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Legislative Council

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Paper for the House Committee meeting
on 9 June 2000

Report of the Bills Committee
on Companies (Amendment) Bill 2000

Purpose

This paper reports on the deliberations of the Bills Committee on Companies (Amendment) Bill 2000 (the Bill).

Background

2. At present, Hong Kong companies that run into financial difficulties may try to come to a voluntary arrangement with their creditors or by means of the arrangement and reconstruction provisions under section 166 of the Companies Ordinance (Cap. 32) (the Ordinance). However, there is nothing in section 166 to prevent a creditor from presenting a petition to wind up the company, an event which could have the effect of ending the formulation of any proposal to creditors. The Law Reform Commission (LRC) considers that the major deficiency of section 166 is the lack of a moratorium that can bind creditors while an arrangement plan is being formulated.

3. The LRC therefore recommended in 1996 in its Report on Corporate Rescue and Insolvent Trading that Hong Kong should introduce a corporate rescue procedure. The two main features of the statutory corporate rescue are (a) the introduction of a moratorium (stay of proceedings) which will protect the debtor company from creditor action for an initial period of 30 days and thereafter any extension of up to six months from the commencement of the moratorium subject to the court's approval, and (b) the taking over of the control of the company during the moratorium by an independent professional third party, the provisional supervisor, who will formulate a voluntary arrangement proposal for creditors within the specified time-frame.

4. In relation to the introduction of a corporate rescue procedure and in order to encourage directors and senior management to act on insolvency earlier rather than later, the LRC has also recommended that directors and senior management be made personally liable for the debts of a company which trades while insolvent. The introduction of the "insolvent trading" provisions will encourage directors and senior management to face the fact that a company is slipping into insolvency at an early date and cause them to address the situation.

The Bill

5. The principal purpose of the Bill is to amend the Ordinance to give effect to the recommendations contained in the Report on Corporate Rescue and Insolvent Trading issued by the LRC. The Bill has also incorporated various recommendations of the Standing Committee on Company Law Reform (SCCLR) to amend the Ordinance, including -

(a) the passing of resolutions by unanimous consent of members of a company without general meetings under section 116B;
(b) the repeal of section 228A on special procedure for voluntary winding up in case of inability to continue its business by a company;
(c) the appointment of provisional liquidators by the Official Receiver in summary winding-up cases under section 194;
(d) the filing requirements in respect of the first annual return by private companies under sections 107 and 109; and
(e) the lowering of the threshold for the requisition for convening an extraordinary meeting by minority shareholders under section 113.

6. The Bill also seeks to rectify certain technical omissions and to streamline and update a number of provisions in the Ordinance.

The Bills Committee

7. The House Committee agreed at its meeting on 21 January 2000 to form a Bills Committee to study the Bill. The Bills Committee first met on 22 February 2000 and Hon Ronald ARCULLI was elected Chairman. The membership list of the Bills Committee is in **Appendix I**.

8. The Bills Committee has held a total of eight meetings with the Administration. In view of the complexity of the Bill, the Bills Committee has found it necessary to invite interested parties and professional bodies to

give views on the policy and technical aspects. Likewise, the professional bodies are equally concerned about the Bill and has requested for an extension of the deadline for submitting written submission to the Bills Committee from late March to mid/late April. The Bills Committee has received written submissions from two individuals and 17 organizations, a list of which is in **Appendix II**.

Deliberations of the Bills Committee

9. Members of the Bills Committee are generally in support of the rationale behind the corporate rescue and insolvent trading proposals. However, in view of the complexity of the subject matter and having regard to the substantive submissions made by various professional bodies, the Bills Committee has come to the view that it is not practically possible to complete the scrutiny of the entire Bill within the time available. It has therefore decided to curtail the examination of the corporate rescue and insolvent trading proposals in the Bill.

10. On the remaining provisions in the Bill, the Bills Committee notes that they are mainly amendments which seek to implement the recommendations of the SCCLR and to rectify certain technical omissions and to streamline and update a number of provisions in the Ordinance. In the course of examination, the Bills Committee has taken into account the views expressed by various professional bodies and made various suggestions to improve the drafting of the provisions.

11. The deliberations of the Bills Committee are summarized below.

<u>Corporate rescue and insolvent trading</u>

12. Recognizing that a statutory corporate rescue proposal is an important piece of legislation which may help a financially-troubled company to turn around instead of proceeding with the winding-up immediately, members of the Bills Committee do not dispute the need and potential benefits of the proposed corporate rescue and insolvent trading proposals. However, the Bills Committee notes that the proposals involve a statutory framework for corporate rescue operation. The introduction of a moratorium to protect the debtor company from creditor actions and the taking over of the control of the company during the moratorium by a provisional supervisor may affect the competing interests of the various parties involved, such as the company, the creditors (secured and unsecured), the employees and the shareholders. As such, there is a need to ensure that the proposals are generally acceptable to the general public, especially to those parties whose interests will be affected by the proposals. As views from various professional bodies were only available

in mid/late April and their submissions contain substantive comments on and criticisms of the proposals, the Bills Committee has decided not to proceed with the examination of the corporate rescue and insolvent trading proposals within the limited time available before the end of the current term.

13. Notwithstanding the curtailment of the examination of the corporate rescue and insolvent trading proposals, the Bills Committee considers it useful to put on record its initial views and reservation on the proposals to facilitate discussion by the future Legislative Council.

14. One of the major criticisms of the Bills Committee on the Bill is about the practical applications of the corporate rescue procedure. Concern has been raised as to whether a financially-troubled company is able to set aside sufficient funds to settle all arrears of wages, severance pay and other statutory entitlements of its employees as if it is a going concern, before initiating the corporate rescue procedure. Further, the Bill does not provide for any flexibility in respect of the requirement on a company to settle all outstanding claims from employees before the relevant date. The effect is that even if the employees concerned are willing to give up their legal rights to assist the company to turn around in return for some other considerations granted by the company, for example, the allotment of stock options, it is, legally speaking, not permitted under the present provisions. There are other situations where the moratorium shall not be applied such as fresh debt incurred by the company during provisional supervision or whenever an exemption is granted by the court for creditor suffering from significant financial hardship. Under such circumstances, there is nothing in the proposal to prevent a creditor from presenting a petition to wind up the company which will effectively defeat the purpose of having a corporate rescue procedure to help a financially-troubled company to turn around instead of proceeding with the winding-up immediately.

15. Apart from the above, the Bills Committee has identified a number of issues which will require further examination in future. These include:

(a) the need to balance and safeguard the interests of the various parties involved, such as the company, the creditors (secured and unsecured), the employees and the shareholders before initiating the moratorium and during the provisional supervision;

(b) the appointment of provisional supervisor and the subsequent monitoring and control mechanism, bearing in mind he will be indemnified out of the assets of a company and the possibility that he may be allowed to turn into a provisional liquidator of the company when he is unable to formulate a plan to the satisfaction of the creditors during the moratorium;

(c) the involvement of the court in the extension of the moratorium for the initial six months from the commencement of the moratorium but not for the period thereafter; and

(d) the potential conflict between a provisional supervisor and the directors of a company as the former will be empowered to manage and control the company and has the right to retain or dismiss directors of the company, and the statutory defence available to directors and senior management for insolvent trading.

16. The Bills Committee is aware that some interested parties, such as the Hong Kong Society of Accountants, are keen to see an early passage of the Bill. However, having reviewed the progress of its work, the concerns expressed by members and the submissions made by various professional bodies, the Bills Committee considers it practically not possible to complete the scrutiny work within this session.

17. The Bills Committee appreciates the need for an early re-submission of the corporate rescue and insolvent trading proposals within a shorter timeframe. The Bills Committee therefore suggests that the Administration should start consulting the Labour Advisory Board on the Bills Committee's suggestion to provide more flexibility in respect of the requirement on a company to provide for in a trust account all the arrears it owes to its employees by virtue of the Employment Ordinance (Cap. 57), before initiating the corporate rescue procedure. In the meantime, the Administration should meet with various professional bodies on the views expressed so that the proposals can be fine-tuned before they are put in a fresh bill to be submitted to the next Legislative Council for consideration.

18. The Administration takes notes of the view expressed by the Bills Committee and agrees to move Committee stage amendments (CSAs) to excise all the clauses in relation to corporate rescue and insolvent trading from the Bill.

Other amendments

19. The Bills Committee is generally in support of the amendments in the Bill other than those related to corporate rescue and insolvent trading. Concerns have however been raised in respect of a number of provisions and the deliberation of the Bills Committee on each of these provisions are summarized below.

Passing of a resolution by unanimous written consent in lieu of general

meetings
under section 116B (Clause 14)

20. The Bills Committee notes that the Administration has proposed to amend section 116B to enable a company to dispense with the holding of general meetings provided, inter alia, that unanimous written resolutions are used; the resolutions are signed by or on behalf of all members of the company; and a copy of the proposed written resolution is sent to the auditors of the company. According to the Administration, this amendment will remove existing conflicts with other provisions in the Ordinance and facilitate the operations of smaller companies by reducing the number of formal meetings. The amendment is also in line with the provisions of the United Kingdom Companies Act 1985.

21. Whilst accepting the rationale behind the proposed amendment, members consider the provision on duty to notify auditors of proposed written resolution in the new section 116BA not sufficiently clear which will lead to confusion as to which directors or secretaries will hold responsible for notifying the auditors. Concern has also been raised about the need to impose a penalty clause for non-compliance with the new provision under such circumstances, letting alone the penalty provision is not available in the case of a physical meeting under section 141.

22. According to the Administration, the rights of auditors to have access to general meetings and notices, etc as set out in section 141 and the new section 116BA imposing an obligation on directors and company secretaries to notify auditors of the proposed written resolution are of different nature. It may not be appropriate to draw a direct comparison between them as regards the necessity of a penalty clause. The Administration takes the view that a penalty clause is considered necessary because there is no physical meeting taking place under the proposed procedure which is applicable to all types of resolution, except those resolutions relating to removal of auditor and director prior to the expiry of his term of office. This procedure of dispensing with the need for a physical meeting applies to resolutions to be passed at annual general meetings. These resolutions will be regarded as valid even though no notice is given to the auditors. If the auditor is not notified in time, he will not have the opportunity to obtain the relevant document at a physical meeting. As a result, the auditor may not be able to carry out his duties. It is therefore necessary to set a more stringent requirement on company's officers if they fail to observe this particular duty.

23. As to the clarity of the provision is concerned, the Administration has pointed out to members that the proposed section 116BA basically adopts section 381B of the United Kingdom Companies Act 1985. It is against the general principle of the Ordinance if a specified person such as the director

moving the resolution or the secretary of a company is tasked with the responsibility to notify the auditors under section 116BA. The Administration is of the view that in order to ensure consistency, it will be more desirable to leave the duty as a kind of collective responsibility of the directors. Notwithstanding, for the purpose of allaying members' concern over the new section 116BA in relation to the defence available to directors/secretaries, the Administration agrees to move a CSA so that it will provide the following grounds for defence by the defendant :

(a) the circumstances are such that it is not practicable for him to comply;
(b) he believes on reasonable grounds that a copy of the resolution has been sent to the company's auditors, or that they have otherwise been informed of its content; and
(c) he has reasonable grounds to believe that someone has been charged with the duty to send a copy of the resolution to the auditors.

24. The Administration has also taken on board the suggestion of the Bills Committee to clarify that non-compliance with the proposed section 116BA will not affect the validity of the resolution passed under the section and that a company shall cause a record of the resolution to be entered in a book in the same way as minutes of proceedings of a general meeting of the company. Corresponding CSAs will be moved by the Administration.

25. As to the feasibility of holding general meetings via the internet, the Bills Committee notes that this possibility is being discussed in the context of the overall review of company law in the United Kingdom and can be examined further in Hong Kong. The Bills Committee also notes that the Ordinance does not have any provisions prohibiting the passing of resolutions via the Internet. With the passing of the Electronic Transactions Ordinance (Cap. 553), the passing of a resolution with acceptable digital signatures via the Internet will be permitted upon the agreement of the parties concerned. The relevant sections of the Electronic Transactions Ordinance has come into effect in April 2000.

Removal of the ability of the directors of a company by majority resolution to place the company into a creditors' voluntary winding up under section 228A (Clause 39)

26. Section 228A of the Ordinance provides for the speedy appointment of a provisional liquidator by majority resolution of the directors of a company so that the company can be placed in voluntary winding up in an emergency situation.

27. Concern has been raised by some deputations about the proposal to repeal section 228A. These deputations are of the view that the section provides a cost effective, immediate and quick procedure for directors to appoint a provisional liquidator in circumstances of insolvency especially against the background of the proposed insolvent trading provision, which requires directors to act on insolvency earlier rather than later. Even though it will still be open to directors to apply to the court for the appointment of a provisional liquidator under other provisions, this cannot be done without incurring considerable legal expenses at a time when there are limited resources available to the company. Given that there are no substantiated instances of abuse in practice, they do not consider it appropriate to repeal section 228A.

28. According to the Administration, section 228A is a voluntary winding up procedure initiated by a director's resolution. There is no need to file a winding up petition. The directors are only required to deliver a statutory declaration to the Registrar of Companies recording the resolution that

(a) the company cannot by reason of its liabilities continues its business;
(b) they consider it is necessary that the company be wound up and that there are good and sufficient reasons for the winding up to be commenced under this section;
(c) meetings of the company and of its creditors will be summoned for a date not later than 28 days after the delivery of the declaration to the Registrar.

29. Given the limited information available, the Administration is unable to ascertain why the section 228A route was chosen and whether the reasons for choosing that route were in fact good and sufficient. The Administration stresses that one of the major weaknesses of section 228A is that because the voluntary winding up process is initiated by directors, and third parties are not involved in the initial process, there is no opportunity for testing the "good and sufficient" requirement. In fact, in an insolvent company's winding up, the interests of creditors shall be given priority. Section 228A does not seem to be able to fulfil that objective. Furthermore, a provisional liquidator appointed under section 228A is not subject to the same degree of court control as in the case of appointment under section 193 after the presentation of a winding-up petition. Given that there are other means provided elsewhere in the Ordinance to initiate voluntary winding up and to appoint a provisional liquidator speedily, the Administration agrees with the recommendations of the SCCLR and LRC to repeal the section accordingly. This can reduce any potential within the winding-up provisions for abuse.

30. The Bills Committee is not persuaded of the need to repeal section 228A. Members are of the view that the rationale behind the procedure under section

228A is to speed up the appointment of a provisional liquidator to preserve and protect assets of a company. It is particularly useful for companies which have ceased trading and whose directors have lost interest. By using the provision, the directors can start the winding-up immediately without having to wait for 28 days before a meeting of creditors can be held, not to mention the possibility that creditors may not turn up at the meeting. Given that there is no sufficient and concrete evidence to show that unscrupulous directors have made use of the provision to their own advantage during the period between the date of the resolution and the meeting of creditors, and having regard to the fact that a creditor may apply to the court to determine any question arising in the winding up of a company under section 255 of the Ordinance, the Bills Committee is of the view that there is no sufficient justification to repeal the section and recommends that consideration be given to tightening the conditions under which section 228A may be applied.

31. Having considered the views of the Bills Committee, the Administration agrees to move a CSA to further tighten the circumstances under which section 228A may be applied. Since the major concern lies with the lack of mechanism to monitor whether the requirement under section 228A(1)(b) has in fact been satisfied, namely that there are "good and sufficient reasons" for using the "special procedure" instead of the normal procedure under section 228(1) and section 241, the Administration proposes to amend the relevant provision so that a voluntary winding-up under section 228A shall only be used in circumstances of extreme urgency and that it is not reasonably practicable for the winding up to be commenced under any other section of the Ordinance. The Bills Committee agrees to the revised proposal put forward by the Administration. The Bills Committee also notes that the existing penalty provision for directors declaring that a company cannot continue in business by reason of its liabilities without having reasonable grounds to do so will remain unchanged.

Committee Stage amendments

32. Apart from the CSAs mentioned above, the Administration has also proposed to move a number of minor amendments to the Bill. These CSAs cover technical amendments to various provisions in the Bill. A full set of CSAs to be moved by the Administration is in **Appendix III**.

Recommendation

33. Subject to the CSAs to be moved by the Administration, the Bills Committee supports the Bill and recommends the resumption of the Second Reading debate of the Bill on 21 June 2000.

Advice sought

34. Members are requested to support the recommendation of the Bills Committee in paragraph 33 above.

Council Business Division 1
Legislative Council Secretariat
7 June 2000

Appendix I

《2000 年公司(修訂)條例草案》委員會
Bills Committee on Companies (Amendment) Bill 2000

委員名單
Membership list

夏佳理議員(主席)	Hon Ronald ARCULLI, JP (Chairman)
田北俊議員	Hon James TIEN Pei-chun, JP
何世柱議員	Hon HO Sai-chu, SBS, JP
何俊仁議員	Hon Albert HO Chun-yan
李卓人議員	Hon LEE Cheuk-yan
李家祥議員	Hon Eric LI Ka-cheung, JP
吳靄儀議員	Hon Margaret NG
許長青議員	Hon HUI Cheung-ching
陳國強議員	Hon CHAN Kwok-keung
陳婉嫻議員	Hon CHAN Yuen-han
單仲偕議員	Hon SIN Chung-kai
劉健儀議員	Hon Mrs Miriam LAU Kin-yee, JP

合共 ： 12 位議員
Total ： 12 Members

日期 ： 2000 年 2 月 22 日
Date ： 22 February 2000

Appendix II

Bills Committee on
Companies (Amendment) Bill 2000

List of organizations/individuals submitted views on the Bill

Organizations

*The Chinese General Chamber of Commerce
*The Chinese Gold & Silver Exchange Society
Consumer Council
*The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies
Federation of Hong Kong Industries
Federation of Hong Kong and Kowloon Labour Unions
The Hong Kong Association of Banks
Hong Kong Bar Association
Hong Kong Exchanges and Clearing Ltd
*The Hong Kong Federation of Insurers
Hong Kong Institute of Company Secretaries
*Hong Kong Productivity Council
Hong Kong Society of Accountants
The Law Society of Hong Kong
PricewaterhouseCoopers
Rutledge Group Limited
*Securities and Futures Commission

Individuals

Mr Philip Smart of the Faculty of Law, University of Hong Kong
Mr Clement Shum, Associate Professor of the Department of Accounting and Finance, Lingnan University

Total: 17 organizations and 2 individual

*These organizations replied that they have no comments on the Bill.