ambiguity be removed and that the word "must" be replaced with "may". Other consequential changes may also be needed.

2. Clause 59

The proposed section 228A(1A) appears to be an amendment to improve the current section 228A(1). However, in separating the actions taken before the commencement of winding up and the action of delivering the statement into subsections (1) and (1A) respectively, we question why the word "may" is retained in relation to delivering the winding-up statement to the Registrar in subsection (1A). This existing subsection (3) makes it clear that a winding-up statement will have no effect under the ordinance, unless it is delivered to the registrar for registration within 7 days of the date on which it is made, i.e., the winding-up cannot commence without delivery of the statement. To avoid any doubt that this is an essential step in the commencement of the winding-up process, therefore, it may be preferable to replace the phrase, "may deliver ", with "shall deliver". We also propose that the statement should be delivered within a shorter period, such as two business days.

3. Clause 73

The Institute notes that the proposed amendments to section 241 introduces a time gap of up to 14 days between the members' meeting and the first creditors' meeting to ensure that creditors have sufficient notice to prepare for the first creditors' meeting, without delaying the members' meeting for passing the resolution for winding up the company. However, we previously expressed reservations on this point when in responding the administration's 2013 consultation paper on legislative proposals for improvement of corporate insolvency ("2013 consultation") and we wish to reiterate our concerns.

We do not agree with the proposed subsection (1)(a) because the time gap potentially introduces uncertainties and opens the process to abuse, which could affect the liquidation process. For example:

(a) <u>Uncertainty around the powers and duties of liquidators</u>

The potential time gap creates a period of uncertainty where the liquidator's position is unclear. Although the company may have nominated the liquidator, the creditors will not necessarily confirm the appointment at the first creditors' meeting. Yet, during this period, the liquidator may need to his exercise powers under section 243A, which could lead to disputes, for example, regarding what constitutes taking assets into custody and what constitutes their disposal.

Given the liquidator's limited powers, during this period, it is also not clear how he would be able to engage solicitors to make any applications to the court, and who would fund the engagement. This lack of certainty is of particular concern in light of the penalties proposed in sections 243A (6) and (7).

(b) Potential abuses by directors which may disadvantage creditors.

More clarity is also required in relation to sections 250A(3)(b) and (4), as the phrase "anything that may be necessary to protect the company's assets" and "without reasonable excuse" would appear to be open to interpretation. We suggest that it may be necessary to clarify that, where directors are in any doubt as to whether their proposed actions are necessary to protect the company's assets, they should be required to apply for a court sanction, as under sections 250A(1) and (2).

While we understand the proposed amendment would not prevent the creditors' meeting from being held on the same day as, or the day following, the members' meeting, in the absence of a licensing regime or particular requirements for qualifications for liquidators, in most winding up situations, the proposed time lag of up to14 days leaves possible scope for abuse.

We are of the view that a key issue surrounding creditors' meetings in the existing ordinance is the lack of a minimum notice period for convening the meeting of creditors. However, it would appear that this has been addressed in the bill by having a minimum notice period of seven days under the proposed subsection (1)(b). This would give creditors sufficient time to prepare for a meeting, which could still be held on the same day as members' meeting or the next day. Therefore, in our view, it is unnecessary to allow for the possibility of up 14 days between the members' meeting and the first meeting of creditors.

4. Clause 76

The Institute suggests that, under the proposed section 244A(6), the power to apply to the court to object to the removal of the liquidator should be extended to the liquidator or former liquidators. In practice, there could be circumstances where a liquidator is seeking to conduct investigation work that could contribute significantly to the success of the winding up, while at the same time his removal is being sought by the same parties whose conduct is being investigated. In discussions with the administration on this point, the administration indicated that it would open to other creditors or contributories to object to the removal of the liquidator. However, this may not be appropriate in the case of a creditors' voluntary liquidation, the nature of which is different from a members' voluntary liquidation. It would be invidious to expect the liquidator to have to rely on a creditor, who has already lost money, to fund an action to prevent his removal in the circumstances set out above.

5. Clause 85

While we agree, in principle, with enhancing transparency in relation to the appointment of liquidators and provisional liquidators in the absence of a more all-embracing qualification regime, we have some concerns about the provisions on the eligibility for appointment and the disclosure regime. In particular, we are unclear as to how the hierarchy of disqualified persons, persons who are disqualified from appointment, except with leave of the court, and persons who may be appointed but who have disclosable relationships, will work in practice. For example, the proposed section 262C requires extensive disclosures which could become very burdensome,

particularly in the case of international professional firms with hundreds of partners, who in principle, would need to make enquires about the connections of family members of all their partners, potentially worldwide. We raised concerns about similar proposal in response to the 2013 consultation and our previous comments are reproduced at Appendix 1.

It is also not clear what the possible consequences may follow after an already-appointed liquidator or provisional liquidator submits a supplementary statement to update his previous disclosure statement, under the proposed section 262F.

We would welcome further discussions on these proposals to find a practicable way forward. If a disclosure-based regime is to be effective, a balance needs to be found between ensuring that relevant information is put before creditors and contributories at the time appointments are being considered and the time, effort and cost required to ascertain and, possibly, verify that information. It will be important to resolve this issue given that criminal sanctions are proposed for omitting a disclosable relationship under the proposed section 262D(4)

6. **Clause 95**

The proposed section 276 extends the personal liabilities of liquidators in court-ordered windings up, under certain circumstances, to beyond the time of the release of the liquidator, subject to the leave of the court. We are concerned that this may, in effect, undermine the purpose of the existing provision on release of liquidator, under section 205 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance, especially in the light of the proviso already contained in subsection (3), that an order for release "may be revoked on proof that it was obtained by fraud or by suppression or concealment of any material fact.

The proposal as it stands is far from being a straightforward matter of providing better protection for other stakeholders. It will have significant implications for insolvency practitioners, as the possibility for an indefinite period of a liquidator's release being revoked on the basis that, e.g., a creditor considers years after the winding up case has been completed, that he may have an actionable case against the former liquidator, may discourage some competent professionals from taking up appointments, and certainly in highly contentious cases where, ideally, very experienced professionals should be appointed. The Institute expressed concerns about this proposal in the 2013 consultation and our detailed comments are reproduced at Appendix 2.

7. **Other matters**

(a) <u>Corporate rescue/ insolvent trading</u>

We should like to confirm our long-standing support for the introduction of a statutory corporate rescue procedure and insolvent trading provisions. We believe that this is a significant gap in the corporate insolvency law of Hong Kong and should be a priority. We welcome the recent announcement that the administration targets to introduce the relevant amendment bill into the Legislative Council in 2017-18 and we hope that this will remain on course.

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(b) UNICTRAL model law

Another major gap in Hong Kong corporate insolvency law of is the lack of a framework for cross-border cooperation on insolvency matters. This is becoming increasing clear in the light of the multi-jurisdictional nature of many larger insolvency cases. The Hong Kong court has already made known its concern about this.

In our view, implementation of the United Nations Commission on International Trade Law (UNCITRAL) Model Law as part of the Companies (Winding Up and Miscellaneous Provisions) Ordinance would facilitate insolvency and restructuring procedures relating to Hong Kong companies with assets overseas and overseas companies with assets in Hong Kong. Legislation based on the model law has been adopted in a number of jurisdictions, including the United Kingdom ("UK"), Australia, New Zealand, the United States, Canada, Japan and South Africa.

There are, for example, express provisions in the Mainland's Enterprise Bankruptcy Law to deal with cross-border aspects of insolvency cases. Another example is section 426 of the UK's Insolvency Act, which gives recognition to cooperation between courts in other countries or territories exercising jurisdiction in relation to insolvency. Given that the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap. 597) specifically excludes bankruptcy/ insolvency-related judgments, it is recommended that the law relating to the cross-border aspects, both inbound and outbound, of insolvency cases, should be clarified and codified.

Should you have any questions on our submission, I can be contacted at the Institute on 2287 7084 or by email at peter@hkicpa.org.hk .

Yours sincerely,

Peter Tisman
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PMT/EC/sc

Appendix 1

Extract of Institute's Response to "Consultation on Legislative Proposals for Improvement of Corporate Insolvency Law" (July 2013)

Eligibility for appointment as liquidator or provisional liquidator

Re. proposals on disqualification

We agree, in principle, with expanding the provisions on disqualification of persons for appointment as a provisional liquidator ("PL") or liquidator ("L"). However, we have reservations on codifying the disqualified persons in primary legislation. We recommend that the list of disqualified persons be set out in a schedule or in a rule (i.e., subsidiary legislation) to facilitate future modifications.

Generally, we agree with disqualifying the types of persons proposed in paragraphs 3.13(a)-(d), 3.15 and 3.16.

Regarding paragraph 3.13(d), we consider that a person who is or has been an auditor of the company within two years before the commencement of winding-up of the company should be disqualified from appointment as a PL/ L in an insolvent winding-up.

Given that an auditor has a significant professional relationship with the company, conflicts of interest or the perception of conflicts will inevitably arise and, as such, it would not be appropriate to allow for such an appointment even with the leave of the court, as stipulated in paragraph 3.14. Under the Hong Kong Institute of CPAs' Code of Ethics for Professional Accountants, section 500, Professional Ethics in Liquidation and Insolvency, an insolvency practitioner ("IP") should not accept appointment in an insolvent liquidation where the IP's practice or an individual within it has performed audit work in relation to the company within the past two years. This has been the standard understood and adopted by members of the HKICPA for many years, and it would not be appropriate for the law to give a signal that there may be situations in which the auditor of a company could become the L of that company in an insolvent winding-up.

Similarly, in relation to paragraph 3.13(c), we cannot see situations in which it would be appropriate for a director of a company to be appointed liquidator in an insolvent winding up of the company.

We suggest, therefore, that further consideration be given to whether some of the persons proposed to be disqualified in paragraph 3.13(a) - (d) should be added to the categories of persons under the existing section 278 of the CO [now the Companies (Winding Up and Miscellaneous Provisions) Ordinance], who are excluded from taking appointments altogether, without provision to seek leave of the court to take up an appointment.

Regarding paragraph 3.13(e), we are of the view that a court-appointed receiver, who needs to act impartially and under the direction of the court, should not be considered to have a conflict of interest and should not be disqualified from appointment as a PL or L in a court winding-up and a creditors' voluntary winding-up.

Re. proposals on disclosure

While we agree, in principle, with enhancing transparency in the appointment of PLs and Ls, in the absence of a more all-encompassing regulatory system for IPs, we have some reservations about the introduction of a statutory disclosure system. We are also unclear about the practical implementation, monitoring and enforcement aspects of this as well as other proposals, which are not set out in the consultation document.

There is a danger that any list of disclosable relationships will be treated as exhaustive by some prospective PLs/ Ls and other potential conflict situations and relationships not on the list may then be viewed as acceptable. Whilst a "catch all" provision can, and may need to be included in the law, this will inevitably result in some uncertainty.

It is also not entirely clear how the statutory disclosure arrangement will operate together with the disqualification provisions, referred to in question 9(a), given that some of the relationships included on the list of disclosable relationships are those that would result in disqualification, as explained in paragraph 3.13 of the consultation document and others are not. Paragraph 3.22 seems to suggest that persons disqualified from seeking appointment would, nevertheless, be able to obtain approval for appointment from the creditors in a creditors' voluntary liquidation, whereas paragraph 3.14 suggests that leave of the court would be necessary.

Regarding whether or not to disclose certain information or relationships in the proposed statement of relevant relationships, including the reasons for believing that none of the facts or relationships stated therein would result in a conflict of interest situation, under the proposal, this would seem to be left largely to the judgment and integrity of the individual persons seeking appointment. In order to provide greater clarity and assist in compliance with the law, we suggest that there should be a standard format for disclosures. The government may consider consulting the relevant professional bodies regarding guidance as to the basic information that should be disclosed and the scope and depth of detail expected to be contained in such disclosures.

If it is considered necessary and appropriate for a statutory disclosure system to be introduced, we recommend that an extensive, but non-exhaustive, list of related parties and relationships be provided in the law in order to avoid uncertainties and legal challenges. There should also be a caveat that there will be other conflict situations and a prospective PL or L must consider whether, in the light of all the circumstances of the case, it is appropriate to disclose a relevant relationship not included on the list. Instead of primary legislation, we suggest that details of the disclosure be set out in subsidiary legislation to facilitate future changes.

In addition, the related parties would need to be clearly defined in the law. Questions that need to be clarified include:

(i) Would a director include a shadow director (paragraph 3.21(a)(iii))?
(ii) Who would be considered to be a "financial advisor" (paragraph 3.21(a)(viii))?
(iii) Is "immediate family member", as defined, the right test for disclosure of close personal relationships? Why, for example, is the Residential Properties (First-hand Sales) Ordinance, seen as a suitable source for this definition (see footnote 61 to paragraph 3.21(b))? We note that the definition of "associate" in relation to the proposed unfair preference provisions covers persons who would normally

be considered to be in a close personal relationship, which include, not only a spouse, but, e.g., a cohabitant, in line with the concept of "cohabitation relationship" in the new CO (see paragraph 5.20(a)). Without seeking to extend the disclosure regime to cover all associates, it would appear to be a discrepancy that these two sets of provisions adopt a different approach in respect of close personal relationships.

From a practical point of view, it will be important to know what would constitute making "reasonable enquiries" (paragraph 3.24). IPs indicate that there may be practical difficulties in identifying all relevant relationships and obtaining information, in particular, in the liquidation of a large multi-national or overseas group of companies. Given that the prospective PL or L needs to disclose information, not only in relation to himself but, if he is partner in a firm, also the other partners, and the firm itself (as indicated in footnote 57 to paragraph 3.21), there could be situations where, for example, a partner of the prospective PL's/L's firm, or the firm itself, is a creditor or debtor of a peripheral subsidiary company and this fact could be inadvertently overlooked.

It is noted that under the existing law, a prospective L is not required to attend the first creditors' meeting at which his appointment would be considered. As such, he may not be present in person to answer questions raised by creditors about the information disclosed to them. In order to deal with this loophole, we recommend that there should be a requirement for a prospective PL or L to attend the first creditors' meeting to answer questions about any disclosable relationships.

Appendix 2

Extract of Institute's Response to "Consultation on Legislative Proposals for Improvement of Corporate Insolvency Law" (July 2013)

Personal liabilities of liquidators in court-ordered windings up beyond the time of the release of the liquidator

We do not agree with this proposal, although, superficially, it may seem to benefit the interests of other stakeholders. This proposal, if implemented, would have significant implications on the liability of Ls, put Ls in a very difficult position once they have ceased practice and may serve to actively discourage professionals from taking up appointments and entering the profession.

Among the reasons for our objections are the following:

1. A court appointed L is an officer of the court and acts under its supervision.

2. An LR can obtain release only if there are no objections from the creditors, contributories, the Official Receiver, other persons interested against the release of the LR, or the court. If there are any doubts, the release can be withheld and under section 205(2), upon application of any interested person, "the court can make such order as it thinks just", charging the L with the consequences of any act or default which he may have done or made contrary to his duty. It needs to be emphasised that a liquidation case can sometimes continue for several years, providing ample opportunity for interested parties to consider whether there are grounds to object to the release and apply for action to be taken against the L.

3. Under section 205(3)(b), an order for release can be revoked at any time "on proof that it was obtained by fraud or by suppression or concealment of any material fact". Accordingly, if an L has acted dishonestly or engages in misfeasance and seeks to cover this up, under the existing law, the release can be revoked.

4. The position of an L is different from other professionals. An L has no contract with a particular client and acts in the interests of the body of creditors as a whole. There may be many different types of stakeholders involved in a liquidation and the nature of an LR's work is that he often needs to negotiate and reach compromises. He has to pursue actions against debtors and investigate the causes of the failure. Inevitably, not all stakeholders will be happy with the situation and some may look for someone to blame. This puts an LR in a vulnerable position.

5. The L's liability is personal. He cannot set up a limited liability vehicle through which he offers his services, as most other professional can. As noted in paragraph 3.41 of the Consultation Document on Improvement of Corporate Insolvency Law Legislative Proposals, under the law on limitation periods in Hong Kong, a claim may be made in negligence, for example, up to six years from the date on which the cause of action accrued, or three years from the date of knowledge, if that period expires later than the afore-mentioned six years.

6. When an insolvency practitioner retires and leaves a firm, he would not normally be covered by the professional indemnity insurance ("PII") policy of the firm. Also, when a L changes his employer firm, he would not continue to be covered by the PII policy of his previous employer firm on subsequent liability arising from cases closed during his employment with the firm. The PII policy of his new employer firm would not normally cover his liability arising from cases closed before he joined the firm. Even if an L's firm has "run-off" cover, it would normally be of limited duration and it is not clear that this would cover the L personally. It is also noted that bond cover ends after an L is released. This uncertainty in relation to subsequent liabilities and the lack of PII protection would expose Ls to a very high level of personal risk. As such, an L may either have to continue to purchase PII for an indefinite period (if that is possible, which is unlikely) or face the continuing threat of the risks associated with the many appointments that he may have taken up.

7. The supposed safeguard for Ls, that the power to make an application to have the LR's release revoked should be exercisable only with leave of the court, is no real safeguard, except against blatantly frivolous or vexatious actions. If there is any possibility of sustaining a case against an LR, a court would not have grounds to deny an application and the court would not be in a position to investigate the validity of details of the claim. In other words, this proposal could open up a whole new area of negligence claims by disgruntled stakeholders who feel hard done by in a liquidation, which an LR would not be able to predict and against which he would have little protection.

8. It would also mean than an L would not safely be able to dispose of the books and records of a company after release, but instead may feel compelled to retain indefinitely and store, at his own cost, the records from, potentially dozens, if not hundreds of cases, in order to be in a position to be able to defend himself against possible future claims.

9. This high and increasing level of personal risk faced by IPs will certainly give cause to some young professionals to re-consider whether insolvency practice is a worthwhile career. In the long run, this will be detrimental to the further development of the profession.

10. It should be clear from the above that, when this proposal is considered in its entirety, it is no small matter and we believe that is not sufficiently justified. As indicated above, there is already provision under section 205(2) for a release order to be revoked under certain conditions. There may be scope to look in more detail at the specific wording of that provision, to ensure that it is effective and can be invoked in a reasonably straightforward manner, in the event of dishonesty or serious misconduct. However, we strongly oppose the proposal as currently framed.

11. We would also add that we are not aware of any cases where interested parties have raised serious concerns that they have been prevented from taking action against miscreant LRs, because the LRs have obtained their release and issues came into light only after their release.