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

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

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Mr. Patrick Ho, JP
Deputy Secretary for Financial Services
& the Treasury (Financial Services)3
Financial Services and the Treasury Bureau
15th Floor, Queensway Government Offices
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Dear Patrick,

**Corporate Rescue Procedure – Framework of Proposals**

The Restructuring and Insolvency Faculty of the Hong Kong Institute of Certified Public Accountants ("the Institute") appreciates being given the opportunity to provide further comments on the proposed corporate rescue procedure and framework ("CRP"). Following our meeting with representatives from the Financial Services and the Treasury Bureau ("FSTB") and the Official Receiver's Office ("ORO") on 30 April 2014, we should like to reiterate and expand on our views on a few specific matters.

Before turning to the detailed issues, we should like to confirm our long-standing support for the introduction of a statutory corporate rescue procedure. We also support the introduction of insolvent trading laws in Hong Kong, which will encourage companies and their directors to seek help when they face severe financial difficulties, rather than continuing to trade as before and to run up ever larger debts, which they have no real prospect of being able to pay. We believe that the legislation on CRP and insolvent trading should be a priority item and be introduced together with the new corporate insolvency law.

The Institute's views on some of the more specific issues discussed at the meeting on 30 April, are indicated below.

*1. Definition of "major secured creditor"*

There is an issue in relation to the current proposed definition of "major secured creditor" ("MSC"). As indicated in our submission of 4 February 2010 in response to the consultation on legislative proposals for a CRP ("2010 submission"), under the current definition, the holder of, for example, a third or fourth charge over the company's property, who in practice, would be unlikely to be able to enforce his security, owing to the insufficiency of the company's assets, would seem to fall within the definition of MSC. Such a creditor could, therefore, stand in the way of a proposal for a provisional supervision ("PSN") and, potentially, hold the process to ransom. It is not clear how the situation could be resolved where, for example, the holder of the first or second charge agrees to PSN, while a creditor with a more tenuous security does not. A lack of specific provisions for alternative means of resolving conflicts or

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uncertainties could result in the need for the involvement of the court more frequently than envisaged, which would defeat one of the objectives of PSN, that is, to minimise court intervention.

At the meeting on 30 April, we suggested that MSC be defined to exclude those who have no real economic interest in the company's property, i.e., those creditors beyond the first charge holder, who would otherwise fall within the definition, but who have no reasonable prospect of being able to enforce their security, outside of PSN. This will inevitably involve some judgment. The judgment could be left to the company and prospective provisional supervisor ("PS")/ (provisional) liquidator, with provision for an aggrieved creditor to be able to apply to the court for an appropriate order.

In addition, there may be an issue of who is a MSC in the case of e.g., a company with assets and creditors dispersed in various different jurisdictions. In practice, there may be no single MSC.

*2. Qualification to be a PS*

Although not all lawyers or qualified accountants would have the relevant experience and expertise to take up appointments as PS, especially in relation to large companies, as a minimum requirement, it is a reasonable starting point, in the initial stages of a CRP regime, to specify that members of relevant regulated professions in Hong Kong, namely certified public accountants ("CPAs") and solicitors holding practising certificates, should be eligible to take up appointments. However, this should be kept under review and we would suggest that encouragement be given to practitioners to build up relevant experience and obtain more specific qualifications. In this regard, consideration should be given to referencing the Institute's specialist qualification and designation in insolvency as a relevant benchmark for PS and other insolvency office holder appointments.

As indicated in our 2010 submission, we would also suggest that, for persons other than CPAs and solicitors, the OR should consider setting up a panel of persons with other appropriate qualifications and experience, who may accept appointments as PS (e.g., insolvency practitioners licensed in major overseas markets or possessing relevant experience in corporate restructuring or voluntary workouts). Suitable procedures would need to be introduced for dealing with complaints and imposing sanctions against panel members, including, potentially, removal from the panel. An appeal mechanism for applicants who consider their application to join the panel have been wrongly declined may also need to be considered.

We suggest that consideration might also be given to permitting persons who are not able to satisfy requirements to be on the OR's panel, but who might have industry-specific or other skills enabling them to act as an effective PS in relation to specific cases, to be able to apply to court for appointment as a PS on an exceptional basis, and subject to the OR expressing no objection.

*Conflicts of interest*

In the context of the proposals for the updating of corporate insolvency law, we expressed some doubts and concerns about an eligibility regime for office holders based around conflicts, including a list of those relationships that would bar a person

from taking up office and another list of relevant relationships that are merely discloseable to creditors. We note that a similar framework is proposed for CRP and so we would refer you to our previous comments in this regard. We also note that, while there is a reference to an auditor of a company being one of those parties who is ineligible to be appointed as PS, there is no reference to the legal advisers of a company being ineligible. This seems to be an inconsistency.

*3. Personal liability of PS*

We have all along questioned the rationale and reasonableness of imposing a statutory personal liability on a PS and we would start by reiterating this position. However, in relation to the proposal in the CRP, that a PS would be personally liable for new contracts entered into by him after his appointment and for the pre-appointment contracts adopted by him, if this proposal is maintained, it should be made clear in the law that, in relation to pre-appointment contracts, a PS would assume personal liability only for those that he has positively adopted by notification in writing. He should not be deemed to have adopted any contracts simply by lapse of time or because, out of necessity or expediency, he has continued payments on particular contracts (e.g., for rentals, utilities or necessary supplies).

In addition, from a practical perspective, where there is a change in PS, such as where the PS is replaced by creditors, there should be a clear statutory priority of indemnities, such that the liabilities and fees of the outgoing PS should be prioritised over the future liabilities of the incoming PS. If a suitable arrangement is not provided for in law, an outgoing PS may feel constrained to terminate all the contracts for which he is personally liable, in order to crystallise his liabilities at the time of leaving office. This would not be helpful to the company or creditors.

*4. Pre-appointment contacts (including contracts with employees)*

We suggest that there should be "anti-avoidance" provisions in the law to govern onerous contracts entered into by the company with associated persons, within a certain period of time, say, six months, prior to the commencement of PSN. The PS should be able to apply to court to have such contracts set aside.

*5. When the liquidation should be deemed to have commenced if the eventual outcome of a PSN is a winding-up of the company*

We are of the view that, if the outcome of a PSN at the final meeting of creditors is that the company will be wound up, the liquidation should be deemed to have commenced on the date on which the PS was appointed. According to the proposed timetable, it is likely to be only a few weeks between the appointment of the PS and liquidation, if liquidation is the eventual outcome of a PSN.

*6. Voting at creditors' meeting*

It is noted that, under the currently proposed CRP framework, for passing a resolution to approve or modify a voluntary arrangement, it would require that:

(i) a majority of the creditors present and voting have voted in favour of the resolution; and

(ii) those voting in favour hold more than $66^2/_3$ per cent of the total value of the creditors voting; and

(iii) no more than 50 per cent in value of those creditors who are not connected with the company have voted against it.

The requirement under sub-paragraph (i) above, in effect, brings back the "headcount test", which differs from the consultation conclusions released in July 2010 (paragraph 126(x) on page 34), where the conclusion is not to provide for the headcount test in the voting at meetings of creditors.

We consider that the situation of companies facing financial distress is different from solvent restructurings and questions of how best to protect the interests of minority shareholders. We do not see the need for a headcount test to be adopted in creditors' meetings under the CRP. No such test is applied in the case of individual voluntary arrangements ("IVAs"). However, if the headcount test is dropped, we would recommend that in relation to value, the threshold for those voting in favour should be increased to 75 per cent of the total value of the creditors voting. A 75 per cent requirement would be consistent with that for IVAs. If the headcount test is to be retained, on the other hand, the value threshold should remain as it is under sub-paragraph (ii) above, that is, $66^2/_3$ per cent of the total value of the creditors voting.

*7. Other matters*

As regards the time periods to be allowed for various actions under the legislation, as far as possible, references in the CRP to "days", "calendar days", "business days", etc., should be standardised.

If you have any questions on this submission or wish to discuss it further, please contact me at the Institute on 2287 7084.

Yours sincerely,

Peter Tisman
Director, Specialist Practices

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