Reply Form for the Consultation on Review of Corporate Rescue Procedure Legislative Proposals

1. The purpose of this reply form is to facilitate providing views and comments on the Consultation Paper entitled Review of Corporate Rescue Procedure Legislative Proposals ("Consultation Paper") published by the Financial Services and the Treasury Bureau ("FSTB") on 29 October 2009.

2. The Consultation Paper can be downloaded from the FSTB's website at http://www.fstb.gov.hk/fsb

3. If you have any views or comments on the Consultation Paper, you are welcome to complete this reply form and return it to us on or before **28 January 2010** by one of the following means:

By mail or hand delivery to:

Division 4, Financial Services Branch
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
Hong Kong

Re: **Consultation Paper on Review of Corporate Rescue Procedure Legislative Proposals**

By fax to: (852) 2869 4195

By e-mail to: corporate_rescue@fstb.gov.hk

4. Any questions about this reply form may be addressed to Miss Sandy CHAN of FSTB, who can be reached at (852) 2867 5844 (phone), (852) 2869 4195 (fax) or corporate_rescue@fstb.gov.hk (email).

5. Submissions will be received on the basis that we may freely reproduce and publish them, in whole or in part, in any form, and use, adapt or develop any proposal put forward without seeking permission or providing acknowledgment of the party making the proposal.

6. Please note that names of respondents, their affiliation(s) and comments may be posted on the FSTB's website or referred to in other documents we publish. If you do not wish your name and/or affiliation to be disclosed, please state so when making your submission. Any personal data submitted will only be used for purposes which are directly related to consultation purposes under this consultation paper. Such data may be transferred to other Government departments/agencies for the same purposes. For access to or correction of personal data contained in your submission, please contact Mr WONG Wing-hang, Assistant Secretary for Financial Services and the Treasury (Financial Services), who can be reached at (852) 2867 5465 (phone), (852) 2869 4195 (fax), or whwong@fstb.gov.hk (email).

PART A: GENERAL INFORMATION OF THE RESPONDENT

Name/Name of Organisation	:
If organisation, name and title of Contact Person	:
	(Please fill in if the respondent is a company or organization)
Phone Number	:
E-mail Address	:

If you do not wish to disclose your affiliation or name to the public, please check the box here:

☒Our organisation does not wish to disclose our name.

☐I do not wish to disclose my name.

PART B: DETAILED QUESTIONS FOR RESPONSE

You may provide your views or comments on all or any of the questions. If the provided space is insufficient, please attach additional pages.

Question 1

Do you agree with the proposed procedural changes relating to initiation of provisional supervision in paragraphs 2.4 to 2.6 above? If not, please provide reasons and suggest alternatives.

1. Yes, we agree with the proposed procedural changes relating to the initiation of provisional supervision. However, we recognise that in some circumstances, the Court or the Official Receiver may need to be involved.
2. For example, we take the view that the Official Receiver will need to be notified of the appointment of a provisional supervisor where the individual appointed is not a qualified solicitor or accountant - see comments in Question 12 about the proposal to set up a Register of "other qualified persons" to act in the role of provisional supervisor.

Question 2

Do you see any need for other changes to the initiation of provisional supervision, including who may initiate the procedure? If so, please elaborate on the suggested changes and reasons.

1. We have reservations about the inability of creditors to initiate the provisional supervision procedure.
2. When a company is facing solvency issues, the directors of the company must consider the interests of creditors (see Tradepower (Holdings) Ltd v Tradepower (Hong Kong) Ltd CFA FACV 5/2009) [2009] HKEC 1940).
3. When a company is of doubtful solvency, creditors have a legitimate interest in the affairs of the company and should be allowed to commence the provisional supervision procedure and play a larger role in the initial stages.
4. This is particularly important in circumstances where the alleged wrongdoers (i.e. directors) are controlling the company and there are suggestions that they are not acting in the best interests of the creditors.
5. As with other winding-up proceedings in the current Hong Kong insolvency regime, creditors should play an equal role, alongside the company, directors, liquidators and provisional liquidators.
6. Apart from the inclusion of creditors to the list of parties who can commence the provisional supervision procedure, we have no other substantial comments on the initiation process.

Question 3

Do you agree that the notice of appointment of provisional supervisor should be published in the local newspapers on the same day as the date on which the last document is filed with the Registrar of Companies? If you prefer additional or alternative means of publishing the notice of appointment, please describe and explain.

1. The notice of appointment of provisional supervisors should be placed when the first substantive document is filed with the Registrar of Companies (e.g. the equivalent to a Form D2 for appointment or removal of directors).
2. This is to avoid any time-lag between the date when the provisional supervision procedure is effectively commenced and the date when the final documents are filed with the Companies Registry which may be purely administrative documents.
3. Stakeholders (i.e. creditors) are entitled to know the precise status of the company in a timely manner and can therefore participate in on-going procedures (e.g. meetings) to express their views.
4. A lack of transparency will seriously hamper the effectiveness of the new provisional supervision procedure.
5. The provisional supervision procedure must not be perceived as a delaying mechanism which enables the company to "buy time" before proceeding to liquidation.
6. This is important because if the company is eventually placed into liquidation, the date of filing of the petition will have important ramifications on issues including void transactions (section 182 Companies Ordinance) and unfair preference transactions (section 266 Companies Ordinance).

Question 4

Do you support an initial moratorium period of 45 days? If not, please suggest alternatives and explain.

1. We recognise the need to balance (i) the opportunity for the provisional supervisors to assess the circumstances of the company and (ii) the rights of creditors to enforce their remedies.
2. From the point of view of creditors, the initial 45 day automatic moratorium period may be viewed as too long.
3. We are inclined to support a shorter period of say, 28-35 days.

Question 5

Do you support the proposal to allow for extension of the moratorium up to a maximum period of six months from the commencement of provisional supervision, subject to approval by the creditors at a meeting of creditors? If not, please explain and suggest alternatives.

1. An extension of the moratorium period for up to 6 months with the approval of a majority of creditors in number (i.e. 51%) who represent at least 75% in value of creditors attending the meeting in person or by proxy is acceptable.
2. The threshold we have suggested would resemble the current percentage requirements for a scheme of arrangement under section 166 Companies Ordinance to be binding on all creditors and is reasonable.
3. It is reasonable that unanimous support of creditors is not required to extend the moratorium period.
4. To require unanimity would be difficult and may defeat the purpose of the provisional supervision procedure.

Question 6

Do you agree with the proposal to allow for extension of the moratorium beyond six months only upon court approval? If not, please explain.

1. The requirement for court approval for an extension of the moratorium period beyond 6 months is advisable to protect the interests of creditors who oppose the moratorium.
2. Logically, the provisional supervisor would need to present a report to the court on progress and the grounds to support an extension of the moratorium period.
3. This report and the proposed application to extend the moratorium period should be made available to all creditors for transparency.
4. If all creditors present and voting at the creditors meeting support the extension and there are no controversies/oppositions to the extension application, the court

can be informed of this and a paper application used to save costs, subject to any queries from the court which require a hearing.
5. If all creditors present and voting do not support the extension, a court application would present a platform for the opposing creditors to voice their concerns and bring legitimate concerns to the court, e.g. undue delay in implementing the provisional supervision procedure.
6. The process outlined above promotes transparency and would minimise costs in the long run because if an extension is implemented and subsequently opposed this would involve an increase in costs to deal with the opposition which would inevitably derail the provisional supervision procedure.

Question 7

If your answer to Q6 is yes, do you agree that any court extension should not exceed a maximum of 12 months from the commencement of provisional supervision? If not, please explain and suggest alternatives.

1. The requirements of each provisional supervision will differ.
2. Where the provisional supervision concerns a large corporation in multi-jurisdictions and/or with assets in various jurisdictions and/or which is facing controversial issues, more time will be required to facilitate a corporate rescue.
3. Where the company which is subject to the provisional supervision is relatively simple and the assets and liabilities not large in scale, less time will be required to complete the provisional supervision procedure.
4. We would suggest that the extension be up to an initial period of 12 months with extensions beyond 12 months being available but subject to the discretion of the court.
5. It must be open to the court to extend the moratorium period, upon application by the stakeholders, if this is requried to complete the corporate rescue.
6. An initial moratorium period of 12 months would seem reasonable for most medium sized corporate rescues. This view is based on our experience implementing schemes of arrangement in Hong Kong for listed companies with creditors in Hong Kong and abroad which generally take about 9 months.

7. On the other hand, our experience with larger group companies facing controversial issues (e.g. the ability to fulfil resumption of trading thresholds set by the regulators etc), is that a corporate restructuring can take a few years.
8. An initial period of 12 months would discourage unnecessary delay because parties will know that any extension beyond this time requires the exercise of the court's discretion.

Question 8

Does the list of contracts and agreements which should be exempted from the moratorium, as set out at Appendix, need to be revised? If so, please suggest and explain.

1. The thinking behind the list of exempted contracts needs explaining and further consideration.
2. The exemption of derivatives contracts for example, would mean the corporate rescue of brokerage firms would not benefit from the provisional supervision procedure. We query whether this is intentional and if so, the rationale.
3. If this is not intentional, the list of exempted contracts should be kept to a minimum, so that parties who have a right to veto the provisional supervision procedure and render it redundant from the outset are limited as far as possible.
4. Perhaps the list of exempted contracts should only include those where due to the nature of the contract, the parties are governed by a different regulatory regime which provides for an alternative corporate rescue mechanism and there is no need to rely on the provisional supervision procedure.

Question 9

Which of the above three options (namely, the 2003 Proposal, Alternative A or Alternative B) would you prefer? Please explain. If you have any suggestion to refine any of the above three options, please describe and explain. If you prefer another alternative, please describe and explain.

1. Alternative B is the preferred option. The payment of "employees' protected debts" (i.e. arrears of wages and other entitlements owing before the commencement of the provisional supervision subject to the Protection of Wages on Insolvency Fund) before or at the time the provisional supervision comes into effect with the remaining employees' debts to be paid within 12 months thereafter is reasonable. This option offers a measure of protection for employees and at the same time allows the new investor some time to raise funds for the continuance of the company and the payment of employee debts.
2. The 2003 proposal to set up a dedicated trust account for paying all arrears of wages, severance payments and other statutory entitlements to employees before the initiation of a provisional supervision procedure is too onerous for financially distressed companies and would be a major obstacle for the use of provisional supervision, therefore defeating its purpose of facilitating corporate rescue. It may be very difficult for a financially distressed company to raise sufficient funds to pay off all employees' debts at such an early stage.
3. Alternative A is not feasible. It would not make sense to exempt employees who are owed wages or other entitlements from the moratorium. To do so will give a special bargainging power to employees and will most likely defeat the purpose of the provisional supervision procedure because the employees will be able to wind-up the company at any time.

Question 10

Independent of which of the above options is adopted, what are your views on the treatment of outstanding employers' MPF scheme contributions?

1. In principle, outstanding MPF contributions should be treated in the same way as

employees' arrears of wages and other outstanding entitlements.
2. However, to deal with situations where the outstanding MPF contributions may be relatively large in quantum, consideration should be given to a cap on the MPF contributions to be included as part of the employees' outstanding entitlements.
3. Alternatively, the amount returned to employees could be linked to the funds available within the company within the initial few years of the rescue plan (i.e. staggered payments).
4. A cap on outstanding MPF contributions or staggered payments would assist to ensure that use of the provisional supervision procedure is not hindered by unduly onerous outstanding employees' entitlements which need to be provided for whilst ensuring a relatively fair outcome for employees.

Question 11

Do you agree with the proposal that solicitors holding a practising certificate issued under the Legal Practitioners Ordinance (Cap 159) and certified public accountants registered in accordance with the Professional Accountants Ordinance (Cap 50) may take up appointment as provisional supervisors?

1. Qualified solicitors and accountants, registered under their respective professional associations should be entitled to take up appointments as provisional supervisors should they wish to do so.
2. The individual appointed should have a minimum number of years of practical experience in the area of insolvency and corporate rescue work (e.g. at least 5-6 years of practical experience) before qualifying for appointment as provisional supervisor.

Question 12

Do you think that other persons without the above qualifications could also be

appointed as provisional supervisors on a case-by-case basis? If so, should such an appointment be made by the OR or the court? Please elaborate, in particular on the appeal channel in case of aggrieved applicants and on the associated investigatory and disciplinary regime in case of complaints against appointed persons.

1. Other persons suitably qualified should be entitled to be appointed as provisional supervisors. However, a system will need to be set up to determine who is "suitably qualified".
2. As a provisional supervisor is not a "court-appointed" officer, it would seem arduous and time-consuming for the court to approve each appointment.
3. We suggest that a system be established whereby individuals who have the requisite qualifications and experience to act as a provisional supervisor but are not qualified solicitors or accountants in Hong Kong (e.g. those with practical experience and qualifications in other common law countries etc) can apply to be registered by the Official Receivers Office on a "Register" of suitable provisional supervisors who are not qualified solicitors or accountants.
4. The Official Receiver should be able to go to court for directions on the suitability of a candidate, if necessary.
5. This would mean that the system is not a "closed door" one but at the same time benefits from the safe-guard of having "other persons" who apparently qualify for appointment as provisional supervisor being vetted and approved before being appointed. This mechanism would mean that creditors have the assurance that the individual is suitable for appointment as provisional supervisor.
6. Those aggreived would look to the Official Receiver for assistance.
7. The Official Receiver's Office could appoint solicitors to assist with (i) the review and registration of potential candidates and (ii) the examination of the conduct of the provisional supervisors who are the subject of complaint.
8. In the event that a complaint is made out, the Official Receiver should have powers to strike the individual off the Register and render him/her disqualified from acting as a provisional supervisor for a suitable number of years, depending on the severity of the misconduct.
9. Based on the current proposals for the provisional supervision regime, a provisional supervisor will have personal liability. For disciplinary purposes, fines could also be imposed by the Official Receiver, again, according to the severity of the misconduct.

Question 13

Do you agree with giving creditors the choice to replace the provisional supervisor appointed by the company or its directors or the provisional liquidators or liquidators of the company and approve the remuneration of the provisional supervisor at the first meeting of creditors to be held within 10 working days from the commencement of provisional supervision? If not, please elaborate on the reasons and suggest alternatives.

1. As major stakeholders, creditors should be able to replace a provisional supervisor and approve his/her remuneration at the first creditors meeting. This is required for transparency and for the credibility of the provisional supervision regime.
2. However, to ensure the smooth running of the provisional supervision regime, conditions should be imposed for any replacement e.g. a majority of creditors in number (i.e. 51%) who represent at least 75% in value of the creditors attending the meeting in person or by proxy should agree with the replacement.
3. A replacement, if appropriate, should be done swiftly to avoid duplication of costs.
4. If any one creditor or a minority group of creditors is/are able to oppose an appointment and seek a replacement at the first meeting, this may unduly hinder the work of provisional supervisors in the critical early stages of the corporate rescue procedure.

Question 14

Do you support imposing personal liability on provisional supervisors as proposed in paragraphs 5.14 to 5.17 above? If not, please suggest alternatives which would effectively address the issues set out under paragraphs 5.16(a) to (c).

1. We support the imposition of personal liability on provisional supervisors.
2. However, we take the view that it is appropriate to have express provisions in the

legislation for provisional supervisors to be indemnified out of the assets of the company in priority to pre-provisional supervision claims.

Question 15

Do you support the introduction of insolvent trading provisions? In case you do not, please explain and suggest alternatives to (a) encourage timely initiation of provisional supervision; and (b) deter irresponsible depletion of the company's assets.

1. The introduction of insolvent trading provisions is supported.
2. Insolvent trading provisions are needed in Hong Kong to deter directors from continuing to trade at a time when they knew or ought to have known that the company would not be able to trade out of its difficulties.
3. This would put the onus back onto those responsible for making decisions within a company to not make decisions which may lead to the reckless depletion of the company's assets to the detriment of its creditors.

Question 16

Do you agree with the proposed revised formulation of "insolvent trading"? If not, please suggest alternatives.

1. The proposed formulation appears to be an amalgamation of the formulae used in the UK and Australia.
2. The formualtion needs to specify whether a debt must be incurred at the time the director or shadow director engages in the insolvent trading for the duty to arise. The purpose of this element is to limit the boundary of a director's breach so that certain autonomy in business judgments can be retained.
3. A defence should be expressly available as in the UK legislation, to the effect that

if the director or shadow director took every step with a view to minimising the potential loss to the company's creditors as he ought to have taken, no breach of duty would arise.

Question 17

Do you agree with the way that "major secured creditors" was defined in the 2001 Bill? If you think any changes are needed, please elaborate and explain.

1. The definition of "major secured creditors" needs fine-tuning.
2. The current definition is too vague and leads to uncertainty.
3. A percentage of the fixed and floating assets of the company should be specified.
4. A clear definition is critical if the major secured creditors are going to have the wide veto rights to terminate the provisional supervision.

Question 18

Do you support the proposal to largely follow the 2001 Bill approach with respect to protection of "major secured creditors" and other secured creditors' rights? If you think any changes are needed, please elaborate and explain.

1. Secured creditors, including major secured creditors should look to their security in the first instance.
2. Traditionally, secured creditors have always been treated differently due to the fact that they possess security.
3. The current proposal which affords secured creditors and major secured creditors the right to (i) not consent to the provisional supervision and (ii) to veto and terminate the provisional supervision outright, respectively, appear too wide.

4. If secured creditors hold onto their security, they should look to their security for recompense and should not be able to object to the moratorium and provisional supervision.
5. If a secured creditor gives up its security or the security is insufficient to cover the debt due to it, it should join the other unsecured creditors and be bound by the moratorium.
6. Secured creditors should not have the right to exercise their security and at the same time not consent to the provisional supervision and the moratorium. This right may jeopardise the provisional supervision processs.
7. If a major secured creditor has a fixed and floating charge over almost all of the company's assets, usually, it will be able to appoint a receiver. Whether this option will still be available in a provisional supervision situation requires consideration.

Question 19

What are your views on retaining or removing the "headcount test" in the voting at meetings of creditors (i.e. requirement (a) stated in paragraphs 8.1 and 8.2 above) for resolutions to be passed at meetings of creditors?

1. The headcount test is used in other situations in the Companies Ordinance which requires creditors to vote on resolutions put to them at meetings (e.g. schemes of arrangement under section 166 of the Companies Ordinance).
2. This requirement ensures that a majority of the creditors present and voting agree with the proposal being tabled, irrespective of the value of their claims. In summary, this ensures that the views of the "small creditors" are heard and reflected in the votes.
3. The additional requirement, that a certain percentage "in value" of the creditors present and voting agree with the proposal being tabled, ensures that the views of the creditors with larger claims are heard and reflected in the votes.
4. This dual-pronged test, which includes the "headcount" test is appropriate and

should be maintained.

5. As with schemes of arrangement, it will be the job of those wishing to promote the provisional supervision to lobby and secure the support of the majority of the creditors in both number and value.

- End -