

INTRODUCTION OF A STATUTORY CORPORATE RESCUE PROCEDURE AND INSOLVENT TRADING PROVISIONS

SUBMISSIONS

Introduction

1. In April 2018, the Financial Services and the Treasury Bureau ("FSTB") released a consultation paper setting out its latest proposals on a number of specific issues on the introduction of a statutory corporate rescue procedure and insolvent trading provisions ("Consultation Paper") and invited the Law Society of Hong Kong for views.
2. Those specific issues include:
 - prior written consent of major secured creditor
 - notification requirements on commencement of provisional supervision
 - moratorium during provisional supervision
 - investigation of company's affairs during provisional supervision
 - personal and statutory liabilities of provisional supervisor
 - pre-commencement outstanding entitlement of employees
 - effect of approval of voluntary arrangement on company in winding-up proceedings taken before commencement of provisional supervision
 - safeguard measures for corporate rescue procedure
3. The Law Society of Hong Kong has reviewed the Consultation Paper and has the following comments.

Comments

Moratorium during provisional supervision

Length of moratorium

4. We note the proposal that the period of the provisional supervision is 45

business days, which may be extended up to six months with the consent of creditors given at a creditors' meeting by way of resolution. (§8 of the Consultation Paper).

5. The issue of the length of provisional supervision has been raised in the public consultation exercise in late 2009 and there were suggestions to put forward for a longer provisional supervision period of up to 60 days (which is the current timeframe in Singapore). However, it has been said that a longer period may prejudice the treatment of employees' outstanding entitlements and other creditors (§3.6 of the Review of Corporate Rescue Procedure Legislative Proposals issued by the FSTB in October 2009¹).
6. Bearing in mind the provisional supervisor is to prepare the voluntary arrangement proposal and have the voting on the voluntary arrangement proposal in the creditors' meeting within this period of moratorium, we consider the period of provisional supervision of 45 business days appears to be extremely short.

Extension of moratorium

7. The period of moratorium, in any event, could be extended up to 6 months with the consent of creditors by resolution at a creditors' meeting. It is however unclear whether such resolution to extend the length of provisional supervision would be by way of a simple majority (notwithstanding it is stated in the Companies (Corporate Rescue) Bill 2001² that, in a final creditors' meeting, for the passing of any resolution other than to approve or modify a voluntary arrangement, the resolution is passed if (1) a majority of creditors present and voting voted in favour, (2) those voting in favour hold more than 50% of total value, and (3) no more than 50% in value of creditors not connected with the company have voted against. We propose the aforesaid requirements for passing a resolution can be expressly stated to apply to a resolution for extension of the provisional supervision period to avoid uncertainty. Alternatively, the requirements for resolution for extension could be spelt out more specifically), and whether the creditors voting would include major secured creditors, secured creditors and unsecured creditors.

Initiation of a provisional supervision before and after the commencement of a winding up

8. We also noted that the latest proposals envisage a provisional supervision also occurring after a winding up has already commenced, pursuant to which the

¹ https://www.fstb.gov.hk/fsb/ppr/consult/doc/review_crplp_e.pdf

² The Companies (Corporate Rescue) Bill 2001 was lapsed at the end of the term of office of the Legislative Council in 2004.

winding up and all proceedings in the winding up will be suspended. (§9(a) of the Consultation Paper)

9. The following references in various reports and consultation papers are relevant to the provisional liquidator being able to nominate himself/herself to assume the role of provisional supervisor:

(a) In the Law Reform Commission's Report on Corporate Rescue dated October 1996, paragraph 7.14 specifically refers as follows: "*Where a provisional supervision is proposed by a liquidator or a provisional liquidator of a company, he should be able to nominate himself to be the provisional supervisor if he is a member of the panel.*"

(b) Paragraph 1.15 of the Review of Corporate Rescue Procedure Legislative Proposals issued by the FSTB in October 2009 refers to a provisional supervision being initiated by , inter alia, a provisional liquidator or liquidator.

(c) The Legislative Council Panel on Financial Affairs in its Consultation Conclusions on a new Statutory Corporate Rescue Procedure dated 7th July 2014 provides at paragraph 11, it states "*We propose that the CRP may be initiated by a company (either by a resolution of its members or directors) or, where the company has already entered into the winding-up process, by the provisional liquidator or liquidator (as the case may be) through the appointment of a PS if they are of the opinion that the company is insolvent or likely to become insolvent.*"

10. If the proposals on the statutory corporate rescue procedure are implemented, there will be a procedure to stay winding up proceedings to allow a corporate rescue to be explored through the means of a provisional supervision and it would appear to allow for the provisional liquidator/liquidator to be nominated and appointed a provisional supervisor throughout the moratorium.

11. We ask for the Bill to be drafted (and can be passed) on the terms envisaged in the consultation papers. Otherwise, serious consideration should be given to a legislative amendment to section 193(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32) to allow provisional liquidators to undertake corporate rescue role.

Investigation of company's affairs during provisional supervision

12. In the Consultation Paper, it is proposed that the provisional supervisor be empowered to require certain persons to provide him/her with a statement of affairs of the company. Such persons cover any person who is or has been an officer of the company. (§11, footnotes 8 and 9 of the Consultation Paper).
13. There are instances when the Court has held that an auditor appointed to report on the balance sheet and accounts may be regarded as an officer of the company for the purposes of various provisions under the Companies Ordinance, see *Re New China Hong Kong Group Ltd (in liquidation)* [2003] 3 HKC 252. However, the current language in footnotes 8 and 9 referred to in paragraph 11 of the Consultation Paper is ambiguous as to whether statutory auditors, who have financial knowledge and information of the company and is deemed an officer of the company, are covered.
14. In this regards, it is desirable to clarify whether the provisional supervisor also has power to require statutory auditors to provide such relevant information.

Personal and statutory liabilities of provisional supervisor

15. We also note the latest proposal that the indemnity of the provisional supervisor will have priority over all unsecured claims and claims of floating charge holders (§15 of the Consultation Paper). However, there was no mention of priority over claims of secured creditors.
16. We are concerned that in reality, the indemnity protection to be given to the provisional supervisor may prove illusory if it does not have priority over secured creditors, as there may be insufficient unsecured assets to cover the provisional supervisor's exposure. In the initial report of the Law Reform Commission in October 1996, it was said that the indemnity would have priority over all other claims, whether secured or unsecured, against the company, other than claims which are secured by a fixed charge (paragraph 9.17 thereof). The latest proposals however appear to have taken a different turn.
17. We consider that in the event that the provisional supervisor's indemnity does not have priority over secured claims, provisional supervisors may be permitted to seek indemnity from the secured creditors who have priority over the secured assets of the company for their own protection.

Concluding remarks

18. We have been waiting for a statutory corporate rescue regime for more than 20 years. We are very keen to see a real progress in the introduction of a statutory corporate rescue procedure and insolvent trading provisions into Hong Kong's insolvency law.
19. We, once again, strongly urge the Government to take active steps to push ahead the reform for corporate rescue procedure.
20. We respectfully ask to be further engaged when the Bill is available.

The Law Society of Hong Kong
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