**BY FAX AND BY POST**
**(2869 6794)**

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The Hon. Margaret Ng, Chairman
Bills Committee on Companies
(Corporate Rescue) Bill,
Legislative Council Secretariat,
3rd Floor, Citibank Tower,
3 Garden Road, Central,
Hong Kong.

Dear Ms. Ng,

**Companies (Corporate Rescue) Bill**

Thank you for giving us the opportunity to present our views on the above Bill at the session of the Bills Committee held on 22 October 2001.

At that meeting, after listening to the views expressed, you asked delegations to consider whether the Bill in its present form would merely be ineffective and rarely used or whether beyond this, it would in practice have an adverse impact. We subsequently received a letter from the Clerk to the Bills Committee inviting our further views.

**Problems with the trust fund arrangements**

Firstly, we would like to repeat our position that in principle we support the introduction of legislation to provide a framework for a corporate rescue procedure. We believe that legislation of this nature is important for the business and investment environment in Hong Kong.

At the same time, the Society has consistently indicated its strong reservations towards any proposal to require an employer to fund all Employment Ordinance entitlements owing to
--- employees before being able to enter into provisional supervision ("PSN"). I attach at Appendix 1 for your information a copy of the Society's response to the Administration's consultation paper on the treatment of employees in PSN which was issued in December 1998.

We are concerned that the trust fund arrangements envisaged under the Bill will have a distorting effect on Hong Kong's existing insolvency regime. This is because, as we have previously pointed out, unlike the Protection of Wages on Insolvency Fund ("PWIF") and the preferential payments in a winding-up provided for under section 265 of the Companies Ordinance ("CO"), the Bill, as drafted, places no limit on the entitlements under the Employment Ordinance ("EO") that must be provided for former employees under the trust fund, other than those entitlements that are capped under the EO itself.

Under both the PWIF and the CO, there is a cap on the absolute amounts payable for each type of entitlement (with the exception of accrued holiday pay under the CO) and in addition the

types of entitlements covered under the relevant legislation are also confined primarily to three, being wages in arrears, wages in lieu of notice and severance/long service payments. Under the EO, other than for severance payments, there is no ceiling on the amount of any entitlements and there are several types of entitlements covered which are additional to those applicable under the PWIF and the CO. Under the EO, employees may be entitled to all of the following payments:

- any payment in lieu of notice payable under Part II of the Ordinance, in the case of a dismissal without due notice;
- any end of year payment payable under Part IIA;
- any maternity leave pay or sum payable under Part III;
- any severance payment payable under Part VA or any long service payment payable under Part VB;
- any sickness allowance or sum payable under Part VII;
- any holiday pay payable under Part VIII;
- any annual leave pay payable under Part VIIIA; and
- any other payments due to employees under the Ordinance (including for example accrued wages).

One of the implications of the above situation is that under the trust fund, for example, a highly-paid employee who is on one year's notice would have to be paid a year's salary in lieu of notice in the event of his/her employment being terminated under PSN. The situation is compounded by the fact that there are no provisions in the Bill that distinguish directors and connected persons from other employees. It is quite possible therefore that directorate staff with employment contracts will in practice be entitled to sizeable payouts from the trust fund and also that senior staff will intentionally restructure their compensation terms in future to ensure that they will derive the maximum benefit from the proposed arrangements.

--- The table at Appendix 2 sets out, as we understand the situation, the disparities that will result in relation to employee entitlements under different insolvency-related procedures if the Bill is implemented in its present form.

Generally speaking, employees will see PSN as a much better option for them financially than a liquidation and they will have a clear interest in seeing an employer who is in financial difficulties embarking upon PSN first even if the likelihood is that ultimately the company will go into liquidation. They may even hope to see it wound up. The Administration has indicated that, in its view, if a PSN fails and the company proceeds into liquidation, then the monies in the trust fund will be ring-fenced and may be used only to satisfy employee entitlements. This could have implications in terms of both principle and practice.

In principle this will potentially establish an alternative route to a winding up under which one particular group of creditors will benefit to a much greater extent than they would do under the existing winding up procedures, while the general body of creditors will suffer a corresponding disbenefit. The Bill will in effect create a statutory preference in favour of employees. As a direct result of this, employees may in practice have an incentive to appear co-operative at the outset of PSN but subsequently be unco-operative with the provisional supervisor so that he/she is reluctant to retain them and/or so that the proposal for a voluntary arrangement is seen as unattractive to other creditors and collapses due to lack of support. This is because employees will receive their full EO

entitlements in the event that a liquidation ensues or they are terminated, whereas they will be immediately entitled only to arrears of wages if they are retained.

One likely consequence of the implementation of the Bill as currently drafted is that there will in time be pressure to change the PWIF Ordinance and section 265, CO to bring them into line with the most favourable terms available in a winding up, i.e. those prevailing under the corporate rescue legislation; but this could be done only at the expense of the interests of the general body of creditors.

It should also be appreciated that while employees, however highly-paid, will be fully protected under the Bill if, after initiating PSN, the eventual outcome is a liquidation, then trade creditors could well be worse of then they would have been had the company been wound up directly. This could well have a very damaging effect on small trade creditors, who will also employ staff who are themselves at risk of redundancy.

Hence the Society's view that if the Bill is implemented with the trust fund arrangements in their present form, then the Bill will create distortions in the existing regime, as a consequence of which the legislation may be worse than merely ineffective and could in practice be positively harmful.

**A way forward**

We believe however that the potentially adverse impacts of the Bill outlined above, could be alleviated if the proposals were brought more into line with the existing insolvency regime and any distortions minimised. We also believe that this would be justified as the equivalent procedures for corporate rescue overseas are commonly treated on the same footing as an insolvency. It is also worth noting that, even now, in Hong Kong a receivership is treated on the same basis as an insolvency proceeding and the priority payments to workers follow the statutory limits under section 265, CO.

As we have previously indicated, our preferred arrangement in relation to employees entitlements would be for the scope of the PWIF to be expanded to cover employees terminated in a PSN, as originally proposed by the Law Reform Commission. However, we understand that there has been opposition from various interested parties to this proposal and therefore we should like to propose another option for consideration. We would instead suggest that a cap be placed on the amount that is required to be provided for any given employee under the trust fund and that the cap be set at the ceiling for payments under the PWIF which, as indicated at Appendix 2, we understand to be currently $258,500. For any entitlements owing above that amount, employees should be regarded as ordinary unsecured creditors and should be entitled to participate in and vote at relevant meetings of creditors under the PSN procedure.

Consideration should also be given to providing in the Bill that if an attempted PSN fails and the company goes into liquidation, then the trust fund monies revert to being part of the general assets of the company which are available for the benefit of all creditors. This would also help to bring the arrangements into line with the existing procedures.

Finally, the Society would also like to reiterate its support for insolvent trading provisions, subject to the detailed comments contained in our submission of 25 September 2001. We would emphasise the importance of introducing legislation to deal with insolvent trading as soon as possible. This will encourage directors to take early action to avoid trading deeper into debt and further dissipating assets at the expense potentially of employees and other creditors.

This submission focuses on the issue of the trust fund, as requested. Our comments on other matters and on the detailed provisions of the Bill are contained in our previous submission referred to above.

Yours sincerely,

PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS & PRACTICE)
HONG KONG SOCIETY OF ACCOUNTANTS

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Encl.