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Division 4, Financial Services Branch
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
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By email: corporate_rescue@fstb.gov.au

Dear Sir/Madam

Review of Corporate Rescue Procedure Legislative Proposals

Thank you for the opportunity to comment on the Consultation Paper on the Review of Corporate Rescue Procedure Legislative Proposals. CPA Australia has considered the Consultation and our detailed comments follow.

CPA Australia represents the diverse interests of 129,000 members in finance accounting and business in 110 countries throughout the world. Our mission is to make CPA Australia the global professional accounting designation for strategic business leaders. We make this submission not only on behalf of members, but also in the broader public interest.

Our comments have been prepared in consultation with a specialist taskforce of the Hong Kong China Division and in liaison with CPA Australia National Office – the latter of which to provide comparison with a similar establish corporate rescue regime.

General Comments

CPA Australia believes the proposed provisional supervision arrangement has significant merit and, with a number of the various foreshadowed changes, strikes an appropriate balance between providing an opportunity for corporate rescue and protecting the interests of creditors. The proposals are consistent with international developments in external administration law, whilst being sensitive to local needs. A further important attribute of an insolvency regime is to ensure that the privilege of limited liability is not abused. In these terms, the proposals in relation to liability for insolvent trading are likewise very sound.

Our responses to the nineteen specific questions are included in the attached appendix.

If you have any questions regarding this submission, please do not hesitate to contact:

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STAT00052 2009/05

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Yours faithfully,

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Past President
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CPA Australia Hong Kong China Division

STAT00052 2009/05

Appendix

CPA Australia Hong Kong China Division:

Submission for Consultation Paper on 'Review of Corporate Rescue Procedure Legislative Proposals'

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.**

We have no comment regarding the proposed changes for the initiation of provisional supervision as mentioned in paragraphs 2.4 and 2.5.

Regarding 2.6, we believe it may not always be practicable for a Statement of Affairs ("SOA") of the subject company to be submitted prior to commencement of provisional supervision ("PSN") due to unavailability of required information. In order to avoid abuse of the PSN process, however, we suggest that directors prepare a declaration stating that: (i) they have reviewed and considered the updated financial statements of the company; and (ii) they have formed the opinion that there are reasonable grounds for putting the company into PSN and that PSN is in the best interests of the company and its stakeholders.

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.**

No, we do not see the need for other changes to be made to the initiation of provisional supervision, including who may initiate the procedure due to the fact that in a normal situation, the creditors may not have sufficient financial information to form a view as to whether a company should be placed in provisional supervision rather than liquidation.

As the Consultation Paper points out, creditors should not be empowered to place the company into provisional supervision, though as the Consultation Paper further alludes, creditors in Australia have specific statutory powers in deciding the future of the company (Pt 5.3A – Div 5 of the Corporation Act) and can indeed, where they are a chargee over substantially all the property of the company's property, appoint an administrator (s 436C) who would be equivalent to the provisional supervisor. The one variation which may be worth considering is allowing a liquidator to appoint the provisional supervisor, this type of arrangement allowed for in Australia under s 436B.

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.**

Yes, we 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. We also suggest that online and electronic media be accepted as alternative media for publishing the same notice.

Under s 450A of the Corporations Act 2001 in Australia, the administrator must lodge notice of the appointment before the end of the next business day after the appointment, publish notice within 3 business days and give a written notice of the appointment to each person holding a charge on the whole or substantial part of the company's property. The FSTB proposal is sound and consideration of additional or alternative means of notice is valid, so long as it can be confident that those dealing with the company in its place of registration and main place of business are capable of being made aware of the appointment.

Question 4 **Do you support an initial moratorium period of 45 days? If not, please suggest alternatives and explain.**

In light of the unique business characteristics of Hong Kong, where a majority of the companies (SMEs, public companies, MNCs) have operations, investments and projects in Mainland China and other offshore jurisdictions. Insolvency Practitioners often need to deal with cross-border issues which inevitably require more time. As such, we suggest that an initial moratorium period of 60 days rather than 45 days be implemented for the following reasons:

1. In our view, (i) it could require up to 5-6 weeks (i.e. 30–40 days) for a provisional supervisor to ascertain and review the financial position of a company, collect the necessary financial information for assessing the feasibility of carrying out a corporate rescue and preparing the voluntary arrangement proposal; and (ii) additional time could be required by major bank creditors to have the voluntary arrangement proposal reviewed and considered in accordance with their internal approval procedures. If the company in provisional supervision were a listed company, the time required for the two above procedures may be even longer;

2. The initial moratorium under the corporate rescue procedure in Singapore is set at 60 days.

As the Consultation Paper notes, the initial moratorium under Australian corporate law is comparatively short at 25 days – this being determined by the duration between the appointment of the administrator and second meeting of creditors at which the future of the company is voted upon. Decision in this area is very much based on a combination of local business practice and views as to the extent to which creditors should be allowed to exert their legal rights and proprietary claims. This said, a competent insolvency practitioner should be able to determine a company's position and prospects in no more than 60 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.**

CPAA: Yes, we support this proposal.

As alluded to above, the stay of proceeding mechanism (s 440D) under Australian voluntary administration procedures is governed by the timing of creditor meetings which compels in a fairly short timeframe decision about the companies' future – trade on, liquidate or, most importantly, enter a deed of company arrangement.

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.**

Yes, we believe it would be appropriate to leave the extension of the moratorium beyond six months to the court's decision.

We would tend to concur with the remarks made on page 19 of the Consultation Paper. There is risk in extending moratorium periods which potentially adds undue delay in resolving an insolvent company's affairs. As such, a court may be the only party appropriately placed to conclude the matter.

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.**

No, we do not agree that any court extension should be limited to a maximum of 12 months from commencement of provisional supervision. We believe the court should have discretion over the length of the moratorium period based on the circumstances of each case. The court should realise that the natural alternative for granting no extension is to place the company into liquidation.

Australian insolvency law has a tendency towards compelling a resolution of an insolvent company's affairs. Whilst there is merit in avoiding liquidation, such protraction given rise to by allowing further moratoriums could be at the cost of economic efficiency, and indeed, the interests of parties with valid claims. Also it may be said that a drawn out procedure may delay errant directors from being brought to account.

We suggest that further application for the extension of moratorium beyond 12 months should only be made by the Provisional Supervisor based on his/her professional judgement. The burden of proof rests with the Provisional Supervisor in his/her affidavit/affirmation to convince the

Court that further extension is necessary and in the best interest of the general body of creditors. Given the inherited personal liability, the Provisional Supervisor would not make such application lightly without solid grounds. This is probably the best safeguard by itself.

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.**

We ask that the government reconsider the merits of exempting the list of contracts and agreements from the moratorium in light of the insolvency experience gained in the recent global financial turmoil. If this exemption is considered necessary, we suggest that there should be a mechanism in place to have this list reviewed and updated from time to time, and exposures such as CDO/CDS should be included.

The nearest equivalent provision under Australian voluntary administration arrangements relates to a general moratorium for bankers' liens and collateral lodged with clearing and settlement facilities. On a similar rationale, this exception applies in recognition of the need for certainty in high volume settlement arrangements. An additional exception which might be worth considering relates to perishable goods – under s 441C of the Corporations Act a holder of a charge over perishable goods is entitled enforce the charge to protect the secured creditor's interest.

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.**

We believe there are pros and cons for each of the three options, the 2003 Proposal, Alternative A and Alternative B:

The 2003 Proposal is the best option in terms of protecting the interests of employees. Nevertheless, a company in financial distress is likely to have difficulty finding the financial resources to meet employees' liabilities.

Under Alternative A, those employees who are not subject to moratorium would have a right to petition the court to wind up the company even after the commencement of provisional supervision. While this may serve to improve employees' protection, it would increase uncertainty in carrying out provisional supervision and increase the difficulty in achieving a successful turnaround plan.

Under Alternative B, it would not be necessary to settle employees' outstanding entitlements prior to commencing the provisional supervision process. However, certain of these entitlements should be settled by the

time the voluntary arrangement comes into effect and the balance within 12 months. Under this proposal, the possibility of rescuing the company will still be subject to the risk that the company may not have sufficient cash flow to settle the employees' outstanding entitlements.

We believe that a better alternative would be as follows: Employees who are not subject to the moratorium and whose claims amount to a certain percentage of total employees' outstanding claims (say two-thirds of the total) would have the right to petition the court to wind up the company. This right to petition to wind up the company is solely for triggering the ex-gratia payment from the Protection of Wages on Insolvency Fund ("PWIF"). Thereafter, the relevant employees could apply to the court to have the winding up petition stayed. This alternative is suggested because the employees would be entitled to apply for ex-gratia payments from PWIF if the company were placed in insolvent liquidation.

Direct comparison and insight from Australian experience is difficult in so much as the Pt 5.3A voluntary administration procedures make no specific reference to employees who are treated amongst the body of general creditors, though are entitled to vote in respect of their claims that are deemed crystallized as if the company entered into a hypothetical liquidation as at the commencement of the administration. Significantly however, company liquidation procedures grant to employees priority in relation to wages and superannuation (s 556(1)(e)), leave (s 556(1)(g) and retrenchment entitlements (s 556(1)(h). Further, this structure of priority is required to be applied to property coming to the administrators control under a deed of company arrangement arising out of the voluntary administration (s 444DA(1)). Section 444DA(2) does however allow for eligible employees to pass a resolution agreeing to the non-inclusion of such provision.

Overlaying this strong orientation towards protecting employees is the General Employee Entitlement and Redundancy Scheme (GEERS) which pays to employees of a company in liquidation their basic wage, leave and other entitlements that remain unpaid (the government then stands in the shoes of the employee in the liquidation). Against this strong protection of entitlements, employee support of any rescue proposal in very much a case of negotiation by the administrator. In light of these comments, we believe the alternative we proposed is appropriate to the local conditions and circumstances.

Question 10 **Independent of which of the above options is adopted, what are your views on the treatment of outstanding employers' MPF scheme contributions[41]?**

We believe the treatment in a provisional supervision of outstanding employers' MPF scheme contributions should not put the creditor in a worse position than the one it would have in a liquidation. (In a liquidation, outstanding employers' contributions have priority for payment as a preferential debt subject to a cap of HKD50,000 plus 50% of any amount that exceeds HKD50,000 [refer to Section 265(1)(ch)].

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?**

No, we do not agree. In provisional supervision, power would be granted to the provisional supervisor to formulate a restructuring as an alternative to provisional liquidation. In formulating a restructuring plan, the provisional supervisor has to review the financial position of a company, assess the feasibility of carrying out a corporate rescue and prepare the voluntary arrangement proposal. The provisional supervisor possessing the necessary financial knowledge will have an advantage in carrying out the aforesaid tasks. The knowledge and experience of the provisional supervisor would be pivotal to the success or otherwise of the provisional supervision. Qualified solicitors and, for that matter, professional accountants, cover a wide spectrum of professionals with varying levels and areas of experience and competence and there is a real risk that the process could be easily mishandled or even abused if not properly performed by a suitably qualified person.

In view of the above, we recommend that qualified accountants with restructuring knowledge and experience should have priority in acting as the provisional supervisor. In addition, only Panel A members (i.e. members of the panel set up under the administrative scheme of contracting out of non-summary court winding-up cases to professional accountants experienced in insolvency matters) and restructuring professionals in Hong Kong who hold relevant local or overseas qualifications (e.g. holders of insolvency practitioner licenses) and who possess relevant and sufficient local experience in corporate restructuring or voluntary workouts be eligible to be appointed as provisional supervisors.

Such qualifications are similarly required in Australia, where an administrator must be a registered liquidator (s 448D). Section 1282 in turn deals with registration of liquidators which tends strongly towards recognition of primarily accountancy and then commercial law qualifications. Additionally, the applicant must show appropriate experience and aptitude befitting the role.

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.**

No, we do not suggest that other persons without the above qualifications be appointed by provisional supervisors, with or without the blessing from

OR or the Court. Provisional supervision is different from procedural matters like liquidation, and allowing firms without sufficient resources/manpower and relevant experience to manage the company's affairs/operations will affect the company's chances of survival, to the possible detriment of creditors and other stakeholders.

Complaints of an aggrieved applicant against a provisional supervisor should be made to the professional body to which the provisional supervisor belongs. This is a useful and necessary deterrent.

However, the issue arises in Hong Kong where there are persons who provide insolvency services and act as liquidators, receiving and spending trust monies, without being a member of the HKICPA or the Law Society. They are not even members of foreign professional bodies with branches in Hong Kong – like CPA Australia and ACCA. Furthermore, they are not associated with any of the licensed Accounting or Law Firms. There is no way to file complaints and they are effectively the "untouchable", if and when things go wrong.

In light of the above, our view is to have the OR to act as the "Supervisor" of the Provisional Supervisors, with the Court as the last resort, in cases where the Provisional Supervisors do not belong to any professional bodies in Hong Kong or licensed professional firms. Given we support the "Panel A" members (Question 11 above) to be the ideal candidates for Provisional Supervisors, OR should have jurisdiction over the conduct of the Provisional Supervisors.

Consistent with the remarks made in relation to Q11, the Australian regime tend strongly towards recognition that administrators must have competence equivalent to that of a company liquidator. The function of registration resides with the Australian Securities and Investments Commission, and serious breaches of conduct are dealt with by the Companies Auditors and Liquidators Disciplinary Board established under Part 11 of the ASIC Act. This is in addition to accounting professional membership body oversight and disciplinary actions which will be conducted with reference to the Accounting Professional & Ethics Standards Board standard APES 330 – Insolvency Services.

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.**

Yes, we believe that creditors should be given the choice to replace the provisional supervisor and to approve the remuneration of the provisional liquidator(s) at the first meeting of creditors.

These are reasonably consistent with Australian arrangements. The

directors when placing the company into administration appoint the administrator (s436A(1)(b)). At the first meeting of creditors a resolution may be passed removing the administrator from office and appointing someone else as administrator of the company. Thereafter, the appointment of a person as administrator of a company or of a deed of company arrangement cannot be revoked (s 449A). However under s 449B, a court may remove an administrator on the application of ASIC, or of a creditor, liquidator or provisional liquidator of the company concerned. Under s 449E, the administrator's remuneration may be fixed by the company's creditors (a committee of creditors if one is formed – s 436F) at the meeting to consider the administrator's proposal for the company's future under s 439A. If no remuneration is fixed by the creditors, the remuneration will be determined by the court on the application of the administrator.

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).

Yes, we support the proposal to impose personal liability on provisional supervisors in 5.14 to 5.17. We further suggest that in respect of their personal liability they should be indemnified out of the assets of the subject company.

With regards to paragraph 5.17, the Provisional Supervisor needs to decide whether or not to accept pre-existing employment contracts within 16 working days and be personally liable if accepted. We support the proposal that creditors be given the choice to replace the Provisional Supervisor at the First Meeting of Creditors to be held within 10 working days.

In light of the above, the new Provisional Supervisor, in case of replacement by the creditors, will have only 6 working days to decide this critical issue with personal liability attached. Our view is to give the new Provisional Supervisor, in case of replacement, 10 working days to investigate and make an informed decision. In the event that no replacement has been made of the Provisional Supervisor, we should adhere to the original proposal of 16 days to protect the interest of the employees.

As the Consultation Paper notes at fn. 34, Australia is one jurisdiction in which the administrator of a company under administration is liable for the debts he or she incurs in the performance or exercise of any of his or her functions and powers as administrator including for services rendered (s 443A). Correspondingly under s 443D, the administrator of a company is entitled to be indemnified out of the company's property for debts for which the administrator is liable. Concerning the specific reference to pre-existing employment contracts, this matter is most likely dealt with under Australian rules within the timeframe for the administrator to propose the future direction of the company.

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.

Yes, we support the introduction of insolvent trading provisions as it will provide an incentive to induce directors and senior management to take action earlier to avoid insolvency and insolvent trading.

To encourage directors to act on insolvency earlier rather than later, we support the introduction of Insolvent Trading Provisions as the "stick". On the other hand, the directors need the "carrot" or safe haven if they have entered into personal guarantees in relation to money owed by their company, because at least while a company is subject to Provisional Supervision, guarantees cannot be enforced against the directors (without leave of the Court) where they relate to company liabilities.

Australia having perhaps the strongest insolvent trading regime amongst comparable jurisdictions, recognizes the voluntary administration procedure as a complementary measure which enables directors to take prompt action to assist in preserving the company's assets and safeguarding the interests of creditors. More generally, the insolvent trading regime by providing a narrow form of corporate veil piercing, is an important mechanism for avoiding abuses of limited liability and the corporate form. The duty to prevent insolvent trading contained in Pt 5.7B – Div 3 of the Corporations Act, is applicable only to directors and is based on the rationale that it is they who are ultimately responsible and should make themselves aware of the company's financial state. The Australian definition of director does recognize shadow and de facto situations. Concerning s 440J, the operation of this section is consistent with other moratorium arrangements and was introduced on the rationale that but for this protection, there would be a positive disincentive to the directors putting the company into administration at an early stage.

Question 16 Do you agree with the proposed revised formulation of "insolvent trading"? If not, please suggest alternatives.

No, we do not agree with the proposed revised formulation of "insolvent trading". Our view is to impose lower threshold in establishing Insolvent Trading liability by keeping the ground (1)(b). As a result, the responsible person will be held liable if there were reasonable grounds for suspecting that the company was insolvent or there was no reasonable prospect that the company could avoid becoming insolvent.

Although there is a concern from the business sector that stringent provisions may "overkill" and discourage entrepreneurs from taking risk,

we should not underestimate that the corporate governance and white collar crimes are one of the major issues we face today. Under the circumstances surrounding insolvent companies, the lack of resources and information and the fact that liquidators are equipped with little power, there have been very few successful prosecutions against delinquent directors of insolvent companies.

The statutory wording of the Australian insolvent trading regime more closely accords with (1)(b). Section 588G(1) states "This section applies [at a time when the company incurs a debt] and, at that time there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent." The onerous nature of the liability is further enforced by the corresponding defence (s 588H(2)) being expressed in terms of grounds to *expect* and did *expect* the company to be, and remain, solvent. In periods of economic downturn, as has recently occurred, the strictness of the regime has been criticized. The most common areas of concern being the absence of a business judgment type protection and lack of clarity around when precisely is a company insolvent.

Though not part of the insolvent trading regime, a further important mechanism for enabling the redressing of wrongdoing is contained in the voluntary administration provisions themselves. There under s 438D, if in the conduct of investigation of the company's affairs, the administrator becomes aware of any matter that may point to a breach of the law in relation to the company, this must be reported to Australian Securities and Investments Commission.

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.**

Yes, we agree with the way that "major secured creditors" was defined in the 2001 Bill.

In Australia, "secured creditor" is not defined in the Corporations Act, though the Bankruptcy Act defines this as a person "holding a mortgage, charge or lien on property of the debtor as securing for a debt due to him from the debtor." Similar to the Hong Kong 2001 Bill, the voluntary administration provisions contained in Pt 5.3A does recognize major secured creditors through the terminology "charge on the whole, or substantially the whole, of the company's property."

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.**

Yes, we agree to the proposal to support the 2001 Bill in these respects.

As the Consultation Paper points out, corporate rescue procedures should have minimal impact of the proprietary right of secured creditors.

Under s 441A of the Corporations Act in Australia, creditors holding a charge over the whole, or substantially the whole, of the company's property, can either before the administration commences or within 10 business days of being notified of the appointment, proceed with enforcing in the usual way, without regard to the administration. This of course does not preclude instances where such creditors may entertain a rescue proposal.

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?

We believe the "headcount test" should be removed because it is open to abuse and could operate to the disadvantage of creditors whose claims represent a significant percentage of the total claims of the company, but whose number might be small, as may be the case with bank lenders, etc.

- End -