HONG KONG SOCIETY OF ACCOUNTANTS
(Incorporated by the Professional Accountants Ordinance, Cap. 50)

香港會計師公會

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BY FAX AND BY POST
(2524 4860)

Our Ref.: C/IPC, M26388 18 March 2004

Mr. Christopher C. Chan,
Registrar,
Registrar's Chambers,
High Court,
38 Queensway,
Hong Kong.

Dear Mr. Chan,

Procedural Guides for Taxation / Determination of Bills in Liquidation Process

Thank you for your letter dated 31 January 2004 requesting comments on the revised draft Procedural Guides for the Taxation / Determination of Liquidators' Remuneration ("the Guides") and the Taxing Masters ("the Masters") response to the comments on the Guides ("the Response"). The views of the Society's Insolvency Practitioners Committee ("IPC") on certain related issues are contained in the Supplementary Paper attached to our letter of 1 March 2004 ("Supplementary Paper"), which outlines the position of the IPC on various issues raised in the joint meeting between the High Court Registry, the Official Receiver's Office ("ORO") and the Society held on 1 August 2003.

The IPC believes that, in the longer term, a complete review and rationalisation of the process of taxation would be desirable. In the Supplementary Paper, referred to above, we suggested that Hong Kong would benefit from establishing a joint working party along the lines of the UK "Working Party on the Remuneration of Officeholders and Certain Related Matters", set up in the United Kingdom (UK) under the chairmanship of Mr. Justice Ferris. The process of taxation could be one of the issues considered by such a working party, comprising representatives from the Judiciary (Judges and Masters), the ORO and the accounting and legal professions. We recognise that, pending any review, it would be useful to establish some procedural guidance to facilitate and help expedite the process of taxation / determination, but are of the view that such guidance can be regarded only as an interim measure and not as a panacea. Against this background, we provide our further comments below on the Guides and on other issues covered in the Response.

Response to the comments on the draft Procedural Guides for Taxation / Determination of Liquidators' Remuneration, etc.

General

We note the statement in paragraph 2 of the Response that the comments received on the draft Procedural Guides covered a much wider area than the Guides are intended to cover and we appreciate that the Masters have endeavoured to state their position on the issues raised. At the same time we should be grateful to know the status of the views contained in the Response that relate to issues within the scope of the Guides, because it appears that there are various instances of important explanations contained in the Response that are not reflected in the revised Guides. The most important of these is probably the clarification in paragraph 14 of the Response that, in relation to

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liquidators' remuneration, the Guides will apply only where there is no Committee of Inspection ("COI") or where no agreement on remuneration has been reached and the Court has made an order for determination or taxation. As we suggest below, this point should be incorporated into the Guides.

Consultation

Paragraph 3

The Response states that "[Madam Justice Kwan] has answered some of the queries". This appears to suggest that Madam Justice Kwan's talk to the Society's Insolvency Interest Group ("IIG") on 2 July 2003 should be treated as a judicial pronouncement on issues concerning the taxation / determination of bills in liquidation. In fact, the event at which Madam Justice Kwan gave her talk was an informative but informal and interactive session to provide her and members of the insolvency profession with the opportunity to exchange views on issues arising from the taxation process. Members of the IPC/IIG who attended the session recall her remarks that she would welcome more opportunities to discuss and exchange ideas with practitioners on various issues of common interest (perhaps indicating that she would be amenable to the idea of a joint working party).

Overhead expenditure, internal conferences and travelling time

Among the issues covered in the talk were overhead expenditure, internal conferences, and travelling time. We have addressed these matters in the Supplementary Paper.

The Peregrine judgment

Paragraph 5

Although in the position paper issued to the Masters in July 2003 ("the Position Paper") prior to the meeting referred to above, we made reference to the "reasonably prudent man" test and gave our views as to how it should be interpreted, this should not be taken to mean that we are in complete agreement with the judgment in the case of *Re Peregrine Investment Holdings Ltd.* ([1998] 2 HKLRD 670).

The IPC does not consider that the proposition quoted at page 679 of the judgment, that it is for the office-holder who wishes to be remunerated to justify his "claim", is appropriate. The IPC believes that the office-holder is, prima facie, entitled to be remunerated for services rendered. It is the quantum of that remuneration that falls to be determined. Secondly, the test of "a reasonably prudent man" does not, in our view, take adequate account of the fact that an office-holder has statutory and common law duties to fulfil, in relation to which a reasonably prudent man, given a choice, might not wish to hazard any of his own time and money. We would suggest that an office-holder is a trustee more in the sense of being a custodian of the funds of a third party to whom he owes certain duties, and that, as suggested above, he should be entitled to reasonable remuneration out of those funds for the work that he undertakes, including work investigating, recovering and realising the assets that form the basis of those funds, as well as the duties that he has to discharge for statutory/regulatory compliance reasons or for the public good. It is also worth pointing out that, except for retaining a small amount of cash for day-to-day expenses, the office-holder is required to transfer any assets realised in a compulsory liquidation, as expeditiously as possible, to the Companies Liquidation Account controlled by the ORO.

Agents' bills (including solicitors' bills)

Paragraph 6

As we indicated in the Supplementary Paper, it may be worth noting that in *Mirror Group Newspapers plc v Maxwell* [1998] BCC 324, the costs of the office-holder and his solicitors were required to be taxed. The result, we understand, was that the taxing master in that case imposed a reduction overall of less than 5% on the amounts claimed.

The judgment in *Re Peregrine Investment Holdings Ltd.*, in summarising the position regarding agents' costs, also indicates that "[a]s between the office-holder and his solicitors, there is a contract and the office-holder is personally bound to pay the solicitors their proper charges for work done in accordance with that contract". This being the case, we are unclear why the Court should be concerned with the first question under point (5), i.e. "what is the proper amount payable by the office-holder as clients?" (as this would surely be a matter between the client and the solicitors), unless the point that is being made is that the Court would want to ask itself this question in order to determine the answer to the second question, i.e., "how much of the amount so payable is to be allowed as payment out of the estate?"

A further question that should be considered, given that the office-holder is acting on behalf of the company in liquidation, is whether it is equitable that he should have to take up the risk of being held personally liable to pay solicitors' fees if the solicitors' bills are taxed down by the Court?

Paragraph 9

Our view on the "reasonably prudent man test" is indicated above. To elaborate further, we would suggest that a different set of criteria apply in a situation where a person has a duty to act in the best interests of, and is accountable to, potentially numerous third parties, in contrast to a situation where a person needs to consider only how to safeguard his own interests. Even if the test of a reasonably prudent man is to be applied, we consider that the proper test should be whether such a person might lay out or hazard his own money in doing what the office-holders have done, because two prudent men could well act differently in the same set of circumstances.

In our opinion, a more appropriate test might be whether "a careful, sensible, prudent and experienced professional person appointed as an office-holder, faced with similar, if not the same circumstances, would regard it as reasonable to lay out or hazard funds of the estate in doing what the office-holder has done." This is consistent with the test applied generally in determining whether a professional has acted negligently in the discharge of his duties.

Nevertheless, insofar as the "reasonably prudent man" test is applied, we welcome the Masters' acceptance that it should not be applied with the benefit of hindsight. We would suggest that hindsight should not be applied in relation to any test that may be adopted to assess the time and resources expended on discretionary action undertaken by office-holders.

Determination of liquidators' remuneration

Paragraphs 11-14

We welcome the Masters' clarification that it is only where there is no COI or the COI and the liquidator cannot agree, that the Court will be asked to determine what the liquidators' remuneration should be and, accordingly, that the Guides apply only to those cases where there is no COI or no agreement has been reached and the Court has made an order for determination or taxation. We note that, unless the Court directs otherwise, summary liquidation cases will also fall outside the scope of the Guides.

We are, however, concerned that there appears to be a suggestion that even the basis of fees may be changed in the process of fee "determination", by way of a "lump sum assessment" or "by reference to a percentage". If the order of appointment of liquidators specifies their fees to be paid on a time-cost basis, we do not see how this basis can be changed by "determination".

Where the office-holder's or his agents' bills are taxed and during the process the bills are reduced, we believe that a proper explanation for the reduction should be given by the Master. Practitioners are of the view that the current practice of not providing any reasons or explanations for the taxing down of fees lacks transparency.

Provisional taxation

Paragraphs 15-16

The IPC is encouraged by the Masters' apparent willingness, in the case of liquidators' bills, to consider making a provisional assessment, instead of proceeding with a formal taxation, where the accumulated total fees do not exceed, say, HK$100,000.

The Response points out that the Companies (Winding Up) Rules require agents' bills to be taxed in accordance with Rules 169 to 177 and that, unless the Rules are amended, it is not proper to follow any other procedure. We believe that a thorough review of the Rules should form part of the remit of the joint working party that we propose above.

As suggested in our Position Paper, the IPC considers that the COI should be given more authority to dispense with taxation in the case of agents' bills and disbursements. We do not see the taxation process as serving any essential purpose. With respect, the Masters will not be in a better position than the liquidator to assess value and there are adequate checks and balances in place to prevent abuse. The COI and creditors are the people who will be most affected by the outcome of the liquidation. If they sanction the fees and disbursements, having had the opportunity to scrutinise the bills, there is no reason why a third party should interfere with that decision. This is consistent with, for example, the review of a solicitor's own bill by his client. In that situation, the Court will be called upon to tax the solicitor's bill only upon the request of a client who takes issue with the solicitor's bill.

Similarly, just as the Court will not generally intervene where there is a COI, but may do so when there is a disagreement between the COI and the liquidator in relation to the liquidator's remuneration, there seems to be no reason in principle why the same approach cannot be adopted for disbursements, including the bills of agents. We note however that this may require amendments to

the primary legislation. In the meanwhile, we welcome the Judiciary's support for increasing the threshold for taxation under Rule 176 to a greater amount. We suggested HK$20,000 in our Position Paper. Perhaps it could be even higher. We believe that a figure should be agreed and an amendment to the Rule should be initiated as soon as possible.

Value of an estate

Paragraph 21

Clarification is needed as to when the rough estimate of the value of the estate is to be made. Practitioners are coming across more and more compulsory liquidation cases where either no statement of affairs has been filed, or the assets initially reported in the statements of affairs are minimal. The value of the estate may increase as and when more investigation is carried out by the liquidator.

Work of liquidators

Paragraph 23

We welcome the acknowledgement that asset recovery is only one part of the work of a liquidator and that all the other activities mentioned in this paragraph are chargeable activities.

Nature of taxation

Paragraph 29

We are somewhat surprised at the suggestion that narratives, etc., are often not provided when bills are submitted. While we concede that, in the past, this may have been an area that required more attention in relation to a relatively small proportion of practitioners, it is our understanding that it is currently the norm to provide sufficiently detailed narratives and explanations. We should be grateful for further clarification on this point.

Procedure

Paragraph 33

The IPC believes that, although a date should be set, a physical hearing requiring attendance should be held only if necessary and should be dispensed with if it is not. In any event the liquidator should generally be able to delegate attendance. It will often not be cost-efficient for the liquidator to attend since one or more of his colleagues will often be at least as familiar as he is with the detail of the bills. Please also see our comments under *Paragraph 34* below.

We welcome the confirmation that all bills relating to the same company in liquidation, and any related companies, will be taxed by the same Master. Yet, we suggest that while taxation of bills relating to the same company in liquidation (and any related companies) should be taxed by the same Master, arrangements should be made for an alternate Master to deal with the taxation in case the "designated" Master is unable to deal with the taxation.

Paragraph 34

It is not clear why, under the requirements of Practice Direction 14.1, a partner, director, or other suitably experienced and knowledgeable member of staff of a liquidator's firm, should not be regarded as competent to appear before a Master in applications for the liquidator's remuneration.

Paragraph 35

The IPC doubts the efficiency of requiring a liquidator to have to excuse himself formally from attendance on each occasion that he wishes to be excused. This creates unnecessary work for the Court and for the liquidator. We would suggest that it would be more practical for the Master to indicate on the relevant form if he believes that the liquidator needs to attend in person, and only in those circumstances should the liquidator need to write to excuse himself if he is unable to attend, or he believes someone else would be more appropriate.

It is not clear who should attend in the case of the bills of an overseas agent and whether, for example, a local representative would be able to attend on the agents' behalf. This needs to be clarified. We consider that the whole area of overseas agents needs to be considered and dealt with separately. For example, solicitors and valuation agents in the Mainland have a fee scale and structure stipulated by the local government / regulatory body. These do not necessarily conform to, say, the 6-minute time-cost recording system used in Hong Kong.

<u>Format of the bill and the accompanying documents</u>

The Masters may wish to note that members of the IPC that have worked in other jurisdictions inform us that, overall, the information currently provided is already in more detail than is required to be provided in those other jurisdictions.

Paragraph 37

As indicated above, we have been given to understand that is it now the norm to provide narratives and explanations in respect of work undertaken. Whilst it is appropriate to provide a description of the nature of the work in the narrative of a bill, practitioners believe that the reasons why such work has to be undertaken are often self-explanatory from the narrative, and the goals that the work aims to achieve would be, generally, either recoveries for creditors, or fulfilment of the office-holder's statutory and common law duties. In many cases, therefore, it should not be necessary to go further than this.

Paragraph 38

While we accept that, where not already apparent from the nature of the work, detailed narratives and explanations should be provided, we do not consider it necessary for the liquidator to have to explain, on each and every occasion, why a solicitor was required to attend the COI meeting or why it was necessary to seek the solicitor's opinion. Solicitors often attend COI meetings to apprise the COI of developments, especially in relation to litigation, advise the COI and to assist generally in any legal questions, which the COI may have from time to time. With respect, there is a question of trust here and, particularly if the involvement of solicitors' at COI meetings is relatively infrequent and limited, we believe that it should be assumed that if such involvement is not necessary, the

liquidator will not invite solicitors, or the COI will object to their presence or seek to have the extent of their presence curtailed. The liquidator is, after all, a professional person who can and should be in a position to judge when it is appropriate and necessary to engage the services of a solicitor. Liquidators take very seriously their fiduciary obligations and their duties to the Court, as officers of the Court, and it is respectfully suggested that there should be a working presumption on the part of the Court that it is reasonable to have engaged other professionals unless the contrary appears.

Paragraph 39

It is not entirely clear what is envisaged by the proposed requirement that the liquidator should explain the nature of each "task" undertaken and the considerations that led the liquidator to embark upon such task. If taken literally, the requirement could be a very onerous one.

In a liquidation of an on-going operation, for example, the liquidator may decide (subject to the necessary Court approval) to continue trading for the benefit of the winding-up. He may, for example, be employing hundreds of the former staff of the company and managing more than 20 trading locations for a continuous period of more than 6 months. It would be almost impracticable, costly and of little benefit to the creditors if the liquidator were to be required to report on and explain the nature of each task undertaken by, say, 20 to 50 of his staff almost on a daily basis.

Furthermore, such a requirement would suggest an underlying doubt about the general conduct and professionalism of the liquidator, as a result of which it is thought necessary to review the exercise of the liquidator's professional judgment, even where there is no indication that it has been defective. We find this inappropriate as liquidators in a compulsory liquidation act as officers of the Court; their appointment by the Court ought in itself to establish their qualifications, experience and integrity.

The IPC believes that issues of materiality, practicality and proportionality should be taken into account, and so clarification is needed as to whether the proposed requirement is intended to refer only to major tasks and, if so, the yardstick that should be used to establish a suitable threshold.

In this connection, we would refer you again to the proposed standard formats for liquidators' fee applications, copies of which were attached to the Society's submission of 30 June 2003 on the previous drafts of the Guides ("Previous Submission"), and we would welcome the Masters' views on them and, in particular, as to whether they would be sufficient to address the matters issues raised in paragraph 39.

Paragraphs 44-45

We note the comments on benchmark fee scales and, as indicated in our Supplementary Paper, we are pursuing this matter further.

<u>Costs relating to taxation / determination</u>

Paragraph 46

Practitioners believe that additional costs will be incurred by the need to comply with the Guides. Quite apart from the time required in preparation for taxation / determination and attending hearings themselves, the overall cost of preparing the relevant documentation in sufficient detail in the

first place (subject, to some extent, to the clarification that is being sought in this submission) will be significant.

Taxing fees

Paragraphs 47-49

We would like to seek clarification as to the basis for levying a court fee for assessing provisional liquidators' fees, particularly where these are approved by the Court without any process of taxation. In this regard, we are not clear as to why, even though the making of an order providing for the (provisional) liquidator's remuneration is part of the winding-up proceeding, the assessment of that remuneration should be regarded as a separate proceeding.

We are particularly concerned that, while there may have been, and may still be, some confusion about the levying of Court fees, the Court is planning to "rectify" the current practice of not charging fees forthwith.

In any event, it should be noted that unlike a taxation following litigation, where the taxing fee will be borne by the paying party (usually the unsuccessful litigant), the significant fees payable on taxation or assessment (amounting to, e.g. 2.45% on a bill of HK$1 million) reduce the funds available to (and are therefore effectively payable by) creditors. It is suggested that, even if the Court does have jurisdiction to charge a Court fee for taxation of liquidators' bills, such fees should be standardised to no more than, say, 1%, across-the-board.

Other suggestions

Paragraph 51

We have dealt with the question of the threshold for taxation under Rule 176 under *Paragraphs 15-16* above.

Paragraph 52

Given the backlog of outstanding invoices, even with the new procedures in place, bills subject to taxation will take time to be paid. Demands on cash flow and debt provisions can result from these delays. In a number of cases, liquidators and their agents (such as solicitors) have had to wait for 18 months for taxation and payment. Few if any professions or trades can afford to give such a long period of credit and none should be expected to do so. Payments on account, as of right, of a substantial proportion of the outstanding fees would help to alleviate the problem. As suggested in our Previous Submission, consideration should be given to incorporating appropriate provisions for payments on account into the Guides. We note from the Response that the Masters do not consider that they have power to deal with this, but we should be grateful to know what authority would be required to enable payments on account to be made; could provision for payments on account be implemented by, for example, amendment of the Rules by the Chief Justice with the approval of the Legislative Council? This is perhaps another subject that could be examined by the proposed working party.

Effective date and transitional period

Paragraph 55

We should be grateful to learn the reasons for making changes to the procedures for the determination of provisional liquidators' bills, which has traditionally been carried out by the Judges. The IPC considers that the Judges, who would have appointed the provisional liquidator in the first place, would generally be more familiar than the Masters with the background of the case.

Establishment of a joint working party

We have made several references in this submission to the suggestion contained in our Supplementary Paper, to set up a joint working party in Hong Kong along similar lines to the working party under the chairmanship of Mr. Justice Ferris in the UK. Having identified the issues and exchanged views with the Masters, we believe that the process of developing and finalising guidelines and practice would benefit from discussion by such a group. In view of the number of issues and matters that would benefit from consideration by such a body, we would recommend that it be established as early as possible.

Appeal procedures

We recommend that formal appeal or review procedures be established to deal with situations where (provisional) liquidators wish to challenge the process or outcome of the taxation / determination of their fees.

The Procedural Guides (for Liquidators' Bills)

Our comments on the Guides are set out below. Some of these reiterate points raised in our Previous Submission.

Introduction

It would be useful and would help to focus the minds of all parties if the objectives of issuing the Guides were to be included in the Introduction. In our view, the main objective should be to facilitate and expedite the process of taxation / determination.

As indicated above, the Guide should expressly state that it applies only in cases where there is no COI, or where no agreement on remuneration has been reached, and the Court has made an order for determination or taxation.

Documents

Paragraph 3.1(B)(i)

We should like to reiterate the suggestion made in our Previous Submission that, orders for the appointment of provisional liquidators should make clear provision for the basis of remuneration. Where for some reason that is not done, an order as to the calculation of remuneration should be made as soon as possible after the appointment of the provisional liquidator.

Paragraph 3.1(B)(ii)

We welcome the assurance, at paragraph 54 of the Response, that the Masters and Judges to whom applications were made for the determination of provisional liquidators' bills will try to clear all of them before the implementation of the Guides. However, as indicated in our Previous Submission, practitioners would like to know whether specific measures will be taken to achieve this aim, e.g., the appointment of more Masters or provision made for additional time to be set aside to complete this work.

Listing and hearing

Paragraph 4.1

We would like to know how the court, in designating a hearing time for the taxation / determination of the bill lodged, will decide upon the time required for the process. If only a short time is allocated, or if the matter cannot be resolved at the first hearing, there is a concern that this could result in lengthy adjournments. If adjournments are fixed for dates too far into the future, this could detract from one of the main objectives of the Guides, which, as indicated under the *Introduction* above, should, in our view, be to facilitate and expedite the process of fee taxation / determination

In our Previous Submission, we referred to the possibility of liquidators attending a "call over hearing", which sometimes takes place under the present procedures, but this did not seem to have been covered in the Guides. Paragraph 33 of the Response makes it clear that the "hearing time" referred to in paragraph 4.1 of the Guide for liquidators' bills, is not intended to be a general call-over. It also clarifies that, at the first hearing, the Master will as far as possible tax the bill. We would be grateful to know, therefore, under what circumstances a bill may be "determined" as opposed to "taxed", and what procedure will be adopted for determinations? Furthermore, what place, if any, will the general call-over have in the context of the Guides?

The Procedural Guides (for Agents' Bills)

Where applicable, our comments on the Guide for liquidators' bills, and on the Response, also apply to the bills of liquidators' agents.

Paragraph 3.1(C)(vi)

According to paragraph 43 of the Response, liquidators are expected to examine the bills critically and give their comments, including reasons for their decisions, before certificates are issued. As suggested in our Previous Submission, the IPC believes it should not also be necessary for a liquidator, as a professional and an officer of the Court, when submitting the bills of his agents and confirming that he approves the bills, to be required to provide specific evidence of scrutiny in addition to a certificate of scrutiny. Certainly, if asked by the Court, the liquidator should be prepared to substantiate the basis of his concluding that the fees are reasonable. As we indicated previously, an analogy may be that an auditor is required only to present his audit report to members of a company, but not his audit report together with all his audit evidence, working papers and files.

We are also not clear as to how the "reasonably prudent man" test should be applied here, as is suggested in paragraph 43 of the Response, given that, as noted in the judgment in *Re Peregrine Investment Holdings Ltd.* (see *Paragraph 6* under the Response above*)* an office-holder has a contractual liability to pay his agents. Therefore, unless his solicitors have acted outside of his instructions, then presumably his scrutiny of the bills will be limited to whether or not the charge is reasonable for the work undertaken.

Paragraph 4.1

In relation to paragraph 4.1, *Listing & Taxation*, we repeat the point made under *Paragraph 33* of the Response, that, although a hearing date should be set, a physical hearing requiring attendance should be held only if necessary and should be dispensed with if it is not.

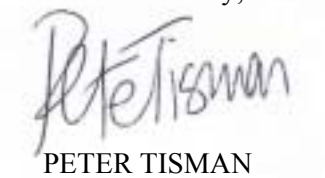
Other Matters

Appeal procedure

We suggest that the avenue for appeal against decisions made under the Guides should be specified in the Guides.

I apologise for any delay in responding to you. If you have any questions on this submission, please feel free to contact me at the Society (on 2287 7084).

Yours sincerely,



PETER TISMAN
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PMT/ay

c.c. Official Receiver (Attn: Mr. Eamonn O'Connell)