HKGCC

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Ms Leung Fung Yee, Julia, JP
Under Secretary for Financial Services & the Treasury
Financial Services and the Treasury Bureau
8th floor, West Wing, Central Government Offices
Low Albert Road, Central
Hong Kong

Dear Julia,

Review of Corporate Rescue Procedure Legislative Proposals

The Hong Kong General Chamber of Commerce welcomes the government's initiatives in examining Hong Kong's existing insolvency laws and its efforts in enacting a corporate rescue procedure which gives companies in financial difficulty an alternative to liquidation. We believe that the proposals provide a useful option for companies that would otherwise resort to liquidation proceedings, resulting in a loss of jobs which might have been saved and substantially reducing the amounts which banks and other creditors can recover in due course.

Our responses to the questions raised in the Consultation Paper are set out below.

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 agree with the proposed procedural changes relating to the initiation of provisional supervision in paragraphs 2.4 to 2.6. In particular, as provisional supervision can be initiated outside of court proceedings, we agree that filing with the Official Receiver (OR) or the High Court is not necessary to commence the proceedings.

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.

We do *not* agree with the proposal that provisional supervision should not be initiated by creditors. To fully align the current legislative reforms with the objectives set out in 1.10 and principle (d) in paragraph 1.13, it is important that creditors be given a right to initiate provisional supervision proceedings. However, in order to avoid an abuse of the process, we suggest that an application by creditors to initiate the process should be subject to the sanction of the court.

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In our experience, major creditors are often the party who initiates dialogue between the company and its creditors, and are often the proponents of corporate restructuring in order to rescue a company from liquidation, Quite often, they have the experience, and in some cases, resources and expertise for dealing with corporate restructuring matters. Currently, major creditors such as banks, often rely on informal rescue procedures for want of better alternatives. In some instances, directors might not be aware that the company is trading at the brink of insolvency and that corporate restructuring, facilitated by provisional supervision, is a desirable or necessary option. Where the directors are uncooperative in initiating provisional supervision, creditors will most likely turn back to provisional liquidation or the appointment of a receiver to protect their interests. Although under the current proposals, a provisional liquidator or liquidator himself could initiate provisional supervision proceedings, time and costs would be wasted and chance to rescue the distressed company would be decreased. In the case of distressed companies, this could mean liquidation is the only available solution.

Hong Kong's company and insolvency legislation have always been viewed as creditor-friendly, so to discriminate against creditors in provisional supervision may decrease Hong Kong's competitiveness against its Asian counterparts.

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 current proposal 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 do, however, believe that there should be a requirement to give notice to the High Court, so that the commencement of provisional supervision can be monitored by those responsible for court lists so that any attempts at time-wasting to commence or continue proceedings against the company already under protection by the moratorium may be avoided. On the other hand, we note that the proposal has suggested that the provisional supervisor is required to notify creditors of the company within 3 working days about the commencement of the provisional supervision. We assumed that the above notification would mention that moratorium will apply to the company and no actions or proceedings can be brought by the creditors against this company.

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

We support an initial moratorium of 45 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.

We 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.

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.

We agree with the proposal to allow for extension of the moratorium beyond six months only upon court approval.

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 do *not* agree with the proposal that any court extension should not exceed a maximum of 12 months from the commencement of provisional supervision. We believe the court should retain discretion to further extend the moratorium period where there are exceptional circumstances for moratorium protection to be retained, especially in cases where a majority of creditors are in support of a restructuring proposal. In cases where the company in question is a large, complex entity, and its creditor group and claims are difficult to identify and calculate (such as Lehman Brothers), the provisional supervisor may need a longer period than 12 months to formulate a restructuring proposal, during which a moratorium should be in place. It is in those cases where there is the greatest need for provisional supervision to succeed, and where there is most value at stake and the greatest number of jobs at risk.

We recognize that there is a need to ensure the provisional supervisor and the company take prompt action to formulate a voluntary arrangement proposal for restructuring the company. The court should therefore ensure that the moratorium is further extended only in exceptional circumstances, to be determined on a case-by-case basis, and taking into account the best interests of the creditors as a whole. The court should take into account certain factors when exercising its discretion, such as whether a voluntary arrangement proposal is imminent, the return to creditors and other stakeholders compared with what would be achieved in a winding up scenario, level of creditors' support for the proposal and prejudice to other stakeholders.

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 have no comments on this item.

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.

Among the three options set out in the Consultation Paper, **Alternative B** will give the company more time to organise its affairs or raise financing to meet its employees' claims before the voluntary agreement is enacted. The 2003 Proposal and Alternative A would be too onerous for a cash-starved company, and a major obstacle to the provisional supervision procedure. But the flexibility provided by Alternative B remains limited as "employees' protected debts" (EPDs) would be required to be paid by the time the voluntary arrangement comes into effect, or within 14 days of the granting of any extension for the moratorium the latest. For a voluntary arrangement to succeed in rescuing a company, it is essential that the company can keep its debts at the existing level and begins to make profits, so that it may continue to hire the employees and pay off the debts as it goes along. Consideration should be given to whether companies can be given a maximum flexibility of settling the EPDs within a longer period, for example six months after the voluntary arrangement comes into effect, or the granting of any extension for the moratorium.

We would like to express our support for the LRC's 1996 Report recommendation of using the protection of wages on insolvency fund (PWIF) to meet the outstanding claims of those employees who were laid off by a company undergoing provisional supervision. We do appreciate that this recommendation has not received universal support.

We would also recommend that consideration be given to not applying the guarantee of full payment of amounts owed to employees to directors and managers to the extent their remuneration exceeds a certain threshold.

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

We believe employers' MPF scheme contributions should not be treated in the same way as employees' arrears of wages and other outstanding entitlements under the EO. We agree that including MPF scheme contributions would make it more difficult for companies in financial distress to make use of the provisional supervision procedure. A balance needs to be struck between protecting the interests of employees and facilitating corporate rescue for the interests of other stakeholders.

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Question 11: Do you agree with the proposal that solicitors holding a practicing 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?

We 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. However, we think this is too wide and the criteria for appointment should be narrowed. We support the LRC's recommendations that a panel comprising solicitors and professional accountants to be operated by the OR should be set up for provisional supervision. As a starting point, those who are already on the panel of insolvency practitioners for the winding up of companies by the court could automatically become members of the provisional supervision panel. For others who wish to become a panel member for provisional supervision, they may apply to do so after demonstrating that they possess the necessary expertise, experience and resources. We also note that there are persons who are experienced insolvency practitioners but are neither practicing solicitors nor registered CPAs. We would support extending eligibility to such persons, which reinforces the need for some sort of panel.

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 Office of the Receiver 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.

Please see our answer to Question 11. We believe that it will *not* be desirable for other persons without the qualifications set out in paragraph 5.6 of the Consultation Paper to be appointed as provisional supervisors on a case-by-case basis, although others should be eligible for the panel which we would support. We also note that inspection and oversight by the relevant professional bodies is important, in the absence of oversight by any other government agency or authority.

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 with the current proposal of 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.

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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).

We support imposing personal liability on provisional supervisors as proposed in paragraphs 5.14 to 5.17 above. However, as with receivers and managers, a provisional supervisor should be entitled to exclude any personal liability when entering into a contract, provided the counterparty agrees with such exclusion and that they should be indemnified out of the assets of the subject 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.

We support the introduction of insolvent trading provisions in Hong Kong.

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

We agree with the proposed revised formulation of "insolvent trading". We agree that "senior management" should not be included in the definition of a "responsible person". We also agree that retaining 6.1(1)(b) in the formulation would mean the test is too strict, and the directors would feel compelled to put their company into formal insolvency proceedings in order to avoid personal liability.

However, the proposed test does not provide for situations where it is proper and reasonable for directors to keep trading to turn the company around if there is a reasonable prospect of being able to do so. Although this is a subjective test, in our view it is important that directors who act reasonably and honestly have such a defence to liability for insolvent trading.

Question 17: Do you agree with the way that "major secured creditors" was defined in the 2001 Bill? If you think any changes are need, please elaborate and explain.

We agree with the way that "major secured creditors" was defined in the 2001 Bill.

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 need, please elaborate and explain.

We support the proposal to largely follow the 2001 Bill approach with respect to the protection of "major secured creditors" and other secured creditors' rights. We believe it is important that Hong Kong's insolvency laws should continue to protect secured creditors' rights in order to encourage lending and business development in Hong Kong.

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?

This question involves a difficult choice between the desire to prevent a small number of large value creditors imposing their will on a large number of small value creditors and the desire not to permit a large number of small value creditors to hold the process to ransom. On balance, we believe the headcount test should be removed in the voting at the meetings of creditors for resolutions to be passed at such meetings. The headcount test places significant veto power in the hands of small creditors, out of proportion to their financial contribution to the company. Their ability to block a voluntary arrangement proposal would be unfair to other creditors (with much greater financial contribution) who support the proposal. This might deter companies from entering into provisional supervision, given the time and cost required to put the voluntary arrangement proposal together. On the other hand, dispensing with the headcount test would mean the outcome of a vote may be easier to predict.

Other issues of import.

Commercial Landlord Concerns

The termination provisions in tenancy agreements normally permit the landlord to re-enter the premises if rent is 15 days in arrear or in various insolvency related events, including stopping or suspending payment of debts. On re-entry the tenancy is terminated. So a tenant's failure to pay rent or its stopping or suspending payment of debts would entitle the landlord to repossess the premises and let them to another tenant.

The corporate rescue bill provides for a moratorium period during which it is not possible to take legal proceedings against a company which is in the rescue procedure or to re-enter its property. The company's rights as a tenant are property for these purposes. So a Landlord could not re-enter premises let to a company in the rescue procedure which has not paid rent. Nor could a Landlord sue the company for arrears of rent. Proponents of the corporate rescue bill would say that landlords, in not being able to sue for arrears of rent, are in no different a position from any other creditor under the rescue. They would also say that preventing landlords from re-entering is necessary so that the company can continue to carry on business during the moratorium period.

The moratorium provisions do not apply to debts or liabilities incurred by a company after the moratorium has started. So, if a company orders goods after the moratorium has started and does not pay for them, the supplier can sue the company for non-payment. However, there is doubt as to whether rent payable under a tenancy agreement entered into before the start of the moratorium period is a liability incurred after the moratorium has started. It could be argued that, as it is a liability incurred under the tenancy agreement, it was incurred when the tenancy was entered into.

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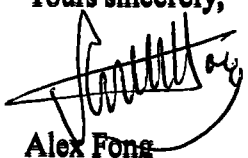
If this is right, the moratorium provisions would operate with particular harshness on landlords, in that as well as being unable to sue for arrears of rent payable before the moratorium starts, they would have to allow the tenant to stay in occupation without paying rent during the moratorium period. ***We would urge special attention be paid to ensuring that all parties are fairly treated in such matters.***

Yours sincerely,



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c.c. Mr Wong Wing-hang
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