THE LAW SOCIETY OF HONG KONG 香港律師會

# Insolvency Law Committee's Views on Review of the Role of the Official Receiver's Office Consultation Paper

General

1. The Committee considers the role of the Hong Kong Official Receiver's Office ("HKORO") should be regulatory and supervisory, not one whereby it has an additional role as a liquidator/trustee-in-bankruptcy of last resort. This function should be with the private sector, and should have been introduced a dozen years ago when the Panel A system was first established. Had this been feasible, the cab rank system would have been introduced in Hong Kong at an early stage. However, the accountancy firms successfully resisted this, on the basis that they would deal with the cream of the work, being liquidations with assets, but not wishing to take the low paying work, namely personal bankruptcies.

   Ideally, a transparent system should be introduced for Panel A legal work and for it to be allocated to qualified firms [of solicitors], with the requisite degree of skills and resources to handle such assignments on a rotational basis. Panel B allocation has been changed to open tender.

2. At the same time, the Committee also finds the consultant's comments at paragraph 2.21 very telling: "*Unlike both Australia and the U.S., Hong Kong has not historically had a significant volume of large cases under other forms of insolvency proceedings, such as administration and receivership that require and reward the skills and experience of highly qualified PIPs. Large liquidations in which assets and fees available materially exceed the HK$200,000 threshold are not common. Over 80% of compulsory liquidations in Hong Kong are summary cases and the majority of those have less than HK$50,000 in assets.*" The findings of the consultant were that it was debatable whether a sufficient mix would be available to persuade PIPs to participate in a rota scheme in the absence of a public subsidy. It seems clear that there is not a sufficient volume of large liquidations with assets to offer the prospect of cross-subsidising summary cases as well as the outsourcing of bankruptcies to the private sector. In light of the liquidation and the bankruptcies statistics since 1997 which appear at paragraph 2.1 and 3.1 of the report, it would appear that had the accountancy firms made an unqualified commitment to act as liquidator/trustee of last resort, they may not have had a sufficient margin from the lucrative work to subsidise the unprofitable work.
3. The report seems to accept too readily that because the Hong Kong system is based on the English system, we should follow what is done in England. This colonial mentality bedevils Hong Kong.

## Liquidations

4. There is no reason why HKORO has to retain certain cases to keep up its skills. A regulator does not have to be doing deals himself to understand how deals work. The answer to proper regulation is to ensure properly trained and remunerated professional staff are employed by HKORO.

5. For liquidation cases, it makes sense to try and expedite the summary procedure.

## Bankruptcies

6. Given that outsourcing is unlikely to be a serious option, Members of the Committee agree with the fast track procedure in relation to consumer bankruptcy cases and the proposals for accelerated discharge subject to the restrictions proposed for the availability of this procedure, e.g., consumer debtors, with small estates who have not consciously or recklessly exploited their credit provider.

7. The Committee believes the rehabilitation provisions of U.S. Chapter 7 are far more suitable for personal bankruptcy than the retributive provisions which still exist in Hong Kong. It is no good banks blaming debtors using the bankruptcy procedure when they cannot repay their debts, and hence somehow "cheating" the banks. The onus falls squarely on the banks to ensure proper credit checks are made before money is lent.

8. Members do not agree with an extra judicial process for bankruptcy. This already exists in the form of Individual Voluntary Arrangements ("IVAs"). IVAs can and should work and Members do not accept the consultants' argument they are only suitable for cases of people of some net worth who can repay something. IVAs are used successfully in Australia: the only reason they are not used here is prejudice from bankers.

9. Members agree generally with the restrictions on access to fast track bankruptcy.

10. The greatest deterrent which is likely to work far more effectively than the retributive provisions under the existing law, are the proposals for enhanced access to and utility of bankruptcy data for the benefit of credit providers, which will not be expunged from the record for a period of five years post-discharge date. This should provide a salutary lesson for discharged bankrupts given the difficulties they will experience in accessing credit post discharge and is therefore likely to discourage potential repeat offenders.

## Regulation

11. Members are in favour of a licensing procedure for insolvency practitioners in Hong Kong. Of course, this raises the thorny issue debated in the past as to solicitors becoming licensed insolvency practitioners. Although most solicitors may not want to be liquidators themselves, they may be loath to lose a right which they presently have.

12. The Committee considers the less regulatory role the HKORO has the better. In as many liquidations as possible, one wants a committee of inspection because creditors have a financial interest in the outcome of the liquidation.

13. The HKORO may have some residual regulatory role if there is no committee of inspection. However, clear guidelines need to be prescribed as to how this is to operate. Members have in mind particularly the difficulties Eammon O'Connell has had with various Companies Judges trying to establish precisely what the HKORO is meant to do.

**Inquiry and Enforcement**

14. The Committee sees no merit in the HKORO retaining a small liquidation caseload purely for the purpose of honing their skills. A lack of such caseload would not be in any way be detrimental to or compromise its supervisory role. The HKORO's main role should be in the field of inquiry and enforcement. Unfortunately, the record to date of enforcement against delinquent directors has been woeful. As the report identifies at paragraph 5.3, problems arise where there are insufficient assets to meet the time and expenses of providing even the most basic level of investigation. Even in those cases where there is reasonable suspicion of serious malfeasance by directors of an insolvent company, the creditors are understandably reluctant to foot the bill for an investigation. It should be noted that the Law Reform Commission Report has acknowledged the importance of a proper investigatory framework and thus the need for enhancing the role of the HKORO to enable it to fulfil this role, regardless of the asset base of the company in liquidation.

15. If the proposals are implemented for a more comprehensive outsourcing of summary cases and bankruptcy work to the private sector, hopefully the HKORO can refocus its resources to providing a more effective inquiry and enforcement regime as the present system is falling far short of the standards required for a leading international financial centre. For example, the fines against delinquent directors for not keeping proper books and records (as outlined in paragraph 5.15 of the report) are a joke and would not even defray the costs incidental to the prosecution. The sanctions imposed pay scant regard to the significant costs that are needlessly incurred in the administration of a company in liquidation due to the absence of adequate books and records. In many cases this is not due to inadvertence or neglect but rather a conscious decision by delinquent directors to stymie any prospective investigation into their conduct of the affairs of the company concerned, particularly in those instances where a contributory factor to the downfall of the company involves misappropriation of assets.

16. Given the current level of prosecutions and the paltry fines and sanctions imposed, the public perception is that the system is not working to provide an effective deterrent to rogue directors and bankrupts. Thus the recommendation that the HKORO establish a specialist investigations unit is to be welcomed. This couples with an openly aggressive policy on prosecution and disqualification of offenders will go someway towards redressing the balance in providing an effective enforcement regime.

**Finance**

17. This has always been a vexed question. The present system of finance is completely unfair: it penalises creditors of insolvent estates which have funds.

18. It was noted from paragraph 6.18 of the report that the Director of Audit has recommended close monitoring of fees levied with the intention to move towards a system whereby full costs of insolvency administration can be recovered. It is unclear how realistic this objective is, but the answer is not by raising fees and petition costs which will cause additional burdens to creditors in an insolvency situation. Public interest requires the HKORO to be properly funded. This is particularly so in its inquiry and enforcement role. It follows logically that fees which are paid for company and business registration should be allocated to the HKORO, at least in part, to ensure company law compliance.

19. At the end of the day, finance is not an issue for us to debate. It is better to put the principles in place first as to what the HKORO should do and then decide how to pay for it.

**Insolvency Law Committee**
**The Law Society of Hong Kong**
**31 August 2002**

61826