香港會計師公會
HONG KONG SOCIETY OF ACCOUNTANTS
(Incorporated by the Professional Accountants Ordinance, Cap. 50)

BY FAX AND BY POST
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The Financial Services Branch
Financial Services and The Treasury Bureau
18th Floor, Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Attn: Ms. Shirley Lam

Dear Sir,

Consultation Paper on Proposals relating to the Trust Account Arrangement under the Companies (Corporate Rescue) Bill

Thank you for inviting the Society to comment on the above consultation paper and my apologies for the delay in replying.

Firstly, we would like to reiterate our support for the introduction of a corporate rescue procedure in Hong Kong and we hope that the consultation on the trust account arrangement will give added impetus to efforts to resolve the outstanding matters relating to the Companies (Corporate Rescue) Bill ("the Bill").

In our submission to the Bills Committee dated 9 November 2001, the suggestion was made that a cap be placed on the amount required to be provided for any given employee under the proposed trust account arrangement, and that the cap be set at the ceiling for payments under the Protection of Wages on Insolvency Fund (PWIF). With this in mind, we welcome the Government's consultation on the feasibility of capping the amount payable under the trust account and, if the trust account approach is to be adopted, we support the principle of setting a ceiling on the amount to be paid from the fund to individual employees.

At the same time, we believe that difficulties remain with some of the proposals outlined in the consultation paper and certain points require further clarification. The Society's views on the proposals are elaborated below.

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Paragraph 4

In relation to the table contained in paragraph 4, we assume that reference to "continuing employees" is to those employees whose contracts the provisional supervisor ("PSR") has accepted within the 14-day period referred to in paragraph 10(a) of Annex B. This needs to be clarified.

Paragraphs 7-8

Paragraph 7 of the consultation paper indicates that employees will be regarded as ordinary creditors in respect of any amount not covered by the cap and owed by the company, and they will be entitled to participate in and vote at a relevant meeting of creditors. However, paragraph 8 states that a voluntary arrangement must contain a term requiring the company to pay its employees any outstanding amounts in full, within 12 months of the approval of the proposal. It seems therefore, assuming the provisional supervision ("PS") proceeds, that employees are to be "assured" of a 100% dividend and within a fixed time frame, which distinguishes them from, and places them at an advantage to, other ordinary unsecured creditors. Under the circumstances, it needs to be considered whether they should be able to participate and vote in a creditors' meeting in the same way as other creditors, particularly given that, under Schedule 7 of the Companies (Corporate Rescue) Bill, various types of resolutions, in order to be passed, require the support of a majority in number and over $66^{2}/_{3}$ in value of creditors attending. Given this requirement, a creditors' meeting could quite possibly end in a stalemate between employees and other creditors.

Paragraph 9

It is proposed, in paragraph 9, that where a corporate rescue procedure fails, the continuing employees to whom the company owes outstanding liabilities may petition to wind up the company in order to recover payment. We believe that the outcome would be more cost effective for the parties concerned if legislative amendments could be made to the effect that payments from the PWIF could be made to such employees on the failure of a corporate rescue procedure without the need to file a winding up petition.

Annex B, paragraphs 10(a), 16 and 17

Paragraph 10(a) of Annex B provides that if the company fails to pay the employees' wages or any other entitlements accrued since the commencement of the corporate rescue process, the PSR will be held personally liable for wages and any other entitlements of the employees if the PSR has accepted in writing the employees' contracts within 14 days immediately following the commencement of the corporate rescue procedure. There is some ambiguity in this statement in that it is not entirely clear whether, for example, in relation to entitlements such as long service/severance payments, the proposal is that the PSR will be liable for the full amount owing to a particular employee, or only for those parts of the entitlement that have accrued after the commencement of the PS. We take it that the position is intended to be the former, and paragraph 20 seems to imply that this is the case.

The Society expressed concern about the extensive potential personal liability of the PSR under the provisions of the Bill in its submission of 25 September 2001 to the Bills Committee, and reiterated this point in a letter of 28 December 2001 to the Deputy Secretary for Financial Services (a copy of which is at Appendix 1). In general terms, we do not consider that a PSR should have any personal liability when acting in accordance with his duties and/or terms of his appointment. In this connection, we note that administrators appointed under the Insolvency Act 1986 ("IA") in the United Kingdom are not made personally liable. Under the IA, protection is given to parties dealing with the office holder by the fact that sums payable in respect of liabilities incurred by the administrator are charged on the company's property, i.e. they are paid in priority to other creditors (see section 19(5)).

While, under the IA, an administrative receiver of a company, does bear some personal liability, it is limited. Furthermore, an administrative receiver is deemed to be an agent of the company. The relevant parts of section 44 of the IA read:

"(1) The administrative receiver of a company –

(a) is deemed to be the company's agent, unless and until the company goes into liquidation;

(b) is personally liable on any contract entered into by him in the carrying out of his functions (except in so far as the contract otherwise provides) and, to the extent of any qualifying liability, on any contract of employment adopted by him in carrying out of those functions; and

(c) is entitled in respect of that liability to an indemnity out of the assets of the company.

(2) For the purposes of subsection (1)(b) the administrative receiver is not to be taken to have adopted a contract of employment by reason by anything done or omitted to be done within 14 days after his appointment.

(2A) For the purposed of subsection (1)(b), a liability under a contact of employment is a qualifying liability if –

(a) it is a liability to pay a sum by way of wages or salary or contribution to an occupational pension scheme,

(b) it is incurred while the administrative receiver is in office, and

(c) it is respect of services rendered wholly or partly after the adoption of the contract.

(2B) Where a sum payable in respect of a liability which is qualifying liability for the purposes of subsection (1)(b) is payable in respect of services rendered partly before and partly after the adoption of the contract, liability under subsection (1)(b) shall only extend to so much of the sum as is payable in respect of services rendered after the adoption of the contract.

The position of a PSR is more akin to that of an administrator rather than an administrative receiver under the IA, hence our view that he should not incur person liability in the normal course of events. However, if the PSR is to be made personally liable, then for the proposals to be workable, the PSR's personal liability for employees' entitlements should be limited in the similar way to that of an administrative receiver under the IA, i.e. primarily a liability in respect of the ongoing wages of continuing employees. It would not be reasonable to extend his personal liability to, for example, all entitlements owed to any continuing employees, which, apart from anything else, are not subject to the cap, given that, the cap appears to apply only to amounts that should be contained in the trust fund, which, for continuing employees, are limited to outstanding accrued wages.

We suggest, therefore, that any entitlements for continuing employees above and beyond wages accrued before the PS commenced (and such wages should in any case have been contained in the trust fund and should, presumably, have been paid out shortly after the commencement of the PS) and wages accruing after the commencement of the PS, should be the liability of the company only. In any event, Annex B, paragraph 10(b), makes it clear that if the company fails to make payment, the relevant employees may petition for the winding up of the company and lodge a claim with the PWIF.

In practice, under the current proposal, due to the extent of his personal liability, the PSR will be discouraged from retaining the company's employees, potentially defeating one of the objects of the exercise. Furthermore, if all of the employees are terminated at the outset, and some subsequently re-employed, this will mean that all of the employees' entitlements up to the cap will need to be provided for in the trust account, which will reduce the likelihood of PS being a practical option for many companies facing financial difficulties.

If, on the other hand, the PSR wishes to retain employees by taking over their contracts within the 14-day period, in order to protect himself, he will probably want to ensure that sufficient funds for all outstanding wages in lieu of notice, long service/ severance payments, etc., for continuing employees, without any cap, are available in the trust account. This is so because it is unlikely that he will know in advance whether any continuing employees may be dismissed, or whether their employment may be otherwise terminated, during the implementation of the rescue plan.

Various consequences would follow from the PSR adopting the latter course of action: (a) prima facie, it will put continuing employees in a better position than employees who have been terminated or left before the PS commences (because all their entitlements without any cap will have to be provided for); (b) secondly, and because of (a) it will mean that few companies in financial difficulties will be able to take advantage of PS. In this connection, we would draw your attention to the Society's comments the Government's 1998/99 consultation paper on the treatment of employees in a corporate rescue (see Appendix 2, in particular comments on Option B); and (c) it could give rise to questions of unfair preferences, given that the inclusion in the trust fund of entitlements for continuing employees, other than unpaid wages accrued prior to the PS, will not be a statutory requirement. Therefore, assuming the PSR seeks to set aside all these entitlements, in order to protect himself from personal liability, if the company is eventually wound up and continuing employees are paid their entitlements in full, other creditors will have grounds to challenge the validity of this action.

Annex B paragraphs 20-21

It is noted that, under the proposals, ex-gratia payments paid by the PWIF to continuing employees in the event of the company being wound up following the failure of a corporate rescue, will be treated "qualifying liabilities" by virtue of subrogation. This will accord the payments made by the PWIF a higher ranking amongst the preferential creditors than would otherwise be the case, which will mean that the PWIF will be in a more advantageous position in a winding up that has been preceded by an attempted PS than it will be in a normal winding up.

In the Society's view this will have an adverse impact on the position of the general body of creditors, including trade creditors (who, it should be remembered, are also employers), not only in the situation of a failed rescue attempt, but also, ultimately, in all liquidations. This was a reason for our not favouring Option D in the 1998/99 consultation paper. For this reason also, we would suggest that the PWIF be treated in the same way as it would in a normal liquidation, i.e. it should have a preferential claim to the extent provided for by the statutory limits in the Companies Ordinance and should be an ordinary creditor for any additional amounts that it has paid out to employees.

Furthermore, under the proposals, there is apparently no provision for the payments made out of the trust account to be "clawed back" by the company in the event that the rescue fails and the company is wound up. Equity would suggest that the company should be able to claim from the PWIF the difference between the statutory preferential claim limits under section 265 of the Companies Ordinance and the amounts paid out by the trust account, which are equivalent to the ex-gratia payment limits under the PWIF. This difference represents the assets of the company that should have been available to the general body of creditors were it not for the setting up of the trust account.

Under the proposals, relevant employees who have been paid out of the trust account will not be able to claim against the PWIF for entitlements accruing before the PS commenced. If the company goes into liquidation, therefore, the general body of creditors will in effect have already paid out the PWIF limits on behalf of the PWIF, without any recourse. As additional loans to the company, supplied most likely by banks, may be needed to fund the trust, the scope for successful rescues will be diminished if the company, on behalf of creditors generally, is not able to claim against the PWIF by subrogation for the monies paid to employees out of the trust.

Consideration should also be given to providing for third party investors who are willing to fund the trust account to have a right of subrogation to the employees' claims against the PWIF in the event of a winding up; or, for trust funds provided by a third party investor to be given priority over other debts of the company in the context of either the voluntary arrangement or the winding up of the company, in a similar way to operating capital provided to the company during moratorium under section 18 of the Bill.

Sections 23 and 25 of Schedule 7 to the Bill

Section 23 of Schedule 7 to the Companies (Corporate Rescue) Bill provides that a resolution is invalid if more than 50% in value of those creditors who are, to the best of the Chairman's belief, not connected with the company have voted against it. Section 25 provides that for the purpose of section 23, a person is connected with a company if (a) he is a director or shadow director of the company or an associate, within the meaning of section 51B of the Bankruptcy Ordinance, of such director or shadow director; or (b) he is an associate, within the meaning of section 51B, of the company.

Given the limited scope of the definition of an "associate" in the Bankruptcy Ordinance, it is possible for holding companies that are substantial shareholders not to be counted as connected persons and to be able to affect the outcome of the creditors' meeting, not necessarily in the interests of creditors as a whole. The Society therefore suggests that the definition in section 25 be amended to cover holding companies, to avoid potential abuses that may currently occur.

We hope that you find the above comments to be constructive. If you have any questions on this submission, please feel free to contact either Mr. John Tang, Assistant Director (Business & Practice) or myself.

Yours faithfully,

PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS & PRACTICE)

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Encls.