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

Purpose

This paper reports on the deliberations of the Bills Committee on Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 ("the Bills Committee").

Background

2. Under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO"), there are primarily three types of winding-up of companies:

(a) "court winding-up" — CWUMPO sets out a number of grounds on which a company may be wound up by the court upon petition by a relevant party.[1] The grounds which are more frequently invoked are (i) the company is unable to pay its debts; or (ii) the court is of the opinion that it is just and equitable that the company should be wound up;

(b) "members' voluntary winding-up" — A company may also wind up voluntarily. If the members of a company resolve that the company be wound up voluntarily, and where a certificate of solvency[2] has been issued and delivered to the Registrar of Companies, then the winding-up would proceed as a "members' voluntary winding-up". In respect of the

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[1] A creditor, a contributory (e.g. a member of the company) and the company itself are amongst those who may present a petition to the court for the winding-up of a company.

[2] A certificate of solvency is issued by the directors of a company certifying that the company will be able to pay its debts in full within a period not exceeding 12 months from the commencement of the winding-up of the company.

company's financial position, the company should be solvent; and

(c) "creditors' voluntary winding-up" — Further to sub-paragraph (b) above, if the certificate of solvency has not been issued and delivered, then the winding-up would proceed as a "creditors' voluntary winding-up". In respect of the company's financial position, the company should be insolvent.

3. The Administration conducted a three-month public consultation from April to July 2013 on a package of legislative proposals to modernize the corporate winding-up regime and improve the provisions in CWUMPO. The consultation conclusions were published in May 2014, and according to the Administration, the legislative proposals set out in the consultation document were supported by a majority of respondents.

4. The Administration published the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 ("the Bill") in the Gazette on 2 October 2015. The Bill seeks to implement the legislative proposals as set out in the consultation exercise in 2013 by amending CWUMPO and its subsidiary legislation to increase protection of creditors, streamline the winding-up process and further enhance the integrity of the winding-up process, as well as make related, consequential and minor technical amendments. The Bill received its First Reading at the Legislative Council ("LegCo") meeting of 14 October 2015.

The Bill

5. The main provisions of the Bill are set out as follows:

(a) Clauses 20, 21 and 26 amend CWUMPO to provide for the liabilities of directors and members concerned to contribute to the assets of the company in connection with a redemption or buy-back of shares out of capital;

(b) Clauses 33 to 35 amend CWUMPO to set out more clearly the duties, the basis for determining remuneration, and tenure of office of provisional liquidators in a court winding-up;

(c) Clause 36 amends CWUMPO to, amongst other things, simplify the procedure for the liquidator to appoint a solicitor

to assist in a court winding-up by giving advance notice to the committee of inspection ("COI");

(d) Clause 37 introduces new provisions in CWUMPO to set out more clearly the provisions on the powers of provisional liquidators in a court winding-up;

(e) Clauses 39 and 95 amend CWUMPO to enhance the regulatory provisions on misfeasance or breach of duty/trust of liquidators notwithstanding their release by the court;

(f) Clauses 42 and 74 amend CWUMPO to prescribe the maximum and minimum numbers of members of COIs;

(g) Clauses 43 and 44 amend CWUMPO to streamline and rationalize the proceedings of COIs in addition to the amendments covered by Clauses 42, 45 and 74;

(h) Clause 45 introduces new provisions in CWUMPO to allow remote attendance at COI meetings and to enable a COI to make decisions through written resolutions;

(i) Clauses 59 and 60 amend CWUMPO to provide for additional safeguards in a director-initiated creditors' voluntary winding-up commenced under section 228A of CWUMPO;

(j) Clause 73 amends CWUMPO to enhance the requirements relating to the first creditors' meeting upon the commencement of a creditors' voluntary winding-up;

(k) Clauses 75 and 81 introduce new provisions in CWUMPO to restrict the powers of the members-appointed liquidator and the directors before the holding of the first creditors' meeting and the appointment of a liquidator respectively;

(l) Clauses 76 and 163 introduce new provisions in CWUMPO and the Companies (Winding-up) Rules (Cap. 32H) ("CWUR") respectively to stipulate the procedures for removal and resignation of a liquidator in a voluntary winding-up;

(m) Clause 85 introduces new provisions in CWUMPO to expand the list of persons disqualified for appointment as a provisional liquidator or liquidator and to introduce a new

requirement for disclosure by a prospective provisional liquidator and prospective liquidator of specified relationships between him or his immediate family members, etc. and the company concerned;

(n) Clauses 88 to 90 introduce new provisions in CWUMPO on the court's power to set aside transactions at an undervalue and transactions which are unfair preferences, which were entered into by a company within a specified period before commencement of winding-up;

(o) Clause 98 amends CWUMPO to expand the existing provisions on the prohibition of offering inducements to secure or prevent appointment as a provisional liquidator or liquidator;

(p) Clauses 101, 123, 137 and 144 introduce new provisions in CWUMPO and amend CWUR to improve the private and public examination procedures;

(q) Clause 105 introduces new provisions in CWUMPO to allow liquidators to communicate with members of COI and other persons by electronic means;

(r) Clause 116 amends the Twelfth Schedule of CWUMPO to set out the penalties for the relevant offence provisions in the Bill;

(s) Clauses 168 and 169 amend CWUR to allow the bills of costs and charges of the liquidators' agents to be approved by COI without taxation by the court; and

(t) Clauses 119 and 174 to 189 contain the transitional and savings provisions, and consequential and technical amendments to certain subsidiary legislation of CWUMPO[3] and other relevant ordinances.

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[3] The items of subsidiary legislation amended are the Companies (Fees and Percentages) Order (Cap. 32C), the Companies (Disqualification Orders) Regulation (Cap. 32I) and the Companies (Reports on Conduct of Directors) Regulation (Cap. 32J).

The Bills Committee

6. At the House Committee meeting on 16 October 2015, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**. Under the chairmanship of Mr WONG Ting-kwong, the Bills Committee has held eight meetings to study the Bill with the Administration, including one meeting to receive views from 13 deputations/individuals. The Bills Committee has also received a total of 29 written submissions. The list of deputations/individuals which have provided views to the Bills Committee is in **Appendix II**.

Deliberations of the Bills Committee

7. The Bills Committee supports the policy objectives of the Bill and its major proposals. The major deliberations of the Bills Committee cover the following issues:

(a) transactions at an undervalue (paragraphs 9-14);

(b) redemption or buy-back of the company's shares out of capital (paragraphs 15-17);

(c) director-initiated creditors' voluntary winding-up of a company (paragraphs 18-19);

(d) commencement of a creditors' voluntary winding-up and calling of the first creditors' meeting (paragraphs 20-23);

(e) membership size and operation of COI (paragraphs 25-34);

(f) powers, duties, remuneration, termination and resignation of provisional liquidator (paragraphs 36-39);

(g) prohibition of touting for appointment as a provisional liquidator or liquidator, or as a receiver or manager (paragraphs 40-41);

(h) liquidator would not be absolved from liabilities arising from the liquidator's misfeasance or breach of duty or trust (paragraphs 42-43);

(i) public examination procedure of persons by the court (paragraphs 44-49);

(j) removal of liquidator (paragraphs 50-51);

(k) licensing regime for private insolvency practitioners (paragraphs 52-53);

(l) interface between the winding-up process and payments under the Protection of Wages on Insolvency Fund ("PWIF") (paragraphs 54-58);

(m) maximum amounts on preferential payments under section 265 of CWUMPO (paragraphs 59-60); and

(n) order of payment of unsecured creditors (paragraphs 61-62).

Increasing the protection for creditors

8. An efficient and effective corporate winding-up regime will give protection and confidence to investors and creditors and promote the business environment in Hong Kong. The Bill includes a number of proposals to ensure that the value of the remaining assets of an insolvent company will be preserved as far as possible and the assets will be distributed among the creditors of the company in a fair and orderly manner in a winding-up.

Transactions at an undervalue

9. At present, the court does not have the power to set aside transactions at an undervalue[4] entered into by a company if the company goes into liquidation. The new sections 265D, 265E, 266B, 266C and 266D of CWUMPO (Clauses 88 to 90) provide that such transactions are voidable at the discretion of the court if the transaction is entered into by a company within five years before the commencement of its winding up, and the court may make orders to restore the position to what it would have been if the company had not entered into that transaction.

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[4] The meaning of "transaction at an undervalue" is provided in new section 265E (Clause 88): A company enters into a transaction with a person at an undervalue if (a) the company makes a gift to that person, or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration; or (b) the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.

10. The Bills Committee notes the concern expressed by some deputations about what transactions would be regarded as transactions at an undervalue. In particular the deputations are concerned that if a company boosts sales by dumping prices prior to its winding up, whether commission payments earned by employees from such transactions of the company would be caught, and whether the interests of the employees would hence be adversely affected.

11. The Administration has explained that the proposal of transaction at an undervalue is to ensure that the company's assets will not be inappropriately disposed of or transferred prior to its winding up and to preserve as far as possible the company's assets available for distribution to the creditors. The relevant provisions will not affect genuine business transactions, e.g. where a company entered into a transaction with a person, at the time of the transaction the value of the consideration paid by that person for the transaction was not "significantly" less than the value of the goods or other considerations provided by the company; or where the company entered into the transaction in good faith at that time for the purpose of carrying on its business and there were reasonable grounds for believing that the transaction would benefit the company. The Administration has pointed out that employees' commission is generally calculated according to employment contracts or company policies rather than as part of a transaction between the company and a third party. Given that the relevant provisions are applicable only to transactions which are at an undervalue, if employees receive commission payment in accordance with the prevailing arrangement of the company in return for rendering their service in that transaction, the commission payments made to the employees will not, in normal circumstances, be affected.

12. The Bills Committee has enquired about the actions the court would take to restore the position of a voided transaction at an undervalue. The Administration has advised that the new section 266C (Clause 90) lists out the types of orders which the court may make and the relevant restrictions. For example, the order may require any property transferred as part of the transaction to be vested in the company; or require a person to pay, in respect of benefits received by that person from the company, any sums to the liquidator that the court may direct. The court shall make orders that it thinks fit after considering the circumstances of the transaction.

13. The Bills Committee notes that some deputations are concerned that the five-year claw-back period for a transaction at an undervalue is too long. In addition, Mr Kenneth LEUNG is concerned that a well-conceived transaction at an undervalue may consist of a number of transactions which are entered into more than five years before the commencement of the winding-up

of a company, and the five-year claw-back period may not cover such related transactions. He opines that the Administration should consider providing the court with discretion to set aside transactions entered into by a company beyond the five-year claw-back period which are related to a transaction at an undervalue.

14. The Administration has explained that the provisions on transaction at an undervalue are drawn up with reference to the relevant provisions in the Bankruptcy Ordinance (Cap. 6) ("BO") and the United Kingdom ("UK") Insolvency Act 1986. It has been ruled in the UK that in 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.[5] It should be noted 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. two years) is shorter than the proposal in the Bill. The Administration does not consider it necessary or appropriate to codify the UK ruling in the Bill. As regards the length of the claw-back period, the Administration has stressed that it is necessary to strike a balance between avoiding the reduction of the pool of property available for distribution to creditors at winding-up and maintaining certainty in business transactions. The five-year claw-back period is in line with the existing provisions of BO, and most respondents of the public consultation exercise in 2013 who commented on this proposal considered the proposed five-year claw-back period appropriate.

Redemption or buy-back of the company's shares out of capital

15. The new section 170A of CWUMPO (Clause 20) provides for the liabilities of directors and past shareholders to contribute to the assets of a company which has made payment out of its capital in respect of the redemption or buy-back of any of its own shares in cases where the company is wound up within one year of the relevant payment out of capital.

16. The Bills Committee is concerned that the proposal may hinder the normal redemption and buy-back of shares by companies. Members have enquired about the rationale for the proposal and the one-year claw-back period.

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[5] The Administration is not aware of any decided case on whether under that ruling, the UK provisions on transaction at an undervalue may also apply to linked agreements which fall outside the claw-back period.

17. The Administration has clarified that the proposal only targets at shares redemption or buy-back "out of the company's capital" and applies only when the company is wound up insolvent within one year of the redemption or buy-back. The proposed provisions will not affect a redemption or buy-back made with payment in other forms, e.g. payments out of the company's distributable profits or out of the proceeds of a fresh issue of shares for the purpose of the redemption or buy-back. The proposal aims to ensure that the company's capital is maintained and will not be improperly returned to its shareholders prior to its insolvent winding-up at the expense of the interests of the creditors of the company being wound up. Moreover, the proposal works in tandem with sections 205 and 206 of the Companies Ordinance (Cap. 622) which provide that prior to the relevant redemption or buy-back, generally speaking, the directors of the company must make a solvency statement to the effect that the company is able to pay its debts in full within one year after the transaction, before payment for shares redemption or buy-back can be made out of the company's capital.

Director-initiated creditors' voluntary winding-up of a company

18. Under existing section 228A of CWUMPO, after the directors (or the majority of the directors in the case of a company having more than two directors) of a company have formed an opinion that the company cannot by reason of its liabilities continue its business, the directors may resolve at a meeting of the directors to commence winding-up of the company by delivering a winding-up statement to the Registrar of Companies (i.e. section 228A procedure). The winding-up of the company is to commence at the time of the delivery of that statement. The Bill introduces additional safeguards to the section 228A procedure.

19. The Bills Committee has examined how the proposed safeguards in the Bill can reduce the risk of abuse of the section 228A procedure by directors, and restrict the powers of provisional liquidator appointed by them. The Administration has explained that the proposed amendments to section 228A (Clause 59) require that the company's meeting must have been summoned and a provisional liquidator must have been appointed before the commencement of the winding-up. Moreover, the new section 228B (Clause 60) restricts the powers of the provisional liquidator such that, with a few specified exceptions (e.g. disposal of perishable goods of the company and actions to protect the company's assets), the provisional liquidator may exercise powers conferred on a liquidator only after obtaining the sanction of the court. If a director or the appointed provisional liquidator without reasonable excuse fails to comply with the above requirements, he/she will be liable to a fine.

Commencement of a creditors' voluntary winding-up and calling of the first creditors' meeting

20. The proposed section 241 of CWUMPO (Clause 73) prescribes a minimum notice period of seven days for calling the first creditors' meeting and requires that the first creditors' meeting shall be held within 14 days after the holding of the company's meeting in which the resolution for voluntary winding-up is proposed.

21. The Bills Committee is concerned that the potential time gap of 14 days between the company's meeting and the first creditors' meeting may create a period of uncertainty on the position of the appointed liquidator and may lead to potential abuses of powers by directors.

22. The Administration has advised that existing provisions in CWUMPO only require the company to convene the first creditors' meeting on the same day as, or the next following day after, the day of the company's meeting in which the resolution for voluntary winding-up is proposed. There is no minimum period of notice required for calling the first creditors' meeting. The proposed amendments are to ensure reasonably sufficient notice period for creditors to prepare for the first creditors' meeting and to make informed decisions. The Bill already provides adequate safeguards during the time gap. In respect of creditors' voluntary winding-up, there will be appropriate restrictions on the powers of the members-appointed liquidator before the holding of the first creditors' meeting under section 243A (Clause 75). For voluntary winding-up, there will also be appropriate restrictions on the powers of directors of the company during the period between the members' meeting and the nomination or appointment of a liquidator under section 250A (Clause 81). If a liquidator or director without reasonable excuse fails to comply with the relevant requirements, the liquidator or director will be liable to a fine.

23. As regards the reasons for setting the minimum notice period for the first creditors' meeting at seven days, the Administration has responded that there are similar requirements in the UK and Australian insolvency regimes in this respect. As the first creditors' meeting is to be held within 14 days after the holding of the company's meeting, it is appropriate to prescribe a minimum notice period of seven days for calling the first creditors' meeting. As a matter of fact, the 14-day requirement only represents the latest date by which the creditors' meeting is to be held and the meeting may be held earlier.

Streamlining the winding-up process

24. In a court winding-up or a creditors' voluntary winding-up of a company, a COI may be appointed to represent the creditors and contributories (e.g. members) of the company for supervising and giving directions to the liquidator during the course of the winding-up. The Bill introduces a number of provisions to improve the proceedings of COIs, promote court-free procedures and simplify other related procedures.

Membership size and remote attendance for meetings of the committee of inspection

25. The new section 206(3) and (4), and the proposed section 243 of CWUMPO (Clauses 42 and 74) prescribe the minimum and maximum numbers of members of a COI to be three and seven respectively, which may be varied by an order of the court upon an application by a liquidator. The new section 207A (Clause 45) provides that members of COI may be represented by other persons in relation to the business of the COI if such persons are authorized by a letter of authority or by a general power of attorney from the member. The new section 207B (Clause 45) allows members of a COI to attend meetings remotely by the use of technology.[6]

26. Given that a COI will consist of a maximum of seven members and in view of the importance of COI meetings for creditors, some members of the Bills Committee, including Miss CHAN Yuen-han and Mr CHUNG Kwok-pan consider that allowing remote attendance of members at COI meetings may not serve any practical purpose, and there should be requirements for using remote attendance to ensure COI meetings would be conducted in a prudent manner, such as providing the chairman of COI with discretion to allow remote attendance for COI meetings. The Bills Committee has also sought elaboration on the arrangements for a COI meeting using remote attendance, including whether COI members could request for a face-to-face meeting if they do not want to attend the meeting remotely.

27. The Administration has explained that the provisions in the Bill allow COI members to attend a meeting at different places by the use of technology, and aim to facilitate the operation of COI meetings, members' participation in meetings and save time and costs for holding and attending COI meetings. The formulation of the provisions has made reference to similar provisions in the UK insolvency regime. It may complicate the provisions if further

[6] The use of technology which enables persons who are not present together at the same place to attend the meeting. A person is regarded to be attending the meeting if the person is able to exercise any rights of the person to speak and vote at the meeting.

preconditions are to be prescribed for using remote attendance for COI meetings.

28. As regards arrangements for a COI meeting with remote attendance, the Administration has explained that the new section 206A(6) of CWUMPO (Clause 43) provides that if a liquidator determines to hold a COI meeting with remote attendance, the liquidator must give 10 days' written notice[7] of the date, time and place of the meeting to every member of the COI. In other words, a meeting may be held by remote attendance but with a place of the meeting specified. In response to such a notice, the COI members may choose to go to the specified place to attend the meeting or join the meeting by remote attendance. The new section 207B(6) (Clause 45) provides that the liquidator may in certain circumstances satisfy the requirement to specify a place for the meeting under the new section 206A(6) by specifying the arrangements the liquidator proposes to enable persons attending the meeting to exercise their rights to speak and vote. In such a case, no place will be specified in the notice of the meeting and all members are expected to join the meeting by remote attendance. However, under the new section 207B(8), after a notice of meeting which does not specify a place for the meeting is issued by the liquidator under the new sections 206A(6) and 207B(6), any member of the COI may reverse the liquidator's decision and request the liquidator to specify a place for the meeting in accordance with the new section 207C (Clause 45), and the liquidator must comply with the request by specifying a place for the meeting. In such a case, the COI members may choose to attend the meeting at the specified place or join the meeting by remote attendance. Hence, there are sufficient safeguards for any COI member who does not opt to attend the meeting remotely.

29. The Bills Committee considers that the relevant provisions in the Bill have not clearly reflected the above arrangements, and has requested the Administration to consider making amendments. Taking into account the views of members and the Legal Adviser to the Bills Committee, the Administration agrees to move a Committee Stage amendment ("CSA") to the new section 207B(8) to clarify the intention as explained in paragraph 28 above. The Bills Committee has examined the draft CSA and has not raised further question.

Letter of authority by members of the committee of inspection

30. The Bills Committee notes that the new section 207A(2)(b)(ii) of CWUMPO (Clause 45) provides that a letter of authority authorizing a person

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[7] The notice for a COI meeting without remote attendance is five days.

to represent a member of COI for COI business may be signed by a COI member concerned or by another person on behalf of the member. To address the concern about possible abuse of the proposed arrangement, e.g. any person may sign a letter of authority on behalf of a member of COI, the Bills Committee, having considered the query raised by the Legal Adviser to the Bills Committee, has requested the Administration to consider imposing restrictions in this regard.

31. The Administration has advised that the new section 207A is to provide flexibility for a COI member to authorize a person to represent him/her in the COI by a letter of authority signed by or on behalf of the member. After considering the Bills Committee's views, the Administration agrees to move a CSA to amend the new section 207A(2)(b)(ii) to the effect that if the COI member is a natural person, the letter of authority must be signed by the member; and for other cases (such as where the COI member is a body corporate), the letter of authority may be signed by or on behalf of the relevant COI member.

Approval of costs and charges by the committee of inspection

32. The proposed rule 176(2) of CWUR (Clause 168) allows the bills of costs or charges of a person employed by the Official Receiver ("OR") or the liquidator (e.g. liquidators' agents, including solicitors, accountants and auctioneers) in a court winding-up to be approved by COI by resolution instead of taxation by the court as currently required.

33. The Bills Committee notes that some deputations have reservation about the proposal in rule 176(2) as they are concerned about the capability of members of COI, such as small and medium-sized enterprises ("SME") creditors, in determining the reasonable costs and charges for the liquidator's agents.

34. The Administration has responded that the proposal in the proposed rule 176(2) aims to provide court-free procedures, which will in turn reduce the costs and time for administering winding-up cases to the benefit of the creditors involved. During the public consultation exercise in 2013, the majority of the submissions received were supportive of the proposal. The Administration has stressed that if the COI does not agree with the proposed fees charged by the liquidator's agents, it may refuse to approve the fees. If the liquidator is unable to reach an agreement with the COI, the liquidator is required to make use of the existing mechanism to seek court's determination on the matter.

Strengthening regulation under the winding-up regime

35. Given the important role played by the liquidator and provisional liquidator in the winding-up of a company, the Bill introduces a number of measures to improve regulatory measures for these professionals in order to further enhance the integrity of the winding-up process.

Powers, duties, remuneration, termination and resignation of provisional liquidator

36. The proposed sections 193, 194, 196 (Clauses 33, 34 and 35) aim to set out more clearly the provisions on duties, the basis for determining the remuneration and tenure of office of a provisional liquidator in a court winding-up. The proposed section 199 (Clause 36), the new sections 199A and 199B (Clause 37) and the new Schedule 25 (Clause 118) aim to set out the powers of different kinds of provisional liquidators and liquidators in a court winding-up, and also the restrictions and exceptions in the exercise of those powers.

37. The proposed section 199 enables the liquidator in a court winding-up to exercise the power directly to appoint a solicitor to assist in performing the liquidator's duties by giving seven days' advance notice to the COI (or to the creditors in case there is no COI). Under the existing arrangement, the liquidator must obtain the sanction of the court or the COI for the exercise of such a power. The Bills Committee notes the concern expressed by some deputations that the proposal would remove the present checks and balances on liquidators imposed by the court or the COI.

38. The Administration has pointed out that it is very common for a liquidator to engage a solicitor to assist in the performance of his/her duties and sanction is usually given for such appointment in normal court winding-up cases. The proposal will streamline the existing procedures and benefit the creditors involved. Under the provisions, the liquidator is required to give notice to the COI or, where there is no COI, to the creditors seven days in advance of his exercise of this power. This will strike a balance between the interests of different parties. Under CWUMPO, any creditor or contributory may apply to the court with respect to any exercise or proposed exercise of any of the powers under section 199. The law also provides that if any person is aggrieved by any act or decision of the liquidator, that person may apply 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 the court thinks just.

39. Members of the Bills Committee have expressed concern about whether there would be safeguards for creditors who are SMEs in the event that liquidators charged unreasonable fees. The Administration has responded that under the existing section 196(2) of CWUMPO, where there is a COI, the remuneration of a liquidator is determined by agreement between the liquidator and the COI; where there is no COI or where the liquidator and the COI failed to agree, by the court. The Bill does not propose changes to the provision.

Prohibition of touting for appointment as a provisional liquidator or liquidator, or as a receiver or manager

40. The amended section 278A of CWUMPO (Clause 98) extends the scope of the offence provision under the existing section 278A to cover offering inducements to any person (instead of only any member or creditor of the relevant company as provided in the existing section 278A) to affect the appointment or nomination of provisional liquidators or liquidators (instead of only liquidators as provided in the existing section 278A). The new section 297B (Clause 106) prohibits the offering of inducements to affect the appointment as a receiver or manager of the property of a company. Both sections 278A and 297B provide exemption for the accounting profession. Members have enquired about the reasons for not providing exemption to other professionals such as solicitors who may serve as liquidators in winding-up cases.

41. The Administration has explained that the exemption is to address the concern raised by the accounting profession during the public consultation exercise in 2013. The accounting profession was concerned that the operational arrangements as described in section 500.65 of the Code of Ethics for Professional Accountants ("the Code") issued by the Hong Kong Institute of Certified Public Accountants might be caught by sections 278A and 297B. Having considered the views, and in order not to affect the existing operation of the accounting profession, exemptions similar to section 500.65 of the Code are added to the two provisions. During the public consultation in 2013, there were no views suggesting similar exemptions be applied to other professions. Besides, the amended provisions were included in the draft provisions of the Bill sent to the relevant professional bodies (including the legal profession) for further comments in July 2015, and no comment on the amended provisions were received from these professional bodies. As different professions have different modi operandi and given that there has been no similar request from other professions, the Administration considers it not necessary to extend the exemptions to other professions at this stage.

Liquidator would not be absolved from liabilities arising from the liquidator's misfeasance or breach of duty or trust

42. There are provisions in the Bill (e.g. the proposed sections 205 and 276 of CWUMPO (Clauses 39 and 95)) providing that a liquidator would not be absolved from liabilities arising from the liquidator's misfeasance or breach of duty or breach of trust notwithstanding that the liquidator has obtained a court order releasing from the position as liquidator after the completion of the winding-up. The proposal would allow a creditor or other interested parties to apply to the court for leave to take legal action under the relevant provisions of CWUMPO against the liquidator after the liquidator's release.

43. The Bills Committee notes that some deputations have expressed concern about the liabilities for liquidators under the proposed section 276. The Administration has clarified that section 276 focuses on the conduct of liquidators during the performance of their duties, e.g. including the misfeasance, breach of duty or breach of trust. There are similar provisions in the UK insolvency regime. Some other professional sectors in Hong Kong are already subject to similar liabilities. In addition, in order to protect liquidators from being exposed to frivolous litigation unreasonably, section 276(1B) specifically provides that if a liquidator has been released under section 205, an application under that section against the liquidator can only be made with the leave of the court.

Public examination procedure of persons by the court

44. The new sections 286A to 286E of CWUMPO (Clause 101) and new rules 51A and 58A and 58B of CWUR (Clauses 137 and 144) aim to improve the private[8] and public[9] examination procedures which are part of the process of investigation conducted by the liquidator during a winding-up to ascertain information about the company's affairs and property, etc.

45. The Bills Committee notes that under the existing section 222 of CWUMPO, the court may after considering a report made by OR or liquidator, stating that in his/her opinion a fraud has been committed by any person in the promotion or formation of the company or by any officer of the company in relation to the company since its formation, direct a person (i.e. the examinee) to attend a public examination by the court, and the examinee will be furnished with a copy of the report before attending the public examination. However,

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[8] This is the procedure provided in new sections 286B and 286C where the court may, inter alia, summon the persons concerned to attend before it and be examined on oath.

[9] This is the procedure provided in new section 286A where the court may direct the persons concerned to attend before it and be publicly examined.

under new rule 51A of CWUR and the new section 286A, which are designed to improve the public examination procedure in the winding-up regime under Part V of CWUMPO, there is no requirement to provide the examinee with a copy of the report before attending the public examination. Members further note that under existing section 168IA(1) of CWUMPO, OR may apply to the court for a public examination by a report stating that in OR's opinion a prima facie case exists against any person that would render the person liable to a disqualification order under Part IVA of CWUMPO. The existing section 168IA(7) also provides a right to the examinee to be provided with a copy of the report before attending the public examination. However, such a right is removed in the proposed amendments to section 168IA(7) (Clause 15). The Bills Committee has enquired about the reasons for removing the right for the examinee to be furnished with the report under the new sections 168IA and 286A. Members are concerned that as the relevant report would set out the reasons for requiring a public examination order, the examinee would be deprived of the opportunity of knowing the case against him/her so as to obtain legal advice before attending the public examination if a copy of the report is not provided. This may give rise to the question whether justice and fairness are preserved. There is a suggestion that the Administration should consider providing the examinee with a summary/gist of the case before the public examination.

46. The Administration has explained that the new section 286A (Clause 101) and new rule 51A (Clause 137) aim to improve the public examination procedure in the winding-up regime under Part V of CWUMPO. The existing provisions on public examination under section 222 are improved and relocated to the new section 286A. The new section 286A(1) provides that the court may, after consideration of a report made under section 191(2), order the examinee to attend a public examination before the court for business relating to a company being wound up. The new rule 51A(1) provides that for the purposes of an application for a court order for public examination under the new section 286A(1), evidence in support of the application may be in the form of a report to the court setting out the reasons why a public examination order is needed and such a report is confidential. The amendment to section 168IA(7) is made as a consequence of the addition of the new rule 51A. The new rule 51A(1) also applies to the proceedings under section 168IA by virtue of the amended rule 57A (Clause 143).

47. The Administration has pointed out that the report to the court has to be kept confidential as it may contain information which, if disclosed to the examinee, may adversely affect the effectiveness of the order being sought or even frustrate its purpose. In particular, the examinee may be alerted to conceal, dissipate or destroy information or materials which may tend to

incriminate him/her but are relevant to the case. The Administration has stressed that there are adequate safeguards in the Bill to ensure justice and fairness for the examinee. The new rule 51A(2) of CWUR provides that the examinee may apply to the court to see the report and the court may allow the examinee to see all or part of the report if the examinee satisfies the court that it would be unfair to him/her not to be allowed to see it. Moreover, the examinee may appeal against the court's decision should the court disallow the examinee to see the report. Besides, under the existing Rule 54 of CWUR, OR or the liquidator concerned (as the case may be) is required to give a "Notice to Attend Public Examination" to the examinee if the court grants a public examination order. The notice will set out, inter alia, the matters to be examined during the public examination, e.g. the conduct or dealings of the examinee in relation to the company being wound up; the promotion, formation or management of that company; and the conduct of the business and affairs of that company. Therefore, the notice already provides the scope of the matters to be examined in the public examination, and this would facilitate the examinee to seek legal advice on relevant matters before the public examination. In addition, the Administration has not received any negative comment from any member of the public, professional body or other stakeholder group on the proposal during the public consultation exercise in 2013. The Administration considers that the present proposal has struck a balance between maintaining effectiveness of the examination procedures and affording a fair treatment to the examinee. Having regard to the safeguards provided in the Bill, the Administration considers that there is no need to provide the examinee with a summary/gist of the case before the public examination.

48. The Administration has emphasized that the purpose of a public examination is to gather more information on the company being wound up for facilitating the administration of the winding-up case rather than seeking court sanction to impose any regulatory or enforcement action against the examinee. A public examination under section 168IA will not by itself lead to a determination by the court of issuing a disqualification order. If the proceedings for a disqualification order are initiated, the Companies (Disqualification of Directors Proceedings) Rules (Cap. 32K) require that there must be a due process to provide the respondent with sufficient safeguards, e.g. respondent must be provided with the summons and informed of the evidence in support of the application for a disqualification order. Furthermore, the new sections 168IB (Clause 16) and 286D (Clause 101) will safeguard the examinee's interest in that any answers or affidavits given by the examinee during the public examination which might tend to incriminate the examinee would not be admissible in evidence against the examinee in criminal

proceedings.[10] The Bills Committee notes the Administration's responses above.

49. The Bills Committee has reviewed the relevant provisions, and notes that the Administration will move CSAs to improve the clarity of the public examination procedure. The CSAs introduce a new revised rule 51A, renumber the original rule 51A as rule 51B, and provide more specific references of the relevant paragraphs of section 268A(1) in the new rules 51A and 51B. As the CSAs make changes to the rule numbers (namely rule 51A and rule 51B), the Administration will also move technical CSAs to the amended rule 57A (Clause 143), sections 2(3)(b) and 15(3)(b) of the new Schedule 26 (Clause 177).

Removal of liquidator

50. Clauses 76 and 163 of the Bill stipulate the procedures for resignation and removal of liquidator or former liquidator in a voluntary winding-up (in addition to the procedures for removal of a liquidator in a court winding-up or a members' voluntary winding-up which are currently provided in CWUMPO). The Bills Committee notes the suggestion from some deputations that besides allowing the creditors or contributories of a company to apply to the court to object to the removal of the liquidator or former liquidator, the provisions should also allow the liquidator or former liquidator to do so. Mr Kenneth LEUNG supports the suggestion because he is concerned that the liquidator may be removed due to the discovery of adverse evidence on illegal transactions against the contributories or directors. Moreover, allowing the liquidator or former liquidator to act as a joint party in the removal application to the court could address the problem that parties who are allowed to apply to the court to object to the removal of the liquidator (e.g. creditors) do not have the financial resources to do so.

51. The Administration has responded that the relevant provisions in the Bill are consistent with those in a members' voluntary winding-up. It would be inappropriate to allow the liquidator to apply to the court to object to the removal as the liquidator has conflict of interest in the matter, and the suggestion may cause delay in the removal process and add to the cost of the winding-up. The Administration has stressed that when the court considers an application for the removal of the liquidator, it would examine the evidence submitted from the relevant parties, including the liquidator's views on the removal (such as whether the liquidator agrees or otherwise to be removed),

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[10] There are specified exceptions, viz. the criminal proceedings relating to the offence of (i) wilfully making a false statement under section 349 of CWUMPO and (ii) perjury under Part V of the Crimes Ordinance (Cap. 200).

and would make the decision having regard to the circumstances of the case. Moreover, under the existing section 200(3) of CWUMPO, a liquidator may apply to the court for directions in relation to any particular matter arising under the winding-up. As the company would need to give notice before holding a meeting to decide on the removal of the liquidator, there would be time for the liquidator to apply to the court for directions relating to the removal upon receipt of the notice.

Related issues

Licensing regime for private insolvency practitioners

52. Mr Kenneth LEUNG shares the views expressed by some deputations that the Bill should introduce a licensing system for private insolvency practitioners ("PIPs") so as to ensure that provisional liquidators and liquidators appointed to take up winding-up cases have the required qualifications and expertise.

53. The Administration has responded that at present, the Official Receiver's Office ("ORO") administers the Panel T scheme and Panel A scheme to outsource court winding-up cases to PIPs according to the estimated value of the property of the company being wound up.[11] ORO has been monitoring the performance of PIPs to ensure the quality of outsourced services, and taking measures to ensure PIPs' compliance with the statutory and administrative requirements.[12] According to past statistics, the quality of the outsourced cases has been good as few problematic cases have been identified by ORO. The Administration has advised that since the outsourcing schemes have been operating smoothly so far, it has no intention to introduce provisions for licensing PIPs under the current legislative exercise. The feasibility of establishing a licensing regime for PIPs will be further considered in the context of another review of the winding-up regime in future.

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[11] Panel T scheme 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 Panel A scheme deals with cases where the property of the company in the opinion of the Official Receiver is likely to exceed $200,000 in value.

[12] At the request of the Bills Committee, the Administration has provided information on the PIP firms admitted to the Panel T scheme and Panel A scheme as well as their admission criteria (LC Paper No. CB(1)383/15-16(02)).

Interface between the winding-up process and payments under the Protection of Wages on Insolvency Fund

54. Some members of the Bills Committee including Miss CHAN Yuen-han, Miss Alice MAK and Mr TANG Ka-pui are concerned that the Bill has not addressed the issue of the long time gap between the commencement of the winding-up process of a company and provision of ex gratia payments to employees from PWIF. They have urged the Administration to explore possible measures to streamline and expedite the process of payment from PWIF. The Bills Committee further notes the suggestions from some deputations that in order to speed up the PWIF process, employees should be provided with ex gratia payments from PWIF without the requirement to present a winding-up petition to the court, or be allowed to apply for PWIF direct without going through the Labour Tribunal ("LT").

55. The Administration has advised that the corporate winding-up regime under CWUMPO and PWIF regime (which is under the ambit of the Protection of Wages on Insolvency Ordinance (Cap. 380) ("PWIO")) operate independently. PWIF provides timely relief to employees of insolvent employers, and the employees will obtain, without having to wait until the completion of the bankruptcy/winding-up process, ex gratia payments as soon as possible. Any amendments to the PWIF regime or PWIO for that purpose will be outside the scope of CWUMPO and the Bill.

56. In response to members' concerns about the PWIF process, 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"). As regards the filing of a winding-up petition against a company, LD has advised that under PWIO, this is a pre-condition for the grant of ex gratia payments from PWIF in the case of an employer who is a company.[13] Irrespective of whether it is a court winding-up or a creditors' voluntary winding-up, the mechanism for the grant of ex gratia payments from PWIF to the employees will be triggered so long as a relevant party (including an employee, a creditor or a shareholder of the company concerned) has filed a winding-up petition to the court against a company.

57. LD has further explained that it will render assistance to employees in filing a winding-up petition to the court, including making referral to the Legal Aid Department ("LAD") if the employees concerned need to apply for legal

[13] Under section 18 of PWIO, notwithstanding that a winding-up petition has not been presented to the court against an employer who is a company, the Commissioner of Labour has discretion to make relevant ex gratia payments from PWIF to an applicant if certain conditions of the company being wound up are met.

aid in filing the petition. If there is any dispute between the employee applying for legal aid and the company over the employee's employment by the company or the payment item(s) and the amount owed, LD will need to refer the employee's case to LT 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 before referring the case to LAD. Regarding the processing time of PWIF applications, upon the presentation of a winding-up petition to the court, LD will, in accordance with its performance pledge, make ex gratia payments to the qualified applicants as soon as possible and in any event not later than 10 weeks after receiving all the information and documents required for processing the applications.

58. FSTB has responded that it has relayed the Bill Committee's views on speeding up the PWIF application process to LWB and LD, including some members' suggestion that LD should review its procedures of verifying and calculating the ex gratia payments so as to expedite the grant of payments to applicants. LD has also taken note of such views, including the need to explore further measures to assist eligible employees in winding-up cases to apply for PWIF.

Maximum amounts on preferential payments under section 265 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance

59. Some members of the Bills Committee, including Miss CHAN Yuen-han, Miss Alice MAK, Mr TANG Ka-pui and Mr POON Siu-ping are of the view that the Administration should take the opportunity of the Bill to raise the existing maximum amounts stipulated in section 265 of CWUMPO on preferential payments to employees ("caps under section 265") to bring the amounts in line with the levels of ex gratia payments payable to employees under PWIO.[14] They have pointed out that there has been no review of the caps under section 265 for years, and increasing the caps would benefit employees.

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[14] The ex gratia payments from PWIF are capped as follows: $36,000 for wages; $22,500 for wages in lieu of notice; $50,000 plus 50% of any excess entitlement for severance payment (as the maximum amount of severance payment payable under the Employment Ordinance (Cap. 57) is $390,000, the ex gratia payment for severance payment is capped at $220,000); and $10,500 for the total payment in respect of pay for untaken statutory holidays/untaken annual leave. Each employee is entitled to receive not more than $289,000 in ex gratia payments. The existing caps stipulated in section 265 of CWUMPO on preferential payments to employees are $8,000 for wages/salary, $8,000 for severance payment, and $2,000 for wages in lieu of notice.

60. The Administration has clarified that for employees who are paid ex gratia payments from PWIF, their beneficial interests will not be affected by the caps under section 265 since the wages and other payment items owed to them will first be paid from PWIF, subject to the maximum amounts on respective items under the PWIF. On the other hand, because PWIO provides that PWIF has subrogation rights to recover the amount of ex gratia payments made to applicants, increasing the caps under section 265 in such circumstances will result in the transfer to PWIF a larger amount of money received from the realization of the assets of a company being wound up. The Administration has pointed out that a number of stakeholders consider that instead of enhancing the rights of employees, increasing the existing caps under section 265 will create unfavourable impact on other creditors in such circumstances. The stakeholders are of the view that the caps under section 265 should not be increased at this stage.

Order of payment of unsecured creditors

61. Some members of the Bills Committee including Miss CHAN Yuen-han, Miss Alice Mak and Mr CHUNG Kwok-pan are of the view that ordinary customers and small suppliers of a company are often disadvantaged in the winding-up of a company as these parties usually do not receive any payment in the distribution of the company's assets during the winding-up process. These members have requested the Administration to consider according ordinary customers and small suppliers a higher payment priority among other unsecured creditors. On the other hand, some other members, including Mr NG Leung-sing and Mr Andrew LEUNG consider it inappropriate to single out particular classes of unsecured creditors for preferential treatment and are concerned that such a proposal may adversely affect the interests of other creditors such as SMEs.

62. The Administration has stressed the importance to handle the distribution of the assets of a company being wound up among the unsecured creditors in accordance with the relevant principles that it must be fair, reasonable and operationally practicable. It has advised that the international norm is to uphold the corporate insolvency law principle of pari passu. With reference to the pari passu principle, the existing CWUMPO provides that except for the preferential debts such as employees' wages in arrears and government statutory debts, all other unsecured creditors should be treated on an equal footing, with the company assets distributed to each such creditor subject to the proportion of the claim amount of each of them in the total claim amounts. The Administration has cautioned that making further distinction among these unsecured creditors and according some of them a higher payment priority as compared to their existing priority status will affect the interests of

the other unsecured creditors, and hence raise the question of fairness of such an arrangement. Besides the difficulty in developing workable definitions of "ordinary customer" and "small supplier", further distinction of an "ordinary customer" and a "small supplier" from other unsecured creditors who are themselves customers and suppliers to differentiate the payment priority will make the payment mechanism even more complicated, prolong the winding-up process, and result in delay of payment to creditors.

Committee Stage amendments to be moved by the Administration

63. Apart from the CSAs explained in paragraphs 29, 31 and 49 above, the Administration will move CSAs to clarify the intention of some provisions, enhance consistency and align the wordings of provisions in the Bill and between those in the English and Chinese texts as well as with existing provisions of CWUMPO, and to introduce other technical, related and consequential amendments. Some of these CSAs are proposed in the light of comments from the Bills Committee and the Legal Adviser to the Bills Committee. The major ones are highlighted below.

<u>The expression of "affidavit of concurrence"</u>

64. The purpose of the proposed CSAs is to replace the expression "affidavit of concurrence" by "supplementary affidavit" in the new section 190(2A) and (2B) (Clause 30(6)) and in other clauses in the Bill where the expression is mentioned, so as to better reflect the nature of the affidavit used in the relevant contexts.

<u>The proposed rule 39(6) on preparation of statement of affairs of a company</u>

65. The proposed rule 39(6) of CWUR (Clause 129) provides for the persons whom OR, provisional liquidator or liquidator may hold interviews with for the purpose of investigating the affairs of the company being wound up. The directors and company secretary of the company being wound up are explicitly covered in paragraphs (a) and (b) of rule 39(6) whereas paragraph (c) covers other persons. Having considered members' views, the Administration has reviewed the proposed rule 39(6)(c) and agrees that since persons such as directors, company secretaries, officers (e.g. a person holding important role in the management titled financial controllers or chief financial officers of a company), etc. are already covered by paragraph (c) of rule 39(6), there is no need to state expressly directors, company secretaries, financial controllers and/or chief financial officers in the other parts of rule 39(6). Hence, the Administration will introduce CSAs to simplify the drafting of rule 39(6) by

removing paragraphs (a) and (b) from the rule. The revised rule 39(6) will in effect provide that OR, provisional liquidator or liquidator may, for the purpose of investigating the company's affairs, hold interviews from time to time with a person "who is or may be liable to make the statement of affairs of the company or a supplementary affidavit in relation to that statement". Similar CSAs will also be made to rule 35(2) and the Note to Forms 9 and 14 of the Appendix to CWUR.

66. The Bills Committee has examined all proposed CSAs from the Administration and raised no objection. The Bills Committee will not propose any CSAs to the Bill.

Resumption of Second Reading debate

67. The Bills Committee has no objection to the resumption of the Second Reading debate on the Bill at the LegCo meeting of 20 April 2016.

Consultation with the House Committee

68. The Bills Committee reported its deliberations to the House Committee on 8 April 2016.

Council Business Division 1
Legislative Council Secretariat
13 April 2016

Appendix I

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

Membership list

Chairman	Hon WONG Ting-kwong, SBS, JP
Members	Hon Andrew LEUNG Kwan-yuen, GBS, JP Hon Alan LEONG Kah-kit, SC Hon NG Leung-sing, SBS, JP Hon CHAN Yuen-han, SBS, JP Hon Kenneth LEUNG Hon Alice MAK Mei-kuen, BBS, JP Hon Dennis KWOK Hon Christopher CHEUNG Wah-fung, SBS, JP Hon SIN Chung-kai, SBS, JP Hon POON Siu-ping, BBS, MH Hon TANG Ka-piu, JP Hon CHUNG Kwok-pan (Total：13 members)
Clerk	Ms Connie SZETO
Legal Adviser	Miss Winnie LO

Appendix II

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

List of organizations/individual from which the Bills Committee has received views

1. Briscoe Wong Ferrier Limited
2. CMA Australia (Hong Kong Branch)
3. The Chinese General Chamber of Commerce
4. Companies Registry
5. Consumer Council
6. CPA Australia
7. The DTC Association
8. Federation of Hong Kong Industries
9. The Federation of Hong Kong & Kowloon Labour Trades Unions
10. The Hong Kong Association of Banks
11. Hong Kong Bar Association
12. The Hong Kong Chinese Importers' & Exporters' Association
13. Hong Kong Confederation of Trade Unions
14. Hong Kong Exchanges and Clearing Limited
15. The Hong Kong Federation of Trade Unions
16. Hong Kong & Kowloon Trades Union Council
17. Hong Kong Institute of Certified Public Accountants
18. The Hong Kong Institute of Directors
19. Hong Kong Monetary Authority
20. Leader Corporate Services Limited
21. Office of the Privacy Commissioner for Personal Data, Hong Kong
22. PricewaterhouseCoopers
23. ShineWing (HK) CPA Limited
24. Zhonglei Specialist Advisory Services Limited
25. Mr YEUNG Wai-sing, Eastern District Council member
26. Mr NG Chau-pei, member of the Labour Advisory Board
27. Mr Stanley LAU, member of the Labour Advisory Board
28. Mr FUNG Hau-chung, member of the Protection of Wages on Insolvency Fund Board
29. Mr CHUNG Siu Kong