Bills Committee on
Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015

Response to Matters Raised by Members at the Meeting on 14 December 2015

This paper sets out the Government's response to the matters, as listed in the letter from the Clerk to the Bills Committee dated 15 December 2015, raised by Members in relation to the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 ("the Bill") at the meeting on 14 December 2015.

<u>Interface between the winding-up process and application for the Protection of Wages on Insolvency Fund</u>

2. In response to Members' concerns on the interface between the winding-up process and application for the Protection of Wages on Insolvency Fund ("PWIF"), the Financial Services and the Treasury Bureau ("FSTB") has followed up the issue with the Labour and Welfare Bureau ("LWB") and the Labour Department ("LD"). We would like to set out our response as follows.

3. As mentioned in the last Bills Committee meeting, no matter whether the employer could be contacted or not, the relevant employees may present a winding-up petition to the court. In case a company fails to pay its employees their outstanding wages and other entitlements, the employees may present a winding-up petition against the company by using a prescribed form as well as an affidavit according to the relevant provisions of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO"). As for the use of a winding-up petition to trigger the PWIF mechanism and other relevant procedures, please refer to the information provided by the LD and the Legal Aid Department ("LAD") in paragraphs 4 to 7 below.

4. The PWIF provides timely relief to employees of insolvent employers. The employees will obtain, without having to wait until the completion of the winding-up process, ex gratia payments to cover the verified outstanding wages, wages in lieu of notice, severance payment and pay for untaken statutory holidays/untaken annual leave payable to them as soon as possible. To ensure the proper use of the PWIF, section 16 of the Protection of Wages on Insolvency Ordinance (Cap. 380) ("PWIO") provides that the filing of a winding-up petition against a company is a pre-condition for the grant of ex gratia payments from the PWIF. Section 18 of the PWIO further provides that notwithstanding that a winding-up petition has not been presented to the court against a company, the Commissioner for Labour ("the Commissioner") may exercise his discretion to make the above-mentioned ex gratia payments as appropriate to an employee if it appears to the Commissioner that:

(a) the employer employs less than 20 employees;

(b) the employer is unable to pay its debts; and

(c) it is unreasonable or uneconomic to present a winding-up petition in that case.

5. Where a company has ceased business without paying debts, and its employees need to apply for legal aid for filing a winding-up petition to the court

against the company, the LD will refer the case to the LAD. In some of the cases where some individual employees may not be eligible for legal aid, the PWIF mechanism can still be triggered to enable all employees of the company to apply to the PWIF for ex gratia payments so long as a winding-up petition has been presented to the court against the company by persons with legal aid granted (such as other creditors or other employees in the employment of the same employer) or persons who have presented the petition by themselves. Besides, an employee may also present by himself a winding-up petition to the court against the relevant company and apply to the PWIF for ex gratia payments.

6. LAD advised that generally speaking, unless the amount owed by the employer is undisputed between the employer and the employee, and the employer has signed a "Statement of Inability to Pay", the employee is required to confirm (a) the employment relationship between the employee and the company being wound up; and (b) the payment item(s) and amount owed by the company being wound up to the employee and the inability of the company being wound up to pay the amount. If the employer has not signed a "Statement of Inability to Pay" or there is dispute between the employee and the company being wound up over items (a) and/or (b) above, LD will be required to refer the employee's case to the Labour Tribunal for determination before referring the case to LAD, so as to ascertain the claim item(s) and amount due to the employee and establish the fact about the inability of the employer to pay the amount.

7. The purpose of a "Statement of Inability to Pay" is to prove that the employer is indeed unable to pay the statutory or contractual entitlements owed to the employees. Therefore, the statement has to be signed by someone who is familiar with and in charge of the company's operation, understands the company's financial situation and is entitled to deploy the company's assets. The person signing the statement should therefore be the company's proprietor, partner or director.

8. Separately, FSTB has also relayed Members' views on speeding up the PWIF application process to LWB and LD, including the suggestion that LD should review its procedures of verifying and calculating the ex gratia payments so as to expedite the grant of ex gratia payments. LD noted Members' views on the PWIF.

Appointment of provisional liquidators / liquidators

9. Under the existing system for Official Receiver's Office ("ORO") to outsource court winding-up cases to private insolvency practitioners ("PIPs") for them to act as provisional liquidators and liquidators of companies under court winding-up, there are two outsourcing schemes administered by ORO, i.e. (a) Panel T scheme which deals with cases where the property of the company in the opinion of the Official Receiver is not likely to exceed $200,000 in value; and (b) Panel A scheme which deals with cases where the property of the company in the opinion of the Official Receiver is likely to exceed $200,000 in value.

10. The operation of the outsourcing schemes has generally been smooth. ORO has been monitoring the performance of PIPs appointed as provisional liquidators or liquidators of the court winding-up cases and has also taken measures to ensure that the services of those PIPs under the outsourcing schemes complied with the statutory and administrative requirements.

Panel T scheme

11. Following the making of a winding-up order, the Official Receiver becomes provisional liquidator of the company being wound up by virtue of his/her office under section 194(1)(a) of CWUMPO. If the property of the company is in the opinion of the Official Receiver not likely to exceed $200,000 in value, the Official Receiver as provisional liquidator may appoint appointment takers[1] of the PIP firm on the Panel T roster list as joint and several provisional liquidators in his/her place under section 194(1A) of CWUMPO. The appointment by the Official Receiver is on a rotation basis of the PIP firms from the Panel T roster list.

12. The PIP firms are put on the Panel T roster list through a tender exercise conducted by the ORO every two years. In order to be awarded the tender, the PIP firms are required to satisfy the criteria set out in the relevant tender document. The PIP firms of the Panel T scheme (please refer to **Annex A**) and the terms and conditions of the relevant tender document (a gist at **Annex B**) are available on ORO's website[2].

Panel A scheme

13. On the other hand, upon the making of the winding-up order, if the property of the company is in the opinion of the Official Receiver likely to exceed $200,000 in value, the Official Receiver as the provisional liquidator must summon separate meetings of creditors and contributories of the company within three months of the date of the winding-up order to appoint a liquidator. In the first meeting of creditors and the first meeting of contributories convened by the Official Receiver, in case there is no nomination by the creditors and contributories at their respective meetings, the Official Receiver will suggest the appointment takers[3] of a PIP firm on the Panel A roster list to the creditors and contributories for consideration of appointment as liquidators. The suggestion of the PIP firm by the Official Receiver from the Panel A roster list is on a rotation basis.

14. The PIP firms are admitted to the Panel A by an Admission Committee, which is chaired by an officer of ORO and comprises representatives from ORO and the Hong Kong Institute of Certified Public Accountants. Please refer to **Annex A** for the PIP firms of the Panel A scheme. The Admission Committee will consider applications by the PIP firms which have to meet the criteria set out in the Panel A scheme rules (a gist at **Annex C**) for admission to the Panel A. The scheme rules are available on ORO's website[4].

Claw-back period of the new provisions for "transaction at an undervalue"

15. The provisions on transaction at an undervalue in the Bill are drawn up with reference to the relevant provisions in the Bankruptcy Ordinance (Cap. 6) and the United Kingdom ("UK") Insolvency Act 1986. It has been ruled in the UK that in

[1] Usually two appointment takers are jointly and severally appointed to act as liquidators of a company being wound up. At least one of the appointment takers must be a proprietor, partner or director of the PIP firm.

[2] http://www.oro.gov.hk/eng/tender/doc/Tender_ORT2015.pdf.

[3] Please see footnote 1.

[4] http://www.oro.gov.hk/eng/publications/pdf/Panel%20A%20Scheme%20Rules.pdf.

assessing the value of the "consideration" for which a company has entered into a transaction at an undervalue, the court may take into account the consideration of a linked agreement and consider the values of these agreements as a whole. It follows that, in certain circumstances, the provisions on transaction at an undervalue can cover the linked agreements of a transaction. However, we are not aware of any decided case on whether under this ruling, the UK provisions on transaction at an undervalue may also apply to linked agreements which fall outside the claw-back period.

16. In determining the claw-back period for the provisions on transaction at an undervalue in the Bill, we have sought to strike a balance between the need to avoid the reduction of the pool of property available for distribution to creditors at winding-up and the need to maintain certainty in business transactions. The 5-year claw-back period is in line with the existing provisions of the Bankruptcy Ordinance. We note that while under the UK ruling the provisions may cover linked agreements of a transaction at an undervalue, the claw-back period adopted in the UK (i.e. 2 years) is shorter than our proposal in the Bill. As such, we do not consider it necessary or appropriate to codify the ruling mentioned above in the Bill.

Changes to the existing insolvency regime

17. In the Annex to our earlier response to the Bills Committee (LC Paper No. CB(1)283/15-16(02)), we outlined new major measures introduced by the Bill to the corporate winding-up regime of Hong Kong. We acknowledge that while there are no explicit provisions in the existing CWUMPO on these proposed new measures, at present some of the matters related to the new measures may be handled according to other statutory provisions or relevant existing practices or under case law. We set out by way of examples further information in this regard in **Annex D**.

Letter from the Legal Adviser to the Bills Committee to the Administration

18. We have issued the Government's response to the letter from the Assistant Legal Adviser dated 10 December 2015 on 7 January 2016.

Financial Services and the Treasury Bureau
Official Receiver's Office
8 January 2016

Annex A

Private insolvency practitioner firms of Panel T and Panel A

(as at January 2016)

(A) Panel A

1. Baker Tilly Hong Kong Restructuring and Recovery Limited
2. Borrelli Walsh Limited
3. Crowe Horwath (HK) CPA Limited
4. Deloitte Touche Tohmatsu
5. Ernst & Young Transactions Limited
6. FTI Consulting (Hong Kong) Limited
7. JLA Asia Limited
8. Kenny Tam & Co.
9. KLC Kennic Lui & Co.
10. KPMG
11. PricewaterhouseCoopers
12. RSM Corporate Advisory (Hong Kong) Limited
13. Sammy Lau CPA Limited
14. SHINEWING Specialist Advisory Services Limited

(B) Panel T

1. Baker Tilly Hong Kong Restructuring and Recovery Limited
2. Huen & Partners, Solicitors
3. JLA Asia Limited
4. Kenny Tam & Co.
5. Neil Collins Corporate Advisory Services Limited
6. RSM Corporate Advisory (Hong Kong) Limited
7. Sammy Lau CPA Limited
8. Vision A.S. Limited
9. Yiu Cho Yan Certified Public Accountant

Panel T tender document

Major essential requirements

1. A tender must be submitted by a firm. The Tenderer must be a sole proprietor, a partnership or a limited company with a minimum of two Appointment Takers. Each of the Appointment Takers must be –

   (a) a certified public accountant within the meaning of section 2 of the Professional Accountants Ordinance (Cap. 50); or

   (b) a solicitor within the meaning of section 2(1) of the Legal Practitioners Ordinance (Cap. 159); or

   (c) a current member of The Hong Kong Institute of Chartered Secretaries.

2. Each of the Appointment Takers must -

   (a) have at least 3 years of post-qualification experience in the relevant profession; and

   (b) have a minimum of 300 chargeable hours of experience acquired after obtaining the relevant professional qualifications ("Qualifying Chargeable Hours") over the last 3 years –

      (i) of which, at least 150 hours of experience must be experience in managing corporate insolvency cases either as a liquidator/provisional liquidator or a receiver or as their senior subordinates assisting them in the performance of their role related to insolvency work on companies or receiverships of companies. The chargeable hours of experience must have been obtained in at least 4 separate compulsory winding-up of unconnected companies. Not more than 75 hours of experience on receivership will be counted as chargeable hours of experience; and

      (ii) the remaining 150 hours of experience may be on solvent liquidations in which case, the chargeable hours counting towards the Qualifying Chargeable Hours would be reduced by half. For example, two chargeable hours on solvent liquidation will be counted as one Qualifying Chargeable Hour.

3. At least one of the Appointment Takers must be a proprietor, partner or director of the Tenderer. All Appointment Takers must be working for the firm on a full-time basis.

4. The Tenderer must have been providing insolvency, accounting, legal or company secretary services in Hong Kong for at least 3 years.

5. The Tenderer must have at least 10 full time employees, not being the proprietor in case of the Tenderer being in sole proprietorship, any of the partners in case of a partnership, any of the directors in case of a company, or any of the Appointment Takers, available to perform the services if a contract is awarded.

Assessment of Panel T tenders

6. All tenders will be required to comply with the essential requirements stipulated in the tender document. Tenders that have met all the essential requirements will be assessed on the basis of the required subsidy per case and any other matters which the Official Receiver considers relevant e.g. past performance of the Tenderer.

Panel A scheme rules

Major admission requirements to the Panel

1. A firm[5] must have provided liquidation services in Hong Kong for at least three years immediately preceding its application.

2. A firm must have adequate minimum resources as follows –

   (a) at least four directly employed full-time certified public accountants (i.e. members of the Hong Kong Institute of Certified Public Accountants ("HKICPA")) each of whom must have at least three years of post-qualification experience, and three of whom must be Insolvency Practitioners[6] with specific qualifications;

   (b) professional staff who have a good command of both English and Chinese; and

   (c) at least 16 directly employed full-time staff (including the certified public accountants / Insolvency Practitioners referred to in sub-paragraph (a) above) available to perform the service and deal with cases allocated to the firm under the Scheme.

   For the purpose of assessing the minimum resources of a firm under this paragraph, a partner of the firm shall be regarded as being under the direct employment of the firm.

3. Appointments as liquidators should be in the names of at least two Appointment Takers of the firm, one of whom must be a partner, a director or the sole proprietor of the firm and the other Appointment Taker must be a principal of the firm or hold a position above that at the firm. All Appointment Takers must be Insolvency Practitioners. At least one Appointment Taker must be contactable at any time and Appointment Takers must be available in Hong Kong when required by the Court, ORO or creditors.

4. Each firm must sign an undertaking with, inter alia, the following provisions –

   (a) to accept any case allocated to it by the Official Receiver, except for special reasons acceptable to the ORO which preclude it from doing so;

   (b) to carry out to the best of the ability of every Appointment Taker of the firm every insolvency case that is to be allocated;

   (c) to carry out statutory investigation;

   (d) to continue to handle a case to reach its reasonable conclusion;

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[5] A firm may include a newly established firm, a merged firm or a firm which has established a new department or division on liquidation subject to certain specific requirements.

[6] Each Insolvency Practitioner of the firm must be a HKICPA member and a full-time employee / partner of the firm with –

(i) (a) minimum chargeable hours of relevant insolvent liquidation work of 600 in the last 3 years or 750 in the last 5 years, and with a minimum of 100 hours in any one year; and

(b) involvement at senior and responsible positions in 10 unconnected non-summary insolvent liquidation cases in the last five years; and

(ii) experience in managing insolvency cases and either holding the position of partner or a senior position of the firm.

(e) to accept and abide by all the terms of the Panel A scheme rules;

(f) to acknowledge and accept that the firm may be removed from the Panel A scheme if the firm is no longer able to satisfy any admission criterion; and

(g) to accept any decision of the Appeal Panel as final in case of a dispute.

Admission Committee

5. An Admission Committee, comprising three ORO officers (one of whom shall serve as the Chairman) and three representatives from HKICPA or other professional bodies as determined by the OR as members, shall meet if required to consider new admission application, or to review admission status of admitted firms, Appointment Takers and Insolvency Practitioners.

Existing practices, etc. in handling some of the matters related to the new major proposals

	Proposals	Examples of existing practices, etc. in handling such matters
1.	<u>Transaction at an undervalue</u> The Bill provides for the power of the court to set aside transactions at an undervalue entered into by a company within five years before the commencement of its winding up. A "transaction at an undervalue" is defined as a transaction entered into by a company prior to its winding-up that involves an outright gift given by the company to a party, or entered into by the company with a party on terms that provides for the company to receive no consideration or for a consideration which is significantly less than the value of the subject of the transaction. However, the relevant provisions in the Bill will not affect genuine business transactions. For example, it is stipulated that the following transactions will not be affected - (i) if a company entered into a transaction with a person and at the time of the transaction the value of the consideration given by the person was not "significantly" less than the value of the goods or other consideration provided by the company; or (ii) if at the relevant time the transaction was carried	At present, there is no provision in the existing CWUMPO specifically empowering the court to set aside a "transaction at an undervalue". The liquidator has to rely on other legislative provisions, common law rules and equitable principles to set aside the transaction or to seek other remedies from the court, for example: - (a) if the transaction forms part of any business of the company that has been carried on with intent to defraud creditors of the company or creditors or for any fraudulent purpose, the court may declare any persons who were knowingly parties to the carrying on of the business shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct (section 275 of CWUMPO); (b) if the transaction is entered into by any person (such as a director) on behalf of the company in breach of duty[7] or breach of trust[8] in relation to the company, the liquidator may act on behalf of the company to claim against the person for damages or compensation in respect of any loss suffered by the company or to seek other remedies[9] from the court. Section 276 of CWUMPO provides a summary procedure for making such claims; and (c) if the transaction is a disposition of the company's property with intent to defraud the creditor, the court may set aside the disposition. This, however, does not apply to disposition for valuable consideration and in good faith or upon good

[7] In general, breach of duty to the company includes, inter alia, breach of fiduciary duty and breach of duty to act with care, skill and diligence. According to case law, conducts amounting to a breach of fiduciary duty include failing to act bona fide in the interest of the company (including where applicable a breach of the duty to have regard to creditors' interests), exercising powers for improper purposes, obtaining secret profits, misapplying or misappropriating corporate property; and entering into transactions in breach of the duty to avoid a conflict of interest. These are based on equitable principles. Duties to act with care, skill and diligence are derived from common law principles of negligence and those in relation to directors are codified by section 465 of the Companies Ordinance.

[8] "Breach of trust" and "breach of fiduciary duty" may be regarded as synonymous. Fiduciary duties which the law requires of directors were developed by the courts by analogy with the duties of trustees.

[9] Apart from damages or compensation, other remedies available include injunction or declaration, restoration of the company's property, rescission of the contract and account of profits.

	Proposals	Examples of existing practices, etc. in handling such matters
	out in good faith by the company for the purpose of operating its business and there were reasonable grounds for believing that the transaction would benefit the company.	consideration and in good faith to any person (such as the other party of the disposition) who does not have, at the time of the disposition, notice of the intent to defraud creditors (section 60 of the Conveyancing and Property Ordinance (Cap. 219)).
2.	<u>Redemption or buy-back of shares out of the company's capital</u> The Bill provides for the liabilities of directors and shareholders concerned to contribute to the assets of the company in connection with a redemption or buy-back of the company's own shares out of capital in cases where the company is wound up insolvent within one year of the relevant payment out of capital.	There is no provision in the existing CWUMPO imposing a specific liability on (a) the shareholder whose shares were redeemed or bought-back by the company out of capital, in cases where the company is wound up insolvent within one year of the relevant payment out of capital; or (b) director involved in the redemption or buy-back to contribute to assets of the company the amount of the payment out of capital made by the company in respect of the redemption or buy-back. Notwithstanding that, under the Companies Ordinance (Cap. 622), a solvency statement in relation to the payment out of capital is required to be made by directors of the company[10]. A director who makes the solvency statement without having reasonable grounds for the opinion expressed in it commits an offence and may be held criminally liable[11].
3.	<u>Appropriate restrictions on the powers of liquidators, provisional liquidators and directors under specified circumstances in voluntary winding-up</u> For creditors' voluntary winding-up, before the holding of the first creditors' meeting, the powers of the following persons will be subject to appropriate restrictions - (i) members' appointed liquidators; and (ii) directors' appointed provisional liquidators. In addition, for voluntary winding-up, there will be appropriate restrictions on the powers of directors before the appointment of liquidators. If the relevant	There is no provision in the existing CWUMPO specifically restricting the powers of a members' appointed liquidator before the holding of the first creditors' meeting or the powers of directors before the appointment of a liquidator. For directors' appointed provisional liquidators under section 228A of CWUMPO, the existing section 228A(16) of CWUMPO provides that a provisional liquidator shall not have power to sell any property of the company unless the property is of a perishable nature or likely to deteriorate if kept or the court orders the sale of the property. To protect creditors' interests, the Bill will specifically include other appropriate restrictions

[10] Section 259 of the Companies Ordinance.
[11] Section 207 of the Companies Ordinance.

	Proposals	Examples of existing practices, etc. in handling such matters
	liquidators, provisional liquidators or directors without reasonable excuse fail to comply with the requirements, they will be liable to a fine.	on powers of this type of provisional liquidator (e.g. this type of provisional liquidator may not exercise the like powers as a liquidator in a creditors' voluntary winding-up except with the sanction of the court (Clause 60 of the Bill)). At present, in the absence of the new provisions of the Bill, a person who is aggrieved by any act or decision of the liquidator has to rely on a general provision on exercise and control of liquidator's powers under the existing section 200(5) of CWUMPO to make application to the court, and the court may confirm, reverse, or modify the act or decision complained of, and make such order in the premises as it thinks fit.
4.	<u>Communication by electronic means</u> Communications by a liquidator with members of the committee of inspection ("COI") and other persons (such as creditors and contributories) by electronic means will be allowed with their prior consent, while a recipient of a document from the liquidator may still request the document to be sent in hard copy form.	At present, there is no provision in the existing CWUMPO specifically allowing a liquidator to communicate with members of the COI or other persons by electronic means. In practice, electronic communications are not uncommon but the traditional means of communications to comply with the requirements of CWUMPO must be used, except that electronic communications may be used where permitted by other legislations (e.g. Companies Ordinance and Electronic Transactions Ordinance (Cap. 553), etc.) under certain circumstances.