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

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

4 February 2010

Our Ref.: C/RIF, M68531

Division 4, Financial Services Branch
Financial Services and the Treasury Bureau
15/F Queensway Government Offices
66 Queensway
Hong Kong

Dear Sirs,

Re: Review of Corporate Rescue Procedure
Legislative Proposals

Please find attached the comments of the Hong Kong Institute of Certified Public Accountants on the proposals set out in the above-referenced consultation paper.

We support the introduction of a statutory corporate rescue procedure in Hong Kong and believe that this should now be a priority item. Our submission includes additional technical and detailed suggestions in relation to some of the proposals which, in our view, will help to facilitate the rescue process.

The Institute also supports the introduction of legislative provisions on insolvent trading and considers that these form an important part of the overall framework for corporate rescue.

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

Yours faithfully,

Peter Tisman
Director, Specialist Practices

PMT/ML/ay
Encl.

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Reply Form for the Consultation on Review of Corporate Rescue Procedure Legislative Proposals

1. The purpose of this reply form is to facilitate providing views and comments on the Consultation Paper entitled Review of Corporate Rescue Procedure Legislative Proposals ("Consultation Paper") published by the Financial Services and the Treasury Bureau ("FSTB") on 29 October 2009.

2. The Consultation Paper can be downloaded from the FSTB's website at http://www.fstb.gov.hk/fsb

3. If you have any views or comments on the Consultation Paper, you are welcome to complete this reply form and return it to us on or before **28 January 2010** by one of the following means:

By mail or hand delivery to:	Division 4, Financial Services Branch Financial Services and the Treasury Bureau 15/F, Queensway Government Offices 66 Queensway Hong Kong Re: **Consultation Paper on Review of Corporate Rescue Procedure Legislative Proposals**
By fax to:	(852) 2869 4195
By e-mail to:	corporate_rescue@fstb.gov.hk

4. Any questions about this reply form may be addressed to Miss Sandy CHAN of FSTB, who can be reached at (852) 2867 5844 (phone), (852) 2869 4195 (fax) or corporate_rescue@fstb.gov.hk (email).

5. Submissions will be received on the basis that we may freely reproduce and publish them, in whole or in part, in any form, and use, adapt or develop any proposal put forward without seeking permission or providing acknowledgment of the party making the proposal.

6. Please note that names of respondents, their affiliation(s) and comments may be posted on the FSTB's website or referred to in other documents we publish. If you do not wish your name and/or affiliation to be disclosed, please state so when making your submission. Any personal data submitted will only be used for purposes which are directly related to consultation purposes under this consultation paper. Such data may be transferred to other Government departments/agencies for the same purposes. For access to or correction of personal data contained in your submission, please contact Mr WONG Wing-hang, Assistant Secretary for Financial Services and the Treasury (Financial Services), who can be reached at (852) 2867 5465 (phone), (852) 2869 4195 (fax), or whwong@fstb.gov.hk (email).

PART A: GENERAL INFORMATION OF THE RESPONDENT

Name/Name of Organisation	: Hong Kong Institute of Certified Public Accountants
If organisation, name and title of Contact Person	: Peter Tisman, Director, Specialist Practices *(Please fill in if the respondent is a company or organization)*
Phone Number	: 2287 7084
E-mail Address	: peter@hkicpa.org.hk

If you do not wish to disclose your affiliation or name to the public, please check the box here:

☐ Our organisation does not wish to disclose our name.

☐ I do not wish to disclose my name.

PART B: DETAILED QUESTIONS FOR RESPONSE

You may provide your views or comments on all or any of the questions. If the provided space is insufficient, please attach additional pages.

Question 1

Do you agree with the proposed procedural changes relating to initiation of provisional supervision in paragraphs 2.4 to 2.6 above? If not, please provide reasons and suggest alternatives.

Paragraph 2.4 – We agree that there is no need to file the notice of appointment of provisional supervisor ("PSR") and the specified documents with the Official Receiver ("OR"). However, given that court involvement may be required, at a later stage, for granting extensions of the moratorium (paragraph 3.8 refers) or for other reasons, we consider that the notice of appointment and documents should also be filed with the High Court, in addition to the Registrar of Companies. This would also be likely to give creditors and other interested parties earlier notice than notices in newspapers that provisional supervision (PSN") has been initiated and would enable them take legal action, such as seeking an injunction, if need be.

It should be clarified what documents need to be filed. We note from footnote 10 on page 13 of the consultation paper ("Paper") that, under the 2001 bill, the relevant documents included a notice of an affidavit of the relevant directors or members, inter alia, confirming that the company has dealt with the entitlements owed to its former and existing employees under the Employment Ordinance ("EO"). Presumably, this confirmation will no longer be required under the currently proposed arrangements, at least not in the case of Alternatives A or B, outlined in chapter 4 of the Paper.

Paragraphs 2.5 and 2.6 – We agree with the proposed procedural changes referred to in these paragraphs.

Question 2

Do you see any need for other changes to the initiation of provisional supervision, including who may initiate the procedure? If so, please elaborate on the suggested changes and reasons.

We do not see any need for other changes to the arrangements for initiation of PSN.

It is noted that some other jurisdictions, such as the United Kingdom ("UK"), Australia and Singapore, allow creditors or major secured creditors to apply for corporate rescue procedures. We would suggest that if creditors are allowed to apply for PSN, they should be required to obtain the court's sanction to do so, in order to avoid potential abuse. We suggest that this issue be kept under review for the time being. Once the corporate rescue regime has been operating for a period, it will be easier to assess whether it is practical and desirable to allow other parties to initiate the procedure.

Question 3

Do you agree that the notice of appointment of provisional supervisor should be published in the local newspapers on the same day as the date on which the last document is filed with the Registrar of Companies? If you prefer additional or alternative means of publishing the notice of appointment, please describe and explain.

The notice of appointment of a PSR should be published in the local newspapers as soon as practicable. However, it may not be feasible to arrange for the notice be published on the same day as the date on which the last document is filed with the Registrar of Companies ("filing date"). For a notice to appear in the newspaper on the filing date, it will have to be confirmed at least a day before the filing date and, therefore, technically, before the notice of appointment has been lodged. This could create problems as there may be reasons preventing the last document from being filed on the expected date. As such, we believe that it would be more practical to require that the notice of appointment of the PSR be published in the newspaper on the next day or the next business day after the date on which the last document is filed with the Registrar of Companies.

This is another reason why, in our response to question 1 above, we consider it to be preferable for the notice of appointment of the PSR and the specified documents to be filed with the court in addition to the Registrar of Companies. The judiciary and the Companies Registry could also be requested to post on their respective websites a list of the companies in relation to which notices of appointment of a PSR have been filed, as soon as practicable after the receipt of such documents. This would also help to alert creditors and stakeholders who may be outside of Hong Kong.

Question 4

Do you support an initial moratorium period of 45 days? If not, please suggest alternatives and explain.

Yes, we support an initial moratorium period of 45 days.

Question 5

Do you support the proposal to allow for extension of the moratorium up to a maximum period of six months from the commencement of provisional supervision, subject to approval by the creditors at a meeting of creditors? If not, please explain and suggest alternatives.

Yes, we support the proposal but there should also be a general provision in the law giving aggrieved parties a right to apply to the court for redress (with additional measures to discourage frivolous or vexatious actions).

Question 6

Do you agree with the proposal to allow for extension of the moratorium beyond six months only upon court approval? If not, please explain.

While we agree with the proposal that court approval should be required, it is not clear from the Paper (paragraph 3.8) whether the PSR would require creditors' consent before applying to court for an extension of the moratorium beyond six months. As PSN is primarily a creditor-driven procedure, it would be logical for creditors' approval also to be required for any extension of the moratorium to beyond six months.

Question 7

If your answer to Q6 is yes, do you agree that any court extension should not exceed a maximum of 12 months from the commencement of provisional supervision? If not, please explain and suggest alternatives.

We recognise that in exceptional circumstances, the PSN process for a large and complicated group may take longer. It is believed that creditors' consent together with the court's sanction would provide effective control over extending the moratorium. Therefore, instead of restricting the moratorium to a maximum of 12 months, it is

suggested that any extension of the moratorium beyond 12 months from the commencement of PSN should be subject to approval by the creditors at a meeting and the sanction of the court, which appears to be akin to the procedure available in the UK (footnote 19 on page 19 of the Paper refers). We believe that, under this arrangement, the interests of the creditors and the company could continue to be served even when the extension of the moratorium exceeds 12 months.

Question 8

Does the list of contracts and agreements which should be exempted from the moratorium, as set out at Appendix, need to be revised? If so, please suggest and explain.

Presumably, transactions executed under the contracts or agreements set out in the Appendix to the paper will be subject to the conditions stipulated under clause 11(5) of the Companies (Corporate Rescue) Bill 2001, i.e., where such a contract or agreement "entered into by the company before the relevant date is terminated on or after that date:

(a) the setting-off of obligations between the company and the other parties to the contract or agreement, in accordance with its provisions, shall be permitted; and

(b) if net termination values determined in accordance with the contract or agreement are owed by the company to another party to the contract or agreement, that other party shall be deemed for the purpose of this Ordinance and, where applicable, any subsequent winding up of the company to be a creditor of the company with a claim provable in respect of those net termination values."

Question 9

Which of the above three options (namely, the 2003 Proposal, Alternative A or Alternative B) would you prefer? Please explain. If you have any suggestion to refine any of the above three options, please describe and explain. If you prefer another alternative, please describe and explain.

Alternative A will in effect allow a single disgruntled employee to prevent the rescue proceeding and would undermine the aim of the moratorium, which is to give a company a breathing-space protection from creditors. Employees represent one of the main categories of interested parties in a rescue and it would therefore be illogical for them not

to be participants in it. It would also potentially give individual employees disproportionate bargaining power in relation to, e.g., demands to be retained. It is likely that any employees not retained would expect to have the debts due to them from the employer immediately satisfied in full. This amounts to giving employees a substantial preference over all other creditors. This in turn may make other creditors unwilling to enter into a rescue agreement as they would believe that they would be worse off than in a liquidation if they are in effect subsidising the employees benefits. Although it is likely to be impossible for the employer to settle all outstanding liabilities with employees from the point of view of cash in hand or available from any external source, even if cash were available, any money used by the employer to pay workers' entitlements will deny the maximum flexibility to the rescue process, which is essential to save the business.

Alternative B would, in principle, be more workable than Alternative A. However, because of the personal liability faced by the PSR for contracts retained by him and the extensive nature of the employees' entitlements, he would in effect be compelled to terminate the contacts of all employees and offer to rehire only those he wished to keep on. In addition, similarly to Alternative A, it may make substantial creditors and potential providers of additional funds reluctant to participate in a rescue if they felt that the first call on the company's existing and future resources would be to pay off all EO entitlements to employees.

We would suggest that other possible sources of funding for employee entitlements accruing up to until the commencement of the PSN should also be explored. The PWIF would be one obvious option. It is suggested that the PWIF should provide a source of funds for EO entitlements accruing up to until the appointment of a PSR (up to the level of the existing caps in a liquidation), and the PWIF should then have subrogated claims in the PSN for any monies paid out.

Expansion of the scope/ambit of the PWIF, as suggested above, may require additional funding. We would suggest that the government implements a mechanism to guarantee top-up of the required funding if and when necessary.

In addition to the above, it is suggested that the mechanisms for funding employee entitlements in corporate rescue procedures elsewhere (e.g., the UK, Australia and Singapore) should also be examined.

Question 10

Independent of which of the above options is adopted, what are your views on the treatment of outstanding employers' MPF scheme contributions?

We are of the view that the treatment of outstanding employers' MPF scheme contributions should follow the requirements stipulated in the MPF legislation.

Question 11

Do you agree with the proposal that solicitors holding a practising certificate issued under the Legal Practitioners Ordinance (Cap 159) and certified public accountants registered in accordance with the Professional Accountants Ordinance (Cap 50) may take up appointment as provisional supervisors?

Given that currently there is no specific professional qualification or licensing system for professionals engaged in restructuring and insolvency operations in Hong Kong, and in order to expedite the introduction of a corporate rescue regime to Hong Kong at this time, we agree that, at the first stage of its implementation, it should be provided that certified public accountants ("CPAs") registered in accordance with the Professional Accountants Ordinance (Cap 50) and solicitors holding a practising certificate issued under the Legal Practitioners Ordinance (Cap 159) may take up appointment as PSRs. In practice, however, not all qualified accountants and lawyers would have the relevant experience and expertise to take up appointments as PSRs, especially in relation to large companies.

At the same time, the experience or background required for each case could vary widely depending on the type of business and the circumstances of the company in question and therefore, other than specifying certain minimum requirements, the suitability and appropriateness of the PSR be left for the directors and creditors to decide.

You may wish to note that the Hong Kong Institute of Certified Public Accountants ("the Institute") is currently developing a specialist professional qualification, which it is envisaged will form the basis of a specialist designation or accreditation awarded by the Institute in the practice of insolvency and restructuring. The Institute's diploma in insolvency programme, which is currently being run, is undergoing assessment by an independent and notable expert in the insolvency field. As part of this process, a number of enhancements have been made and it is hoped that the diploma programme will be granted the status of the Institute's first specialist qualification. It is a taught, examination-based course, which is open to both members and non-members of the

Institute. The additional experience and other criteria required for the specialist designation are also being discussed. While initially, it is envisaged that the designation will be open only to members of the Institute, primarily because there will be a level of quality assurance and regulation attaching to it, in the longer term, the intention is to explore the possibility of opening the designation to insolvency practitioners who are not members of the Institute but who meet the admission criteria for the designation.

The minimum requirements for PSRs should be kept under review. We believe that the Institute's specialist professional qualification and designation will become suitable benchmarks for PSRs and other insolvency office holders.

Question 12

Do you think that other persons without the above qualifications could also be appointed as provisional supervisors on a case-by-case basis? If so, should such an appointment be made by the OR or the court? Please elaborate, in particular on the appeal channel in case of aggrieved applicants and on the associated investigatory and disciplinary regime in case of complaints against appointed persons.

We would 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 could accept appointments as PSR (e.g., insolvency practitioners authorised (licensed) under the Insolvency Act 1986 in the UK or registered (licensed) by the Australian Securities & Investments Commission under the Corporations Act 2001, 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.

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

Question 13

Do you agree with giving creditors the choice to replace the provisional supervisor appointed by the company or its directors or the provisional liquidators or liquidators of the company and approve the remuneration of the provisional supervisor at the first meeting of creditors to be held within 10 working days from the commencement of provisional supervision? If not, please elaborate on the reasons and suggest alternatives.

We agree with the proposal.

Question 14

Do you support imposing personal liability on provisional supervisors as proposed in paragraphs 5.14 to 5.17 above? If not, please suggest alternatives which would effectively address the issues set out under paragraphs 5.16(a) to (c).

We do not consider it necessary or desirable that a PSR should bear statutory personal liability when acting in accordance with his duties and/or terms of his appointment and we note that no such liability is imposed on the UK equivalent of a PSR. It is suggested that, in any event, PSRs should be able to obtain an indemnity from the assets of the company/be required to have professional indemnity insurance cover and should be able to contract out of personal liability by notifying counter-parties, otherwise the PSR might be seen as guaranteeing all the debts of the company. Moreover, PSRs should be exempted from criminal sanctions under the EO in the event that a voluntary arrangement proceeds but then subsequently fails, as a result of which the employees' residual entitlements cannot be paid out.

Paragraph 5.15 of the Paper states that the imposition of personal liability on the PSR is in line with personal liability currently imposed on a receiver or manager of the property of a company under the Companies Ordinance (Cap 32). We note that this latter liability is also qualified by section 298A(2) of the Companies Ordinance, which states that a receiver or manager will "*be personally liable on any contract entered into by him in the performance of his functions, except in so far as the contract otherwise provides, and entitled in respect of that liability to indemnity out of the assets;* …".

While we do not support the imposition of an unqualified statutory personal liability on PSRs, taking the proposal in the Paper at face value, we should like to clarify certain procedural issues arising from it , including the following:

- How would a PSR be able to discharge his liability in the situation where, for example, the creditors ultimately decide that they prefer to put the company into liquidation and want to appoint a liquidator other than the individual who is the PSR, or where a voluntary arrangement proceeds but then subsequently fails? Even if the voluntary arrangement proceeds as agreed, it is unclear as to what extent the PSR can transfer personal liabilities to, say, the supervisor of the voluntary arrangement.

- How and when will a PSR's liabilities cease? If a PSR cannot disclaim contracts that he has adopted or adopt them conditionally at the outset, what happens if, for example, the creditors do not agree that the company should be wound up where it is the PSR's recommendation that it should be?

- Under the situation where there is a change in PSR (e.g., he is replaced by creditors) what would be the respective personal liabilities of the incoming and the former PSR? Would the former PSR remain liable for contracts that he entered into even where the incoming PSR might have acted negligently resulting in the company's assets being insufficient to cover the former officeholder's indemnities? (In fact, it does not seem to be indicated in the Paper whether a PSR will be entitled to an indemnity from the assets of the company, as provided for in the 2001 Bill.) What are the respective priorities of the indemnities given to the former and the incoming PSRs? Would the former PSR be able to retain control over some of the company's assets to enable him to satisfy his liabilities or until he is sure that the liability has been discharged or transferred?

Question 15

Do you support the introduction of insolvent trading provisions? In case you do not, please explain and suggest alternatives to (a) encourage timely initiation of provisional supervision; and (b) deter irresponsible depletion of the company's assets.

We support the introduction of insolvent trading provisions.

Question 16

Do you agree with the proposed revised formulation of "insolvent trading"? If not, please suggest alternatives.

Yes, we agree with the proposed revised formulation of "insolvent trading".

Question 17

Do you agree with the way that "major secured creditors" was defined in the 2001 Bill? If you think any changes are needed, please elaborate and explain.

Generally, we agree with the way that "major secured creditors" was defined in the 2001 Bill, subject to the qualification below.

Under the definition in the 2001 Bill, it would appear that the holder of, for example, a third or fourth charge over the company's property, who in practice, would be unlikely to enforce his security owing to the insufficiency of the company's assets would nevertheless fall within the definition of "major secured creditor" and would therefore still be able to stand in the way of a proposal for a voluntary arrangement. It is not clear how the situation would be resolved if the holder of the first or second charge meanwhile agreed to the proposal. A lack of specific provisions for alternative means of resolving conflicts or uncertainties would result in the need for the involvement of the court more frequently than envisaged, and this would defeat one of the principles of PSN, which is to minimise court intervention. This will also be potential impediment to the success of the corporate rescue procedure, as a PSN will cease when a major secured creditor objects to it.

In view of the above, we would suggest "major secured creditor" be defined to exclude those who have no real economic interest in the company's property (i.e., those creditors that would otherwise fall within the definition in the 2001 Bill, but who have no reasonable prospect of receiving a distribution from the realisation of the property, outside of PSN). It is unlikely that, for example, the holder of a fourth charge over the company's assets would have the required economic interest, in most circumstances, and we would regard it as reasonable that such a charge-holder should not alone be able to prevent a proposal from proceeding.

Question 18

Do you support the proposal to largely follow the 2001 Bill approach with respect to protection of "major secured creditors" and other secured creditors' rights? If you think any changes are needed, please elaborate and explain.

While it is important that the process does not proceed too far before it is known whether major secured creditors will support it, three working days for major secured creditors to decide whether or not to participate in PSN is very tight – particularly since they are unlikely to have seen a draft proposal from the PSR within that time. However, if the period were to be extended to, e.g., seven working days, this would run up against the first meeting of creditors, which, under the proposals in the Paper, is required to be held within ten working days of the commencement of PSN. We would suggest, as a compromise, extending the period for major secured creditors to decide to, say, five working days.

Other than this point and the qualification in our response to question 17 above, we support the proposal to largely follow the 2001 Bill approach with respect to protection of "major secured creditors" and other secured creditors' rights.

Question 19

What are your views on retaining or removing the "headcount test" in the voting at meetings of creditors (i.e. requirement (a) stated in paragraphs 8.1 and 8.2 above) for resolutions to be passed at meetings of creditors?

We understand that the "headcount test" is a safeguard for the smaller creditors. However, as far as employees of the company are concerned, we do not see that this additional safeguard is necessary, as their interests are already well protected under the proposed corporate rescue regime.

From the perspective of PSRs, being able to obtain approval from the majority in value of the creditors, provided there is a quorum at the meeting, would reduce the cost of the rescue process, improve its efficiency, and increase the likelihood of success. It would not, in any case, be in the interests of PSRs to ignore the interests of smaller creditors, who, were they to feel aggrieved at their treatment, under our proposal (see the Institute's response to question 5 above), would be able to seek redress from the court.

- End -