25 July 2013

By email < corporate_insolvency_law@fstb.gov.hk **> and by post**

Our Ref.: C/RIFEC, M90047

Division 4
Financial Services and the Treasury Bureau
15th Floor, Queensway Government Offices
66 Queensway
Hong Kong

Dear Sirs,

Consultation on Legislative Proposals for Improvement of Corporate Insolvency Law

--- Please find attached a completed questionnaire from the Hong Kong Institute of Certified Public Accountants in response to the above consultation document.

Generally we welcome the review of the law relating to corporate insolvencies which is in need of updating. Many of the proposals will help to streamline and rationalise the procedures for insolvent windings up and we support them. However, we have reservations about certain specific and quite significant proposals, as indicated in our responses in the questionnaire. These include:

(a) The proposals for disqualification of certain categories of persons from appointment as liquidator or provisional liquidator and the requirement to disclose relevant relationships that could give rise to a conflict.

We consider that the partially overlapping lists of disqualified persons and disclosable relationships, and the interface between them, could create confusion. There is also a risk that the list of disclosable relationships will be treated as exhaustive, which would not be desirable.

We would recommend that, inter alia, the way in which the processes of disclosure of relationships and approvals to accept to appointment will operate together should be clarified. Further consideration should also be given to whether it is appropriate that those persons whom it is proposed should be ineligible to accept appointment, due to existing or recent relationships with the company, should, nevertheless, all be permitted to seek leave of the court to accept appointment.

We would also recommend that the details of the proposed framework, if it is introduced, should be placed in subsidiary legislation.

(b) The proposal to extend the personal liabilities of liquidators in court-ordered windings up beyond the time of the release of the liquidator, subject to the leave of the court.

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓
Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603
Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

This is not a straightforward issue of providing better protection for other stakeholders. It will have significant implications for insolvency practitioners and we believe that the proposal needs to be given further deliberation.

(c) The proposal to remove the requirement to hold the first creditors' meeting on the same day as, or the day following, the meeting of members and to provide, instead, that the company must call the first meeting of creditors no later than the fourteenth day after the meeting of members.

We consider that this could create opportunities for abuse of creditors. We recommend that creditors be given a minimum period of seven days' notice of the first meeting of creditors and that, where the resolution is to wind up the company, the meetings of members and creditors should be held either on the same day or not more than one day apart, as is the case now. If there is an urgent need to take action, application can be made to the court to appoint a provisional liquidator or, where the relevant criteria are met, the winding up can be commenced under section 228A of the Companies Ordinance.

In addition to the above, it will be important to ensure that the technical changes proposed in Annex C of the consultation document align with any changes to the legislation resulting from the main proposals.

Finally, the Institute made a submission to the Financial Services and the Treasury Bureau, in February 2012, on proposals for changes to corporate insolvency law, before work on the consultation document started. Some of our proposals have been addressed, wholly or partially, in the consultation document, while others have not.
--- We attach a copy of our earlier submission and hope that, in drawing up detailed legislation, you will give further consideration to those matters that have not yet been addressed.

If you have any questions on our submission, please contact either Mary Lam, deputy director, specialist practices (mary@hkicpa.org.hk or 2287 7086) or myself (peter@hkicpa.org.hk or 2287 7084).

Yours faithfully,

Peter Tisman
Director, Specialist Practices

PMT/ML/ay
Encls.

Attachment

Hong Kong Institute of Certified Public Accountants
Comments on Consultation Document on
"Improvement of Corporate Insolvency Law Legislative Proposals"

Chapter 2 COMMENCEMENT OF WINDING-UP

Q1 Do you support the proposal to adopt a prescribed form of statutory demand, which would contain key information as described in paragraph 2.7 as well as a statement of the consequences of ignoring the demand?

Yes, we support the proposal.

Q2 Do you think that the section 228A procedure, whereby the directors of a company may commence a voluntary winding-up of the company without first having the members of the company resolve to do so, should be maintained or repealed?

We consider that the section 228A procedure should be maintained to be available to directors as a "last resort" procedure in exceptional circumstances.

Q3 If the section 228A procedure is to be maintained, do you agree to the proposed improvement measures as set out in paragraph 2.14 to reduce the risk of abuse of the procedure?

We agree to the proposed improvement measures set out in paragraph 2.14 of the consultation document. We suggest that consideration be given to strengthening the checks and balances around the use of s. 228A. As this provision gives directors the ability to wind up a company without reference to the members, greater protection may need to be given to members' rights and interests under this section. There may also need to be more monitoring to ensure that the conditions set out in this section are properly complied with by the directors. Therefore, as an additional safeguard, we suggest that directors be required to make a statutory declaration of the matters stated in s. 228A(1).

Q4 Do you agree to replacing the existing requirement of holding the first creditors' meeting on the same or the next following day of the members' meeting with the requirement of holding the first creditors' meeting on a day not later than the fourteenth day after the day on which the members' meeting is held in a creditors' voluntary winding-up case?

No, we do not agree with the proposed change. We consider that extending the potential time difference between the holding of the members' meeting, when the resolution for voluntary winding-up is proposed, and the first creditors' meeting for up to 14 days, rather than, as now, requiring the holding of the first creditors' meeting on the same or the day following the day of the members' meeting, could disadvantage the creditors and potentially open the situation to abuse. We note that in paragraph 2.24 of the consultation paper, it is also proposed that, where no liquidator ("LR") has been appointed by the company at the members' meeting "the directors may dispose of perishable goods and other goods the value of which is likely to diminish if not

immediately disposed of, or do all things necessary for the protection of the company's assets". This would add to the potential for abuse.

We are of the view that the present system works well in practice, except that the Companies Ordinance ("CO") does not provide for a minimum period of notice for calling the first creditors' meeting. This problem is addressed in Q5, below.

We consider that, if sufficient notice has been given to creditors (see Q5 below), the first creditors' meeting should preferably be held on the same day as the members' meeting, when the resolution for voluntary winding-up is proposed. This would avoid any potential time gap between the two meetings and minimise the opportunities for the process to be abused.

As a protection to shareholders, we recommend that the law should also prescribe a minimum notice period of seven days for calling a members' meeting when a resolution for voluntary winding-up is to be proposed. If the company needs to be wound up urgently, an application could still be made to the court for the appointment of a provisional liquidator ("PLR") or, where appropriate, section 228A could be used.

Q5 Do you support the proposal on prescribing a minimum notice period for calling the first creditors' meeting in a creditors' voluntary winding-up case? If so, do you consider a period of seven days appropriate?

Yes, we support the proposal. A minimum notice period of seven days will allow creditors reasonable time to prepare for the meeting.

Q6 Do you agree to the proposal on limiting the powers of the liquidator appointed by the company during the period before the holding of the first creditors' meeting in a creditors' voluntary winding-up case?

Yes, we agree with the proposal.

If the first creditors' meeting is held on the same day as, or the day following, the members' meeting when the resolution for voluntary winding-up is proposed (refer to our answer to Q4 above), the potential risk of "centrebinding", identified in the consultation document (i.e., where an LR appointed by the members deliberately puts off the holding of the first creditors' meeting and does things to the detriment of the creditors' interests), will be substantially reduced.

Q7 Do you agree to the proposed restrictions on the exercise of the directors' power before a liquidator is appointed in a creditors' voluntary winding-up case?

Yes, we agree with the proposed restrictions on the exercise of the directors' power.

If the first creditors' meeting is to be held on the same day as, or the day following, the members' meeting when the resolution for voluntary winding-up is proposed (refer to our answer to Q4 above), the risk of abuse by the directors during the period before an LR is appointed at the first creditors' meeting will be minimised.

Q8 Do you agree with the proposed technical amendments relating to the commencement of winding-up as set out in Annex C?

We agree with the proposed technical amendments relating to the commencement of winding-up as set out in Annex C except, for proposal #3 regarding the obligation of the LR in a members' voluntary winding-up, where he is of the opinion that the company will not be able to pay its debts in full within the period stated in the certificate of solvency issued under section 233 of the CO.

We suggest that under the proposal #3 situation, consideration be given to adopting similar meeting arrangements as for a creditors' voluntary winding-up. We further suggest that a note be included in the notice of the creditors' meeting, setting out the reasons for believing that a conversion of the winding-up from a members' voluntary winding-up to a creditors' voluntary winding-up is necessary.

It is noted that point (c) requires "… *that the liquidator should provide creditors with all reasonable information concerning the affairs of the company free of charge*". We would like to clarify whether there will be any template report showing the relevant information to the provided to creditors, as different LRs may provide different amounts of information to creditors. As regards providing creditors with all reasonable information free of charge, we should like to clarify whether LRs may continue to be reimbursed with the disbursement costs (e.g. photocopying, postage and delivery) of providing such information.

Chapter 3 APPOINTMENT, POWERS, VACATION OF OFFICE AND RELEASE OF PROVISIONAL LIQUIDATORS AND LIQUIDATORS

Q9 (a) Do you agree to the expansion of the list of disqualified persons from being appointed as a provisional liquidator or a liquidator? If so, do you agree with disqualifying the types of persons as proposed in paragraphs 3.13, 3.15 and 3.16?

We agree, in principle, with expanding the provisions on disqualification of persons for appointment as a PLR or LR. However, we have reservations on codifying the disqualified persons in primary legislation. We recommend that the list of disqualified persons be set out in a schedule or in a rule (i.e., subsidiary legislation) to facilitate future modifications.

Generally, we agree with disqualifying the types of persons proposed in paragraphs 3.13(a)-(d), 3.15 and 3.16.

Regarding paragraph 3.13(d), we consider that a person who is or has been an auditor of the company within two years before the commencement of winding-up of the company should be disqualified from appointment as a PLR or a LR in an insolvent winding-up. Given that an auditor has a significant professional relationship with the company, conflicts of interest or the perception of conflicts will inevitably arise and, as such, it would not be appropriate to allow for such an appointment even with the leave of the court, as stipulated in paragraph 3.14. Under the Hong Kong Institute of CPAs' Code of Ethics for Professional Accountants, section 500, Professional Ethics in Liquidation and Insolvency, an insolvency practitioner ("IP") should not accept appointment in an insolvent liquidation where the IP's practice or an individual within it has performed audit work in relation to the company within the past two years. This has been the standard understood and adopted by members of the HKICPA for many years, and it would not be appropriate

for the law to give a signal that there may be situations in which the auditor of a company could become the LR of that company in an insolvent winding-up. Similarly, in relation to paragraph 3.13(c), we cannot see situations in which it would be appropriate for a director of a company to be appointed liquidator in an insolvent winding up of the company

We suggest, therefore, that further consideration be given to whether some of the persons proposed to be disqualified in paragraph 3.13(a) - (d) should be added to the categories of persons under the existing section 278 of the CO, who are excluded from taking appointments altogether, without provision to seek leave of the court to take up an appointment.

Regarding paragraph 3.13(e), we are of the view that a court-appointed receiver, who needs to act impartially and under the direction of the court, should not be considered to have a conflict of interest and should not be disqualified from appointment as a PLR or LR in a court winding-up and a creditors' voluntary winding-up.

(b) Do you agree to provide clearly that the appointment of a disqualified person as a provisional liquidator or liquidator shall be void and that he shall be liable to a fine if he acts as a provisional liquidator or liquidator?

Yes, we agree.

(c) Do you agree that the disqualification proposals should also apply to the appointment of a receiver or a receiver and manager of the property of a company with suitable modifications?

Since a receiver or a receiver and manager is accountable to the party that appoints him/her, we do not see the need to extend, in the statute, the disqualifying proposals to the appointment of a receiver or a receiver and manager.

Q10 (a) Do you agree that a new statutory disclosure system should be introduced for the appointment of provisional liquidators and liquidators?

While we agree, in principle, with enhancing transparency in the appointment of PLRs and LRs, in the absence of a more all-encompassing regulatory system for IPs, we have some reservations about the introduction of a statutory disclosure system. We are also unclear about the practical implementation, monitoring and enforcement aspects of this as well as other proposals, which are not set out in the consultation document.

There is a danger that any list of disclosable relationships will be treated as exhaustive by some prospective PLRs/LRs and other potential conflict situations and relationships not on the list may then be viewed as acceptable. Whilst a "catch all" provision can, and may need to be included in the law, this will inevitably result in some uncertainty.

It is also not entirely clear how the statutory disclosure arrangement will operate together with the disqualification provisions, referred to in question 9(a), given that some of the relationships included on the list of disclosable relationships are those that would result in disqualification, as explained in paragraph 3.13 of the consultation document and others are not. Paragraph 3.22 seems to suggest that

persons disqualified from seeking appointment would, nevertheless, be able to obtain approval for appointment from the creditors in a creditors' voluntary liquidation, whereas paragraph 3.14 suggests that leave of the court would be necessary.

Regarding whether or not to disclose certain information or relationships in the proposed statement of relevant relationships, including the reasons for believing that none of the facts or relationships stated therein would result in a conflict of interest situation, under the proposal, this would seem to be left largely to the judgment and integrity of the individual persons seeking appointment. In order to provide greater clarity and assist in compliance with the law, we suggest that there should be a standard format for disclosures. The government may consider consulting the relevant professional bodies regarding guidance as to the basic information that should be disclosed and the scope and depth of detail expected to be contained in such disclosures.

(b) If yes, do you agree with the details of information required to be disclosed as set out in paragraph 3.21?

If it is considered necessary and appropriate for a statutory disclosure system to be introduced, we recommend that an extensive, but non-exhaustive, list of related parties and relationships be provided in the law in order to avoid uncertainties and legal challenges. There should also be a caveat that there will be other conflict situations and a prospective PLR or LR must consider whether, in the light of all the circumstances of the case, it is appropriate to disclose a relevant relationship not included on the list. Instead of primary legislation, we suggest that details of the disclosure be set out in subsidiary legislation to facilitate future changes.

In addition, the related parties would need to be clearly defined in the law. Questions that need to be clarified include:

(i) Would a director include a shadow director (paragraph 3.21(a)(iii))?

(ii) Who would be considered to be a "financial advisor" (paragraph 3.21(a)(viii))?

(iii) Is "immediate family member", as defined, the right test for disclosure of close personal relationships? Why, for example, is the Residential Properties (First-hand Sales) Ordinance, seen as a suitable source for this definition (see footnote 61 to paragraph 3.21(b))? We note that the definition of "associate" in relation to the proposed unfair preference provisions covers persons who would normally be considered to be in a close personal relationship, which include, not only a spouse, but, e.g., a cohabitant, in line with the concept of "cohabitation relationship" in the new CO (see paragraph 5.20(a)). Without seeking to extend the disclosure regime to cover all associates, it would appear to be a discrepancy that these two sets of provisions adopt a different approach in respect of close personal relationships.

From a practical point of view, it will be important to know what would constitute making "reasonable enquiries" (paragraph 3.24). IPs indicate that there may be practical difficulties in identifying all relevant relationships and obtaining information, in particular, in the liquidation of a large multi-national or overseas group of companies. Given that the prospective PLR or LR needs to disclose information, not only in relation to himself but, if he is partner in a firm, also the other partners, and the firm itself (as indicated in footnote 57 to paragraph 3.21), there could be situations where, for example, a partner of the prospective PLR's/LR's firm, or the

firm itself, is a creditor or debtor of a peripheral subsidiary company and this fact could be inadvertently overlooked.

It is noted that under the existing law, a prospective LR is not required to attend the first creditors' meeting at which his appointment would be considered. As such, he may not be present in person to answer questions raised by creditors about the information disclosed to them. In order to deal with this loophole, we recommend that there should be a requirement for a prospective PLR or LR to attend the first creditors' meeting to answer questions about any disclosable relationships.

(c) Do you agree that a statutory defence as proposed in paragraph 3.24 should be provided for a failure in disclosure?

The proposed statutory defence should be provided if a statutory disclosure system is to be introduced.

Q11 (a) Do you agree that the existing prohibition on inducement being offered to members or creditors in relation to the appointment of liquidators should be extended to cover inducement being offered to any person?

Subject to our comments below, we agree that the existing prohibition on inducement should be extended to cover any inducement being offered to any person instead of only to the members and creditors.

There are two exceptions in the HKICPA's Professional Ethics in Liquidation and Insolvency to the prohibition on offering or paying commissions (section 500.65). These are:

(a) An arrangement between an IP and his practice's employee whereby the employee's remuneration is based in whole or in part on introductions obtained for the IP through the efforts of the employee.

(b) Change of appointment resulting from transfer/sale of an existing practice due to, e.g., the sale or merger of an insolvency practice or retirement of the outgoing IP (owner of the practice).

We believe that the proposal does not intend to cover these two types of situations and we certainly consider that they should not be caught by any such prohibition. Accordingly, care would need to be taken in the drafting of the relevant provisions to avoid inadvertently catching situations such as these.

(b) Do you agree that the prohibition should also be extended to inducement offered in relation to the appointment of provisional liquidators, receivers, and receivers and managers?

We agree that the prohibition should be extended to the appointment of PLRs, receivers, and receivers and managers.

Q12 Do you agree with the proposal to designate all provisional liquidators who take office upon and after the making of a winding-up order (i.e. section 194 PL) as “liquidators” such that they will be subject to the provisions in the CO which apply to liquidators?

No, we do not agree with the proposal, which we believe will perpetuate and exacerbate any existing confusion, particularly given that, as we understand it, the proposal does not simply involve a change in terminology, but also a change in the powers of appointment takers, depending upon the office they hold and the circumstances of their appointment; for example, a s.194(1A) LR will have different powers from a s.193 PLR who becomes the LR after the winding-up order has been made.

After the making of a winding-up order by the court, the s.194 PLR's appointment as a LR would still need to be confirmed at the first creditors' meeting. It would create more confusion if a s.194 PLR is designated as LR and assumes the powers of an LR before his appointment is confirmed at the creditors' meeting. It would put the former type of LR in an invidious position. He will have the full authority and powers of an LR and will be expected to take action accordingly. However, as he has not been confirmed by the creditors, and eventually may not be appointed, this would put the LR in office appointed immediately after the winding up order has been made at greater risk of being challenged by any successor LR who is appointed at a creditors' meeting.

At the same time, it could, potentially, disincentivise the s.194 LR from calling an early creditors' meeting (given that the creditors may wish to appoint a different LR) and increase the risk of abuses, e.g., allowing assets to be sold off at less than market value to shareholders or directors.

Instead, we would suggest, retaining the status quo, which is well understood and works effectively. Currently, the powers of a PLR are contained in the order of the court and are generally limited to preserving the assets, before an LR is appointed at the first creditors' meeting. This is a more accountable procedure. In specific cases, where necessary, the court may grant the PLR the power to sell assets.

The current problem appears to be that the differences between the roles of the s.193 PLR and the s.194 PLR are not expressly reflected in the present law, and that it is not entirely clear in certain provisions of the CO that make reference to PLRs, which type of PLR is the subject of the relevant provision. We believe that a more appropriate way to address the problem is to provide greater clarity in the law regarding the existing arrangements, rather than changing the process in ways that are likely to create further confusion.

Q13 Do you agree with the proposal to clearly stipulate that it is up to the court to determine the powers, duties, remuneration and termination of appointment of provisional liquidators who were appointed by the court before the making of a winding-up order (i.e. section 193 PL)?

Yes, we agree with the proposal.

Q14 Do you agree with the proposal of setting out the powers of liquidators now found in section 199(1) and (2) of the CO in a Schedule to improve the clarity of the provisions?

Yes, we agree with the proposal.

Q15 Do you agree that the requirement for the liquidator to apply to the court or the COI for exercising the power to appoint a solicitor in a court winding-up should be removed, provided that prior notification is given to the COI or, where there is no COI, the creditors when the liquidator exercises such power?

Yes, we agree with the proposal, subject to providing an option to the LR to allow him to apply to the court to exercise the power to appoint a solicitor where there is no COI.

Q16 (a) Do you agree that, notwithstanding the release of a liquidator by the court, the liquidator should not be absolved from the provisions of section 276 of CO?

We do not agree with this proposal, although, superficially, it may seem to benefit the interests of other stakeholders. This proposal, if implemented, would have significant implications on the liability of LRs, put LRs in a very difficult position once they have ceased practice and may serve to actively discourage professionals from taking up appointments and entering the profession.

Among the reasons for our objections are the following:

- A court appointed LR is an officer of the court and acts under its supervision.
- An LR can obtain release only if there are no objections from the creditors, contributories, the Official Receiver, other persons interested against the release of the LR, or the court. If there are any doubts, the release can be withheld and under s.205(2), upon application of any interested person, "the court can make such order as it thinks just", charging the LR with the consequences of any act or default which he may have done or made contrary to his duty. It needs to be emphasised that a liquidation case can sometimes continue for several years, providing ample opportunity for interested parties to consider whether there are grounds to object to the release and apply for action to be taken against the LR.
- As indicated in paragraph 3.40, under s.205(2), an order for release can be revoked at any time "on proof that it was obtained by fraud or by suppression or concealment of any material fact". Accordingly, if an LR has acted dishonestly or engages in misfeasance and seeks to cover this up, under the existing law, the release can be revoked.
- The position of an LR is different from other professionals. An LR has no contract with a particular client and acts in the interests of the body of creditors as a whole. There may be many different types of stakeholders involved in a liquidation and the nature of an LR's work is that he often needs to negotiate and reach compromises. He has to pursue actions against debtors and investigate the causes of the failure. Inevitably, not all stakeholders will be happy with the situation and some may look for someone to blame. This puts an LR in a vulnerable position.
- The LR's liability is personal. He cannot set up a limited liability vehicle through which he offers his services, as most other professional can. As noted in paragraph 3.41, under the law on limitation periods in Hong Kong, a claim may be made in negligence, for example, up to six years from the date on which the cause of action accrued, or three years from the date of knowledge, if that period expires later than the afore-mentioned six years.

- When an IP retires and leaves a firm, he would not normally be covered by the professional indemnity insurance ("PII") policy of the firm. Also, when a LR changes his employer firm, he would not continue to be covered by the PII policy of his previous employer firm on subsequent liability arising from cases closed during his employment with the firm. The PII policy of his new employer firm would not normally cover his liability arising from cases closed before he joined the firm. Even if an LR's firm has "run-off" cover, it would normally be of limited duration and it is not clear that this would cover the LR personally. It is also noted that bond cover ends after an LR is released. This uncertainty in relation to subsequent liabilities and the lack of PII protection would expose LRs to a very high level of personal risk. As such, an LR may either have to continue to purchase PII for an indefinite period (if that is possible, which is unlikely) or face the continuing threat of the risks associated with the many appointments that he may have taken up.

- The supposed safeguard for LRs, that the power to make an application to have the LR's release revoked should be exercisable only with leave of the court, is no real safeguard, except again blatantly frivolous or vexatious actions. If there is any possibility of sustaining a case against an LR, a court would not have grounds to deny an application and the court would not be in a position to investigate the validity of details of the claim. In other words, this proposal could open up a whole new area of negligence claims by disgruntled stakeholders who feel hard done by in a liquidation, which an LR would not be able to predict and against which he would have little protection.

- It would also mean than an LR would not safely be able to dispose of the books and records of a company after release, but instead may feel compelled to retain indefinitely and store, at his own cost, the records from, potentially dozens, if not hundreds of cases, in order to be in a position to be able to defend himself against possible future claims.

- This high and increasing level of personal risk faced by IPs will certainly give cause to some young professionals to re-consider whether insolvency practice is a worthwhile career. In the long run, this will be detrimental to the further development of the profession.

- It should be clear from the above that, when this proposal is considered in its entirety, it is no small matter and we believe that is not sufficiently justified. As indicated above, there is already provision under s.205(2) for a release order to be revoked under certain conditions. There may be scope to look in more detail at the specific wording of that provision, to ensure that it is effective and can be invoked in a reasonably straightforward manner, in the event of dishonesty or serious misconduct. However, we strongly oppose the proposal as currently framed.

- We would also add that we are not aware of any cases where interested parties have raised serious concerns that they have been prevented from taking action against miscreant LRs, because the LRs have obtained their release and issues came into light only after their release.

(b) Do you agree that, where the court has granted a release to a liquidator, the power to make an application under section 276 should only be exercisable with the leave of the court?

See our answer to Q16(a).

Q17 Do you agree with the proposed technical amendments relating to the appointment, powers, vacation of office and release of provisional liquidators and liquidators as set out in Annex C?

Yes, we agree with the relevant proposed technical amendments set out in Annex C.

Chapter 4 CONDUCT OF WINDING-UP

Q18 Do you agree that a maximum and a minimum number of members should be set for the COI appointed in both a court winding-up and a creditors' voluntary winding-up? If so, are the proposed maximum number (seven) and minimum numbers (three) appropriate? Do you agree that the court should have the discretion to vary the maximum and minimum numbers on application by the liquidator?

Yes, we agree that a maximum and a minimum number of members should be set for the COI. We also agree that the court should have the discretion to vary the maximum and minimum numbers on application by the LR.

Q19 Do you agree to allow the COI not to fill a vacancy if the liquidator and a majority of the remaining members of the COI so agree, provided that the total number of members does not fall below the proposed minimum number?

Yes, we agree.

Q20 Do you agree to the proposals as set out in paragraphs 4.12 and 4.13 for streamlining and rationalising the proceedings of the COI?

While we agree with the proposals set out in paragraphs 4.12 and 4.13, as we understand that a written notice by the liquidator to members of the COI can be given by electronic means, we suggest that this should be made clear in the law. We would like to make the following suggestions to further streamline and rationalise the proceedings of the COI: (i) To introduce a mechanism allowing a COI to dispense with the audit requirement for LR's accounts, e.g., by passing a resolution in the beginning of the process, which the COI could subsequently revoke by giving notice to the LR. (ii) The current wording of the COI certificate, which requires the COI to certify that the LR's accounts are full, true and complete, may deter some COI members from signing off on the certificate. Rather than a certification by the COI, as in the current Forms 86 and 88, it is suggested that COI be required to review the accounts and that the accounts can be taken as accepted if no committee member has any objection.

(iii) To consider reducing the number of permissible absences from COI meetings under s.207(5) of the CO, so that the office of a COI member will be vacated if he/she is absent from three consecutive meetings of the committee without the leave of other members (instead of five consecutive meetings currently specified in s.207(5)).

(iv) To provide for COI meetings to be conducted using dial-in or video conferencing facilities.

Q21 Do you support the proposal to enable the COI to function through written resolutions sent by post or using other electronic means (such as using emails or through websites)?

Yes, we support the proposal and agree that resolutions should be able to be passed in the manner suggested and that a majority decision by the COI should be sufficient to pass a resolution.

Q22 (a) Do you agree with allowing the costs and charges of the agents employed by the liquidators to be determined by agreement between the liquidator and the COI?

Yes, we agree.

(b) Do you agree that if such agreement cannot be reached, the costs and charges of the agents shall be delivered up or taxation by the court?

Yes, we agree.

Q23 Do you support the proposal to allow liquidators and provisional liquidators to communicate with creditors, contributories or other parties by electronic means, subject to the conditions as set out in paragraph 4.21?

We welcome the proposal to provide PLRs/ LRs with the flexibility to communicate with creditors, contributories or other parties by electronic means. They should be permitted to seek the recipients' agreement to receiving communications electronically on a continuing (not only case by case) basis, subject to the right of recipients to opt out and receive printed communications again, if they so wish. The current wording of paragraph 4.21 is ambiguous in this regard.

In practice, LRs usually do not have a complete list of creditors to enable them to issue the proposed notice/circular, in particular in the early stage of administration. Therefore, we recommend the following possible arrangements be considered:

(i) PLRs/LRs should be able to specify in the notice of appointment published in the Government Gazette and filed with the Companies Registry that it is their intention to deliver notices or documents by electronic means (e.g., using email or through websites).

(ii) PLRs/LRs should specify in the notice of appointment details of designated email addresses and websites for communication purpose, including the contact details which may be used to request hard copies of notices or documents.

(iii) PLRs/LRs should provide hard copies of the notice or document upon receiving a written request from the intended recipient.

It is further suggested that the standard proof of debt form be modified to allow creditors to opt to receive future correspondence from LRs by electronic means, by providing a designated email address. If they wish to opt out again in future and receive hard copies of communications, they may do so.

Q24 Do you agree with the proposed technical amendments relating to the conduct of winding-up as set out in Annex C?

Yes, we agree with the relevant proposed technical amendments set out in Annex C.

In addition, as regards proposal #13, we should like to reproduce the comments that were made in our submission of 7 February to the Financial Services and the Treasury Bureau. We submitted that s.265 should be completely redrafted and simplified in order to make the preferential provisions understandable, using the following basic underlying principles:

- The priority of payment of creditors' claims in a liquidation should be dealt with in a linear order (rule 179 needs further clarification).
- All references to specific amounts should be excluded from this section and should be placed in subsidiary legislation, such as a separate schedule or the rules, to facilitate future revisions.
- The number of classes of priority creditors should be reduced for specific debts. This would better reflect the principle of *pari passu* than is presently the case.
- Debts within each class should "rank equally among themselves" (*pari passu* principle).
- Debts within the class should be paid in full, unless the assets are insufficient to meet them, in which case they should be abated in equal proportions among themselves.
- It would be beneficial to merely allow as the preferential claim an amount in total which is outstanding to employees. This amount may be made up of holiday pay, severance pay, wages, etc., due as at the date of liquidation. This would further simplify calculation of priorities and ensure that set limits are also easy to understand and amend in the future.

We do not suggest that there should be any changes in the preferential status of any of the classes of creditors, although consideration could be given to removing the government's preferential status, as has been done in the UK.

It is noted that the Employees Compensation Assistance Fund ("ECAF") is a preferential creditor under s.265(1)(ea). There are also other compensation schemes providing protection against insurer insolvency in Hong Kong, e.g., the Insolvency Fund Scheme administered by the Motor Insurers' Bureau of Hong Kong, which provides insolvency protection in relation to motor vehicle policies and the Employees Compensation Insurer Insolvency Scheme, administered by the Employees Compensation Insurer Insolvency Bureau ("ECIIB"), which provides insolvency protection in relation to employee compensation policies.

However, not all of these funds are paid in priority to other creditors under s.265 of the CO, where they have compensated the policyholder following the insolvency of an insurer. Under the ECIIB's agreement with the government, for example, it is expressly stated (clause 7(f)) that where the ECIIB has "an entitlement against the estate of the [insolvent] Insurer, ECIIB shall only rank as an ordinary, non-preferential creditor against that estate". The ECAF, on the other hand, is categorised as a preferential creditor, under s.265, for the subrogated rights of policyholders whom the scheme has compensated. There appears to be some inconsistency here and we suggest that the ECAF's preferential status should be reconsidered.

S.265(5B) provides that the court may, on the application of the OR or LR or relevant creditor, make an order as it deems just, to distribute the assets and the amount of the expenses recovered, to give those creditors who indemnified the cost of recovering such assets and expenses an advantage over others, in consideration of the risk run by them in doing so. In order to encourage creditors to fund the recovery of assets, it is suggested that this provision be extended to empower the court to allow prospective applications, and so enable creditors to consider whether to fund an LR, taking into consideration the potential benefits.

We consider that the legislation should be amended to allow the fees of a LR to be paid out of the realisations of floating charge assets, as opposed to the current situation in Hong Kong, which follows the English authorities established by the decision in Buchler v. Talbot. Subsequent to this decision, legislation was introduced in the UK to nullify its effects, but as the decision was affirmed by the court of first instance in Hong Kong, in the case of Good Success Catering Ltd., Hong Kong is now bound by this interpretation.

In relation to the law regarding "destinations of recovery" of office holder actions, there are English cases that have held that recoveries from "office holder actions" (i.e. unfair preference and insolvent trading) do not form part of the company's assets. As such recoveries are not the company's assets, LRs cannot use them or assign them to raise funds to finance litigation under s.199(2)(a). At present, it is not clear how a preference action could be funded. We suggest that the legislation should clarify the position, rather than having to follow the case law principles, which are unnecessarily technical and complicated.

Chapter 5 VOIDABLE TRANSACTIONS

Q25 (a) Do you agree that new provisions should be introduced to empower the court to make orders for restoring the position of a company to what it would have been if the company has not entered into a transaction at an undervalue?

Yes, we agree.

(b) Do you agree to the proposal regarding “relevant time” as proposed in paragraph 5.10?

Yes, we agree.

(c) Do you agree that transactions at an undervalue entered into by the company with a person who is connected with the company should be subject to a more stringent control as proposed in paragraph 5.11?

Yes, we agree.

(d) Do you agree that statutory protection should be provided for the party seeking to resist an application made by the liquidator of a company in respect of the undervalue transaction? If so, do you agree with the statutory protection as proposed in paragraph 5.12?

Yes, we agree.

Q26 (a) Do you agree that the current provisions in the CO incorporating the provisions in the BO on unfair preference should be replaced by new standalone provisions which apply to winding-up cases as proposed in paragraph 5.17 to rectify the existing anomalies which limit the application and effectiveness of such provisions?

Yes, we agree.

(b) Do you agree with the definitions of "person who is connected with a company" and "associate" as proposed in paragraphs 5.19 and 5.20?

While we have no objection to the definitions as proposed in paragraphs 5.19 and 5.20, we have the following observations:

(i) We are of the view that "major shareholders" and "controlling shareholder" should also be considered to be "a person who is connected with the company". While we understand that paragraph 5.20(f) could be interpreted as covering these parties, presentationally, it is not entirely clear because these parties would normally be viewed from the perspective of being associates of the company (to which reference is made in paragraph 5.19(b)), rather than from the perspective of the company being their associates, which is the focus of paragraph 5.20(f). This is primarily a matter of the drafting in the final legislation.

(ii) We suggest that a person is an associate of an individual if that person is accustomed to act in accordance with the individual's directions or instructions.

(c) Do you agree that the existing protection for persons who have received benefits or acquired or derived interest in property in good faith and for value from unfair preference should be maintained, and that the same protection should also be applicable to the proposed new provisions on transactions at an undervalue?

Yes, we agree.

Q27 Do you agree to the proposed special provisions in relation to floating charges created by a company in favour of a person who is connected with the company as detailed in paragraph 5.26?

Yes, we agree.

Q28 Do you support the expansion of the scope of the exemption of a floating charge from invalidation catered for genuine credit transactions to cover "property and services supplied to the company" and "money paid at the direction of the company" as detailed in paragraph 5.28?

While we support the expansion of the scope of the exemption of a floating charge from invalidation to cater for genuine credit transactions, we are concerned that "property or services supplied to the company" could include convertibles or other derivative products which may or may not have a true value. Care should be taken in the drafting to ensure that the creation of complex synthetic transactions, of no real underlying value to the company, would not be able to benefit from the exemption.

We recommend, therefore, the imposition of some additional conditions, for example, that the charge is created on an arm's length basis for a genuine commercial purpose, and the property or services supplied to the company are of true value and/or of commercial benefit to the company.

Chapter 6 INVESTIGATION DURING WINDING-UP, OFFENCES ANTECEDENT TO OR IN THE COURSE OF WINDING-UP AND POWERS OF THE COURT

Q29 (a) Do you agree to expressly set out in the legislation the common law position that a person summoned for either a private or a public examination cannot invoke the privilege against self-incrimination during the examination?

We do not have any objection to this proposal, although we believe that, in practice, the existing case law is clear enough and there is no pressing need for change.

(b) If so, do you agree that we should introduce provisions to prohibit the subsequent use of answers given and statements made during the examination in subsequent criminal proceedings if certain conditions are satisfied, subject to certain exceptions such as offences relating to perjury and provision of false statement and offences under the future Companies (Winding Up and Miscellaneous Provisions) Ordinance?

This seems to provide a reasonable balance, if the privilege against self-incrimination is to be removed.

Q30 (a) Do you agree to the removal of the requirement that the OR or the liquidator must have alleged in his “further report” that fraud has been committed for initiating the public examination procedure, and to provide that a public examination may be ordered by the court upon the application by either the liquidator or the OR?

We agree.

(b) Do you agree with the proposed new categories of person that may be examined under the public examination procedure, namely (i) any person who has acted as liquidator of the company or receiver or receiver and manager of the property of the company; and (ii) any person who is or has been concerned, or has taken part, in the management of the company?

We agree.

Q31 (a) Do you agree that if a company is wound up insolvent within one year of its shares being redeemed or bought back by payment out of capital, certain categories of persons should be required to contribute to the assets of the company for an amount not exceeding the payment made by the company in respect of the shares redeemed or bought back by the company so as to meet the deficiency in the company’s assets?

We recommend that there should be different provisions for private and public companies.

For private companies, we suggest that the relevant period should be extended from within one year to within two years of the shares being redeemed or bought back by payment out of capital. The proposed two-year period is in line with the relevant time for unfair preferences.

For public and, in particular, listed companies the focus should be primarily on substantial shareholders as defined under the Securities and Futures Ordinance (Cap 571).

(b) If so, should the members from whom the shares were redeemed or bought back and the directors who made the solvency statement which supported the redemption or buy-back without having reasonable grounds for the opinion expressed in the statement be jointly and severally liable to contribute to such assets?

While we agree, in principle, we are concerned about the implementation aspects. While it may be easier to trace the members from whom the shares were redeemed or bought back in the case of private companies, there would be practical difficulties in doing so for public companies, in particular, listed companies. It would not be practical to recover the money from retail investors or make them jointly and severally liable for the amount that they have received.

This indicates that there may need to be different provisions for private and public companies. As regards public companies, it is suggested that the proposal apply only to substantial shareholders.

(c) Should such persons be allowed to apply for winding-up of the company under the specific grounds as set out in paragraph 6.22?

Yes, we agree.

Q32 Do you agree with the proposed technical amendments relating to the investigation during winding-up, offences antecedent to or in the course of winding-up and powers of the court as set out in Annex C?

We agree to the relevant proposed technical amendments set out in Annex C, subject to the following comments:

Proposal #15 –

(i) We would like to clarify that the proposal to provide that the PLR or the LR may require a person to submit a statement of concurrence is only an alternative, and it does not preclude the PLR or LR from requiring a person to provide a statement of affairs.

(ii) We would like to clarify whether the PLR or the LR is expected to comment on the statement of concurrence, in the same manner as a statement of affairs.

(iii) We suggest a statement of concurrence should by sworn be affidavit, as with a statement of affairs, so that similar sanctions would apply in the case of dishonest statements.

Proposal #18 –

It is suggested that an application under s. 221 many also be made by a PLR.

--- END ---

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

7 February 2012

Our Ref.: C/RIFEC, M816010

Mr. Darryl Chan
Deputy Secretary for Financial Services
and The Treasury (Financial Services)3
Financial Services and Treasury Bureau
15th Floor, Queensway Government Offices
66 Queensway
Hong Kong

Dear Darryl,

Review of the Law Relating to Corporate Insolvency

--- Please find attached a set of proposals from the Hong Kong Institute of CPAs on reviewing and updating the law relating to corporate insolvency in Hong Kong.

Following recommendations on broader policy matters, the submission examines in more detail the winding up provisions of the Companies Ordinance and related matters. The Institute's comments and recommendations are set out in serial order of the relevant provisions.

Separately, the Restructuring and Insolvency Faculty of the Institute is looking at the issue of possible licensing of insolvency particulars and we may in due course have additional proposals in this regard.

If you have any questions on our submission, please give me a call.

Yours sincerely,

Peter Tisman
Director, Specialist Practices

PMT/ay
Encl.

c.c. Miss Au King Chi, JP
Permanent Secretary for Financial Services and The Treasury (Financial Services)

Ms. Teresa Wong
Official Receiver's Office

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓
Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603
Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

Hong Kong Institute of Certified Public Accountants
Restructuring and Insolvency Faculty ("RIF")
Recommendations for Improvements to the Winding-up Provisions of the Hong Kong Companies Ordinance

PART A – RECOMMENDATIONS ON POLICY ISSUES

1. Introduction of a single piece of insolvency legislation to include all matters relevant to winding-up, receivership and bankruptcy

There are numerous examples within the winding-up provisions where cross-references are made to the provisions of the Bankruptcy Ordinance ("BO") or its subsidiary legislation.

It is proposed that Hong Kong should consider introducing a single piece of insolvency legislation to bring together all insolvency and insolvency-related matters, including corporate rescue and insolvent trading provisions, and also section 60 of the Conveyancing and Property Ordinance, which is commonly used by liquidators to recover assets if the disposals are conducted with the intent to defraud creditors. A stand-alone Insolvency Ordinance would provide a comprehensive legal framework for insolvency in Hong Kong, help align definitions, where at present some terms are defined slightly differently in different pieces of legislation, and avoid the necessity of making frequent cross-references. Consolidation would also reduce the time needed to search for the relevant provisions and make Hong Kong insolvency law easier to follow. The United Kingdom ("UK")'s Insolvency Act 1986 ("IA"), which contains provisions on receivership, bankruptcy, winding-up, voluntary arrangements and administration of companies, could be a model for this.

As regards the layout of the separate insolvency ordinance, if it is considered to be appropriate, there could be different sections dealing with different types of insolvency, e.g., one part on bankruptcy, another part on company windings-up, etc.

We understand the winding-up provisions will remain in the residual part of the existing Companies Ordinance ("CO") upon the enactment of the new Companies Bill. This could form the basis of a separate insolvency ordinance.

On the other hand, if, ultimately, it is decided not to propose a separate insolvency ordinance, we would suggest that the remaining parts of the existing CO should be amended to become a stand-alone Companies (Winding Up) Ordinance, which will to avoid the necessity having to cross-refer to the BO in conducting company windings-up (e.g., in relation to section 264 of the CO on the application of the bankruptcy rules and sections 266 and 266B on fraudulent and unfair preferences).

2. Implementation of UNCITRAL model law to deal with cross-border aspects of insolvency engagements

Implementation of the United Nations Commission on International Trade Law ("UNCITRAL") Model Law should be part of the update of the CO, to facilitate

insolvency and restructuring procedures relating to Hong Kong companies with assets overseas and overseas companies with assets in Hong Kong. Legislation based on the model law has now been adopted in around 20 jurisdictions, including the United Kingdom, Australia, New Zealand, the United States, Canada, Japan and South Africa.

There are express provisions in the Mainland's Enterprise Bankruptcy Law to deal with cross-border aspects of insolvency cases. This is true of insolvency legislation in many other countries. One such example is s.426 of the IA, which gives recognition to co-operation between courts in other countries or territories exercising jurisdiction in relation to insolvency. Given that the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap. 597) specifically excludes bankruptcy/ insolvency-related judgments, it is recommended that the law in this regard (i.e., the cross-border aspects, both inbound and outbound, of insolvency cases) should be clarified and codified.

On the practical level, channels of liaison with the relevant authorities on the Mainland, and in other overseas jurisdictions should be developed, to facilitate the recognition of liquidators appointed in Hong Kong, amongst other things.

3. Compulsory/Voluntary Liquidation Procedures

There are numerous examples within the existing legislation where administrative procedures for a compulsorily liquidation are different to those for a voluntary liquidation. Examples include those relating to payment of dividends, committees of inspection and proofs of debt.

As far as possible, it would be advantageous to have similar procedures for voluntary and compulsorily liquidations.

PART B – RECOMMENDATIONS ON INDIVIDUAL PROVISIONS OF THE CO

We have reviewed the recommendations for specific changes to the winding-up provisions of the CO contained in the 1999 report of the Law Reform Commission, "*The Winding-up Provisions of the Companies Ordinance*" ("LRC report"). Although the LRC report was published 13 years ago, a number of the recommendations in it remain relevant today. Where appropriate, we make reference to the relevant recommendations below.

S.178 Definition of inability to pay debts

We support the LRC's recommendation that a statutory demand under section 178(1)(a) of the CO should be in a prescribed/standard format. It is suggested that the form under this provision should mirror section 6A of the BO, requiring certain particulars, similar to those set out in the Bankruptcy Rules, to be contained in a valid statutory demand.

As regards the minimum debt amount under section 178(1)(a), it is recommended that the amount should be subject to regular review. It is further suggested that the amount be specified in subsidiary legislation, so that it will be easier to amend in future. We note that the small claims limit is now $50,000. The minimum debt on which a petition can be

presented, which currently stands at $10,000, should be reviewed and may need to be increased.

We also support the LRC's recommendation for the codification of both the cash-flow test and balance-sheet test to determine whether a company is insolvent (see also IA, s.123).

S.183 Avoidance of attachments
S.186 Actions stayed on winding-up order

We support the LRC's recommendation that the principles of sections 183 and 186 be applied to a creditors' voluntary winding-up in that the *pari passu* principle should be upheld. The provisions applying to the various types of liquidations should be harmonised as far as possible.

S.193 Appointment and powers of provisional liquidator

As regards the powers of provisional liquidators ("PLs"), we support the LRC's recommended approach that a standard framework or set of powers be provided in the statute, either in a schedule or in a rule (i.e., subsidiary legislation) in order to facilitate future changes. In addition, the PL would still have the right to apply to the court for additional powers that may be tailored to specific situations. At the moment, the PL's powers are specified only in the order appointing the PL and any subsequent changes, in variations to the order. In future, if the PL's basic powers are specified in the law, it would be helpful if these were in a bilingual form. It would also be useful to have an official Chinese translation of any court order providing for additional powers granted to the PL.

In relation to the specimen powers of a PL, referred to in the LRC report, we do not share the LRC's view that the power to close down a business, which is a business decision, should be a matter for the sanction of the court.

S.194 Appointment, style, etc., of liquidators

We do not support the LRC's recommendation for the introduction of the concept of an “interim liquidator” as we think it would result in unnecessary confusion.

We consider that the views of the creditors should take priority over those of the contributories in a compulsory winding-up, where they differ as to who should be appointed liquidator. Any objection to the appointment by the creditors should be made to the court within, say, 14 days. Under the present system, where there is a difference of opinion between the creditors and the contributories as to nomination of the liquidator, there is often a considerable delay in the confirmation of the liquidator's appointment due to the necessity of a determination hearing. We consider that the creditors’ nomination should immediately be appointed as the liquidator with the option for dissenting contributories to apply to court if they are unhappy with the decision. This could be achieved by the order for the liquidator’s appointment not taking effect until 14 days after the date of the submission of the Official Receiver (“OR”)’s report on the outcome of the meeting to the court. In the interim, the OR should remain as the PL until the appointment of a liquidator by court order.

It is suggested that substantial creditors should be allowed to require that the OR's Office ("ORO") convene a meeting rather than allocating the case to the ORO's panel scheme for contracting out liquidation work. Furthermore, it is suggested that creditors be allowed to nominate a PL at the time the court makes a winding-up order, instead of the OR automatically becoming the PL and allocating the job out to the next firm on the roster. This would save both time and costs. As such, section 194(1) should be amended to give the court the discretion to appoint a liquidator of the creditors' choosing if it is satisfied with the creditors' representation; otherwise, the existing procedure would be followed. It is further suggested that in cases where there are competing nominations by different creditors, the court should be able to hear the respective representations and decide.

It is noted that a creditor whose claim exceeds 10% of the total debt by value can request the OR or liquidator to call a creditors' meeting by paying a small fee. It is suggested that the amount of the fee should be reviewed, with criteria to determine how the amount should be charged. This should also be amended to allow such a request to be made of a PL appointed under section 194(1A). At the moment, the rules regarding the costs of convening the meeting are unclear.

S.195 Provisions where person other than OR is appointed liquidator

This section provides that where someone other than the OR is appointed liquidator, he must, among other things, provide security to the satisfaction of the OR. Both the amount of security and the way in which security is given are determined by the OR. The cost of a security bond constitutes a significant expense for the liquidator, which under the existing law is not recoverable from the assets of the company.

The Institute understands that, to date, no cases have ever triggered the OR to make a call on a bond. However, if it is decided to retain a requirement for this specific type of security, we would support the LRC's recommendation that the cost of a security bond be regarded as an expense of the winding-up, which can be recovered from the assets of the company.

To enhance transparency and consistency, the OR should also be asked to develop and disclose clear criteria for determining the level of the security requirement.

As an alternative to requiring individual bonds, as a matter of practice, the OR should also be able to accept a "global bond", i.e., a single bond to cover all cases handled by an individual insolvency practitioner ("IP"), in respect of which cover can be adjusted either up or down as he is appointed to new cases and/or released from completed cases.

S.196 General provisions as to liquidators

We generally agree with the LRC's recommendations that there should be separate sections for the resignation, removal and remuneration of liquidators.

We also share the LRC's view that, at present, the process for a liquidator to resign, as provided for in the Companies (Winding-Up) Rules, is time-consuming and costly. We agree that the process should be simplified, especially in the circumstance where an IP is replaced by another IP within the same firm, due to, for example, a change in personnel or retirement of the former IP. We consider that a liquidator should be able to resign without the need to

hold a meeting of creditors. However, he must obtain the approval of the court. If the resignation is going to result in a previously unconnected IP from another firm being appointed, we consider that a meeting of creditors should be held.

In relation to remuneration of liquidators' agents, there is an anomaly in the legislation. During the provisional liquidation period, under section 193, the PL's fees are approved by the court, whilst the PL has the power to scrutinise and approve the fees of his agents. However, following his appointment, the fees of a liquidator can be approved by the committee of inspection ("COI"), whilst the fees of his agents have to go through the taxation process. Given that the COI can approve the fees of a liquidator, and the PL can approve the fees of his agents, we do not see why the COI cannot also approve the fees of the liquidator's agents. This would be likely to encourage more solicitors to offer insolvency-related services. At the moment, many are discouraged from doing so by the potentially lengthy delays in the payment of their fees caused by the taxation process. We recommend a change in the legislation to allow the COI to approve the fees of the agents appointed by the liquidators. However, in cases where there is no COI, the fees of the liquidator's agents would still need to be taxed in the same way as those of the liquidator. This should give sufficient comfort to all stakeholders regarding the control of the agents' fees.

We further suggest that as far as possible, there should be consistency between creditors' voluntary liquidations ("CVLs") and compulsory liquidations regarding the procedures for the appointment of agents and the agreement and payment of their fees.

S.199 Powers of liquidators

As regards whether a PL appointed under section 194(1A) should have the power to dispose of assets without waiting for appointment as liquidator, we are of the view that, as the private sector PL under section 194 is an officer of the court, and he is on a list of tenderers approved by the OR, he should be able to dispose of the assets. Whilst it is not suggested that the existing practice whereby a PL appointed under section 194 is required to seek the OR's approval for such a disposal has given rise to any problems in practice, codification of PL's power in this regard would be helpful.

It is further suggested that the powers of liquidators (section 199 for court windings-up ("CWUs") and section 251 for CVLs) should be standardised as far as possible and set out in a separate schedule to the ordinance. The powers, duties and responsibilities of liquidators under CWUs and CVLs are substantially the same. However, we consider that it would be useful to specify not only the powers of a PL/ liquidator but also any approvals required for the exercise of those powers in a CWU and a CVL.

S.202 Payments of liquidator into bank or Treasury

We consider that the word "forthwith" in subsection (2)(b) is ambiguous; and suggest that it should be replaced by "within 28 days" or "not later than 28 days after its receipt" (with a consequential amendment to the number of days specified under subsection (2)(a)).

It is noted that for bankruptcies and compulsory liquidations in the UK, a liquidator must pay in all money received into the Insolvency Services Account ("ISA") in carrying out his IP functions, without deduction, once every 14 days, or immediately if he receives £5,000 or

more (Regulations 5 and 20 of the Insolvency Regulations 1994 refer). For CVLs, a liquidator may pay money into the ISA where this is convenient. However, it was announced last year that the ISA facility for CVL cases would be withdrawn with effect from 1 October 2011. This means that as of 30 September 2011, no new ISA accounts will be opened in CVLs. The decision was made following a consultation exercise conducted in 2010 and in view of the continuing decline in the number of voluntary liquidation ISA estates. This recent development in the UK insolvency law is also worth considering in Hong Kong.

S.203 Audit of liquidator's account

We agree with the LRC's recommendation that the prescribed forms used in sections 203 and 284 should be simplified and the forms should be regularly reviewed and updated.

We further submit that the existing format of the section 203 accounts should be simplified as it can be very confusing for creditors. The current wording of the COI certificate, which requires the COI to certify that the liquidator's accounts are full, true and complete, may be a deterrent to some COI members to sign off on the certificate. Rather than a certification by the COI, as in the current Forms 86 and 88, it is suggested that COI be required to review the accounts and that the accounts be taken as accepted if no committee member has any objection.

We also agree with the LRC's recommendation that the requirement to send a summary of accounts to every creditor and contributory should be replaced by a provision facilitating creditors and contributories to obtain a summary on request. As an alternative, consideration should be given to replacing the existing delivery method with a more cost-effective method. This could be achieved by, for example, section 203(5) being amended to provide flexibility for liquidators to send the accounts to creditors and contributories by electronic means; or to post the accounts on the liquidator's website for inspection. This, together with simplification of the standard forms, would lead to a higher level of transparency and greater clarity of disclosure. It is noted that the CO has been changed to allow companies to communicate with shareholders by electronic means. This could be extended to liquidators, who communicate with stakeholders on behalf of the company.

S.206 Meetings of creditors and contributories to determine whether a COI should be appointed

We agree with the LRC's proposals regarding holding meetings, i.e. section 206(1) should be amended to delete the reference to the obligation on the first meeting of creditors and contributories to determine whether or not a COI should be appointed. An alternative provision should be added to provide that a liquidator may call subsequent meetings for the purpose of appointing a COI.

A liquidator should also have the power to convene a creditors' meeting for the replacement of existing members and/or appointment of additional members to the COI, and such replacement and appointment should subject to court sanction. However, it is too onerous to require the resignation of a COI member or co-option of a member to fill a casual vacancy of the committee to have to follow such procedures.

We support, in principle, the LRC's recommendation that a COI should be able to function through written resolutions sent by post or by electronic means. However, we believe that a majority view should be sufficient rather than having to obtain 100 percent approval, otherwise this could create practical difficulties.

We also support the LRC's recommendation that directors of a company being wound-up by the court or in a CVL should be obliged to attend meetings of creditors, if required to do so by the PL and be available to comment on the company's affairs and answer questions, if necessary. It is further suggested that there should be appropriate penalty imposed on a director who fails to fulfil this obligation, e.g., a possible disqualification order.

S.207 Constitution and proceedings of COI
S.243 Appointment of COI

We suggest that the number of members for the COI should be a minimum of three and a maximum of five for all types of liquidations, both voluntary and compulsory, but that this number could be varied by the court, if it thinks fit.

Section 207(5) – we suggest reducing the number of consecutive meetings from which a COI member may be absent from five to three before his office is deemed to be vacated.

Section 207(7) – The liquidator should have the discretion not to fill the vacancy in the COI without applying to the court, if he is of the opinion that it is unnecessary for the vacancy to be filled.

S.209A Power of court to order winding-up to be conducted as creditors' voluntary winding-up

We consider that, at some stage during the liquidation process, there may be merit to converting a winding-up by the court to a CVL, which would subject to fewer procedures and generally save costs. It is suggested that the relevant provisions should be revised to allow a liquidator or a creditor, based on the merits of the case, to present a conversion proposal for consideration at a meeting of creditors, at any stage during the liquidation process, and not to restrict conversion proposals to being considered only at the first meeting of creditors/ contributories, as is currently the case.

Once the conversion proposal has been passed at a meeting, an application for conversion will still have to be submitted to the court for its approval.

S.211 Delivery of property to liquidator

We support the LRC's recommendation that "*any contributory, trustee, receiver, banker, agent, or officer of the company"* in this section should be replaced by *"any person"* who possesses or controls assets of the company. The IA equivalent is s.234, which provides that "*any person"* who possesses or controls assets of the company may be required by the court to hand over the assets.

We further suggest that this provision should apply to all kinds of liquidations, including where a PL has been appointed.

S.227A Court may make a regulating order
S.227B Appointment of liquidator and committee of inspection

It seems that there is an inconsistency between sections 227A and 227B in relation to bringing an application to the court for a regulating order. Although it appears that the legislation envisages that such an application can be made by the OR or the liquidator/PL, section 227B refers to the OR only.

In the Guangnan (KK) Supermarket Ltd case (HCCW 618/2001), it was noted by Hon Yuen J that:

> "*It is clear under Section 227A that a private provisional liquidator may make the application to the court for a regulating order. Section 227A(2) also says that where a regulating order is made, Section 227B shall apply to the winding up. However, Section 227B(1) says expressly that the court may "on the application of the Official Receiver" by order dispense with the summoning of first meetings of creditors and contributories, etc. It would appear therefore that under Section 227B, a literal interpretation of the express provisions of sub-section (1) would restrict the application under Section 227B to one made by the Official Receiver and not by a private provisional liquidator. … It may well be that the draftsman was not aware of certain other provisions when he drafted Section 227B(1) to refer to the Official Receiver only, but be that as it may, in light of the express provision of Section 227B(1), it seems to me that there was at least a substantial query as to the Provisional Liquidators' locus standi. ... … I am told by the Official Receiver that the attention of the law draftsman will be brought to what would appear to be an unnecessary distinction between Section 227A and Section 227B. …*"

We recommend that the inconsistency between the two sections be resolved.

S.228A Special procedure for voluntary winding up of company in case of inability to continue its business

It is suggested that consideration be given to easing the circumstances in which this section can be used. There are still situations in which it would be beneficial to be able to make use of this section, but many professionals have expressed the view that it is virtually impossible to utilise it because of the restrictive amendments made in 2000, i.e., the additional condition that directors should resolve at a meeting that the winding-up should be commenced under section 228A, because it is not reasonably practicable for the winding-up to be commenced under another section of the CO. If there are no reasonable grounds to justify such a resolution, the directors will be liable to a fine and imprisonment.

While we recognise that it has been suggested that there need to be safeguards against its abuse, we are not aware of any evidence of abuse arising from this section in the past. We suggest removing the above condition introduced in 2000 and reverting to the earlier version of the provision, i.e., the directors must state that there are good and sufficient reasons for the winding-up to be commenced under section 228A.

As an additional safeguard, there could be a provision to restrict the power of the PL to certain activities before the meetings of the company and of the creditors, similar to s.166 of the IA. This means that a liquidator appointed by the company will have no power to do

anything other than take control of the assets, dispose of perishable goods and do such other things as may be necessary for the protection of the company's assets, until such time as his appointment has been confirmed by the creditors at a meeting of creditors.

S.241 Meeting of creditors

We do not have any strong view on the LRC's recommendation to replace this section by a provision like s.98 of the IA, which provides that the company shall summon a meeting of creditors for a day not later than the fourteenth day after the day of passing the resolution for voluntary winding-up.

The statement of affairs should disclose prescribed information by reference to a schedule in the ordinance. At present the amount of information disclosed by private sector IPs when convening such meetings varies considerably. Creditors have a right to expect that a minimum level of information should be provided so that they can make an informed decision.

S.251 Powers and duties of liquidator in voluntary winding-up

We consider that there should be more statutory clarity as to the powers of a liquidator appointed under section 228A (see also sections 199 and 228A, above), and that the powers of liquidators in different types of liquidation should be placed together in subsidiary legislation (e.g., in a schedule to the ordinance or in rules).

S.264 Application of bankruptcy rules in winding-up of insolvent companies

We reiterate our support for the LRC's recommendation that the winding-up provisions of the CO, the provisions on receivership under the CO, the provisions on provisional supervision (when they are introduced), and the BO should be combined in one ordinance.

It addition, we are of the view that cross-referencing between the CO and the BO should be discontinued. Confusion is caused by random cross-referencing to the BO, for example, in relation to proof of debts. Section 184 states that the winding-up of a company commences at the time of the presentation of the petition, suggesting that debts have to be incurred before that date to be provable. However upon closer inspection, section 264 of the CO provides that the law of bankruptcy applies to, amongst other matters, provable debts. If reference is then made to section 34 of the BO, it is found that, in fact, it is debts incurred prior to the date of the order, and not the date of filing the petition, that are provable.

As corporate insolvency is different to bankruptcy, we recommend that there should be separate provisions to deal with issues such as proofs of debt, dividends, meetings of creditors, associates and other areas in the CO, where presently definitions are imported from the BO. Furthermore, these should apply to all types of liquidations unless there are exceptional circumstances.

S.265 Preferential payments

The Institute's submission on the LRC's 1998 consultation paper expressed the view that this section is very complicated and cumbersome, and in particular, the insurance provisions cause significant difficulties. We maintain this view and propose that this section should be completely redrafted and simplified in order to make the preferential provisions understandable, using the following basic underlying principles:

- The priority of payment of creditors' claims in a liquidation should be dealt with in a linear order (rule 179 needs further clarification).

- All references to specific amounts should be excluded from this section and should be placed in subsidiary legislation, such as a separate schedule or the rules, to facilitate future revisions.

- The number of classes of priority creditors should be reduced for specific debts. This would better reflect the principle of *pari passu* than is presently the case.

- Debts within each class should "rank equally among themselves" (*pari passu* principle).

- Debts within the class should be paid in full, unless the assets are insufficient to meet them, in which case they should be abated in equal proportions among themselves.

- It would be beneficial to merely allow as the preferential claim an amount in total which is outstanding to employees. This amount may be made up of holiday pay, severance pay, wages, etc., due as at the date of liquidation. This would further simplify calculation of priorities and ensure that set limits are also easy to understand and amend in the future.

We do not suggest that there should be any changes in the preferential status of any of the classes of creditors, except that the government's preferential status should be abolished, as there appears to be no good reason to retain it. The preferential status of the government has been removed in the UK.

It is noted that the Employees Compensation Assistance Fund is a preferential creditor under section 265(1)(ea). There are also other compensation schemes providing protection against insurer insolvency in Hong Kong, e.g., the Insolvency Fund Scheme administered by the Motor Insurers' Bureau of Hong Kong, which provides insolvency protection in relation to motor vehicle policies and the Employees Compensation Insurer Insolvency Scheme, administered by the Employees Compensation Insurer Insolvency Bureau ("ECIIB"), which provides insolvency protection in relation to employee compensation policies.

However, not all of these funds are paid in priority to other creditors under section 265 of the CO, where they have compensated the policyholder following the insolvency of an insurer. Under the ECIIB's agreement with the government, for example, it is expressly stated (clause 7(f)) that where the ECIIB has "an entitlement against the estate of the [insolvent] Insurer, ECIIB shall only rank as an ordinary, non-preferential creditor against that estate". The Employees Compensation Assistance Fund ("ECAF"), on the other hand, is categorised as a preferential creditor, under section 265, for the subrogated rights of policyholders whom

the scheme has compensated. There appears to be some inconsistency here and we suggest that the ECAF's preferential status should be reconsidered.

Section 265(5B) provides that the court may, on the application of the OR or liquidator or relevant creditor, make an order as it deems just, to distribute the assets and the amount of the expenses recovered, to give those creditors who indemnified the cost of recovering such assets and expenses an advantage over others, in consideration of the risk run by them in doing so. In order to encourage creditors to fund the recovery of assets, it is suggested that this provision be extended to empower the court to allow prospective applications, and so enable creditors to consider whether to fund a liquidator, taking into consideration the potential benefits.

We consider that the legislation should be amended to allow the fees of a liquidator to be paid out of the realisations of floating charge assets, as opposed to the current situation in Hong Kong, which follows the English authorities established by the decision in Buchler v. Talbot. Subsequent to this decision, legislation was introduced in the UK to nullify its effects, but as the decision was affirmed by the court of first instance in Hong Kong, in the case of Good Success Catering Ltd., Hong Kong is now bound by this interpretation.

In relation to the law regarding "destinations of recovery" of office holder actions, there are English cases that have held that recoveries from "office holder actions" (i.e. unfair preference and insolvent trading) do not form part of the company's assets. As such recoveries are not the company's assets, liquidators cannot use them or assign them to raise funds to finance litigation under section 199(2)(a). At present, it is not clear how a preference action could be funded. We suggest that the legislation should clarify the position, rather than having to follow the case law principles, which are unnecessarily technical and complicated.

S.266B Fraudulent preference deemed to be an unfair preference

We are of the view that this section needs to be reviewed. The provisions should not rely on cross-referencing to the BO, particularly in relation to the definition of "associates" of companies. We consider that the provisions on "associates" should be tailored to fit the needs of the CO. At present, it is doubtful whether even a director is regarded as an associate for the purpose of the “desire to prefer”.

It is noted that very few cases in Hong Kong can be pursued under this section, as it is very difficult to prove the intent – "desire to prefer" – which is a subjective element. Indeed, it is probable that many cases have simply not been brought before the courts because of the problems with the definition of "associate" and its importation from the BO.

We consider that the legislation should be amended to match more closely the law in Australia, where there is no necessity to establish the “desire to prefer” as in the Hong Kong law. Rather, if payments have been made during the relevant period, they are automatically recoverable by a liquidator, with the onus on the recipients to show that they were not preferred.

We support the LRC's recommendation for introduction of provisions on transactions "at an undervalue" into the CO. This concept would apply where a company makes a gift to a

person, or otherwise enters into a transaction with that person, on terms that provide for the company to receive no consideration or a consideration that is significantly less than the actual value of the subject of the transaction. The court should be empowered to make an order to restore the position to what it would have been had the company not entered into the transaction. The provisions of s.423 to s.425 of the IA could provide a useful reference.

We also consider that the provisions for transactions "at an undervalue" should include transactions "at an overvalue", i.e., where an insolvent company has purchased assets at an inflated price, as the effect on the company would be similar.

S.267 Effect of floating charge

In order to improve clarity, we propose that the phrase “within 12 months of the commencement of the winding up” be replaced by “within 12 months after the commencement….". We also suggest that the term "property" in this section be replaced by "anything valuable, including properties, securities, services, secret formulae, tangible and intangible assets, reduction of debts, loans and any type of liabilities, or something people would pay for".

We support the LRC's recommendation that:

- the effect of the provision should be extended from 12 months to two years in the case of persons who are connected to the company (which would follow a similar provision under s.245(3) of the IA).

- a provision along the lines of s.245(2)(b) of the IA should be introduced, to the effect that the value of consideration which consists of the discharge or reduction, at the same time as, or after, the creation of a charge, of any debt of a company, should not be treated as invalid.

S.273 Frauds by officers of companies which have gone into liquidation

To be consistent with section 267, we suggest that the term "property" in this section be replaced by "anything valuable, including properties, securities, services, secret formula, tangible and intangible assets, reduction of debts, loans and any type of liabilities, or something people would pay for".

We propose that the level of fines under this section be increased and kept under review to ensure fines are adjusted in line with inflation and prevailing economic circumstances. In addition, the consequence of the serious crime of fraud should not be a fine only, but also a penalty to compensate the company and creditors. The latter penalty should be as determined by the court.

S.283 Disposal of books and papers of company

We propose that the level of fines under this section should be raised and be kept under review to ensure fines are adjusted in line with inflation and prevailing economic circumstances.

The inconsistency between section 283(2), which requires that books and records be kept five years from the dissolution of the company, and section 121(3A), which provides that any books of account that a company is required to keep must be preserved by it for seven years, from the end of the financial year in which the last entry was made, should be resolved.

S.295 Separate accounts of particular estates

It is noted that section 295(4) requires an amount equal to 1½ per cent per annum of the amount invested under this section to be paid to the credit of the OR, while the balance should be paid to the credit of the company. The percentage required to be paid to the OR is high, given the very low bank interest rates over the past few years, and given that the situation is likely to remain the same for some time. We suggest that the percentage charged by the OR should be adjusted in line with the market interest rate (perhaps by linking it to a percentage of the interest actually earned). To enhance flexibility, it is further suggested that the rate be specified in subsidiary legislation as opposed to the primary legislation.

Hong Kong Institute of CPAs
February 2012