香港董事學會
The Hong Kong Institute of Directors

28 January 2010

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

Dear Sirs

Review of Corporate Rescue Procedure Legislative Proposals

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 professional directors working together to promote good corporate governance. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In relation to the captioned paper, we have gone through the processes of consulting our members and conducting focused review by our Corporate Governance Committee under the chairmanship of Mr Henry Lai. Hence, the response represents our consolidated collective views.

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

Enc

cc Dr Kelvin Wong, Chairman of Council, HKIoD
Mr Henry Lai, Council Member, HKIoD &
Chairman, Corporate Governance Committee

Consultation Paper on Review of Corporate Rescue Procedure Legislative Proposals (the "Consultation Paper")

In relation to the captioned paper, the Hong Kong Institute of Directors ("HKIoD") has gone through the process of focus review by our Corporate Governance Committee under the leadership of Mr Henry LAI. The comments and response forwarded as follows represents the HKIoD's consolidated collective views:-

Capitalized terms used herein but are not otherwise defined shall have the meanings ascribed to them in the Consultation Paper.

General comments

The HKIoD welcome the Government's decision to revive legislative plans for the introduction of a corporate rescue procedure. We believe a corporate rescue procedure will be a useful tool to supplement the options currently available to Hong Kong companies running into financial difficulty.

The options now available to Hong Kong companies tend to be complex and costly to administer. More importantly, the current framework does not have provisions specifically designed for corporate rescue. Hong Kong needs to modernize the legislative framework to provide for simpler, less costly procedures to help companies in distress devise rescue plans to go forward.

A corporate rescue procedure will allow companies in financial difficulties to undergo debt restructuring during a "moratorium". The companies are therefore protected from being wound up immediately and have a chance of turning themselves around, thereby preserving the jobs of many employees. In addition, the many suppliers and vendors can retain their business with these companies under rescue. We agree with these reasons for having a corporate rescue procedure.

There is another reason why a "moratorium" can help Hong Kong companies in distress survive. Many Hong Kong companies now hold significant business assets in one or more jurisdictions outside Hong Kong and rely on these assets to derive profits. Often times, these Hong Kong companies had originally obtained financing from one or more creditors to acquire these assets. When these Hong Kong companies run into financial difficulty, even temporarily so, and when a

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"moratorium" cannot be put in place as deterrence, these creditors may be tempted to look over the value of keeping the business in survival and race among themselves to seize the business assets situated outside Hong Kong to satisfy the debts owed to them. In doing so, these Hong Kong companies are more likely to be forced into liquidation. A "moratorium" clearly makes it unlawful for creditors of ailing Hong Kong companies to make end runs to seize assets located outside of Hong Kong at the expense of other creditors. It has the effect of keeping vital business assets from being "ripped", and thereby enhances the chance of successful rescue.

As stated in the Consultation Paper, the Government considers that it would be the most beneficial and expedient approach to make use of the 2001 Bill as the basis for the review. We note, however, that almost a decade has gone by since the 2001 Bill. We recommend that the Government seriously revisit the issue of whether there are indeed changes of background circumstances that might warrant adjustments to the design of the proposed corporate rescue procedure.

We also urge the Government to review and update the mechanisms and procedures for insolvency, liquidation and bankruptcy, as part of the Companies Ordinance Rewrite or otherwise, to comprehensively modernize Hong Kong's legislative framework in these areas.

Specific comments

Our responses to specific questions as set out in the Consultation Paper are as follows:-

Question 1

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

HKIoD response:

- We generally agree with the proposed procedural changes relating to the initiation of provisional supervision.
- We believe it will greatly assist company directors in assessing whether to initiate provisional supervision, if there are available easily understandable and practical guidelines or criteria for making such determination. We recommend that, in conjunction

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with the drafting of the corporate rescue legislation or at another appropriate stage, the Government examines whether it is practicable to come up with such guidelines or criteria, and invite further comments from stakeholders and other interested parties on this aspect.

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.

HKIoD response:

- On the issue of who else may initiate the procedure, we believe shareholders who individually or collectively own or control a substantial block of the shares of a company should be permitted to initiate provisional supervision. Directors of a company should have the responsibility and duty to inform shareholders of the status of affairs of the company. Shareholders, therefore, should have sufficient knowledge of the financial position of the company to make a judgment on whether it is a viable candidate for provisional supervision. The LRC Report noted that "there was no support for allowing shareholders to initiate provisional supervision" and that "section 168A of the Companies Ordinance already provides shareholders with alternative remedies to winding-up". We, however, believe that shareholders of company should have a strong interest in and should be given the tools and means to "obtain a better return from the success of the rescue plan than from the outcome of a winding up". See Consultation Paper para 1.11 on one of the objectives for provisional supervision. While in many situations shareholders may be in a position to direct the board or ask the management of the company to initiate provisional supervision, we submit that this is not always the case, as when the ownership of a company is scattered among many shareholders and no single shareholder can control the company.

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.

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HKIoD response:

- On the timing of publishing the notice of appointment of provisional supervisor in the local newspapers, we suggest changing the requirement to publish "on the same day" to "as soon as practicable but in no event later than three (3) working days". In practice, there can be logistical difficulties in coordinating the filing of the notice (together with specified documents) with the Registrar of Companies and the publishing of the notice in newspapers on the same day. For instance, it takes some typesetting time for the notice to be ready for print, but details that must appear in the notice may not be finalized until a very short time before filing with the Registrar of Companies. We think our suggested change will add some flexibility while satisfying the need for informing creditors and stakeholders in a timely manner.
- On the issue of additional or alternative means of publishing the notice of appointment, we think the Administration should examine the practicability of imposing a requirement for companies that regularly maintains a company website to post the fact of appointment of a provisional supervisor on such company website.

Question 4

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

HKIoD response:

- We think the 45 days initial moratorium period is reasonable, noting that the moratorium period can be subsequently extended. See also our responses to Q6 and Q7 below.

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.

HKIoD response:

- Our recommendation is to extend the maximum period for which the moratorium can be extended to at least 9 months from the commencement of provisional supervision. In situations where a listed company that has commenced provisional supervision seeks to

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de-list, the six month period proposed will in practice not be long enough to cover the time period that it would normally take to complete the de-listing process. See also our response to Q6 below.

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.

HKIoD response:

- We do not agree with the proposal. We note that one of the objectives of provisional supervision is to reduce court involvement. We recommend that an extension should be permitted as long as the majority creditors agree, subject only to a requirement of court approval if the extension (and any further extension thereafter) would go beyond a certain period of time to be stipulated in the legislation. We think it would be reasonable for such period to be 12 months (or longer, up to 18 months) from the commencement of provisional supervision. See also our response to Q7 below.

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.

HKIoD response:

- No, we do not agree. We recommend that an extension should be permitted as long as the majority creditors agree, subject only to a requirement of court approval if the extension (and any further extension thereafter) would go beyond the stipulated period.

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.

HKIoD response:

- We express no views on this subject matter at this time.

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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.

HKIoD response:

- We feel strongly that employees should not be worse off in situations of provisional supervision. We think that, among the three options, Alternative B is the most fair for employees.

Question 10

Independent of which of the above option is adopted, what are your views on the treatment of outstanding employers' MPF scheme contributions (and outstanding employers' ORSO scheme contributions which are not covered by PWIF)?

HKIoD response:

- We think these should be treated the same way as employee entitlements.

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?

HKIoD response:

- We agree with the proposal.

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

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applicants and on the associated investigatory and disciplinary regime in case of complaints against appointed persons.

HKIoD response:

- We recommend that persons, especially those who have prior experience as company directors working in or with companies in distress to implement reorganization, restructuring or liquidation plans, should also be considered for appointment as provisional supervisors. Such persons would have the power and should be encouraged to engage professional advisors (lawyers, accountants, etc.) with requisite skills and experience to help in the work. We do not believe it is necessary to require an actual appointment of such persons with prior experience as provisional supervisor be made by either the OR or the court. We note, however, that the Government may want to consider whether to maintain an approved panel (through the OR or otherwise) comprising such other persons with skills and experience suitable to be appointed provisional supervisor. We note also that the person so appointed will be subject to the confirmation of the creditors at the first meeting of creditors. We also believe the imposition of personal liability is sufficient deterrence for unsuitable persons to accept the appointment.
- On the issue of an "appeal channel", we recommend that any person who seeks to be appointed as provisional supervisor on the basis of such person having prior relevant experience as company director be, among other credentials as may be necessary or appropriate, a Fellow-grade member of the HKIoD. We submit that the HKIoD, being the professional body representing professional directors with a system of accrediting directors, can serve the function of an "appeal channel" in case of complaints against such HKIoD Fellow appointed as provisional supervisors.

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.

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HKIoD response:

- We do not object to the proposal in principle. Giving creditors the right to replace the provisional supervisor appointed by the company or its directors can be a safeguard against the company or its directors just appointing someone close to the company. We note, however, that this might in some cases lead to certain major creditors being able to essentially take over the corporate rescue process.

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).

HKIoD response:

- We do not object to imposing personal liability on provisional supervisors. We note, however, that persons acting as provisional supervisors should have available to him for purchase in the open market proper and affordable insurance coverage as protection. We recommend the Government to conduct research to determine if such liability insurance is or can be made available, and to take appropriate steps to maintain or promote the availability of such insurance coverage. As in the case of receivers, provisional supervisors should have the opportunity to obtain indemnity from the party appointing them. We note, also, that the Companies Ordinance spells out statutory protection for liquidators, and we recommend that statutory protections, as appropriate for provisional supervisors, be spelled out in relevant legislations.
- We agree with extending the time period for provisional supervisors to decide whether to accept pre-existing employment contracts from 14 days to 16 working days from the commencement of provisional supervision. In case there is a replacement provisional supervisor, our view is the replacement provisional supervisor should have a new statutory period of time to make the determination, not just the 6 working days (16 minus 10 working days) by default. In as much as the replacement provisional supervisor might already have the time and opportunity to perform due diligence prior to being nominated as replacement provisional supervisor, we recommend ten (10) working days as the new period of time that should be made available to the replacement provisional supervisor to decide whether to accept pre-existing employment contracts.

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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.

HKIoD response:

- We agree with the introduction of insolvent trading provisions.

Question 16

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

HKIoD response:

- We agree with the two proposed adjustments set out in paragraphs 6.5(a) and 6.5(b).

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.

HKIoD response:

- We agree with the way "major secured creditors" was defined in the 2001 Bill.

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.

HKIoD response:

- We agree with the proposal to largely follow the 2001 Bill approach with respect to protection of "major secured creditors" and other secured creditors' rights.

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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?

HKIoD response:

- Our view is that voting by value of debt and not by headcount will result in outcomes that are fairer.

-END-

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