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Dear Sir

Re: Review of Corporate Rescue Procedure - Legislative Proposals – Consultation Paper ("the Paper")

I write in response to the Paper, having also participated in the Institute of Asian-Pacific Business Law's and Asian Institute of International Financial Law's conference on this topic, chaired by John Leung, JP and Charles Booth on 22 January 2010.

I am a shareholder and director of a private equity fund, Palin Capital Partners, that invests in businesses needing operational and financial turnaround, and which are often in financial distress. I am also a member of the Hong Kong Turnaround Community and this matter has been discussed with this wider community.

My personal comments are, therefore, from the view point of a Turnaround Practitioner, potential investor, company owner and provider of working capital to facilitate corporate rescue – utilising the formal and informal rescue and insolvency processes available in the jurisdictions of our investee companies.

Prior to joining Palin Capital, I worked in Corporate Recovery at Deloittes and Kroll and have over 20 years experience as a turnaround agent and insolvency practitioner, the last 8 of which were based in Hong Kong at Kennic L.H Liu & Co and then at Baker Tilly Hong Kong, which I founded in 2000.

I have an extensive working knowledge of the administration and voluntary arrangement processes used for corporate rescue in the UK, which are very similar to legislation proposed in the Paper.

My preliminary comment is that the draft proposal is positive and will be a valuable step for Hong Kong to modernise its corporate rescue regime to align with those utilised in most developed economies. The enactment of corporate rescue legislation will enable Hong Kong to take a leadership role in regional restructuring and related financial services.

From my experience, many companies and therefore jobs, would have been saved had such legislation been available in the Asian Economic Crisis in the later 1990's and more recently in the global financial crisis. The absence of such legislation has and continues to reduce Hong Kong's competitiveness and has cost unknown losses and damage.

In my opinion, enactment of corporate rescue legislation should be a priority for LegCo and related authorities.

While I welcome this legislative proposal, I do have various comments and suggestions to make the legislation more effective:

Employee Claims:

On one hand, I am concerned that an upfront cash commitment and/or the adoption of liabilities will cause a barrier for companies to commence this procedure, and/or for new financing of the process.

However, in reality a corporate rescue will not be successful if key staff do not buy into the process/or face unreasonable financial hardship. Paying them is clearly important in this regard. I am completely in agreement with the principle of preserving an employee's rights of liquidation priority and distribution. All employees need to be assured that they will be no worse off from their employer entering into the process than if it closed down. In reality, they often have most to gain from a successful rescue.

However, if employees are to be paid an advance or a preferential amount that does not reflect a strict liquidation right of payment in accordance to a company's available assets that would be available to a liquidator, then the Government should provide funding for these payments, which are made for public social and hardship reasons.

The legislation should also clearly state that the provider/funder of any payments that are made to staff has effective rights of subrogation over any future payments/dividends that may be payable to them from the company, or any new government fund or the PWIF.

Provisional Supervisor's Personal Liability

I agree that the Provisional Supervisor should be personally liable for their actions and for contracts entered into, or adopted, after their appointment. I do, however, consider it is essential that the Provisional Supervisor be permitted to contract out of such liability. This should include liability for an employee's remuneration.

If this contracting out provision is not incorporated into the legislation, then the general practice of Provisional Supervisors will likely be to terminate contracts and dismiss staff, thereby losing jobs and reducing the prospects of a corporate rescue, because of the onerous liability that will rest on them personally and where the Company's assets available to them under indemnity will often have an uncertain realisable value.

The ability of a Provisional Supervisor to disclaim contracts and renegotiate terms thereon will be an essential tool in their ability to rescue a company, through restructuring its business.

Insolvent Trading

I consider that the draft legislation is suitable. Having insolvent trading provisions is absolutely essential to make the Corporate Rescue effective. It should encourage a culture of directors seeking professional assistance at an early stage, thereby leaving time and scope for a rescue, before a situation becomes terminal.

As a potential provider of financing for corporate rescue, I would be very cautious in making such funding available where incumbent directors/management are not incentivised to work with my fund and the Provisional Supervisor to effect a successful rescue. Insolvent trading provisions will assist this incentive.

I also suggest that the legislation states that a company's lenders and financiers of it when in Provisional Supervision are excluded from the definition of shadow directors.

Super Priority Lending

Almost all corporate rescues require new financing to fund the process and change required to make a distressed business viable and to rehabilitate the company.

Having a statutory priority for new funding for the Provisional Supervision process is key and has the positive effects of:

1. Widening the burden of financing a rescue to all the creditor banks, rather than relying on one of them.
2. It allows new parties to invest in company's undergoing a rescue, thereby increasing the finance available to facilitate a rescue culture.
3. It avoids the problem of single creditors forcing a better return for themselves to the detriment of other creditors by unreasonably not agreeing to interim financing terms, where they are able to frustrate a majority consensus to support a company in financial distress.
4. It sets a precedent for corporate rescue.

There are, however, several problems with the currently proposed order of priorities for a new rescue lender:

Priority is only granted over floating charge assets. Often these assets will have a small realisable value and therefore be ineffective to secure financing – thereby making a corporate rescue not viable.

My recommendation is for priority over all assets, including those with a fixed charge.

This is adopted in the USA in its Chapter 11 procedure, where over 50% of debtor in possession financing ("DIP") is provided by a company's creditor banks. Often the provision of this financing creates new assets (such as receivables and inventory) that can be charged to existing fixed charge holders.

The terms of DIP financing require the Court's approval in the US (and Canada). This provides protection for creditor banks, where they believe they are unfairly prejudiced by the terms of DIP finance (when they do not themselves participate in it). A common practice in the USA is for additional security to be granted to creditor banks with fixed charges, where they would otherwise be prejudiced.

In the proposed legislation, a lender bank that has security over the majority of a company's assets and who is provided a right to enforce its security over a Company's assets upon notice of the appointment of a Provisional Supervisor, is protected by this right in an event.

My real concern is that without the enhanced super priority for new funding of companies in Provisional Supervision, new funding will not be widely available and that the Provisional Supervisor will simply be unable to rescue companies, as there will be insufficient working capital available for the process – other than a quick debt rescheduling and sale of non-core

assets (i.e. an orderly liquidation by another name) and what is managed consensually through HKAB Guidelines on Corporate Difficulties.

The United Kingdom has recently undertaken a review of its corporate rescue legislation and made comparatives with those used in the USA. One of its conclusions is that a super priority lending, akin to that provided in the USA's Chapter 11, is more beneficial to all creditors and to the companies and their staff. The UK Government is expected to enact such changes in UK legislation this year.

Appointment, Notification of Appointment and Voting

Creditors should be able to petition for the appointment of Provisional Supervisors, as in the USA, New Zealand, Australia and UK amongst other territories. This may be to effect a management change, where there has been a deadlock and where there is a viable business to be rescued.

The major lender that is able to supersede the appointment of a Provisional Supervisor by enforcing their existing security should have enough time to make an informed decision on where to do so or not. The default decision will always be to enforce their security rights.

I believe that 14 days is reasonable and in reality, I would expect the creditor bank to have agreed to the Provisional Supervision and the Provisional Supervisor prior to its application for SMEs, but for more complex global groups this may not be the case.

I believe that a Provisional Supervisor should notify the major lender of their appointment on the same day of appointment. I can see no valid justification for any delay.

I believe that a creditor should be able to vote for its entire claim (without any set off for the estimated value of its security - which is often problematic to quantify). I see an argument that it is unreasonable for a creditor that has financed a Company to be prejudiced in the decision as it its rescue (and the recovery of its debt) for having obtained commercial terms that include security.

I am completely against any headcount vote. The vote should only be based on the quantum of debt, not the number of creditors – which would open the process up to abuse and unfair negotiation.

Having more than one rule/calculation of vote will bring uncertainty to the process, where potentially a split vote could be made resulting in delay and unnecessary

failure/costs/dispute.

The Provisional Supervisor

First and foremost, acting as a turnaround agent or in a corporate rescue is a specialist service area. It requires real business, commercial, legal, accounting and crisis management experience.

It is different skill base required to act as a liquidator, auditor, litigator, tax advisor or company secretary, etc. In an analogy, a general practitioner of medicine is not allowed to perform open heart surgery. For the very good reason that the patient may die by malpractice from inexperience (even though the practitioner would of course know the theory).

My preference is for there to be a formal examination and licensing body (like the JIEB in the UK). This will take resource, time and funding. I suggest that the industry should fund some of this, through annual licensing fees, or a tax on remuneration, etc.

Should this be discounted for the reasons and the size of the Hong Kong market, then my next preference would be for there to be minimum criteria for qualification that should include:

- Qualified accountant or lawyer
- Adequate professional indemnity insurance, or a bond
- Evidence of the management of at least 5 corporate rescues (not liquidations)
- 8 years post qualification experience
- Adequate staffing resource
- Continual professional development and training in corporate rescue
- Approval from: The Official Receiver's Office, HKAB, HKICPA, Law Society. etc.

Other Issues

The moratorium should not affect third party guarantees or third party security, which would be unfair and a distortion of equity.

Practical issues related to cross border scope and jurisdiction of a Provisional Supervisor mirror the issues faced by insolvency practitioners and turnaround managers today. The support of the Hong Kong Courts, trade bodies and the Official Receiver's Office will continue to be important in the promotion for cross border judicial recognition.

I'd be delighted to discuss this further or assist The Financial Services Branch in any way.

Yours faithfully

Rupert Purser
Palin Capital Partners