

**For discussion
on 2 November 2020**

**Legislative Council
Panel on Financial Affairs**

Legislative Proposals of the Companies (Corporate Rescue) Bill

Purpose

The Government will present to the Legislative Council (“LegCo”) the Companies (Corporate Rescue) Bill (“the Bill”) to introduce a statutory corporate rescue procedure (“CRP”) and insolvent trading provisions in Hong Kong. This paper briefs Members on the legislative proposals.

Why a statutory CRP is needed?

2. At present, a company which is in financial difficulties may try rescuing its business with (i) non-statutory workout agreement between a company and its major creditors to restructure debts; or (ii) scheme of arrangement under the Companies Ordinance (Cap. 622) which enables a compromise between a company and its shareholders and creditors. These options, however, do not provide for a moratorium (stay of proceedings) to bind the creditors for not applying for winding up of the company, hence hindering the effectiveness of the rescue plan.

3. A new CRP regime with a statutory moratorium will be an additional tool to allow necessary breathing space for a financially distressed company to preserve its assets and devote undivided attention to formulate a rescue plan. It provides a new option for the company to try turning around and reviving its business as much as possible, instead of pursuing immediate liquidation. The current lack of a CRP mechanism in Hong Kong leaves a gap in our insolvency regime¹. The introduction of a statutory CRP will bring our regime more in line with international practices. The new CRP may also be a timely and useful option for companies experiencing short-term difficulties brought by Hong Kong’s recent economic set-back highlighted by the COVID-19 challenges to try reviving their business. The proposals under the Bill have drawn references from other well established CRP regimes.

¹ For example, this has been noted in the World Bank’s Doing Business Study.

4. All parties involved will benefit if a company is rescued under the CRP rather than going for liquidation -

- (a) For shareholders, they have relatively low priority in the distribution of company's assets in case of liquidation, their interests are better served if the company is rescued;
- (b) For secured creditors, the value of their security is better preserved if the company's business can carry on;
- (c) For unsecured creditors, they may get a better return otherwise they usually receive very little in the distribution of the company's assets in case of liquidation; and
- (d) For employees of the company, they can keep their jobs when the company continues to operate. Our CRP proposals also include a statutory timeframe to provide reasonable certainty for employees to receive outstanding entitlements.

Major Legislative Proposals

5. The Government published a package of detailed proposals on CRP in May 2014 and briefed the Panel on Financial Affairs of LegCo in July 2014. We then worked further on the proposals with an iterative process of engagement with various stakeholders' groups. We have taken into account the views of stakeholders when we prepared the Bill, especially those concerning the initiation of the CRP, protection of the rights of the employees, safeguard measures as well as the statutory defences under insolvency trading provisions. The latest major legislative proposals in the Bill are set out in the **Annex**.

Overview

6. In gist, a company (or the liquidator/provisional liquidator of the company if it has already entered into winding-up or is subject to a winding-up application) which is insolvent or will likely become insolvent may initiate a CRP and appoint an independent professional third party as a provisional supervisor ("PS") who must be a certified public accountant or solicitor. The company shall also solicit the support of its major secured creditor ("MSC"), if any, before the initiation (please refer to paragraph 8). The PS will displace the directors and management of the company and act as its agent in the moratorium period (called provisional supervision) during which the company continues to operate as a going concern.

7. The period of provisional supervision will be set at 45 business days for the PS to draw up a rescue plan. The period may be extended up to six months with the consent given at a creditors' meeting by way of resolution, or beyond six months for complex cases but it must be sought by an application to the court. The PS will investigate the company's business, property, affairs and financial circumstances so as to prepare a rescue proposal (called voluntary arrangement ("VA")) for consideration at a creditors' meeting at the end of the provisional supervision. The creditors will decide whether to approve the VA proposal by resolution. The VA will then be implemented under the supervision of a Supervisor who also must be a certified public accountant or solicitor.

Role of MSC

8. Major stakeholders including the business and insolvency professionals' groups were concerned that the requirement for getting support from the MSC before initiating a provisional supervision should be practical enough so as not to compromise the usefulness of the CRP. To strike a reasonable balance between safeguarding the interests of the MSC and upholding the usefulness of the CRP, the current proposals provide the MSC a right to object. The provisional supervision may be initiated if the MSC does not issue a notice of objection within a defined period (5 business days) after it has been informed of a company's intention to initiate the CRP.

Protection of employees' interests

9. The labour sector was concerned that the CRP regime should contain sufficient safeguard to prevent abuse by employers to evade their obligations to pay employees' entitlements. Some labour groups were also concerned about how the statutory moratorium would affect the timing for employees to receive outstanding entitlements and other legitimate employees' rights. To address these concerns, the current proposals contain the following measures to protect employees -

- (a) the outstanding entitlements of employees owed by a company as at the commencement of provisional supervision should be paid in accordance with a phased payments scheme. In case of a failure to make a phased payment, the employees concerned will no longer be bound by the moratorium and may petition the court to wind up the company;
- (b) the entitlements of employees arising after the commencement of provisional supervision should be paid in compliance with relevant statutory provisions and terms/conditions of employment contracts. In case of a failure to make a payment, the employees concerned may

petition the court to wind up the company; and

- (c) specified exemptions from the statutory moratorium are provided, such that the employees' actions/claims under certain provisions of the Employment Ordinance (Cap. 57), and specified claims of an employee for compensation or damages as defined in the Employees' Compensation Ordinance (Cap. 282) will not be hindered.

Applicability of CRP to Registered Non-Hong Kong Companies ("RNHKCs")

10. Under the Bill, the proposed CRP would be applicable to local companies as well as RNHKCs. The inclusion of RNHKCs is important as Hong Kong is a major international financial centre and business hub and there is a considerable number of RNHKCs operating in Hong Kong in one form or another.

Safeguard measures of CRP

11. While a statutory CRP should involve predominately out-of-court arrangements to save time and costs, our proposals would involve the court appropriately in safeguard measures. The court will have a role in preventing abuse of the CRP process, maintaining its overall integrity and facilitating its proper comportment. The court will also be given suitable powers to provide for proper checks and balances on the powers of PS and Supervisor to prevent abuse.

Statutory defences for insolvent trading provisions

12. Insolvent trading provisions are proposed to ensure that when a company is slipping into insolvency, the director would be held responsible if they have not acted promptly to address the situation. At the same time, the proposals also stipulate statutory defences to provide recourse to directors for avoiding from being caught inadvertently by the provisions.

Legislative Timetable

13. We will introduce the Bill into LegCo in early 2021. In parallel, we are also preparing the subsidiary legislation covering various operational matters for holding of creditors' meetings, organisation of committee of creditors, preparation of statements of affairs and report, applications to the court, etc., so that the subsidiary legislation can be tabled for negative vetting a few months after the enactment of the Bill. The new CRP regime can then be formally commenced.

Advice Sought

14. Members are invited to offer their views on the legislative proposals of the Bill.

Financial Services Branch

Financial Services and the Treasury Bureau

22 October 2020

**Companies (Corporate Rescue) Bill:
Details of Major Legislative Proposals**

The Companies (Corporate Rescue) Bill (“the Bill”) aims to introduce a statutory corporate rescue procedure (“CRP”) and insolvent trading provisions in Hong Kong.

2. The objects of CRP are (a) to maximize the chances of a company that is insolvent or is likely to become insolvent continuing in existence as a going concern or as much as possible of its business continuing in existence; and (b) if it is not reasonably practicable to achieve the object in (a), to achieve a better return for the company’s creditors as a whole than would result from an immediate winding-up of the company.

3. The insolvent trading provisions provide that after a company goes into insolvent liquidation, the liquidator of the company will be empowered to make an application to the court to seek a declaration that a director of the company responsible for the insolvent trading of the company is liable to make a contribution to the company’s assets that the court considers appropriate.

4. Major legislative proposals in the Bill are set out in the paragraphs below.

(A) Provisional Supervision and Provisional Supervisor

Commencement of Provisional Supervision

5. For a company to undertake a statutory CRP, the Bill stipulates a defined timeframe to facilitate speedy determination of the way forward for the company. This process is known as provisional supervision. Provisional supervision may be initiated by the company¹ (either by

¹ It is proposed that besides companies formed and registered in Hong Kong, registered non-Hong Kong companies may also commence provisional supervision in Hong Kong, but the latter type of companies will be subject to certain different requirements. Please refer to the details in paragraphs 33-35. On the other hand, it is proposed that the CRP will not be applicable to the

resolution of its members or directors) or, where a company has already entered into winding-up or is subject to a winding-up application, by the provisional liquidator or liquidator² through the appointment of a provisional supervisor (“PS”)³ if they are of the opinion that the company is insolvent or likely to become insolvent⁴ at some future time and provisional supervision is reasonably likely to achieve the statutory objects (see paragraph 2 above). At the end of provisional supervision, some companies may enter into a voluntary arrangement (“VA”) which is a rescue plan prepared by the PS.

6. A written notice of intention to appoint a PS should be given to the major secured creditor (“MSC”)⁵ of the company, if any. This

following categories of companies which are subject to regulation by statutes that have provisions for the relevant financial regulators to assume control of them or oblige them to act in certain manner –

- (a) an authorized institution as defined in the Banking Ordinance (Cap. 155);
- (b) an authorized insurer as defined in the Insurance Ordinance (Cap. 41) (“IO”);
- (c) Lloyd’s as defined in the IO or a member of Lloyd’s;
- (d) an association of underwriters carrying on insurance business as provided in the IO;
- (e) a licensed corporation, a recognized clearing house, a recognized exchange company, a recognized exchange controller, a recognized investor compensation company, an associated entity of an intermediary and a person providing authorized automated trading services as defined in the Securities and Futures Ordinance (Cap. 571);
- (f) a within scope financial institution and a holding company of such a within scope financial institution as defined in the Financial Institutions (Resolution) Ordinance (Cap. 628); and
- (g) a licensee as defined in the Payment Systems and Stored Value Facilities Ordinance (Cap. 584).

² Provisional supervision cannot be initiated by the company if there is a pending application to wind up the company or after the commencement of the winding up of the company. In case provisional supervision is to be initiated by the provisional liquidator or liquidator, the provisional liquidator or liquidator is required to obtain leave of the court prior to the initiation of provisional supervision.

³ More than one qualified person can be appointed as provisional supervisor.

⁴ The existing insolvency test used in section 178(1)(c) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (“CWUMPO”) would be adopted (i.e. a mixture of the cashflow and balance sheet tests).

⁵ MSC is defined as –

- (a) a person who holds a charge on the whole, or substantially the whole, of the company’s property; or
- (b) a person who holds two or more charges on the company’s property, where the property subject to those charges constitutes the whole or substantially the whole of the company’s property,

and for the purpose of this definition, “charge” means a charge created in any way and includes a mortgage, and an agreement to give or execute a charge or mortgage, whether on demand or otherwise.

notice of intention should relate to the initiation of provisional supervision, but not to the choice of a particular PS. The MSC has a right to object to the appointment and will be given at least five business days to convey the objection, if any, by issuing a written notice. The provisional supervision may be initiated if the MSC has no objection. We consider it essential that the rights of secured creditors should not be radically altered as secured lending is very important in the business world⁶. Therefore, the support of the MSC for the company to undergo CRP is vital. If the company has more than one MSC (i.e. in cases where there are holders of subsequent charges over the whole, or substantially the whole, of the company's property), the above requirement should be complied with in respect of each of them before the company, or the provisional liquidator or liquidator (as the case may be) can commence provisional supervision by appointing a PS. For a company without any MSC, there is no requirement to give the notice of intention to any creditors.

7. The PS must summon the first creditors' meeting⁷ under provisional supervision to be held within 10 business days from the date of commencement of provisional supervision, and preside at the meeting (or nominate a person to preside at the meeting). At the first creditors' meeting, the creditors may determine, among other things, whether the appointed provisional supervisor should be removed, and if so, who is to

⁶ The rights of secured creditors are also protected by other measures under the proposed CRP regime –

- (a) the security right of secured creditors is always preserved (though the enforcement of security is subject to the statutory moratorium during the provisional supervision);
- (b) if the PS disposes of property subject to a floating charge, the floating charge has the same priority in respect of the acquired property. For property subject to a security other than a floating charge, prior court's leave will be required before the PS may dispose of the property and the net proceeds (based on market value) must be applied to discharge the sums secured;
- (c) secured debts cannot be compromised in a VA without the agreement of the relevant secured creditors;
- (d) a secured creditor may exercise voting right at the creditors' meeting on the approval of a VA to the extent of the unsecured part, or if he relinquishes the security to participate in the proposed rescue plan; and
- (e) a secured creditor may choose to enforce security after the end of provisional supervision.

⁷ For all creditors' meetings convened during provisional supervision and when the company is subject to a VA, the creditors who may attend the creditors' meeting and vote do not include creditors in respect of: claims of employees covered by the phased payments which have been verified and admitted, claims under certain proceedings exempted from the moratorium during provisional supervision and certain claims that are not subject to the VA. For a secured creditor, he may attend the creditors' meeting and vote to the extent of the unsecured part, or if he relinquishes the security to participate in the proposed rescue plan.

be appointed instead.

8. Upon the commencement of provisional supervision, the PS is required to make the following notifications –

- (a) filing a notice of appointment of the PS with the Registrar of Companies not later than the first business day following the appointment;
- (b) publishing a notice of appointment of the PS in the Gazette within 15 days from the appointment; and
- (c) where there is a pending application for the winding up of the company or the company was in the course of being wound up preceding the appointment of the PS, giving a notice of beginning of provisional supervision to the petitioner, the court and other specified bodies (as applicable) not later than the first business day following the appointment.

9. Not later than three business days following the commencement of provisional supervision by the appointment of the PS, the appointor (i.e. the company or the provisional liquidator or liquidator (as the case may be)) must file with the Registrar of Companies a statement that contains specified particulars of the appointment. In addition, while the company is under provisional supervision, the business documents and every website of the company should contain a statement that the company is under provisional supervision.

10. It is proposed that the period of provisional supervision be set at 45 business days, which may be extended up to six months with the consent given at a creditors' meeting by way of resolution. As time is of the essence during provisional supervision, it should be of a limited duration to facilitate speedy determination of the way forward for the company. On the other hand, we recognise that there could be more complex situations (e.g. larger companies) where more time is needed to draw up a rescue plan. Therefore, it is proposed that any extension beyond six months has to be sought by an application to the court, which has the power to extend the period of provisional supervision as it thinks fit.

PS' Roles, Functions, Powers and Liabilities

11. The PS is an independent professional third party who must be a certified public accountant or a person qualified to act as a solicitor. During provisional supervision period, the PS will take control of the company⁸, consider options for rescuing the company and prepare proposals for consideration and decision at the final creditors' meeting under provisional supervision. When performing a function as the PS of a company under provisional supervision, the PS is taken to be acting as the company's agent. The PS must perform his or her functions in accordance with the statutory objects (set out in paragraph 2 above) and also in the interests of the company's creditors as a whole. The major powers of the PS include the following –

- (a) has control of the company's business, property and affairs;
- (b) may carry on the company's business and manage the company's property and affairs;
- (c) may terminate or dispose of all or part of the company's business, and may dispose of any of the company's property; and
- (d) may perform any function that the company or its officers could perform if the company were not under provisional supervision.

12. During provisional supervision, the PS will consider options for rescuing the company and, where appropriate, prepare proposals for a VA for consideration at the final creditors' meeting. To enable the PS to do so, he or she should be empowered to investigate the company's business, property, affairs and financial circumstances as soon as possible after appointment, with a view to assessing its financial position. In order to facilitate the investigative duties of the PS, it is proposed to empower the PS to –

⁸ Unless with consent of the PS, with leave of the court, or otherwise permitted or required by a provision in the Bill, a person cannot perform or exercise a function or power as an officer of a company (including a director, manager or company secretary), a receiver or manager of the property of a company, or a provisional liquidator or a liquidator of a company.

- (a) require certain persons⁹ to provide the PS with a statement of affairs of the company containing specified information within 28 days. A person who is so required may request the PS, failing which the court, to revoke the requirement, or to allow more time for compliance;
- (b) require certain persons¹⁰ to inform the PS of the whereabouts of any books and papers of the company, and to answer questions or provide relevant information concerning the company; and
- (c) require a person to deliver to the PS the books and papers of the company specified by the PS, which are in the person's possession, custody or control¹¹.

13. It is also proposed that for appropriate cases, the PS may apply to the court for examination of certain persons¹² for the purpose of obtaining relevant information and books and papers of the company.

⁹ Such persons cover any of the persons who —

- (a) is or has been an officer of the company;
- (b) has taken part in the formation of the company at any time within one year before the date on which provisional supervision began;
- (c) is in the employment of the company, or has been in the employment of the company within the preceding year, and is in the opinion of the PS capable of giving the information required; or
- (d) is or has been within the preceding year an officer of or in the employment of a company that is an officer of the company, or was an officer of the company within the preceding year.

¹⁰ Such persons cover a person in footnote 9 above and any of the persons who is or has acted as —

- (a) the provisional liquidator or liquidator of the company;
- (b) a receiver or manager of the property of the company; or
- (c) a PS of the company or a supervisor of a VA of the company.

¹¹ If the person is entitled to the books and papers of the company under a lien, he cannot retain possession, custody or control of the books and papers, or claim or enforce the lien on those books and papers, but such a lien is not otherwise prejudiced. On the other hand, if a secured creditor of the company is entitled to possession, custody or control of the books and papers (otherwise than because of a lien), while he may retain possession, custody or control of the books and papers, the PS is entitled to inspect and make copies of the books and papers at any reasonable time.

¹² Such persons cover any of the persons who is —

- (a) an officer of the company;
- (b) a person supposed to be indebted to the company;
- (c) a person known or suspected to have in the person's possession, custody or control any property of the company; and
- (d) a person whom the court considers capable of giving information concerning the company; the promotion, formation, business, trade, dealings, affairs or property of the company; or any provisional supervision, VA or winding-up of the company.

14. Other powers of the PS include the following –

- (a) may remove from office a director of the company;
- (b) may appoint a person as a director of the company, whether or not to fill a vacancy;
- (c) may execute a document, bring or defend proceedings, or do anything else in the company's name and on its behalf; and
- (d) may do whatever else is necessary for the purposes of the Bill.

15. To maintain the confidence of others trading with the company under provisional supervision, which is essential for a CRP to be successful, the Bill provides that the PS is personally liable under the following two categories of contracts –

- (a) any contract entered into by the PS (in the performance or purported performance of the functions of a PS), except to the extent the contract provides otherwise; and
- (b) any pre-appointment contract adopted by the PS (in the performance or purported performance of the functions of a PS) in writing, within 16 business days from the date of appointment as PS, except to the extent that the PS and the party to the contract otherwise agree in writing¹³.

16. The PS will be allowed to agree with the contracting parties on the extent of his or her personal liabilities in respect of the relevant contracts. The Bill will provide that the PS is entitled to be indemnified out of the company's property for his or her personal liabilities as set out in paragraph 15 above, his or her remuneration and the expenses properly incurred by him or her in the capacity as the PS, and the indemnity will have priority over the company's unsecured debts and debts secured by floating charges, subject to certain exceptions.

¹³ For debts which arose before the commencement of provisional supervision, the PS will not be personally liable for any such debts. Such pre-commencement debts will be the subject of the proposal for a VA. In relation to contracts entered into by the company before the commencement of provisional supervision, they will not be automatically deemed to be adopted by the PS if he or she has not adopted them in writing. This approach of requiring positive adoption of contract will be applied to all types of pre-appointment contracts.

17. Since the company under provisional supervision continues to operate as a going concern and the PS will act as an agent of the company in exercising his or her functions and powers under the law, he or she may, as appropriate, be subject to relevant statutory obligations imposed in respect of the company or on the officers or persons responsible for the management of the company, subject to certain exceptions in relation to the phased payments.

(B) Statutory Moratorium during Provisional Supervision

18. The Bill provides that during provisional supervision of a company, there is a statutory moratorium on civil proceedings and actions against the company and its property¹⁴. The moratorium is the cornerstone of provisional supervision. It has the dual effect of suspending the rights of creditors while preserving the company's property in order to allow the company to continue trading as a going concern and give the PS the necessary breathing space to investigate the company's affairs and formulate a rescue plan.

19. The effects of the moratorium are summarised as follows –

- (a) no resolution can be passed for a company to be wound up voluntarily; no winding up statement as defined in section 228A(20) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (“CWUMPO”) may be delivered to the Registrar of Companies under section 228A of CWUMPO; where voluntary winding up had already commenced before provisional supervision of a company began, the winding up and all proceedings relating to the winding up must be suspended;

¹⁴ The following should also be noted –

- (a) A transaction or dealing affecting the company's property while the company is under provisional supervision would be void unless it is entered into by the PS on the company's behalf or with the PS's prior written consent or under a court order, or is otherwise permitted or required by a provision in the Bill. Other exceptions have also been provided in the Bill.
- (b) The moratorium would not operate to automatically terminate contracts entered into by the company except that contractual ipso facto clauses continue to be enforceable.
- (c) The moratorium would not affect the right of set-off against the company, i.e. the parties can exercise their right of set-off notwithstanding the moratorium.

- (b) no application to the court can be made for the winding up of a company; any application to wind up a company by the court which had been made before provisional supervision of the company began but has not been disposed of must be suspended; no order may be made by the court for the winding up of a company; where the winding up of a company had already commenced, pursuant to an order for winding up made before provisional supervision of the company began, the winding up and all proceedings relating to the winding up must be suspended;
- (c) unless with consent of the PS, with leave of the court, or otherwise permitted or required by a provision in the Bill, no proceedings in a court¹⁵, except for criminal proceedings¹⁶, against a company or in relation to any of its property can be commenced or continued with;
- (d) unless with leave of the court, or otherwise permitted or required by a provision in the Bill, no enforcement process in relation to a company's property (i.e. execution against the property or any other enforcement process in relation to the property that involves a court or a bailiff) can be commenced or continued with;

¹⁵ For proceedings in a court subject to the statutory moratorium during provisional supervision, a court means –

- (a) the Court of Final Appeal;
- (b) the Court of Appeal;
- (c) the Court of First Instance;
- (d) the District Court;
- (e) a magistrate;
- (f) the Labour Tribunal;
- (g) the Lands Tribunal;
- (h) the Competition Tribunal;
- (i) the Minor Employment Claims Adjudication Board; or
- (j) the Small Claims Tribunal.

¹⁶ The criminal proceedings exemption is intended to cover a wide scope of proceedings including, but not limited to, proceedings in which any public prosecuting authority prosecutes a party (including sentencing proceedings), proceedings in which a private individual prosecutes a party, proceedings in respect of applications (e.g. for various types of warrants, orders, etc.) the purpose of which are related to criminal investigations and offences, hearing on costs in relation to criminal cases, appeal proceedings in relation to any of the above, etc.

- (e) unless with leave of the court, the duties of court officers (i.e. bailiffs or the registrar or other appropriate officers of the court) in relation to a company's property are restricted¹⁷;
- (f) unless with consent of the PS or leave of the court, the exercise of third party property rights is subject to restrictions¹⁸; and
- (g) unless with consent of the PS, leave of the court, or otherwise permitted or required by a provision in the Bill, the powers of a receiver or manager of the property of a company are suspended; and if required by the PS, the receiver or manager must vacate his office.

20. Apart from criminal proceedings, we recognise that certain other exemptions from the moratorium during provisional supervision are justified for public policy reasons or public interest purposes. Firstly,

¹⁷ If any court officer receives a written notification from the PS that the company has begun provisional supervision, a court officer, unless the court otherwise permits, cannot –

- (a) take action to sell the company's property under a process of execution;
- (b) pay to a person (other than the PS) the proceeds of selling the company's property (at any time) under a process of execution; or the money of the company seized (at any time) under a process of execution; or the money paid (at any time) to avoid seizure or sale of the company's property under a process of execution;
- (c) take action in relation to the attachment of a debt due to the company; or
- (d) pay to a person (other than the PS) the money received because of the attachment of such a debt.

On the other hand, a court officer must, *inter alia*, –

- (a) deliver to the PS any property of the company that is in the court officer's possession or custody under a process of execution (whenever begun);
- (b) pay to the PS the proceeds of selling the company's property (at any time) under a process of execution; or the money of the company seized (at any time) under a process of execution; or the money paid (at any time) to avoid seizure or sale of the company's property under a process of execution (provided that the proceeds or money are in the court officer's possession or custody, or have been paid into the court and have not since been paid out); and
- (c) pay to the PS the money received because of the attachment of a debt due to the company (provided that the money is in the court officer's possession or custody, or has been paid into court and has not since been paid out).

¹⁸ For example, a person cannot enforce a charge on the company's property; if the company's property is subject to a lien or pledge and the property is in the lawful possession of the holder of the lien or pledge, the holder of the lien or pledge cannot sell the property or otherwise enforce the lien or pledge; an owner or lessor of property that is used or occupied by, or is in the possession of, the company cannot take possession of the property or otherwise recover it; and distress cannot be levied against the goods and chattels of the company.

there will be exemptions for the purpose of protecting employees' entitlements. Please refer to paragraphs 28 – 32 below.

21. In addition, the Bill specifies the proceedings and other matters that are “exempted matters”¹⁹ for the purpose of exemptions from the effects of the moratorium during provisional supervision. These exempted matters are –

- (a) criminal proceedings and enforcement action²⁰ for fines, penalties and sum payable to the Government in criminal proceedings;
- (b) proceedings in relation to unfair prejudice petitions by the Financial Secretary under section 879(3) of the Companies Ordinance (Cap. 622);
- (c) proceedings under the following Ordinances and enforcement action for enforcing an order made in a proceeding under any of the following Ordinances –
 - (i) the Prevention of Bribery Ordinance (Cap. 201);
 - (ii) the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405);
 - (iii) the Organized and Serious Crimes Ordinance (Cap. 455);
 - (iv) the Mutual Legal Assistance in Criminal Matters Ordinance (Cap. 525);
 - (v) the Securities and Futures Ordinance (Cap. 571);
 - (vi) the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575); and
 - (vii) the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615);
- (d) proceedings, enforcement process and other acts of the Government otherwise than in the capacity of a creditor or member of a company, including (but not limited to) resumption

¹⁹ Generally speaking, the exempted matters do not provide for any exemption allowing the commencement or continuation of winding-up proceedings.

²⁰ In this paper, enforcement action means any proceedings, enforcement process, distress or other action.

by the Government pursuant to a Government lease or otherwise;

- (e) acts to deal with unlawful occupation of unleased land under relevant provisions of the Land (Miscellaneous Provisions) Ordinance (Cap. 28);
- (f) proceedings by an employee relating to compensation or damages as defined in the Employees' Compensation Ordinance (Cap. 282) ("ECO") and any enforcement action for enforcing a claim for the relevant compensation or damages (please also see paragraph 32(d) below); and
- (g) proceedings under Part VA or VIA of the Employment Ordinance (Cap. 57) (please also see paragraphs 32(b)-(c) below).

22. In relation to some exempted matters in paragraphs 21(b) and (c) above, the Bill provides that certain "exempted receivers" who can be appointed under specified provisions of the following Ordinances are not subject to the moratorium on restrictions against exercise of third party rights and the provisions restricting the performance of functions as a receiver or manager of the property of a company during provisional supervision –

- (a) the Companies Ordinance (Cap. 622);
- (b) the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405);
- (c) the Organized and Serious Crimes Ordinance (Cap. 455);
- (d) the Mutual Legal Assistance in Criminal Matters Ordinance (Cap. 525);
- (e) the Securities and Futures Ordinance (Cap. 571); and
- (f) the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575).

23. The Bill also provides certain "exempted winding up provisions" so that during provisional supervision, a company can be wound-up in

cases where the application of certain specified provisions of the following Ordinances is warranted, mainly for public interest reasons²¹ –

- (a) the Trustee Ordinance (Cap. 29);
- (b) the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32);
- (c) the Insurance Ordinance (Cap. 41);
- (d) the Banking Ordinance (Cap. 155);
- (e) the Trading with the Enemy Ordinance (Cap. 346);
- (f) the Securities and Futures Ordinance (Cap. 571); and
- (g) the Companies Ordinance (Cap. 622).

(C) PS' Recommendations (including Voluntary Arrangement)

24. Under the Bill, the PS is required to make recommendations on the specified alternative outcomes for consideration and decision at the final creditors' meeting in accordance with the timeframe set out in paragraph 10 above. The PS should recommend whether –

- (a) the company should enter into a VA which is a rescue plan prepared by the PS;
- (b) the company should be wound up (in accordance with the relevant provisions of CWUMPO); or
- (c) the company's provisional supervision should end.

25. During the final creditors' meeting, a resolution may be passed to approve a VA proposal under which debts owed by the company may be compromised (e.g. a "haircut" and/or a postponement of repayment). At the meeting, if the creditors approve a VA proposed by the PS with or without modifications²², they must also appoint a qualified person as the

²¹ For a company that is subject to an exempted winding up, no PS may be appointed for initiating a CRP.

²² Under the Bill, a resolution at the final creditors' meeting to approve a VA proposal is passed if a majority in number representing more than two-thirds in value of the creditors present and voting, in person or by proxy, have voted in favour of the resolution but the resolution is invalid if those voting against it include more than half in value of the creditors to whom the notice of meeting was sent and who are not connected with the company.

Supervisor of the VA²³. The PS will be taken to be the Supervisor of the VA, unless another person is appointed as the Supervisor by the creditors. A Supervisor must be a certified public accountant or a person qualified to act as a solicitor. In general, the VA binds a creditor of the company in respect of a specified claim of the creditor against the company which arises on or before the commencement of provisional supervision and in respect of a claim for phased payments (please refer to paragraph 28 below for the details of phased payments). The VA also binds the company, the Supervisor, and the members and officers of the company.

26. While the company is subject to the VA, there is a moratorium on commencement of voluntary winding-up proceedings for the company, and the company may not by special resolution resolve that the company be wound up by the court. However, it does not prevent the passing of a resolution to terminate the VA and wind up the company at a creditors' meeting. For a creditor who is bound by the VA of the company (to the extent of a claim covered by the VA), the creditor is bound by a moratorium and cannot, until the termination of the VA²⁴ –

- (a) make an application to the court to wind up the company;
- (b) unless with leave of the court, or otherwise permitted or required by a provision in the Bill, begin or continue with any proceedings against the company or in relation to any of its property; and
- (c) unless with leave of the court, or otherwise permitted or required by a provision in the Bill, begin or continue with any enforcement process in relation to the company's property (i.e. execution against the property or any other enforcement process in relation to the property that involves a court or a bailiff).

Similar to the reasons mentioned in paragraph 21, claims relating to certain proceedings and under certain Ordinances should warrant exclusion from the effects of the VA (i.e. the terms of the VA and the moratorium during the VA). See paragraph 27(e) below.

²³ More than one qualified person can be appointed as Supervisor.

²⁴ In respect of any claim of a creditor which does not fall under the VA (or is exempted from the effects of the VA), the creditor is not bound by the moratorium.

27. Details of implementation of a VA are set out below –

- (a) after approval of the VA, the Supervisor is required to give relevant notices and documents to the creditors of the company and the Registrar of Companies, and where there is a pending application for the winding up of the company or the company was in the course of being wound up preceding the commencement of provisional supervision, additional notices and documents are to be given to the petitioner, the court and other specified bodies (as applicable);
- (b) while the company is subject to a VA, the business documents and every website of the company should contain a statement that the company is subject to a VA;
- (c) if the company was in the course of being wound up (or an application to wind up the company was pending) immediately before the beginning of provisional supervision which began by the appointment of a PS by the provisional liquidator or liquidator, when a VA takes effect, all proceedings relating to the winding up are stayed permanently (or where applicable, the pending application to wind up the company and all the proceedings relating to the application are dismissed) and the person who was the provisional liquidator or liquidator of the company is removed from office. On the other hand, as a safeguard measure to prevent unfairness or injustice, the court is empowered to make an order to lift the stay of proceedings relating to the winding up (or where applicable, an order not to dismiss the pending application to wind up the company and the proceedings relating to the application) if the court is satisfied that no other remedy is adequate;
- (d) there are a number of measures for protecting employees' interests in the implementation of a VA. Please refer to paragraphs 28-32 below;
- (e) a VA will not bind a creditor of the company in respect of an "excluded claim" of the creditor against the company and such a claim is excluded from the effects of the VA. The excluded claims include claims arising from certain proceedings and certain Ordinances set out in paragraphs 21 (a), (b), (c) & (f)

above and employees' entitlements which are not phased payments;

- (f) the creditors of the company subject to a VA may pass a resolution to vary the VA at a creditors' meeting. On the other hand, after the variation, a creditor of the company may apply to the court for an order to cancel the variation on specific grounds; and
- (g) upon a breach of a VA that has not been rectified, the creditors of the company subject to a VA may at a creditors' meeting pass a resolution to terminate the VA and wind up the company. In such case, the company is taken to have passed a resolution for winding up under the relevant provisions of CWUMPO. The VA of a company may also be terminated under the following circumstances²⁵ –
 - (i) an order to terminate the VA is made by the court on specified grounds upon an application from a creditor of the company, the Supervisor, the Official Receiver or, with leave of the court, any interested person. In such case, the company is also taken to have passed a resolution for winding up under the relevant provisions of CWUMPO;
 - (ii) the VA is fully implemented as certified by the Supervisor; or
 - (iii) the court appoints a provisional liquidator or orders that the company be wound up.

(D) Protection of Employees' Interests

28. One of the major considerations in designing the CRP regime is that there should be adequate protection of the interests of employees.

²⁵ CRP may not be initiated for a company that had previously been under provisional supervision during the period of 12 months from the date on which provisional supervision ended (in a case where a VA was not approved) or from the date on which a VA ceased to have effect (in a case where a VA was approved) (as the case may be). However, the court may, on application made by a company, grant approval for an appointment of a PS to be made during the said 12-month period.

There are specific proposals in the Bill to protect their interests. On outstanding entitlements of employees owed by a company as at the commencement of provisional supervision (pre-commencement entitlements), we propose that, subject to an application and verification process, the company should pay them in three phases (phased payments) –

- (a) Phase 1: arrears of wages due before the commencement of provisional supervision should be paid with reference to the relevant cap that applies for the purposes of the Protection of Wages on Insolvency Fund (“PWIF”) within 30 days after commencement of provisional supervision;
- (b) Phase 2: for employees whose employment had been terminated before commencement of provisional supervision, payments calculated with reference to the relevant PWIF-caps for any outstanding wages in lieu of notice of termination, severance payments, pay for untaken annual leave and pay for untaken statutory holidays should be paid within 45 days after a VA has been approved (or, if the time limit for holding the final creditors’ meeting under provisional supervision is extended, within 45 days from the date of the approval of the first extension); and
- (c) Phase 3: any remaining pre-commencement entitlements, including outstanding contributions under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) or the Occupational Retirement Schemes Ordinance (Cap. 426) and outstanding wages, wages in lieu of notice, severance payments, etc., should be paid in full within 12 months after the date of approval of a VA.

29. To the extent of the pre-commencement entitlements covered by the phased payments, the employees are also bound by the moratorium during provisional supervision and the moratorium when the company is subject to a VA. If, however, there is a failure to make a phased payment in accordance with the relevant provisions, the employee concerned will no longer be bound by the moratoria. That means the employee concerned may petition the court to wind up the company²⁶

²⁶ In case where the company has already entered into winding up, the employee concerned may apply to the court to end provisional supervision so that the winding up proceedings would cease

(thus eligible to apply for ex-gratia payments under the PWIF). In addition, a VA must not contain any provision that is inconsistent with the operation of the phased payments.

30. In cases where provisional supervision is preceded by a court winding up of the company (i.e. when the appointment of the PS was made by the provisional liquidator or liquidator), it is likely that the employees of the company may have made applications for ex-gratia payments under the PWIF. As the PWIF was set up to provide timely financial relief in the form of ex-gratia payments to employees in the event of cessation of the business of their insolvent employers but a company undergoing the CRP process operates as a going concern, it would not be appropriate for the PWIF to continue to process the applications made by employees of such a company. As such, we propose that, upon the commencement of provisional supervision, processing of the PWIF payments, where applicable, will be suspended and no ex-gratia payment would be made. On the other hand, for the PWIF payments that were made, the PWIF Board will have a subrogation right to recover suitable sums from the phased payments.

31. As regards the protection of employees' entitlements arising on or after the commencement of provisional supervision, the following two safeguard measures are proposed in the Bill –

- (a) if there is or has been, on the part of the company, any failure to comply with a provision of the Apprenticeship Ordinance (Cap. 47) and the Employment Ordinance (Cap. 57) (“EO”) or a term or condition in an employment contract requiring the company to make a payment to an employee, or an order for the company to make a payment to an employee under Part VA or VIA²⁷ of

to be suspended.

²⁷ Under Part VA of the EO, an employee shall not be entitled to a severance payment unless, before the end of the period of 3 months beginning with the relevant date or within such extended period as the Commissioner for Labour may agree – (a) the payment has been agreed and paid; (b) the employee has made a claim for payment by notice in writing given to the employer; or (c) a question as to the right of the employee to the payment, or as to the amount of the payment, has been made the subject of a claim filed with the Minor Employment Claims Adjudication Board or the Labour Tribunal.

Under Part VIA of the EO, an employee may be granted remedies against his/her employer if the employer dismisses the employee or varies the terms of the employment contract (without the employee's consent and, in the absence of an express term in the employment contract which so

the EO, or an obligation to make a payment for the purpose of a contribution to the Mandatory Provident Funds or Occupational Retirement Schemes or the relevant contribution surcharges arising on or after the commencement of provisional supervision, the employees will be exempted from the moratorium (e.g. the employee may apply to the court for the winding up of the company or enforce the claims for the relevant outstanding entitlements²⁸); and

- (b) in cases of late payment of post-commencement entitlements of employees, the PS may, as appropriate, be subject to statutory liability in accordance with existing offence provisions in the relevant employment-related ordinances.

32. Furthermore, we propose a number of new and additional safeguard measures for protection of employees' interests in the CRP regime –

- (a) there is no provision in the Bill which will hinder an employee to invoke section 10A of the EO²⁹ any time during provisional supervision and when the company is subject to a VA. Therefore, when a company is under the CRP, where necessary, an employee may still invoke section 10A for termination of the employment contract and the employer would be subject to a statutory obligation to settle the relevant termination payments within seven days;

permits), in either case with intent to extinguish or reduce any right, benefit or protection conferred or to be conferred upon the employee by the EO, without a valid reason. The employee will not be entitled to such remedies unless – (a) the employee has made a claim for such remedies by notice in writing given to the employer before the end of the period of 3 months beginning with the relevant date, or within such extended period not exceeding 6 months as the Commissioner for Labour may permit; or (b) a question as to the right of the employee to such remedies has been made the subject of a claim filed with the Labour Tribunal before the end of the period of 9 months beginning with the relevant date.

²⁸ In case where the company has already entered into winding up, the employee concerned may apply to the court to end provisional supervision so that the winding up proceedings would cease to be suspended.

²⁹ Under section 10A of the EO, if wages are not paid within one month after they become due, an employee may terminate the contract of employment, and the contract of employment is deemed to be terminated by the employer and the employee would be entitled to payment in lieu of notice in addition to other statutory and contractual termination payments (including severance payment where applicable).

- (b) the proceedings under Part VA of the EO will be exempted from the moratorium during provisional supervision and the moratorium when the company is subject to a VA. Therefore, an employee's claim for severance payments will not be hindered when the company is under the CRP;
- (c) the proceedings under Part VIA of the EO will be exempted from the moratorium during provisional supervision and the moratorium when the company is subject to a VA. Therefore, an employee's protection under Part VIA of the EO will not be hindered when the company is under the CRP; and
- (d) the proceedings by an employee of a company under provisional supervision for claiming compensation or damages (as defined in the ECO) from his employer company, the proceedings by an employee of a sub-contractor for claiming compensation (as defined in the ECO) from the relevant principal contractor under provisional supervision, and the proceedings for enforcing such a claim are exempted from the moratorium. In addition, a creditor is not bound by a VA in respect of such a claim. The purpose is that the CRP will not hinder claims of an employee against his employer company or the relevant principal contractor (if applicable) for compensation or damages as allowed by the ECO.

(E) Applicability of CRP to Registered Non-Hong Kong Companies ("RNHKCs")

33. We propose that RNHKCs should be included in the scope of the CRP regime, in a way similar to how the existing court winding-up regime under CWUMPO may apply to such companies. To ensure a level playing field, RNHKCs will in general be subject to the same set of pre-requisite conditions for commencing provisional supervision. However, since RNHKCs are not incorporated in Hong Kong, there will be necessary adjustments to address the characteristics of RNHKCs.

34. We propose to require an RNHKC to obtain leave from the court before it commences provisional supervision in Hong Kong by appointing a PS. Under this approach, the court is given discretion to determine, on a case-by-case basis, whether or not to grant the leave. Aside from otherwise being satisfied that it is appropriate to grant leave, the court may grant leave only if it is satisfied that a statutory declaration

has been made by a director or member of the RNHKC or the provisional liquidator or liquidator of the RNHKC (as the case may be) stating whether the requirement of “no objection” from the MSC (if any) has been complied with³⁰.

35. In addition, the legal position under Part X of CWUMPO is that an RNHKC is prohibited from being wound up voluntarily in Hong Kong, and may only be wound up by the court. To ensure consistency between the proposed CRP framework and the existing winding up framework, we propose that in the final creditors’ meeting during provisional supervision of an RNHKC, the creditors cannot pass a resolution that the company be wound up (and may only resolve to approve a VA or end provisional supervision), and in the creditors’ meeting passing a resolution to terminate the VA of an RNHKC, the creditors cannot pass a resolution that the company be wound up. Further, in the above cases and in the event the court makes an order terminating the VA of an RNHKC, the RNHKC would not be taken to have passed a special resolution that the company be wound up. In such cases, the RNHKC concerned may be wound up by the court under CWUMPO.

(F) Safeguard Measures of CRP

36. Under the Bill, the court has a role in preventing abuse of the CRP process, maintaining its overall integrity, and facilitating its proper comportment. For this purpose, there are suitable safeguard provisions in the Bill.

37. In addition, given the powers of the PS and Supervisor in the CRP, there is also a need to provide for proper checks and balances on their powers to prevent abuse.

38. It is therefore proposed that the court should be empowered³¹ –

³⁰ While a Hong Kong company is under statutory obligations to do annual filings and to maintain its register of charges properly, there is no equivalent filing or registration requirement on charges on property owned by an RNHKC if the charged property is not in Hong Kong. As a result, the identity of the MSC of an RNHKC might be less certain to the public, investors, or creditors.

³¹ In addition to the powers of the court in providing checks and balances, the Bill also has provisions governing the following –

- (a) duties and procedures of disclosure applicable to PS and Supervisor;
- (b) disqualifications from being PS and Supervisor;
- (c) appointments to fill vacancies of PS and Supervisor, and resignation and removal of PS and

- (a) upon an application by a PS or a Supervisor, to give such directions that the court thinks fit in relation to a particular matter arising under provisional supervision or VA of a company;
- (b) upon an application by a company, a PS, Supervisor or creditor of a company or, with leave of the court, an interested person, to make such orders that the court considers appropriate with respect to how the Ordinance is to operate in relation to the company (other than ending the provisional supervision or terminating the VA);
- (c) upon an application by a creditor, member or PS of a company or, with leave of the court, an interested person, to end provisional supervision of the company for specified reasons³²;
- (d) upon an application by a creditor, member, PS, Supervisor, provisional liquidator or liquidator of a company or the Official Receiver, to examine the conduct of a PS or Supervisor (including former PS or Supervisor) over an allegation that the PS or Supervisor concerned –
 - (i) has misapplied or retained money or other property of the company;
 - (ii) has become accountable for money or other property of the company;
 - (iii) has breached a fiduciary or other duty in relation to the company; or
 - (iv) has been guilty of misfeasance;

and to make a court order requiring the PS or Supervisor to repay, restore or account for the money or property, to pay interest, and

-
- Supervisor; and
 - (d) determination of remuneration of PS and Supervisor.

³² The reasons include –

- (a) the statutory objects of the CRP cannot be achieved in relation to the company;
- (b) the company is not insolvent, or is not likely to become insolvent at some future time;
- (c) the provisions in relation to provisional supervision are being abused; or
- (d) there is an improper motive on the part of the person who appointed the PS.

to contribute a sum to the company's property by way of compensation for breach of duty or misfeasance; and

- (e) upon an application by a creditor or member of a company alleging that a PS or a Supervisor has managed or is managing the company's business, property or affairs in such a way that is prejudicial to the interests of some or all of the company's creditors or members, or has done an act or made an omission, or proposes to do so, that is or will be prejudicial to such interests, to make such order as the court considers just.

(G) Insolvent Trading Provisions

39. Under the Bill, a company engages in insolvent trading if the company incurs a debt in circumstances where the company –

- (a) is insolvent at the time when the debt concerned is incurred;
- (b) becomes insolvent by incurring the debt concerned; or
- (c) becomes insolvent by incurring at the time when the debt concerned is incurred, other debts including the debt concerned.

A director³³ of a company at the material time is responsible for insolvent trading of the company if the director at the material time knew or ought to have known that the company –

- (a) was insolvent at the time when the debt was incurred; or
- (b) would become insolvent by incurring the debt; or
- (c) would become insolvent by incurring at the time when the debt concerned is incurred, other debts including the debt concerned.

For this purpose, the facts that the director ought to have known are the facts a person described in paragraph 41 below would have known. If the company goes into insolvent liquidation, the court may, on application by the liquidator, declare that a director of the company responsible for

³³ The insolvent trading provisions also apply to a shadow director.

insolvent trading is liable to make a contribution to the company's assets that the court considers appropriate. It is proposed that the liability should be of a civil nature.

40. To address the concern of the business sector that comprehensive safeguard measures should be provided for directors so that they will not be caught by the insolvent trading provisions inadvertently, statutory defences are proposed in the Bill. It is proposed that it will be a statutory defence if –

- (a) the director had taken all reasonable steps to prevent the company from incurring the debt concerned (the reasonable steps that the director concerned ought to take are those that would be taken by a person described in paragraph 41 below); or
- (b) when the debt concerned was incurred:
 - (i) the director believed in good faith that the debt was incurred by the company for the purposes of returning the company to a state of solvency within a reasonable period; and
 - (ii) there were reasonable grounds for believing that the incurrence of the debt would benefit the company and that the company was likely to return to a state of solvency within a reasonable period (whether reasonable grounds existed is to be determined by reference to whether a person described in paragraph 41 below would consider such grounds existed).

41. The person mentioned in paragraphs 39 and 40 (a)&(b)(ii) above refers to a reasonably diligent person with—

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
- (b) the general knowledge, skill and experience that the director has³⁴.

³⁴ These elements are modelled on section 465 of the CO, which deals with the directors' duty of care, skill and diligence, and section 214(4) of the UK Insolvency Act 1986.

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