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15 January 2010

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

Dear Sirs

Corporate Rescue Procedure Submission

Please find attached a submission on behalf of Ferrier Hodgson Limited with respect to the Review of Corporate Rescue Procedure Legislative Proposals Consultation Paper.

Should you have any queries with respect to our submission or require any further information, please do not hesitate to contact us.

Yours faithfully

Nick Gronow
Executive Director

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About Us

Ferrier Hodgson is a specialist firm that practices in the areas of Restructure & Turnaround, Corporate Advisory, Risk Solutions and Corporate Recovery. We deal with business problems, usually involving financial distress. With around 75 staff in Hong Kong alone, we are the largest practitioner in our field in Hong Kong.

Over the past few years we have been involved in many of the high profile collapses of Hong Kong companies. These include Asia Aluminum, Peace Mark, Tack Fat, Moulin Global Eyecare and Orient Power to name a few. We have also been involved in numerous large restructuring or workout matters involving Hong Kong companies or groups, many of which have regional and global operations. We have worked with all Hong Kong's major financial institutions and majority of smaller institutions as well as many local and international private equity and hedge funds and have regular dealings with Hong Kong solicitors specialising in corporate recovery and restructuring matters.

Certain of our Executive Directors are qualified to take appointments as liquidators in Hong Kong and regularly do so. We have operated in Hong Kong for 25 years but have also had substantial dealings throughout the region and been involved in advising clients on global financial collapses and restructuring matters. As such, we have seen many different corporate rehabilitation and insolvency regimes in different countries. Furthermore, we have offices throughout Asia and Australia and strong affiliations with leading firms in the US and Europe.

Certain of our Executive Directors in Hong Kong are expatriate Australians, all of whom have worked in Hong Kong for at least 5 years and all of whom worked in Australia for at least a further 7 years, gaining considerable exposure to Australia's Voluntary Administration ("VA") regime, which is Australia's equivalent to Hong Kong's proposed Provisional Supervision ("PS"). One of our Executive Directors remains qualified to take Voluntary Administration appointments in Australia by virtue of being an Australian registered Court Liquidator. Two of our Executive Directors have worked in the United Kingdom for over a year, gaining exposure to and experience with the UK's Company Voluntary Arrangement ("CVA") legislation, the UK's equivalent to Hong Kong's PS. Indeed, the proposed PS legislation in Hong Kong has clearly borrowed elements of both the UK's CVA and Australia's VA legislation.

In light of the above, we consider we are eminently qualified to comment on the proposed PS legislation for Hong Kong.

The Need For PS

We wish to take this opportunity to reiterate the need for the PS legislation in Hong Kong. Hong Kong is one of the few, if not only, major financial centres in the World that does not have any proper form of corporate rehabilitation legislation (we do not consider Provisional Liquidation and Scheme of Arrangement legislation to be for the purpose of corporate rehabilitation). Currently, China has far more progressive corporate rehabilitation legislation than Hong Kong by virtue of its relatively new Corporate Bankruptcy Law.

Many countries in Asia have corporate rehabilitation regimes. Following the Asian Financial Crisis of the late 1990s, many countries in Asia put in place or materially modified their insolvency and restructuring legislation. These include developing countries such as Indonesia, Thailand and the Philippines and more developed countries like South Korea and Taiwan. Asia's other major financial centres, Singapore and Japan, have had corporate rehabilitation legislation in place for some time. As noted above, China introduced its new

Bankruptcy Law in 2008. India, Asia's other powerhouse economy, also has relatively new corporate rehabilitation legislation.

Hong Kong lags these countries in the development of measures for corporate rehabilitation. In our view, this is to Hong Kong's disadvantage. We consider that returns to creditors would be greater and certainly faster if Hong Kong introduces the proposed PS legislation. Whilst we understand there are certain difficult issues to be dealt with, such as the treatment of employee entitlements, the role of secured creditors, the strength of insolvent trading provisions and who may take appointments as the Provisional Supervisor ("Supervisor"), no piece of legislation is perfect. It is our strong view, that a slightly imperfect PS regime is far better than none at all.

The example of the introduction of the VA legislation in Australia in 1993 is relevant. The legislation is generally heralded as a substantial success. It was not, however without its shortcomings and further changes were made to improve the legislation after it had been operating for about 10 years and following substantial review. The key point though is that the legislation has been effective. Returns to creditors are considered to be higher and have been received faster than in the past. Whilst many companies were unable to be saved and went into liquidation (one of the criticisms of that legislation), these companies would always have been liquidated in any event. Even in these situations, the legislation allowed them to be liquidated efficiently in the majority of cases.

As noted, Hong Kong currently does not have any corporate rehabilitation legislation. Courts have often been accepting of allowing Provisional Liquidation ("PL") to be used for restructurings in certain cases, although even then, judicial interpretation has deviated at different times. Whilst Courts have often been accommodating to allowing restructuring through a PL, it is far from ideal and not what that legislation is really intended for.

Changes to insolvency and restructuring legislation is often the outcome of recession or difficult economic times. The substantive changes to legislation in many Asian countries followed the Asian Financial Crisis. The introduction of the VA legislation in Australia followed a recession in the late 1980s. By comparison, China's new Bankruptcy Law, was introduced to provide certainty to investors and lenders that there was a means of appropriately dealing with financially distressed companies.

For Hong Kong, whilst the global economy is improving and Asia has to a large extent avoided the calamitous economic conditions of Western countries, the need for corporate rehabilitation legislation remains paramount. Paramount to ensure that Hong Kong has equivalent regimes to major global financial centres such as the US and UK and also does not continue to remain behind the Asian financial centres of Singapore and Japan. It is also paramount to ensure that Hong Kong has equivalent legislation to China (even though the Chinese legislation is debtor oriented and the proposed Hong Kong legislation is creditor oriented) given the strong ties between the two and the number of financially distressed companies and groups that have exposure to both Hong Kong and China. Finally, the PS legislation is paramount to help improve returns to creditors, in terms of both quantum and speed.

As such, we urge the Financial Services and the Treasury Bureau to continue to pursue the implementation of the PS legislation, which has for too long been allowed to be put aside.

Our Submission

Our response to the questions for consultation follows in the subsequent pages. Our responses are based on the following principles:

- The manner in which provides the greatest opportunity for PS to achieve the objectives set down (ie save businesses, enhance returns to creditors);

- Ensuring flexibility and efficiency throughout the PS process; and

- What we consider will work best in actual practice i.e. in the field.

If you require any clarification on any aspect of our submission, please do not hesitate to contact us.

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.

Before responding to Question 1, we make the following comments regarding Chapter 1 of the Consultation Paper:

Our comments in relation to 2.1 are as follows:

It is proposed that PS can be initiated by the company. It is also proposed that the company's directors or provisional liquidators or liquidators can appoint a Supervisor.

It is unclear as to the difference between a company or its directors making such an application. The company acts via its directors. Clarification of what is meant by the company appointing a Supervisor needs to be made.

We would suggest that the provisional liquidator or liquidator should be able to appoint themselves as the Supervisor. We see no reason for the wastage of time and costs which would result from a completely new appointee.

Our comments in relation to 2.2 are as follows:

The relevant notices to be filed seem reasonable.

However, it is impossible to state the level of remuneration of the Supervisor at this point in time. Most companies in Hong Kong are complex and cover multiple jurisdictions. To think the level of remuneration can be accurately estimated is not even likely to be feasible and is highly unrealistic.

Clarification needs to be obtained in relation to the Supervisor's request for a Statement of Affairs. For example, if the PS was commenced by the directors, they are required to produce a Statement of Affairs at the directors' meeting. Would a further Statement of Affairs be required or would this be dispensed with?

Our comments in relation to 2.3 are as follows:

As noted in the Explanatory Memorandum, the UK, Australia and Singapore allow creditors, or major secured creditors, to apply for the relevant corporate rescue procedure. The purpose of such legislation is to rescue companies as opposed to having Receivers appointed. It would seem that allowing major secured creditors the opportunity to appoint a Supervisor would allow a greater chance of saving the business where such an appointment is more appropriate than a Receiver. It will also be unusual that Hong Kong moves in a different direction to the majority of the world.

We now turn to Question 1.

Our comments in relation to 2.4 are as follows:

Agreed.

Our comments in relation to 2.5 are as follows:

In Hong Kong, employees' entitlements are protected as priorities payments set out in the Companies Ordinance and the Wage Protection Board Legislation.

This proposed legislation is intended to strengthen the trading whilst insolvent provisions and encourage directors to seek corporate rescue.

If a company cannot meet obligations to its employees, it is unlikely to be able to put insurance coverage into place. If directors cannot pay wages, what should the company's directors do? Simply ignore the requirement the new rules to trade responsibly and continue to run up debts if there is not enough money for wages. Or seek a liquidator to be appointed to wind up a business that could be saved.

By simply mandating that wages be paid, does not extract blood from a stone. Whilst our commentary may seem harsh, from our experience it is the reality. Therefore we suggest 2.5's proposition be rejected as it will stop companies from using the process. Please also see our comments regarding question 9 below.

Our comments in relation to 2.6 are as follows:

Please refer to our comments on point 2.2 above.

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.

Please see our comments regarding 2.1 and 2.3 above. In our view the key issues are:

- A provisional liquidator or liquidator should be able to appoint themselves as the Supervisor so as to be able to pursue a restructuring. Having the same appointee will save costs and avoid the disincentive of a liquidator considering a different appointee.

- A major secured creditor should be able to appoint a Supervisor. This may be considered a better alternative than appointing a Receiver in some cases e.g. to use the moratorium or as part of a group restructuring.

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.

We agree with the proposed approach.

Question 4

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

We believe that an initial moratorium of 45 days is appropriate so that the company and the Supervisor have sufficient time to prepare a rescue plan which is realistic and workable for the company and creditors. From our experience, it takes at least 2 weeks for an insolvency practitioner to obtain necessary financial operational and information from the debtor company and the insolvency practitioner can then start to prepare a workable plan for the company.

To balance the interests of the creditors, we propose that certain matters should be allowed to proceed during the moratorium period, on the basis that such matters would not affect the ongoing operation of the debtor company. In particular, employees could register their claims for outstanding wages and other entitlements with the Protection of Wages on Insolvency Fund Board ("Fund Board") upon the appointment of the Supervisor. From our experience, it normally takes around 8 weeks for the Fund Board to register and adjudicate the claims filed by employees. We believe that the PS should allow this process to continue, and in the event a Voluntary Arrangement proposal is not proposed or accepted by the creditors, the employees can accelerate their claims and obtain the ex-gratia payments from the Fund Board forthwith.

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.

To balance the interests of different stakeholders, we believe that an initial extension of the moratorium up to a maximum period of six months is reasonable.

The actual length of the moratorium should vary from case to case based on the complexity of the company and the possible terms of the voluntary arrangement proposal being prepared but, in any event, should not exceed 6 months initially.

We consider that an extension of the moratorium period should be able to be made by resolution of creditors or the Court. We consider that the Supervisor should have flexibility to use either option based on what they consider is in the best interests of the company. In very large matters for example, it may not be efficient or cost effective to convene a meeting of creditors. Similarly, where there are large creditor groups (e.g. employees, related parties) that may unduly influence a creditors' resolution, the Court may be a more appropriate forum to determine the extension.

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.

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.

We are of the view that an extension of time for more than 6 months should be allowed. We consider that the extension should be able to be made by resolution of creditors or an application to the Court (as per our view at 5 above) to maintain flexibility for the Supervisor. Where application is made to the Court, affected parties such as creditors should be notified of the proposed application and have the right to be heard.

We do not agree to impose a maximum extension of 12 months as there could be complexity regarding the company, its business or voluntary arrangement proposal that requires more time to deal with. Key examples include with respect to listed companies where investors may be sought and for companies with operations in say, China, where the Supervisor may need to take actions or steps before the terms of the voluntary arrangement proposal can be finalised. Accordingly, the maximum time for the moratorium should not be fixed at 12 months but should allow a higher level of flexibility for the company, creditors and Court to consider.

Question 8

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

We are of the view that this issue should remain open and be at the discretion of the Supervisor and the relevant contracting parties (e.g. financial institutions).

From our experience, most contracts or agreements contain termination clauses in the event of liquidation, restructuring or compromising of debts with creditors, triggering the operation of the termination clause. Accordingly, we expect that in a PS, most (if not all) contracts entered into by the debtor company would be capable of being terminated on commencement of the PS.

For all other scenarios, we opine that the Supervisor shall be in a position to consider and take appropriate steps to deal with the terms of the agreements on a case by case basis.

Accordingly, we do not suggest having a set list of contracts and agreements that should be exempted from the moratorium. In the event the contracting parties or the company wish to enforce the terms of the contracts during the PS period, the parties should apply to the Court for leave to enforce their rights.

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.

Whilst we agree that employee entitlements need to be addressed under the PS, we fail to understand the focus on paying entitlements (or setting aside cash to meet them) before PS even commences. In this regard, we note:

- The only entitlement actually due and payable to employees is likely to be unpaid wages (if any, given wages are usually paid in arrears in Hong Kong). Other entitlements such as annual leave and redundancy pay only crystallise on resignation or termination.

- Companies in financial difficulties are unlikely to have sufficient cash available to pay or meet such entitlements. Given the proposed insolvent trading amendments, what does a company do if it cannot pay these entitlements before entering into PS? It will have no alternative than to seek liquidation when it could possibly be otherwise saved by PS.

- One of the aims of PS is to save businesses. Employees will be better off by ensuring the legislation has the best chance of being successful. Retaining a job is better than losing a job even if entitlements are covered, not just for the employee but for Hong Kong's economy.

- Many Hong Kong companies are part of a group of companies. This will result in (at least) 2 problems:

  i. The employing company may simply be left out of PS and other companies placed into PS, resulting in no protection for employees; and

  ii. The Supervisor will be in a very difficult position if employees of a Hong Kong company have had their entitlements protected and employees in China and other jurisdictions have not.

In addition to the above, in our view, Alternative B is the preferred option for the following reasons:

- Allowing any creditor to not be subject to the moratorium risks (i.e. Alternative A) undermining the entire PS process. It would be a bizarre position to allow a company to be in PS and then have a winding up petition brought against it by an employee. Whilst we appreciate that Alternative A seeks to reduce the upfront burden on the company, given the entitlements will need to be dealt with in the rescue plan in any event, it is something of a nothing solution if there is not an effective moratorium.

- Although the 2003 Proposal would reduce the financial burden for the company by reducing the upfront payment to employees, i.e. the capped amount provided by the PWIF, it still imposes a material upfront burden on the company to place funds into trust.

- Alternative B protects the position of employees without providing them excessive leverage and without imposing an excessive burden on the financially distressed company. Alternative B provides:

  - Less financial burden on the company in the initial stages of PS;
  - More time for the company to raise funds to settle entitlements;
  - Employees are unlikely to be worse off than if the company is subsequently put into liquidation; and
  - Employees are protected given their entitlements must be looked after in the rescue plan.

Question 10

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

For the reasons outlined above, we consider outstanding MPF contributions should also be treated under Alternative B.

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 disagree with any proposal that solicitors with a practising certificate and all certified public accountants may take up an appointment as a Supervisor. Our reasons are as follows:

- Whilst certain Supervisor appointments may be relatively straightforward, many will not be. The legislation is intended to save businesses and avoid companies going into liquidation where they have a longer term viable business but facing short term financial difficulties. Based on our experience, we consider that dealing with a business and its stakeholders in times of severe financial distress requires certain specialist skills. With no disrespect intended to solicitors or general CPAs, they are unlikely to have the specialist skills to handle a large company facing financial difficulty. Similarly, solicitors specialise in the law and even then solicitors will specialise in particular areas of law where they have or have developed expertise. Likewise, accountants specialise in particular areas where they have developed expertise eg audit, tax and so on.

- It is not easy dealing with companies and stakeholders facing distressed situations. Some examples of the difficulties that can be encountered are as follows:

  - Whilst the legislation will only be available for Hong Kong incorporated companies, it is common that those companies will be holding companies of subsidiaries in other jurisdictions including China. As such, the Supervisor will need to control that asset (i.e. the shareholding). This may require changing the Board of Directors and more importantly, the legal representative in China. From our past experience, we have needed to appoint individuals from our firm as the legal representative to ensure control of PRC subsidiaries of Hong Kong incorporated companies. We query if solicitors and other CPAs will be prepared to take on such roles. To this end, taking on the role of a legal representative entails substantial responsibility and obligations.

  - Dealing with suppliers, customers, joint venture partners and creditors in the PRC can be difficult. Our staff have been put in situations where they have been threatened with physical violence against them, been wrongly imprisoned for periods of time by suppliers seeking payment for debts, offered bribes to treat stakeholders more favourably, dealt with tens of thousands of protesting employees, faced blockades of suppliers trying to prevent access to factories, been required to negotiate with Court officials regarding the placement of freezing orders over key assets and so on.

  - Dealing and negotiating with employees, suppliers etc that protest outside or even in your office, refuse to leave unless they are paid and whom can otherwise be quite hostile.

- Given the legislation is intended to save viable businesses, this implies that the Supervisor will need to continue to trade the majority of businesses when appointed. Solicitors and other CPAs (auditors and tax advisors for example) are not accustomed to managing someone else's business, particularly one that is in financial difficulty. Insolvency practitioners are used to dealing with such situations and managing the personal liability issues that they will be faced with under PS.

- Strong commercial skills will be required by the Supervisor. For example, the Supervisor will need to:

  - Determine whether to make employees of a business redundant to reduce costs.

  - Negotiate with suppliers to provide further materials to enable a business to continue to trade.

  - Ascertain any funding requirements to enable the business to continue and how to meet those funding requirements.

  - Determine which contracts and agreements should be honoured or adopted and which should be terminated.

- The aim of the legislation is to save businesses. This will most likely require some form of restructuring to be pursued. Only insolvency practitioners, restructuring professionals and solicitors specialising in restructuring will have the experience of putting together an achievable restructuring plan.

- We query if professional indemnity insurance available to solicitors covers them for PS type appointments, and appointments as directors and legal representatives of companies that could be subsidiaries of the company in PS that would be necessary to control a group. We are also doubtful that solicitors would have appropriate accounting skills that would be necessary to properly manage an operating business. Whilst they could engage someone to assist them, this would result in additional cost. A solicitor would also need to engage another solicitor if legal advice was required on a particular issue, as we expect a solicitor acting as a Supervisor could not or should not advise themselves where independent legal advice is required.

- There is sufficient competition among practitioners that can currently take liquidation appointments to ensure there is not a "closed shop".

Whilst, it may be argued that creditors can replace the Supervisor with someone they consider more suitable at the first meeting of creditors, we do not consider this to be a sufficient safeguard given the first one to two weeks can be absolutely critical to stabilising a distressed business and much damage could be done by an inexperienced PS before they are replaced. Further, there may be situations where creditors themselves do not realise that a Supervisor that has been appointed is inappropriate or the creditors vote may not be successful due to related party voting or other creditors friendly to a particular course of action.

The issue of widening who may be appointed was considered in Australia by the Corporations and Markets Advisory Committee ("CAMAC") in a review of the effectiveness of Australia's VA legislation with respect to large and complex enterprises. In Australia, only registered liquidators were permitted to accept appointments as the Administrator. CAMAC recommended that additional parties should be able to be appointed where they had the requisite skills and expertise. CAMAC acknowledged the difficulty of licensing such further individuals and that it may require further Court involvement which would be undesirable. Ultimately, the recommendation was not adopted.

In conclusion, to assist the legislation work to maximum effect, it is recommended that practitioners that can be appointed as the Supervisor should be people sufficiently experienced in performing similar roles eg liquidations. As such, we support a panel type system as has been proposed previously. Whilst this may increase cost, we consider it will greatly assist the legislation achieve its aims and offer far more benefits over time. The parties that are eligible to take the appointment can always be expanded later if it is considered appropriate.

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.

It is possible that other parties may have skills enabling them to perform the Supervisor role eg restructuring advisors with experience in other jurisdictions. It however, seems more sensible to us that practitioners who are more familiar with Hong Kong, its laws and business practices would be more suitable, at least in the initial stages. We envisage situations where

a Supervisor may need to engage a party with particular specialist skills depending on the situation. For example, the Supervisor may seek to engage an investment bank to assist in the marketing/sale/listing of a business. In this way, other parties with particular relevant skills may be used in the PS process.

We consider that the appeal channels that should be available to aggrieved parties should be to the Court for issues relating to the application of the legislation and otherwise to the Official Receiver, similar to the current manner in which liquidators are subject to the scrutiny of the OR. This further supports our views with respect to question 11 that the parties able to be appointed as a PS should be placed on some form of panel so that they can be subject to scrutiny from the OR that a wider range of potential appointees may not be able to.

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.

We agree that the PS should be able to be replaced at the first meeting of creditors. This is essential in circumstances that the directors initially appoint the PS in order to limit suggestions of bias by the directors' appointee.

We consider it would be more appropriate for remuneration to be approved at the second meeting of creditors. In this regard, we note:

- By the time of the second meeting, a proposal will be put to creditors for a restructuring or the company will need to go into liquidation. As such, the majority of necessary work will only be done by the time of the second meeting, whereas it will still be very early at the time of the first meeting to seek to approve future remuneration.

- If creditors were asked at the first meeting to approve future remuneration, they are likely to seek to cap that remuneration which may be unfair on the Supervisor particularly in larger matters, and/or require subsequent approval later, if it is possible. To this end, in a very large matter it may be near impossible to seek to agree remuneration at the first meeting of creditors. By way of an extreme example, it is possible that Lehman Brothers could have been placed into PS if the legislation was available (indeed given that Lehman Brothers applied to the Court to enter Provisional Liquidation, we expect they probably would have used the PS regime if it had been available). In such large matters, it would be extremely difficult for creditors to consider an appropriate fee mechanism after only 10 days.

- By having approval of remuneration occur at the same meeting that determines whether the Supervisor should be replaced is more likely to result in a "reverse auction" whereby creditors award the role to the party that agrees to the lowest fee. This may not result in the most appropriate candidate being appointed as the Supervisor. Creditors would have the ability at the first meeting to ask potential candidates as to how they propose to charge for the role if they are appointed and provide a non binding estimate.

- Whilst it may be argued that creditors are not able to properly control the remuneration being incurred if approval only occurs at the second meeting, given that the Supervisor would not be able to be paid until remuneration is approved by the creditors (at the second meeting) or the Court, this should provide appropriate safeguard.

This issue was also considered in Australia in the CAMAC report. Under the VA legislation, remuneration would be approved at the second meeting, although scales of fees may be approved at the first meeting. CAMAC recommended that a Committee of Creditors be allowed to approve the remuneration or creditors at a meeting convened for such purpose. From a practical standpoint, in the absence of an extension of the moratorium period, fees are almost always approved at the second meeting.

A further suggestion is that given we expect that most Supervisors will seek to charge based on a scale of hourly rates, creditors may approve the scale to be adopted at the first meeting of creditors with the quantum of fees to be approved at the second meeting of creditors when most of the work will have been performed.

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 strongly support the imposition of personal liability as proposed for the reasons stated at 5.16(a) to (c).

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 co9mpany's assets.

We do support the introduction of insolvent trading provisions.

Given the objectives of the PS process are to maintain the company's ongoing survival and to provide a better return to stakeholders than it would in liquidation, with the introduction of insolvent trading provisions, directors are more likely to be encouraged to place the company into PS rather than risk taking on some form of personal liability.

In our view, it will result in appointments occurring earlier than would otherwise be the case, which increases the chances of survival of the company. In our experience, many companies seek professional help far too late, when liquidation may be the only option available. We consider, based on our experience in Australia and the UK, that the introduction of PS will likely save more companies and result in increased and quicker returns to creditors.

Question 16

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

We understand that the proposed formulation of the key "insolvent trading" provisions will be as follows:

"A responsible person will only be held liable for insolvent trading:

a) if they knew or ought to reasonably to have known the company was insolvent or knew or ought reasonably to have known that there was no reasonable prospect that the company could avoid becoming insolvent; and
b) the responsible person failed to take any steps to prevent the insolvent trading."

We note that a responsible person includes directors and shadow directors.

We suggest that the definition of a shadow director should be wide enough to capture a person who is not formally appointed as a director but who act in a position of a director or in accordance with the company's directors are accustomed to act.

In our view, ideally the proposed modification of the standard in establishing liability should not occur, i.e. (1)(b) should not be deleted.

We consider that on its own, (1)(a) is only a weak deterant to insolvent trading and that the intention of the insolvent trading provisions will be better served by including (1)(b). As Australia has found, even including "suspicion" type wording in an insolvent trading clause, is difficult to prove.

Question 17

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

We agree with the way that "major secured creditors" is defined. From our experience in Australia, which uses a similar definition, and knowledge of the use of security in Hong Kong, we do not expect many problems stemming from the definition. A valuation / percentage approach could arguably have greater difficulty given the scope for disagreement over valuation figures.

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.

We generally agree that the rights of secured creditors should be protected. We are concerned however with the proposed operation of the 3 day decision period.

We understand that the 3 day period is intended to expedite the decision making process to avoid any potential objection from any other major secured creditors which will cause the PS process to cease. However, we consider that a 3 day period is too short for reviewing and discussing the factors surrounding the PS thoroughly.

The 3 day period may force secured creditors to quickly decide to reject the PS simply because they have not had sufficient time to assess the matter and do not wish to be bound by the moratorium. Rejecting the PS will become necessary where there is not enough time to fully understand the situation, the company's financial position, the value of the security and intentions of the Supervisor.

From a practical perspective, if a notice advising of the appointment is sent on day 1, the major secured creditor may not receive it until day 2 and it may not find its way internally to an appropriate person until day 3 (or even later!). Therefore, as an absolute minimum, the decision period should be based on when the notice is received by the secured creditor.

We are also deeply concerned at the prospect of a major secured creditor being able to veto the entire PS process. In our view, this is at odds with the intention of the proposed regime and, together with the proposed insolvent trading, will result in a greater number of liquidations as directors will have no choice but to seek liquidation if the PS is rejected by a major secured creditor.

We note that in the UK, under the CVA process, major secured creditors are subject to the moratorium and cannot appoint a Receiver. Whilst we consider this approach would be more preferable than allowing a veto right, critics argue that it could result in an increase in the cost of borrowing, restrict the Administrator's ability to obtain funding (given the party most likely to provide that funding would be the major secured creditor) and result in an increase in Receiverships (as lenders will enforce more readily than risk being restricted by a moratorium) which would disadvantage unsecured creditors.

These issues were also considered by CAMAC in Australia, which stayed away from the UK approach and recommended an extension of the decision period (whether to enforce security) to 15 business days.

In light of the above, and with reference to our Australian experience in particular, we would like to see the following:

- A decision period of say 7 to 10 working days (based on receipt of a notice by the secured creditor).

- The decision to relate to enforcement of security or otherwise being bound by the moratorium. The Supervisor and major secured creditor may agree to an extension of the decision period.

- Major secured creditors not to have a veto right over PS. If a major secured creditor enforces its security, the PS should continue. The Supervisor will then need to work with a Receiver appointed by the major secured creditor. We see this as being particularly relevant in a Group situation where some companies may have both a Receiver and Supervisor appointed and other companies may only have a Supervisor appointed. Furthermore, the existence of a moratorium under the PS process may greatly assist a Receiver stabilise a business given there is no such moratorium in a Receivership.

- Where the major secured creditor does not enforce its security (and is therefore bound by the moratorium), the Supervisor is to protect the interests of secured creditors e.g. cannot sell secured assets without consent.

- The proposed voluntary arrangement is to protect the rights of secured creditors, whom would then be able to enforce their rights once again when the moratorium ends.

Whilst we would prefer to see the above adopted, if it is decided to allow the major secured creditor a veto right on the PS process, that veto right should only be allowed if a major secured creditor actually enforces its security (rather than simply rejects the PS) and a minimum 5 business day decision period.

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?

Given the likely protection of employee entitlements under PS, even for Alternative B, a headcount test is likely to be less important. Furthermore, in our experience, the likelihood of assignment of a debt to multiple parties to influence voting is very low.

However, we should be careful where the claims of related parties make up the majority of the company's debts as under these circumstances, there is a risk that related parties will take advantage of a "no headcount test" rule.

As such, we suggest that in order to balance the interests of all stakeholders, the headcount test should remain but the Chairman of the meeting (which will be the Supervisor or their nominee) have a casting vote if the vote is tied e.g. a majority in value is in favour but a majority in number is against. The casting vote would typically be used to support the majority in value, however if this vote was only carried by related parties, the Chairman may go with the numbers rather than value.

This issue was also considered by CAMAC in Australia, which recommended the retention of the headcount test. The Australian VA regime also uses a casting vote by the Chairman where there is a voting deadlock.