K K YEUNG MANAGEMENT

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Our Ref:KK/cl/TIAB

22nd January, 2010

Professor K. C. Chan, SBS, JP
Secretary for Financial Services and the Treasury
Financial Services and the Treasury Bureau
8th Floor, West Wing, Central Government Offices
Hong Kong

Dear Prof. Chan,

Re: Consultation on Review of Corporate Rescue Procedure Legislative Proposals

It was my pleasure meeting your good self briefly at the dinner hosted by Hong Kong Trade Development Council Hong Kong for the Fashion Extravaganza 2010 on the 18th January, 2010.

As you know, Trade and Industry Department (TID) has written to all non-official member of Trade and Industry Advisory Board (TIAB) including myself on the 4th November, 2009 inviting our views on the captioned proposals to be submitted to FSTB by the 28th January, 2010.

As spoken to your good self, I have prepared a statement of the views from my company, K K Yeung Management Consultants Limited in respect of the captioned matter and enclosed herewith a copy for your kind perusal.

For your information, the General Committee of the Management Consultancies Association of Hong Kong of which I am the Chairman has expressed their support of the Association's corporate members including my consulting company to send their individual views to your esteemed Bureau.

I sincerely wish that the enclosed paper will be helpful to your good self and should you require further information, please do not hesitate to contact the undersigned.

Yours sincerely,

K K Yeung, JP
Chairman

c.c.: Trade and Industry Advisory Board

Re: Review of Corporate Rescue Procedure Legislative Proposals Consultation Paper by Financial Services and the Treasury Bureau of October, 2009

As requested, K K Yeung Management Consultants Ltd (KKYMCL) hereby provides comments on the above Consultation Paper based on its 25 years of experience in debt rescheduling assignments.

Since its inception in May, 1983, KKYMCL has undertaken over 30 debt rescheduling assignments all based on non-statutory arrangements. These assignments involved debt rescheduling with over fifty banks in Hong Kong and resolved the position of about two hundred Hong Kong companies.

KKYMCL has a decade-long policy to offer professional assistance and financial advice exclusively to debtor-companies, their major shareholders and management prior to the companies committing acts of bankruptcy.

A debt rescheduling arrangement usually begins when the main shareholder of a debtor-company or one of its friendly creditor-banks approaches KKYMCL informally for its service. The service will usually include advising a debtor-company in its negotiation with its creditor-banks and bringing the banks in line to enter into a debt-rescheduling agreement.

It is an objective of KKYMCL to assist Hong Kong companies to conclude debt rescheduling arrangements with their creditor-banks which will enable the debtor-companies to work out and resolve their positions by continuing business as the most practical and efficient way forward. Consequently, the debtor-company concerned will continue to deal with its non-bank creditors (for example: employees and suppliers) in the ordinary course of business without risks of litigation. Usually, there is an intensively coordinated working relationship between the debtor-company, the creditor-banks and KKYMCL. The whole process is carried out in a moratorium period of four to twelve weeks. At the end of the period, a debt rescheduling agreement is negotiated and signed by a debtor-company with all its creditor-banks in syndication.

During the forementioned four to twelve weeks of the moratorium period, KKYMCL would report on the debtor-company's financial position either by its consultant seconded to the company or a CPA firm nominated to act as the Company's interim financial controller. During the period, KKYMCL convenes regular meetings between the major shareholder and management of the debtor-company and creditor-banks to

ensure good communication and transparency.

The debt-rescheduling process will commence with an appointment letter signed by the debtor-company with KKYMCL. The company concerned will appoint KKYMCL to prepare a debt rescheduling proposal and negotiate with the creditor-banks for its acceptance. Apart from this, KKYMCL will also prepare regular reports on the debtor-company's business, day-to-day cash transactions and litigation status such as the serving of writs and stay of action. Accordingly, KKYMCL works closely with the law firm instructed by the debtor-company as well as the law firm instructed by the lead bank who acts for all creditor-banks.

KKYMCL has not acted for creditor-banks nor any non-bank creditors in keeping with its policy to exclusively assist diligent and honest clients who are Hong Kong companies with a genuine desire to resolve their position with creditor-banks for the companies to continue operations.

KKYMCL does not act as receiver or liquidator nor has it involved in any compromise or arrangement under section 166 of the Companies Ordinance (CO), or a corporate restructuring by a provisional liquidator appointed under section 193 of the CO in the course of winding up. KKYMCL believes that the forementioned types of statutory arrangements are costly, complex and so time consuming that consequently, the Hong Kong companies involved will usually not survive any intended rescue. In particular, the long duration taken to prepare and successfully negotiate a proposal acceptable to all creditors will already render a debtor-company in financial difficulties to suffer badwill and loss of business. The debtor-company would therefore have a high risk of closing shops and ending business fairly quickly. Consequently, the debtor-company will not be able to maintain its normal course of business status to meet the payment terms of the employees and suppliers who usually would not wait but exercise their right and bring an action to liquidate the company, in the hope of getting a distribution from a force-sale disposal of the Company's assets.

With the above background, KKYMCL offers comments to a list of questions in the Consultation Paper as follows:

1. <u>Re: Question 1</u>
   We agree to Para 2.4 and 2.5 but suggest to amend Par 2.6 that apart from the Statement of Affairs of the company, a detailed cash-flow forecast plan for the ensuring 12 months and a work-out plan should also be submitted by the directors at the meeting that decides to appoint a provisional supervisor. We would wish that the provisional supervision will be a discretionary feature of a

non-statutory arrangement but once a decision is made in favour of provisional supervision, a provisional supervisor has to be appointed. We would also wish that the intended role of provisional supervisor as a special manager/controller should better be changed to a role of an independent financial advisor/controller of the Board so that the directors of the company who should know the business better than any professional practitioners parachuted from outside are given the opportunity as well as the responsibility to trade the company out of its difficulties, helped by an independent financial advisor/controller who should offer a neutral and professional financial and accounting advisory service. We would not wish that the provisional supervision will be a new process, or the forth route to deal with companies in financial difficulty.

2. Re: Question 2

Yes. The Board acting in agreement with the major creditor-bank defined as the bank which may have the largest amount of exposure in terms of the unsecured portion of their debt can initiate the procedure. The low profile of the work-out team and without labeling the debtor-company to be in the process of liquidation will give a much higher chance of success in resolving its current position. Banks have to trust fellow banking institutions. The inter-bank relation in the banking circle will help creditor-banks to work closely together especially in providing revolving working capital finance or not enforcing repayments in the moratorium period.

3. Re: Question 3

We do not agree that the notice of appointment of provisional supervisor should be published in the local newspaper at all. We believe that it is sufficient that the appointment of the 'provisional supervisor' by the board and approved at a shareholders' EGM is recorded in the company's minute book. To avoid misunderstanding and rumours, the appointment need not be registered with the Registrar of Companies nor to be notified to the public media. Any public exposure of the appointment will cause undue panic to trade creditors who usually will over-react by withdrawing their current trade credit and sue for payments instantly which will invariably disrupt corporate rescue operations.

4. Re: Question 4

We support an initial moratorium period of 30 days in lieu of 45 days as prompt action is the most important factor to enable a Company to continue business to achieve the objective in Para 1.10 of Chapter 1 of the Consultation Paper.

The initial period of 30 days is sufficient for the provisional supervisor to assist the

company to prepare (a) an Independent Financial Advisory Report (IFA) (say Day 1 to Day 20), (b) a Cash-flow forecast of the next 12 months (say Day 1 to Day 20), and (c) a Debt Re-scheduling Proposal (say Day 1 to Day 30). It is envisaged that the provisional supervisor will at the same time attend to negotiations with all credit banks in order to syndicate them with the major creditor-bank for funding of the Company or stay of action, as appropriate.

It is envisaged that an extension period of 45 days (say Day 31 to Day 75) may be required by the provisional supervisor to engage a selected firm of legal experts for them to draft and agree the contents of a deed of debt re-scheduling agreement with the creditor-banks and the company's main shareholder.

In practical terms, it would be more efficient if the provisional supervisor will help the major shareholder to swiftly work out the company's position with a body of creditor-banks than with all creditors. To achieve this fast route, it should not require more than a total of 75 days of moratorium after which the debtor-company will be expected to go forward according to the terms negotiated in a deed of debt-scheduling agreement.

5. Re Question 5

We do not support the proposal to allow for an extension of the moratorium up to a maximum of six months from the commencement of provisional supervision, subject to approval by the creditors at a meeting of creditors.

Firstly, the technical work involved in a corporate rescue exercise as outlined in the answers to Question 4 should not need more than 75 days in total. Most importantly, patience will run out very fast with creditors and in no time, writs will be flying around pushing the Company to head for liquidation. This will quickly defeat the original purpose of provisional supervision.

Secondly, different types of creditors have different rights. The payment of their debts out of the assets of the Company are statutorily ranked differently under the liquidation laws. Different types of creditors also have different vested interests. They use different ways to pursue their rights for repayment of debts. It is time consuming, inefficient, and sometime impracticable to seek consensus from different classes of creditors, not to mention consensus from all creditors at their meetings.

6. Re: Question 6

We do not agree with the proposal to allow for an extension of the moratorium

beyond six months only upon court approval. If this is the way forward, question will be asked why not better fix a moratorium to have a statutory limit of six months after which the provisional supervision will terminate and the company will proceed to (a) an arrangement under Section 166 or (b) winding up according to Section 193.

7. Re: Question 7
Answered per Question 6.

8. Re: Question 8
We do not have a view on whether the list of contracts and agreements which should be exempted from the moratorium as set out at the Appendix needs to be revised.

9. Re Question 9
We would not prefer any of the three options namely the 2003 Proposal, Alternative A or Alternative B. We consider all the options to be undulely complicated and to a large extent, impracticable. Also, we consider that public funds like the PWIF should not be used outside their currently established purposes for which the funds were set up. We do not think the options are necessary if the main job of the provisional supervision would be to help the debtor-company to continue as a going concern. The provisional supervisor should try his best to reach a debt rescheduling agreement with the creditor banks within our proposed moratorium period. The agreement negotiated will address the issue of working capital. In this connection, the creditor- banks may be asked to postpone their rights on having their unsecured portion of their debts serviced for an agreed period of time. Consequently, the creditor-banks allow the company to keep all in-coming trade receipts and free asset sale proceeds in a neutral bank account monitored by the provisional supervisor. The debtor-company can therefore pay employees and suppliers on a revolving basis without servicing or repaying the existing indebtedness due to the creditor-banks. As a matter of fact, the creditor-banks well know that they have given away little in a debt rescheduling agreement because insolvency laws already offered preferential rights to employees and for other preferential debts that have priority claims on company assets in the event that the company is not rescued. The laws also forbid any undue preference or fraudulent preference obtained by any creditors. The creditor-banks also well know that if revenues are retained in the company (a) to meet payments to preferential creditors like employees and creditors with distressed rent and if possible (b) keep trade creditors' position current, then the company can avoid litigation and the consequential liquidation.

If the Company will be able to perform as required by the debt rescheduling agreement, the creditor-banks will in due time recover a higher proportion or whole of their debts than from liquidating the company. In reality, payments to workers and the MPF contributions (as well as the trade creditors) are given a priority for repayment ahead of the unsecured portion of the bank debts. The creditor-banks in general has given away only a very little part of their right in as much as they will bear a longer time but for larger repayments than from a forced-sale of the company's assets.

10. Re: Question 10

The treatment of outstanding employers' MPF scheme contributions shall not be anything different from the treatment of salary in arrears.

11. Re: Question 11

We would rather agree that (a) a qualified certified public accountant representing a firm registered in accordance with the Professional Accountants Ordinance (Cap 50) or (b) a qualified management consultant representing a firm which is registered as a corporate member of the Management Consultancies Association of Hong Kong may take up appointment as provisional supervisors. We envisage that a solicitor representing his firm may have difficulty to fit the necessary requirements.

As stated in Para 5.1 of Chapter 5, the provisional supervisor 'would manage and control the company, acting as the agent of the company when exercising his powers'. This would impose far reaching responsibilities and risks to the appointee as he will be open to risks of allegations and claims which are not commensurate with the scale of fees likely to be approved by OR. The risks can of course be reduced if the appointee can obtain an indemnity from the company. However, the later might not be a viable candidate to promise indemnity anyway due to its own financial risks. Accordingly, it will be difficult to find a qualified candidate to come forward to be appointed as a provisional supervisor if he has to accept a role to manage and control.

Assuming even a certified public accountant, a management consultant or a solicitor is willing to come forward, questions would be raised as to whether he is qualified to manage and control the Company's business without the assistance of in-company management. The appointee should as a matter of course possess general and practical business knowledge and experience as well as special knowledge and experience in financial and management accounting methods and internal control systems. At the end, it should be emphasised that

these professionals would do a better job if they work with the senior management of the company in question. It is therefore proposed for consideration that the provisional supervisor need not be required to "manage and control" the company. However, he would better take an independent and professional advisory role reporting jointly to the Board (or an interim senior manager who may be the company's main shareholder or his representative) and the lead bank named in the deed of the debt rescheduling agreement.

12. Re: Question 12

No. We do not support unqualified person to be appointed for the intended purpose. We also do not support an appointment be made by OR or the Court which, inevitably, will end up with appointing an 'undertaker' more experienced in the work of a liquidator than of a 'savior' or 'rescuer' type of person who has to react diligently and flexibly to business circumstances.

13. Re: Question 13

We do not agree with giving creditors the choice to replace the provisional supervisor attended by the company or its directors or the provisional liquidators or liquidators of the company. We also do not agree with giving the creditors the choice to approve the remuneration of the provisional supervisors at the first meeting of creditors to be held within 10 working days from the commencement of provisional supervision. We consider that giving the creditor the forementioned choices is not consistent with the comments given on the foregoing questions. In particular, the company is the focus of the corporate rescue and any procedures resembling or being half-way of liquidation proceeding will not deliver the desired results for corporate rescue or liquidation. Consequently, all the stakeholders would be confused and at the end, no fairness could be brought to all parties or any party. We believe the provisional supervision route should exclusively aim for corporate rescue to benefit the creditors primarily and then also the shareholders and if the exercise fails to work, the company should proceed with a statutory arrangement per Section A166 of the CO or winding upper Section 193 of the CO. It is noted that provisional supervision should be regarded as falling within the category of non-statutory arrangements of which some official guidelines can be laid down by the OR. The guidelines should avail all HK companies in financial difficulty (evident by an act of bankruptcy) to have a discretion to go through a provisional supervision as part and partial of a non-statutory arrangement and if the choice is taken, then the company board is obliged to appoint a qualified provisional supervisor.

14. Re: Question 14

We do not support imposing personal liability on provisional supervisors as proposed in paragraphs 5.14 to 5.17 of Chapter 5. We believe imposing personal liability will certainly deter experienced, cultural-minded, confident and genuinely qualified local professionals to come forward to be a provisional supervisor. If a qualified certified public accountant or a qualified management consultant representing their professional firms is appointed, his performance and conduct will be overseen by his firm as well as by the relevant membership body in additional to public monitoring agencies such as CBB, ICAC etc who all are capable in pursuing an offender for any wrongful act. On the other hand, a provisional supervisor aggrieved by damages claimed against him should be allowed to have an indemnity from the assets of the company.

15. Re: Question 15

We do not support the introduction of insolvency trading provisions. We consider that the Companies Ordinance should already have included very clear provisions to prevent the directors of a company from over trading. In this respect, any offending directors should be made personally liable, jointly and severally, for any debts that the company contracted after it has become insolvent. We should avoid duplicated efforts on matters already covered by the Companies Ordinance.

16. Re: Question 16

We do not agree with the proposed revised formulation of ' insolvent trading'. We do not believe business should be over-regulated. Otherwise, beating the regulations will become a business itself rather than the genuine business which includes taking of risks. However, we agree that in different ways, for example via an education route in cooperation with bodies like Institute of Directors and some recognized professional accountancy bodies in HK, the directors should be encouraged to act on insolvency earlier than later to prevent, indeed, further erosion of the distressed company's assets at the detriment of creditors. In fact, the "Review of Corporate Rescue Procedures Legislative Proposals" if well publicised in the right circles will achieve the same or perhaps even better effect.

17. Re: Question 17

We do not think that there is a need to define major secured creditors. We also think no changes are needed. The provisional supervisor will determine the market values of the securities and agree with the secured creditor concern as to whether he will rely on his securities or join other bank creditors for a non-statutory arrangement.

18. Re: Question 18

Again, we do not support the proposal to largely follow the 2001 Bill approach with respect to protection of "major secured creditors" and other secured creditors' rights. We do not think any changes are needed.

19. Re: Question 19

We agree to remove the head count test in the voting at meetings of creditors. According to our experience, small creditors have the tendency to invariably vote against the wish of the major creditors who do not want to see the winding up of the debtor-company. In some situations, it was indeed noted that the small creditors could hold the major creditors at ransom to buy out their debts.