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2 December 2015

Hon Wong Ting-kwong SBS JP
Chairman of Bills Committee
Legislative Council
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Sirs

HKIoD's Response to the Bills Committee on Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members and organised focused discussions.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. 2889 9986.

With best regards

Yours sincerely

The Hong Kong Institute of Directors

Dr Carlye Tsui
Chief Executive Officer

cc: Mr Henry Lai, Chairman of Council, HKIoD & Chairman,
Corporate Governance Policies Committee

Issued on: 2 December 2015

**Companies (Winding Up and Miscellaneous Provisions)
(Amendment) Bill 2015**

We at HKIoD have pleasure in submitting views to the Bills Committee on the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill. We look forward to working closely with the Bills Committee, the Administration and other stakeholders to achieve the intended benefits of the Bill.

* * *

HKIoD previously commented on the subject matter in our 12 July 2013 response to the Consultation Document “Improvement of Corporate Insolvency Law Legislative Proposals (April 2013)”.

HKIoD also had the opportunity in April 2014 to discuss with the team from the Financial Services & the Treasury Bureau and from the Official Receiver’s Office on certain key proposals relating to the subject matter of the present Bill.

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HKIoD supports the exercise to bring Hong Kong’s corporate insolvency law into the modern era. Overall, HKIoD considers the legislative proposals now embodied in the Bill a major improvement over the existing provisions on the subject matter.

Five-year look back is too long

In this submission, we take issue with one aspect. The five year look back period in connection with voidable transactions at an undervalue is just too long. (Clause 88 and 89, referring to Sec 265D(2) and 266B(1)(a).)

The Administration lifts and drops the look back period applicable to individuals into the current Bill, but to do so is to conveniently ignore the differing context of corporate insolvency.

The look back period in the equivalent legislation in the UK, applicable in the context of corporate insolvency, is only two years.

And on a related subject matter, the look back period for voidable unfair preferences is only two years. (Clause 89, referring to Sec 266(2) and 266B(1)(b).)

A five year look back is excessive. We object.

Creditor protection in context

Our objection stems from the need to put creditor protection in the proper context. No business decision, however brilliant and appropriate at the time made, can guarantee eventual success; circumstances can change. In any typical economic cycle, circumstances can change a lot in five years. Hindsight bias would have it that bad outcomes could easily be viewed as

knowable beforehand. Even the best able judge cannot always set apart careful decisions that do not turn out good results from plain bad ones. Absent fraud or egregious behaviour, directors should not be made to operate in a sphere where someone, and someone with much less knowledge of the company's situation and need, will second guess the decisions they make five years down the line.

When a company is not insolvent, directors should be able to take up what might seem risky or odd but could well be value-maximising transactions. Their duty runs to shareholders. They in fact have the tasks to take risks to generate value for shareholders.

When a company is not insolvent, directors do not owe fiduciary duty to creditors. To have a long look back period, however, creates a false duty to creditors when there is not and should not be. Our free market economy allows creditors to negotiate for their own protection as they see fit. Creditors have many tools and ample opportunities to guard their interests when the company-debtor exhibits signs towards financial distress. Credit contracts get re-negotiated and loans get called, often way before the company is actually insolvent.

Creditors (certainly the more sophisticated) do not rely on look back periods for protection; and they should not. But a long look back period can imply a false duty to creditors that will, if erroneously taken as true, make creditors better protected than shareholders. That false duty to creditors will stifle capitalist risk taking and be counter-productive to the economy.

The availability of defence is good, but that does not justify the long look back period

Admittedly, there are provisions intended to protect "genuine business transactions". A court must not make an order to void a transaction if it is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business; and at the time of the transaction, the company had reasonable grounds to believe that the transaction would benefit the company. (Clause 88, referring to Sec 265D(4).)

These provisions are to protect "genuine business transactions", but more importantly they are to recognise and honour the freedom and autonomy honest directors must have in making good faith business judgments as they guide their company in proper pursuit of value for their shareholders. They are much needed, and we welcome and embrace their inclusion in the Bill. Their inclusion still does not justify a long look back of 5 years.

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