香港董事學會
The Hong Kong Institute of Directors

12 July 2013

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

Dear Sirs

Re: Improvement of Corporate Insolvency Law 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 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: Dr Kelvin Wong, Chairman of Council, HKIoD
Mr Henry Lai, Deputy Chairman, HKIoD & Chairman,
Corporate Governance Policies Committee

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香港董事學會
The Hong Kong Institute of Directors

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CO Rewrite

Improvement of Corporate Insolvency Law Legislative Proposals

In relation to the captioned Consultation Document, the Hong Kong Institute of Directors ("HKIoD") is pleased to present its views and comments.

* * *

General comments

HKIoD considers the legislative proposals a major improvement over the existing provisions on the subject matter. We also want to praise the FSTB / ORO for making the legislative proposals easier to understand. In our view, the use of schematic diagrams has gone some distance to help readers, even practitioners, to better understand the changes to be made and what the new regime would look like.

Creditor protection in context

We support the exercise to bring Hong Kong's corporate insolvency law into the modern era. We take issue with one aspect, however.

We believe the five year look back period is too long. (Reference is made to Question 25 and the corresponding legislative proposals.) 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 behavior, 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. This is not what our company law envisions. This runs contrary to the notion of a capitalist economy that the Joint Declaration and the Basic Law each seeks to preserve.

Cross border issues

Some of our members are concerned about the difficulties and challenges often encountered in cross border insolvency and liquidation matters. They are right. But we will take note that the present exercise is to modernise the domestic Hong Kong law on corporate insolvency and will not directly address cross-border issues. To modernise the domestic regime is an important step that should come before policy discussions on how to tackle the difficulties and challenges in cross border insolvency and liquidation matters. We expect the Administration to turn attention and come up with good proposals in the near future.

* * *

Responses to specific questions

Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Document as follows.

Question 1 Do you support the proposal to adopt a prescribed form of statutory demand, which would contain key information as described in paragraph 2.7 as well as a statement of the consequences of ignoring the demand?

HKIoD Response:

- YES.

Question 2 Do you think that the section 228A procedure, whereby the directors of a company may commence a voluntary winding-up of the company without first having the members of the company resolve to do so, should be maintained or repealed?

HKIoD Response:

- Section 228A procedure SHOULD BE MAINTAINED.

Question 3 If the section 228A procedure is to be maintained, do you agree to the proposed improvement measures as set out in paragraph 2.14 to reduce the risk of abuse of the procedure?

HKIoD Response:

- AGREE.

Question 4 Do you agree to replacing the existing requirement of holding the first creditors' meeting on the same or the next following day of the members' meeting with the requirement of holding the first creditors' meeting on a day not later than the fourteenth day after the day on which the members' meeting is held in a creditors' voluntary winding-up case?

HKIoD Response:

- AGREE.

Question 5 Do you support the proposal on prescribing a minimum notice period for calling the first creditors' meeting in a creditors' voluntary winding-up case? If so, do you consider a period of seven days appropriate?

HKIoD Response:

- SUPPORT.
    - About one week is an appropriate length, but there may be good reasons to pin the length of the notice period to business days (appropriately defined) rather than calendar days.

Question 6 Do you agree to the proposal on limiting the powers of the liquidator appointed by the company during the period before the holding of the first creditors' meeting in a creditors' voluntary winding-up case?

HKIoD Response:

- AGREE.

Question 7 Do you agree to the proposed restrictions on the exercise of the directors' power before a liquidator is appointed in a creditors' voluntary winding-up case?

HKIoD Response:

- AGREE.

Question 8 Do you agree with the proposed technical amendments relating to the commencement of winding-up as set out in Annex C?

HKIoD Response:

- We do not have major comments.

Question 9 (a) Do you agree to the expansion of the list of disqualified persons from being appointed as a provisional liquidator or a liquidator? If so, do you agree with disqualifying the types of persons as proposed in paragraphs 3.13, 3.15 and 3.16?

(b) Do you agree to provide clearly that the appointment of a disqualified person as a provisional liquidator or liquidator shall be void and that he shall be liable to a fine if he acts as a provisional liquidator or liquidator?

(c) Do you agree that the disqualification proposals should also apply to the appointment of a receiver or a receiver and manager of the property of a company with suitable modifications?

HKIoD Response:

- As to 9(a):
  - We SUPPORT the expansion of the list of disqualified persons. We note also that the disqualified persons under paragraphs 3.13 and 3.16 can still seek to be appointed with leave of court.
  - But if those persons mentioned in paragraph 3.13 are deemed to have conflict per se, we ask why other persons who would have as much if not more influence over the affairs of the company (e.g., substantial shareholders, a chief executive officer and perhaps even a senior management personnel in the right circumstances) are not deemed to have conflict per se. Under the current proposal, such other influential persons can get appointed with a statement of relevant interest. Those who are deemed to have conflict per se can only get appointed with leave of court. The proposal might seem to be turning the matter on its head, giving those with more dosage of "conflict" an easier time to get appointed.
- As to 9(b):
  - We SUPPORT the notion that the appointment of a disqualified person should be void, but subjecting a disqualified person to a fine may be a bit harsh if the person had done a diligent check and had reasonable grounds to believe he is not disqualified from taking up the appointment. The issue then is what defence is available.
- As to 9(c), AGREE.

Question 10 (a) Do you agree that a new statutory disclosure system should be introduced for the appointment of provisional liquidators and liquidators?

(b) If yes, do you agree with the details of information required to be disclosed as set out in paragraph 3.21?

(c) Do you agree that a statutory defence as proposed in paragraph 3.24 should be provided for a failure in disclosure?

HKIoD Response:

- As to 10(a), AGREE.
  - But see our response to Q9.
- As to 10(b), AGREE.
- As to 10(c), AGREE.

Question 11 (a) Do you agree that the existing prohibition on inducement being offered to members or creditors in relation to the appointment of liquidators should be extended to cover inducement being offered to any person?

(b) Do you agree that the prohibition should also be extended to inducement offered in relation to the appointment of provisional liquidators, receivers, and receivers and managers?

HKIoD Response:

- As to 11(a), AGREE.
- As to 11(b), AGREE.

Question 12 Do you agree with the proposal to designate all provisional liquidators who take office upon and after the making of a winding-up order (i.e. section 194 PL) as "liquidators" such that they will be subject to the provisions in the CO which apply to liquidators?

HKIoD Response:

- AGREE.

Question 13 Do you agree with the proposal to clearly stipulate that it is up to the court to determine the powers, duties, remuneration and termination of appointment of provisional liquidators who were appointed by the court before the making of a winding-up order (i.e. section 193 PL)?

HKIoD Response:

- AGREE.

Question 14 Do you agree with the proposal of setting out the powers of liquidators now found in section 199(1) and (2) of the CO in a Schedule to improve the clarity of the provisions?

HKIoD Response:

- AGREE.

Question 15 Do you agree that the requirement for the liquidator to apply to the court or the COI for exercising the power to appoint a solicitor in a court winding-up should be removed, provided that prior notification is given to the COI or, where there is no COI, the creditors when the liquidator exercises such power?

HKIoD Response:

- AGREE.

Question 16 (a) Do you agree that, notwithstanding the release of a liquidator by the court, the liquidator should not be absolved from the provisions of section 276 of CO?

(b) Do you agree that, where the court has granted a release to a liquidator, the power to make an application under section 276 should only be exercisable with the leave of the court?

HKIoD Response:

- As to 16(a), AGREE.
- As to 16(b), AGREE.

Question 17 Do you agree with the proposed technical amendments relating to the appointment, powers, vacation of office and release of provisional liquidators and liquidators as set out in Annex C?

HKIoD Response:

- We do not have major comments.

Question 18 Do you agree that a maximum and a minimum number of members should be set for the COI appointed in both a court winding-up and a creditors' voluntary winding-up? If so, are the proposed maximum number (seven) and minimum numbers (three) appropriate? Do you agree that the court should have the

discretion to vary the maximum and minimum numbers on application by the liquidator?

HKIoD Response:

- AGREE.
  - Sometimes there may just not be enough number of creditors to form a COI, so the minimum of three may not always be practical. The court should have discretion to vary the minimum (or maximum) as circumstances require.
  - But the real practical issue on COI is really not quantity but quality. At the early stage of proceedings, there are likely to be enough – in some cases can even be too many – interested parties (from banks, from among employees, etc.) wanting to be on the COI. However, it is not unheard of that, soon after the appointment, the members begin to resign or just not turn up as to hamper the proper functioning of the COI. To form a COI with commitment and the right combination of expertise is more important than driving for a sheer number.

Question 19 Do you agree to allow the COI not to fill a vacancy if the liquidator and a majority of the remaining members of the COI so agree, provided that the total number of members does not fall below the proposed minimum number?

HKIoD Response:

- AGREE.

Question 20 Do you agree to the proposals as set out in paragraphs 4.12 and 4.13 for streamlining and rationalising the proceedings of the COI?

HKIoD Response:

- AGREE.

Question 21 Do you support the proposal to enable the COI to function through written resolutions sent by post or using other electronic means (such as using emails or through websites)?

HKIoD Response:

- SUPPORT.

Question 22 (a) Do you agree with allowing the costs and charges of the agents employed by the liquidators to be determined by agreement between the liquidator and the COI?

(b) Do you agree that if such agreement cannot be reached, the costs and charges of the agents shall be delivered up for taxation by the court?

HKIoD Response:

- As to 22(a), AGREE.
- As to 22(b), AGREE.

Question 23 Do you support the proposal to allow liquidators and provisional liquidators to communicate with creditors, contributories or other parties by electronic means, subject to the conditions as set out in paragraph 4.21?

HKIoD Response:

- SUPPORT.

Question 24 Do you agree with the proposed technical amendments relating to the conduct of winding-up as set out in Annex C?

HKIoD Response:

- We do not have major comments.

Question 25 (a) Do you agree that new provisions should be introduced to empower the court to make orders for restoring the position of a company to what it would have been if the company has not entered into a transaction at an undervalue?

(b) Do you agree to the proposal regarding "relevant time" as proposed in paragraph 5.10?

(c) Do you agree that transactions at an undervalue entered into by the company with a person who is connected with the company should be subject to a more stringent control as proposed in paragraph 5.11?

(d) Do you agree that statutory protection should be provided for the party seeking to resist an application made by the liquidator of a company in respect of the undervalue transaction? If so, do you agree with the statutory protection as proposed in paragraph 5.12?

HKIoD Response:

- As to 25(a), AGREE, but see our response to Q25(b).
- As to 25(b), DISAGREE.

- A five-year look back is too long. See our general comments. We also note that the UK look back period is only two years.

- As to 25(c), AGREE.
- As to 25(d), AGREE.
  - The statutory protection is a much needed provision. The existence of the statutory protection still does not justify a five-year look back.

Question 26 (a) Do you agree that the current provisions in the CO incorporating the provisions in the BO on unfair preference should be replaced by new standalone provisions which apply to winding-up cases as proposed in paragraph 5.17 to rectify the existing anomalies which limit the application and effectiveness of such provisions?

(b) Do you agree with the definitions of "person who is connected with a company" and "associate" as proposed in paragraphs 5.19 and 5.20?

(c) Do you agree that the existing protection for persons who have received benefits or acquired or derived interest in property in good faith and for value from unfair preference should be maintained, and that the same protection should also be applicable to the proposed new provisions on transactions at an undervalue?

HKIoD Response:

- As to 26(a), AGREE.
- As to 26(b):
  - Regarding "person who is connected with a company", we have no comments.
  - Regarding "associate", the definition turns on what amounts to "control". The voting power that would amount to "control" is deemed as one-third (see Consultation Document, footnote 122). We do not have an issue with that threshold, but we note that the concept of "control" appears in other laws and rules. In the Listing Rules, the threshold is 30%. Is there a good reason or need to make the threshold consistent across different laws and rules?
- As to 26(c), AGREE.

Question 27 Do you agree to the proposed special provisions in relation to floating charges created by a company in favour of a person who is connected with the company as detailed in paragraph 5.26?

HKIoD Response:

- AGREE.

Question 28 Do you support the expansion of the scope of the exemption of a floating charge from invalidation catered for genuine credit transactions to cover "property and services supplied to the company" and "money paid at the direction of the company" as detailed in paragraph 5.28?

HKIoD Response:

- AGREE.

Question 29 (a) Do you agree to expressly set out in the legislation the common law position that a person summoned for either a private or a public examination cannot invoke the privilege against self-incrimination during the examination?

(b) If so, do you agree that we should introduce provisions to prohibit the subsequent use of answers given and statements made during the examination in subsequent criminal proceedings if certain conditions are satisfied, subject to certain exceptions such as offences relating to perjury and provision of false statement and offences under the future Companies (Winding Up and Miscellaneous Provisions) Ordinance?

HKIoD Response:

- As to 29(a), AGREE.
- As to 29(b), AGREE.

Question 30 (a) Do you agree to the removal of the requirement that the OR or the liquidator must have alleged in his "further report" that fraud has been committed for initiating the public examination procedure, and to provide that a public examination may be ordered by the court upon the application by either the liquidator or the OR?

(b) Do you agree with the proposed new categories of person that may be examined under the public examination procedure, namely (i) any person who has acted as liquidator of the company or receiver or receiver and manager of the property of the company; and (ii) any person who is or has been concerned, or has taken part, in the management of the company?

HKIoD Response:

- As to 30(a), AGREE.
- As to 30(b), AGREE.

Question 31 (a) Do you agree that if a company is wound up insolvent within one year of its shares being redeemed or bought back by payment out of capital, certain categories of persons should be required to contribute to the assets of the company for an amount not exceeding the payment made by the company in respect of the shares redeemed or bought back by the company so as to meet the deficiency in the company's assets?

(b) If so, should the members from whom the shares were redeemed or bought back and the directors who made the solvency statement which supported the redemption or buy-back without having reasonable grounds for the opinion expressed in the statement be jointly and severally liable to contribute to such assets?

(c) Should such persons be allowed to apply for winding-up of the company under the specific grounds as set out in paragraph 6.22?

HKIoD Response:

- As to 31(a), AGREE.
- As to 31(b), AGREE.
  - We must emphasise that the issue of whether the directors have reasonable grounds for the opinion expressed in the solvency statement must be viewed not with hindsight bias. See also our general comments.
- As to 31(c), AGREE.

Question 32 Do you agree with the proposed technical amendments relating to the investigation during winding-up, offences antecedent to or in the course of winding-up and powers of the court as set out in Annex C?

HKIoD Response:

- We do not have major comments.

<END>