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29 February 2000

Mr Jim Wardell
Rutledge Group Limited
Room 1602, One Hysan Avenue
Causeway Bay
Hong Kong

BY FAX ONLY
(2972 2742)

Dear Mr Wardell,

Companies (Amendment) Bill

I refer to your letter dated 11th February to the Legislative Council in which you raise a number of concerns regarding the Insolvent Trading provisions in the Companies (Amendment) Bill. I have been asked by the Secretary for Financial Services to respond. Before I comment in detail on those concerns, could I make a number of general observations on the 2nd, 3rd and 4th paragraphs of your letter.

Apart from section 166 of the Companies Ordinance which allows for compromises between a company and its creditors, debt restructuring for companies in financial difficulties in HK has always been the favoured option. I must stress, however, that corporate rescue and provisional supervision does not seek to replace debt restructuring but rather to complement it. Indeed, the debt restructuring process may actually benefit from having a corporate rescue and moratorium procedure in place because creditors will know that a company could seek a moratorium under provisional supervision in the event that settlement negotiations were e.g. protracted and difficult. It would also help to avoid the problems normally associated with informal corporate workouts of the smaller creditors holding out for a much better deal than otherwise would be the case from the larger creditors. In addition, informal workouts can prove to be quite lengthy which the corporate rescue provisions seek to address by imposing time limits.

With regard to your observation that HK banks have always taken a proactive role in recovering their money, I certainly hope that will continue. Such banks will still be able to consider, in conjunction with their customers, whether informal restructuring or provisional supervision would be their best option. Again the draft legislation seeks to provide the commercial community with more options, not less, when debt restructuring problems arise.

The aim of the Insolvent Trading provisions is to encourage directors and senior management to face up to the fact sooner rather than later that a company may be slipping into insolvency and to address the situation before it is too late. This is to be welcomed. At the moment, the tendency is for directors to keep such companies trading, usually in the hope rather than the expectation, of a financial turn around. These new draft provisions will lead to greater accountability on the part of directors and senior management. You will appreciate directorship of a company is a serious matter. Statutory defences are provided in the Bill. So long as directors and senior management have carried out their duties conscientiously and diligently and have taken every step to minimise potential losses for the company's creditors, they will have a defence to a claim for Insolvent Trading. In addition, senior management which is unhappy with the decision of a company to continue trading whilst insolvent can protect themselves by a notice under section 295C(2)(a)(ii).

The Law Reform Commission studied the position in the UK, Australia and locally before it finally concluded that senior management should also be responsible for 'Insolvent Trading'. Under section 295A of the Bill, the definition of Senior Management is confined to those who are involved to a "substantial or material degree in directing the company's business or affairs" and this most certainly will not include every manager of a company. Given their position, it is on balance right that senior management too should also shoulder responsibility for Insolvent Trading when it arises.

In summary, the honest and conscientious director has nothing to fear from the Insolvent Trading provisions, whilst the dishonest and unscrupulous director most certainly does. These provisions are a modest addition to the statute book and will, we hope, go a little way in promoting honesty, accountability and transparency by directors when they find that their companies are in financial difficulty. If there are no reasonable prospects of saving a company which is in a financial difficulty, the directors should cause it to cease trading and to put into liquidation as soon as practicable.

Thank you for taking the time and trouble of writing to us to express your concerns. I do hope the above explanation goes some way to allay those fears.

Yours sincerely,

(E T O'Connell)
Acting Official Receiver

ETO/ll