The Institute of Accountants in Management
IAM
專業管理會計師公會

28 January 2010

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Dear Sirs,

Response to Consultation Paper on
Review of Corporate Rescue Procedure
Legislative Proposals

With reference to the consultation paper on the proposed corporate rescue procedure, the Institute would be pleased to learn the effort of the government to restart the consideration of and taking actions to implement the proposed procedure. The proposed procedure is an alternative to the existing procedures in relation to winding up of companies and similar to that of Chapter 11 of the US Bankruptcy Code.

The Institute welcomes the proposed procedure, albeit the expectation that only a few number of small and medium enterprises ("SME's") would be benefited from the proposed procedure. The government seems to expect that larger companies would consider the proposed rescue procedure.

The new procedure will be particularly helpful to the business sector after the financial crises since some of the enterprises carrying on business in Hong Kong would have financial difficulties and, in the absence of the proposed rescue procedure, be forced to be wound up, resulting in lost of employment in the labor market and lost of money in the banking field.

The general views of the Institute are that the cost of the procedure should be kept to a low level and smoothly implemented for the good of the creditors and employees in general.

In response to the questions raised in the consultation paper, the Institute is pleased to provide the following response in connection with the enactment of the proposed procedure.

Initiation of provisional supervision

1. Prior to the notification of the start of the procedure to the Registrar of Companies, the directors should ensure that the insurance policy for the benefit of employees should have effect and that a statement of the affairs of the company should be ready to be given to the board of directors of the company.

2. As the proposed procedure should be a quick and not a complicated procedure, the proposed procedure should only be initiated by the board of directors of the company and not other persons, like creditors. The start of the proposed procedure is by the notification of the director of the company concerned to the Registrar of Companies.

3. The notification of the start of the proposed rescue procedure should be delivered to as many stakeholders as possible, like the creditors and employees. The modern communication means of email should be considered and made use of. As a matter of practice, publication of the start of the proposed rescue procedure in the newspaper seems to be only a matter of formality and not an

effective method.

Moratorium

4. The initial moratorium period of 45 days is supported in view of the length of the moratorium period set in other common law jurisdictions of the United Kingdom, Australia and Singapore. Further, during this moratorium period, the company with the assistance of the provisional supervisor within the moratorium period will recommend a rescue plan. Anyway, the board of the directors should spend more time and effort to formulate a rescue plan during this 45-day moratorium period if they really try to take the benefit of the new procedure and keep the company on a going concern basis. Therefore, it is not desirable to have a long moratorium period.

5. With unexpected circumstances, the Institute concurs to allow an extension of the moratorium period to six months without court approval and to twelve months with court approval. If within 12 months of the start of the proposed rescue procedure, the company is unable to produce a rescue plan, it is preferable to put the company into winding up in the normal manner, so as to protect the interests of the creditors and employees.

Employees' outstanding entitlements

6. What amount of money to pay and how to pay the employees' outstanding entitlement are really controversial topics. The maximum length of the proposed moratorium period could be twelve months. After this twelve month period, the company may continue to carry on business or undergo winding up procedure. In either event, employees are very concerned about the prospect of their future income right, after the start of the proposed rescue procedure.

7. Employees' outstanding entitlement should be protected in any event and the relevant procedure should not be complicated, bearing in mind of keeping the cost to a minimum level. As such, Alternative B which will involve court supervision and much legal costs should be disregarded.

8. The Institute supports the principles that (a) the terms of the voluntary arrangement proposal should include terms for the payment of the employees' outstanding entitlement and (b) a fund should be created to contain sums for

the payment of the employees' outstanding payments, subject to the cap of PWIF (Protection of Wages on Insolvency Fund). Employees' right to petition the company for winding up should not be less than the present right under existing law.

Provisional supervisors

9. In the proposed procedure, the provisional supervisor will play a key and important role for the success of the rescue plan. At the same time, the fees charged by the provisional supervisors should be competitive so that many financially depressed companies may take the benefit of the proposed rescue procedure. As such, the Institute is of the view that the qualification of the provisional supervisors should not be too high so as to attract more persons to take up the provisional supervision assignments and, at the same time, not too low so as to ensure that only competent persons are eligible to act as provisional supervisors. In consideration of all these factors, the provisional supervisors should be certified public accountants registered in accordance with the Professional Accountants Ordinance (Cap. 50) but not necessarily auditors, as well as solicitors holding a practising certificate issued under the Legal Practitioners Ordinance (Cap. 159). Non inclusion of the auditors will not jeopardize the quality of the provisional supervision work because formulation and implementation of a rescue plan is more on the financial restructuring of a company's business affairs, rather than verification of the assets and liabilities of a company. Audit experience is not a crucial matter in the formulation and implementation of a rescue plan. Additionally, the Institute is of the view that qualified and competent provisional supervisors should be extended to include professional accountants in business of other professional accounting bodies, like the Chartered Management Accountants and Chartered Certified Accountants who have much experienced in the management and financial accounting matters, as well as business matters, and are capable of providing much assistance in the provisional supervision. A list of these persons should be provided in the form of a panel for the public to choose as the provisional supervisors in additional to the persons qualified under the aforesaid Professional Accountants Ordinance (Cap. 50) and Legal Practitioners Ordinance (Cap. 159).

10. Further, as rescue plans demand accounting, financial and legal knowledge and experience, it is not desirable to allow unqualified persons to take up the

position of provisional supervisor.

11. So that the provisional supervision work should be carried out by the assigned persons carefully, the Institute is of the view that whether a provisional supervisor is personally liable for the provisional supervision assignment should be considered in light of the given information in the hands of the provisional supervisor and the information which he ought to seek. Further, test of objective reasonableness should be applied in order to assess whether he has carried out his duties carefully and therefore should be personally liable. At the same time, it is necessary to take into account of the co-operation of the directors in assessing the personal liability of the provisional supervisor since the directors of the company have all the relevant information of the company which has been run by them for a long period of time before commencement of the rescue procedure.

12. Given that the proposed rescue procedure should be a quick and efficient procedure to formulate plans to rescue a company, it is preferable not to allow more persons, like the creditors to replace the provisional supervisors as by then the procedure will become more complicated and costly. It should be borne in mind that the proposed rescue procedure is an alternative means to winding up procedure. If the proposed rescue procedure fails, creditors will be protected as in the existing winding up procedure.

Insolvency trading

13 The nature of and sanction of persons involved in insolvency trading are controversial topics. As disclosed in the consultation paper that in 2001 the proposed sanction of those persons were not entirely approved by the business sector. The issue should be considered in the special business environment of Hong Kong wherein most, in terms of numbers, of the enterprises are SME's. Failure of companies may not be owing to the greed or incompetence of the directors or senior mangers of the SME's or the financially depressed companies. It could be owing to the uncontrollable external business and financial environments as what Hong Kong has experienced in the financial crisis generated from the business failure in the United States of America. To impose penalty on the directors or senior managers in the cases of failed companies may not gain the support of the financial and business sectors. Further, until and unless there are more criminal cases of conspiracy to defraud

committed by directors and senior managers in the failure of companies, it is too early, at this stage, to introduce penalties on directors and senior mangers involved in insolvency trading. Alternatively, another survey could be conducted on this single topic so as to consolidate the views of the commercial sectors and other related parties.

Secured creditors

14. The proposed rescue procedure is close to a voluntary financial plan to rescue the financially depressed companies. As a matter of practical solution to resolve the financial difficulties of companies, it is preferable to obtain the consent of the major creditors who may be willing to offer a number of alternatives to rescue the company, including buying out the company, converting outstanding debts into shares in the company or extending debt repayment period, etc. Therefore, the Institute is of the view that the major creditor or creditors should be allowed, shortly at an early stage, to be notified and be allowed to participate in rescue work during the moratorium period. As the meaning of major secured creditors, the principle could be that if decision of those secured creditors in the moratorium will affect the failure or success of the rescue procedure, they will be major secured creditors. Major secured creditors may also be defined by reference to the size of outstanding debt at the start of the rescue procedure. Further, in reality, these major secured creditors may not participate in the rescue procedure because they may favor other alternatives, such as taking over the company in private manner in order to secure repayment of their debts.

Voting at meeting of creditors

15. The headcount test should be disregarded because in the proposed rescue procedure, time is important; and the majority view of the creditors should be taken into account so that a shorter time will be spent on whether and how to save the financially depressed companies from further financial failure. For these reasons, the Institute supports deletion of the headcount test.

Yours sincerely,
For and on behalf of
Institute of Accountants in Management

Albert Law
President