An Analysis of the Corporate Rescue Objectives: Voluntary Administration in Australia, Administration Order in the United Kingdom and Provisional Supervision in Hong Kong

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Abstract

The global financial crisis in 2008 has greatly reduced the profitability of companies around the world and many companies failed to repay their debts. Some companies were fortunate enough to rescue their businesses through corporate rehabilitation regime, some went into liquidation.

In Hong Kong, insolvent companies that are unable to meet their debts most likely end up in winding up. This is due to the fact that Hong Kong does not have statutory corporate rescue procedures like many major jurisdictions.

In fact, Hong Kong realized the need to establish corporate rescue regime early before the several major financial crisis. A lot of effort and time was put into the research by the Law Reform Commission in 1996, and the Companies (Corporate Rescue) Bill 2001 was initiated. However, the legislation has never been passed through the Legislative Council.

Following the Asian Financial Crisis of the late 1990s, many countries in Asia have put in place or modified their insolvency and restructuring legislation. As one of the major financial centres in the world, Hong Kong should implement corporate rehabilitation legislations that are in line with jurisdictions worldwide.

This study is divided into two parts. The first part is about the concept of corporate rescue and its advantages. The second part is the analysis of provisional supervision, with reference to the voluntary administration in Australia and the administration in the United Kingdom.
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Chapter 1 Introduction

The “credit crunch” of 2007-2008 has greatly affected companies worldwide and brings about numerous corporate failures, Hong Kong is no exception. In Hong Kong, companies such as U-Right, 3-D Gold Jewellery, Smart Union Group (Holdings) Limited and Peace Mark (Holdings) Limited were forced to close down.

Provisional liquidation may not be appropriate for a company merely facing a short-term crisis which is not yet insolvent and there is no danger to its assets. “There is indeed a desire to rescue rather than liquidate”. ¹ To give such enterprises a chance to turn around, a number of countries such as the United States (US)², the United Kingdom (UK)³ and Australia⁴ have enacted a law on corporate rescue procedures. Enterprises which face financial problems are allowed to undergo debt restructuring during the "moratorium", instead of liquidate immediately. In Hong Kong, a bill⁵ on corporate rescue was put to the Legislative Council several years ago but held back due to objection from various parties.

At present, companies in financial difficulty could only opt for non-statutory arrangement with their creditors, a compromise or arrangement under s 166 of the Companies Ordinance (CO) or effect a corporate restructuring by a provisional liquidator appointed under s 193 of the CO in the course of winding up. Under these situations, it is generally difficult to reorganise a company in financial difficulty. The use of provisional liquidation as a corporate rescue method has been discouraged by the Hong Kong Court of Appeal decision in Re Legend International Resorts Ltd.⁶ In view of the expected

² Chapter 11 of the US Bankruptcy Code.
³ Enterprise Act 2002.
⁴ Corporations Act Pt 5.3A.
⁵ Companies (Corporate Rescue) Bill 2001.
⁶ [2006] 2 HKLRD 192.
increase in business closures and insolvencies, there is a need to introduce a formal corporate rescue procedure to bridge the gap. Given the majority of businesses in Hong Kong are small and medium size enterprises (SMEs)\(^7\), the ideal procedure should be at lowest cost and highest effectiveness\(^8\).

\(^7\) There are about 280,000 small and medium enterprises (SMEs) in Hong Kong. They constitute over 98% of our business establishments and employ about 50% of our workforce in the private sector.

Chapter 2 The concept of corporate rescue

Corporate rescue does not necessarily mean keeping the company structure in its current form, but rather alter the structure to support the future development of the company.\(^9\) Besides, rescue procedures involve going beyond the normal managerial responses to corporate troubles so it may operate through informal mechanisms and formal legal process.\(^10\) Many developed countries and major international financial centres such as the UK, Australia and the US. Even Singapore, the competitor of Hong Kong, has their own corporate rescue legislation.

In the US, the US Bankruptcy Code contains Chapter 11 where the statutory goal is the preparation and confirmation of a reorganization plan. Chapter 11 sets out the reorganizational steps and requires many potential court hearings including a hearing to determine whether adequate information has been disclosed to investors before voting on the plan.\(^11\) The one size fits all approach towards corporate reorganization and small businesses are required to follow the same reorganization steps as large conglomerates. There has been much criticism about the applicability of the procedure on small businesses. Many Chapter 11 small business cases failed and finally adopted Chapter 7 to liquidate the companies.\(^12\) With small businesses as the majority in Hong Kong, Chapter 11 shall not be applied in Hong Kong.\(^13\)

In Singapore, judicial management has been used for a long time and it reflects

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\(^13\) The concept of Chapter 11 is “debtor in possession”, the Law Reform Commission believed it was not acceptable to creditors in Hong Kong.
Singapore’s own response to introducing rescue philosophies into its insolvency regime.\(^\text{14}\) Judicial management in Singapore includes a statutory moratorium on creditor enforcement actions that is similar in concept and effect to Chapter 11 of the US Bankruptcy Code\(^\text{15}\). Therefore, we are not going to discuss it in this study.

2. Advantages for introducing corporate rescue scheme in Hong Kong

According to the Companies Registry, there are more and more Hong Kong companies being wound up. There was a huge increase in number, from only 900 in 2007 to 1,175 in 2009. However, Hong Kong does not have any corporate rescue legislation. In response to the rising trend, Hong Kong should introduce the corporate rescue procedure in order to match the international trend and to maintain its status as a major international financial centre.

Effective corporate rescue legislation is important for corporate survival, retention of the value of corporate assets and generation of higher returns for creditors than an immediate winding up.\(^\text{16}\) In 2003, a survey was conducted by Ernst & Young with 3,000 companies in Hong Kong. 83.7 percent of the respondents supported the introduction of corporate rescue bill. The survey also showed that 16.6 percent of companies' profits had been significantly affected by bad debt, which could explain their support for the bill.\(^\text{17}\) Ernst & Young insolvency division managing director Kenneth Yeo Boon Ann said experience in the U.S. had shown that about half of all firms in danger of failure could be resurrected during grace periods granted by moratoriums. In Australia about 20 percent of

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\(^{17}\) “Corporate rescue bill wins support”, *South China Morning Post*, 11 December 2003, p 4.
firms could resume normal trading after their rescue, while creditors could get back 25 percent of their loans to the firms. This record was much better than in Hong Kong, since the absence of a corporate rescue bill meant many firms went directly into liquidation and, as a result, creditors often got back less than 10 percent of their claims.\(^\text{18}\)

In 1999, the chairman of the Hong Kong Society of Accountants (now it is called the Hong Kong Institute of Certified Public Accountants ‘HKICPA’) insolvency practitioners committee, John Lees, stressed that one of the most important benefits of corporate rescue scheme is that provisional supervision should not only save business but save employment. He said that the liquidation of one company could have knock-on effects on its trading partners which can lead to further job losses.\(^\text{19}\)

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\(^{18}\) “SAR accused of dragging heels on rescue bill; Ernst partner urges action to cut bankruptcies”, *South China Morning Post*, 23 September 2002, p 2.

\(^{19}\) “Early help urged for troubled companies”, *Hong Kong Standard*, 12 February 1999, p 1.
Chapter 3 Existing options in Hong Kong to reorganize a company

Currently in Hong Kong, there is no statutory corporate rescue procedure. A company facing financial problems can only reorganize itself under Company Ordinance s 166. This section allows a company to compromise or make arrangements with its creditors or shareholders. However, the sanction of the court is required.\textsuperscript{20}

A compromise is an agreement between a company and its creditors which involves a modification of their rights in settlement of their claims where there is dispute or difficulty in enforcing creditors’ rights.\textsuperscript{21} Accepting a repayment of lesser amount in settlement of a debt or accepting repayment by installments for immediate due debt are examples of compromise.

An arrangement refers to any other type of agreement modifying the rights between the company and its creditors or shareholders.\textsuperscript{22} An arrangement is different from a compromise in which it can be entered into even there is no dispute or difficulty in enforcing rights and the company is not in financial distress.\textsuperscript{23}

The steps for a s 166 scheme are:

1. Apply for a court order to hold creditors or shareholders’ meetings

2. Obtain a majority representing 75 percent in value of the creditors or members at the meeting

   (or at each meeting when there is more than one)

3. Obtain court approval of the scheme

4. Register the court order with the Companies Registry

\textsuperscript{20} Vanessa Stott, \textit{Hong Kong Company Law} (Hong Kong: Longman, 2003) p 358-363.
\textsuperscript{21} \textit{Re Guardian Assurance Company} [1917] 1 Ch 431 at 443.
\textsuperscript{22} \textit{Re Wah Nam Group Ltd (No 2)} [2003] 1 HKLRD 282.
\textsuperscript{23} \textit{Mercantile Investment and General Trust Co v International Co of Mexico} [1893] 1 Ch 484.
Once the above requirements have been satisfied, the scheme is binding on all the creditors or members of the company.

Despite the existence of s 166 which seems for corporate rescue, Hong Kong still lacks a comprehensive yet simple voluntary corporate rescue regime. The purpose of insolvency law in Hong Kong is to realize assets and repay the creditors, which was not a rescue type culture.\(^\text{24}\) A fire sale of a company when it could be rescued effectively will harm the interests of all stakeholders, including the employees, creditors and shareholders. This is the reason why various jurisdictions have developed legislation to assist the process of corporate rescue.\(^\text{25}\)

\(^{24}\) See n 14 above, p 115.

\(^{25}\) Pang Melissa Kaye, “Corporate Rescue and Hong Kong's Statutory Limitations” (2009) 8 Hong Kong Lawyer 1.
Chapter 4 Voluntary Administration in Australia

In Australia, the value of corporate rescue has been recognized by the Australian Law Reform Commission General Insolvency Inquiry (the Harmer Report) and by the Federal Parliament which enacted the corporate rescue recommendations of the Harmer Report by introducing voluntary administration in 1993. Subsequent government insolvency inquiries have confirmed the value of effective corporate rescue laws. Voluntary administration is the most common formal corporate rescue process in Australia.

4.1 Appointment of Administrator

Appointment is made either by directors, liquidators, or a charge with enforcement rights over substantially all the company’s property. The administrator is usually appointed by the company’s directors, after they have assessed that the company is insolvent or is likely to be insolvent. An administrator must be an independent registered liquidator. Those who have close relationships with the company, its stakeholders or its business will be excluded.

4.2 Powers of Administrator

On appointment, the administrator will take control over the company. The appointed administrator will assess the prospects of the troubled company and make recommendations to creditors regarding the company’s future. The powers of other

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26 Corporations Act Pt 5.3A.
28 Corporations Act 2001, s 436A(1).
29 Ibid. s 436B(1).
30 Ibid. s 436C(1).
31 Ole Kramp, The role of the administrator in the corporate rescue process in Australia and Germany (Germany: GRIN Verlag, 2008), p 3-10.
32 OCEC, Forum for Asian Insolvency Reform – Insolvency Reform in Asia: An Assessment of the Recent Developments and the Role of Judiciary, February 2001, available
officers of the company may not be exercised without the administrator’s written approval. It must be noted that these powers exist only up to the point when the creditors decide the fate of the company and any powers during a deed of company arrangement will depend on the wording of the deed itself.

4.3 Procedure

The process of voluntary administration commences with the appointment of an administrator.

During the administration, there is a statutory moratorium on legal proceedings, execution against company property and wind up proceedings. During the process, two creditors meetings will be held. The first meeting of creditors must be held within eight business days after the administration begins. The purpose of the meeting is to allow the creditors to determine whether to appoint a committee of creditors. The second meeting must be convened within 20 business days of the appointment. The administrator will put forward a proposal and the creditors will vote to determine the fate of the company – to liquidate or to continue to trade under a Deed of Company Arrangement (DCA). DCA is a formal arrangement between a company and its creditors. Once this is executed, the


33 Under s 437A the administrator has control of the company's business, property and affairs as well as the ability to carry on or terminate as well as sell the business. He or she may also perform any of the functions or powers of officers when the company is not in administration: see *Brash Holdings v Shafir* (1994) 12 ACLC 619.


35 Corporations Act 2001, s 435C(1)(a).

36 Corporations Act 2001 (Cth), s 436E.


38 *Ibid.* s 439A.

39 This deed may be in one of the following forms: (a) a moratorium under which the company is given extra time to repay its debt accrued before the commencement of voluntary administration; (b) a compromise whereby the creditors agree to accept payment of a lesser amount as settlement of the company’s debts; (c) a combination of a moratorium and compromise with creditors; and (d) An orderly sale of all the company’s property over a period of time that was mutually agreed.
administration ends and the terms of the arrangement replace the statutory moratorium.

4.4 Objective

The objective of Part 5.3A, as stated in section 435A of the Law, is to allow the “business, property and affairs of an insolvent company to be administered in such a way that:

(a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or

(b) if it is not possible for the company or its business to continue in existence — results in a better return for the company’s creditors and members than would result from an immediate winding up of the company.”

The first objective to continue the existence of the company is significant in preserving employment, positions of creditors and other members. When a financial distressed company can be saved, employees can retain their jobs and assist the company to turnaround by smoothing the operation of the company. Thus, revenue may be generated from business and creditors can get their money back. The ultimate goal is to continue the existence of the company.

The second objective emphasizes the maximization of return for the company’s creditors or members, even if it is not possible to prevent the company from liquidation.40

4.5 How the procedure assists in achieving the objectives

The strategic options available will be significantly affected the current financial position of the company. Therefore, the VA is designed in such way to allow a speedy process to ‘save’ the company. In order to enhance the possibility of rescuing the distressed

company and to maximize the return to its creditors and members, the legislation imposes a
tight timetable on administrators in carrying out their tasks to avoid delays.

An empirical analysis of a sample of listed public companies over the critical time
immediately prior to VA suggests that the companies’ prospects for reorganization were
significantly diminished in the time prior to VA. Due to the compounding effects of
financial distress, the liquidity of the company may drop quickly to a point in which the
chance of saving the company will be minimal. Therefore, directors should have taken
actions to enter VA earlier as to enhance the effectiveness of the procedure.  

To ensure the administrator have adequate time to develop a best plan for the
company, the part 5.3A procedure may be extended with court approval. In Re Diamond
Press Australia Pty Limited Barrett J said “the function of the court on an application such
as this is as I see it to strike an appropriate balance between on the one hand the expectation
that administration will be a relatively speedy and summary matter; and on the other hand
the requirement that undue speed should not be allowed to prejudice sensible and
constructive actions directed towards maximising the return for creditors and any return for
shareholders”. The court will have regard to the objects of Part 5.3A when considering any
application to extend time.

4.6 Any abuse of the objectives

Young J in Sydney Land Corp Pty Ltd v Kalon Pty Ltd noted the section is to be
used in a broad or general way rather than seeking to make a strict analysis of the meaning
of particular words in the provision. It is not stated whether the first object in paragraph (a),

41 James Routledge, “The Decision to Enter Voluntary Administration: Timely Strategy or Last Resort” (2007)
42 Re Pan Pharmaceuticals Limited (2003) FCA 598 (75 day extension granted).
is a necessary precondition for the use of the Part. The raises the question as to whether the procedure can be used only to obtain a 'better return' than in an immediate winding-up. Decision in *Dallinger v Halcha Holdings*\(^{45}\) suggested that it is acceptable to use Pt 5.3A to put a company into administration with no intention to have the company or business survive.\(^{46}\) However, an administration may be terminated by court under s 447A if it is being abused. In *Aloridge Pty Ltd v Christianos*\(^{47}\), Burchett J found that the appointment of the administrator had been made, not in the interests of the company or its creditors, but to wrest control of the company's affairs from the provisional liquidator in the hope that the administrator will favor Christianos. Therefore, an order was made under s.447A to terminate the administration.

There are two key incentives for directors to apply for voluntary administration. The first is the ability to choose the administrator. The second is that directors may avoid potential liability for insolvent trading. Under the Law, directors have a duty to prevent the company from engaging in insolvent trading.\(^{48}\) A breach of this duty makes directors owe the personal liability to compensate the company or its creditors for any loss resulted from insolvent trading.\(^{49}\) This can be one of the reasons why the majority cases of voluntary administration is initiated by directors of the companies.\(^{50}\)

**4.7 Conclusion**

Compared to the insolvency laws, which usually force the companies into

\(^{46}\) Sundberg J commented in para 28"Section 435A does not in my view require Part 5.3A to be limited to the case where, at the date of the administrator's appointment, there is some prospect of saving a company from liquidation".
\(^{48}\) Corporations Act 2001 s 588G, 588H.
\(^{49}\) *Morley v Statewide Tobacco Services Ltd* (1992) 8 *ACSR* (305).
liquidation, the legislation of voluntary administration offers a chance for company to turnaround. Since the administration process is speedy, entering VA in a timely manner enhances the probability of the company being saved. In addition, VA is relatively inexpensive to initiate. Unnecessary court involvement will be eliminated. Hence, administration costs can be reduced. In many cases, the court will be totally uninvolved. However, the court will supervise the operation of the administration when creditors, administrators or other interested persons consider the scheme is being abused. It must be noted that the supervision power is not to be used to make or re-make commercial decisions of the administrators.\(^{51}\) Another good point is that, given there is no prescription in the legislation as to what the deed must contain, tailor-made and creative solutions are possible.\(^{52}\) Nevertheless, the support from creditors, employees and clients play a key role.\(^{53}\) These may explain why the VA has out-weighted liquidation in terms of number of regimes initiated.

Statistics reveals that only 7.3 percent of companies entering some sort of insolvency administration successfully execute a DCA. There has been a decline from 14.2 percent in 1999 to the current level.\(^{54}\) However, it must be noted that whether a DCA is executed is not the key determinant of success or failure of VA.\(^{55}\) Since DCA is simply a statutory outcome, entering into a DCA does not have any practical implications. There is

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\(^{51}\) Re Pan Pharmaceuticals Ltd (n 40 above)


little concrete evidence to prove whether VA has really achieved the statutory objective of “a better return for the company’s creditor’.”

It should also be acknowledged that for some companies, entry into VA might result in an undesirable outcome regardless of the timing.\textsuperscript{56} This is the case for companies that are experiencing financial distress as a result of economic distress. As economic distress results from external factors that are beyond the control of the company, little can be done in VA to rescue the companies. The VA process will merely delay an inevitable liquidation.

Chapter 5 Administration Order in the United Kingdom

There are two main routes to the opening of administration proceedings. One is the process of appointment through the courts and the other is out of court appointment.

5. 1 Appointment of Administrator

The procedure for court appointment through the courts starts with an application made by one or more of these persons:

- The company;
- The directors of the company;
- One or more creditors;
- The clerk, or justice’s chief executive, of a magistrates’ court in connect with the enforcement of a fine on the company under s.87A of the Magistrates’ Courts Act 1980; or
- The supervisor of a voluntary arrangement of the company

The ‘out of court’ appointment process enables the holder of a floating charge to make an appointment\(^{57}\) or enables the company or its directors to make the appointment.\(^{58}\)

It can speed up the procedures and a company can gain the benefit of the moratorium at an early stage so the chances of survival for the company can be increased.\(^{59}\)

The ‘notice of intention to appoint’ is to be filed at court together with a statement from administrator consenting to act and stating that an objective of the administration is likely be achieved for both of the appointments in order to appoint the administrator.\(^{60}\)

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\(^{57}\) Insolvency Act 1986 Sch B1, paras 14-21.

\(^{58}\) Ibid. Sch B1, paras 22-34.

\(^{59}\) Rebecca Parry, Corporate Rescue (The United Kingdom: Sweet & Maxwell, 2008), p 44.

\(^{60}\) Insolvency Act 1986 Sch 2B, paras 18-19.
the company gains the protection of a moratorium while it is in administration.61

5.2 Qualification of the administrator

As the administrator is given wide managerial powers and the company depends on his approach, his professional expertise is needed to drive the process.62 He is subject to the control of the court, however, the court will not tend to interfere in matters of professional judgment. In the light of the skilled and demanding nature of the role of a person who is appointed to act as administrator must be qualified to act as an insolvency practitioner.63 Therefore, he must be a member of a recognized professional body,64 and authorized by that body to act as an insolvency practitioner; or he must be a non-member of such a body but subject to its rules in respect of the profession of insolvency practitioner;65 or they must have authorization granted by a competent authority such as the Secretary of State.66 Besides, he must not be subject to any disqualification such as bankruptcy and he is ineligible if he lacks capacity under mental health legislation.

5.3 Power of the administrator

The administrator is required to exercise his powers in the interests of the company’s creditors as a whole67 and he must perform his functions as quickly and efficiently with reasonably practicable.68 The administrator has the power to do anything necessary or expedient in relation to the management of the affairs, business or property of the company.69 He will take custody and control of all the property to which he believes the

61 Ibid. Sch 2B, para 43.
62 See n 59 above, p 25.
63 Insolvency Act 1986 Sch B1, para 6.
64 Ibid. s 390(2)(a) and s 391.
65 Ibid. s 391(3).
66 Ibid. s 390(2)(b).
67 Ibid. Sch B1, para 3(2).
68 Ibid. Sch B1, para 5.
69 Ibid. Sch B1, para 59.
company is entitled.\textsuperscript{70} Besides, the court can empower the administrator to override any fixed security on assets of the company, or to sell assets. With the permission of the court, he can make payments to secured, preferential creditors and unsecured creditors.\textsuperscript{71} In \textit{Re GHE Realisations Ltd}\textsuperscript{72}, the approach to be taken by the court in deciding whether to grant permission to the administrator to make distributions under this provision was considered. He may also remove any director of the company and appoint director.\textsuperscript{73}

\textbf{5.4 Procedure}

The administrator submits a statement of his proposals within as soon as is reasonably practicable after the company enters administration\textsuperscript{74} or within 8 weeks after the company enters administration.\textsuperscript{75} Then, an initial creditors’ meeting must be held as soon as is reasonably practicable after the company enters administration or within a period of 10 weeks after the company enters administration.\textsuperscript{76} The administrator will present a copy of his proposals at this meeting and the creditors can either approve the proposals without modifications or approve them with modifications to which the administrator consents.\textsuperscript{77} With the modifications of proposals that have been approved, the administrator must call a further meeting.\textsuperscript{78} The administrator must report the conclusion of the meeting to the court and the registrar of companies. If the creditors have refused to accept the proposals, or a revision of the proposals, the court may order that the administrator’s appointment is to cease to have effect, or adjourn the hearing, make an interim order, make an order on a
petition for winding up, or make such order as it considers appropriate.\textsuperscript{79}

Administration is only a facilitative procedure, designed to give the company short-term protection until some other measures can be put in place, such as a voluntary arrangement or scheme of arrangement, reflecting the compromise to the claims of creditors put forward in the administrator’s proposals, or in a case where no viable rescue proposals can be put in place, the liquidation of the company. \textsuperscript{80} Therefore, administration can be considered as a successful means to an end.\textsuperscript{81}

5.5 Objectives

There are three objectives for administration which are introduced by the Enterprise Act 2002 (EA 2002) and these objectives are arranged in a hierarchy.

(1) The administrator of a company must perform his functions with the objective of:

(a) Rescuing the company as a going concern,\textsuperscript{82} or

(b) Achieving a better result for the company’s creditors as a whole than would be likely if the company were wound up (without first being in administration),\textsuperscript{83} or

(c) Realizing property in order to make a distribution to one or more secured or preferential creditors.\textsuperscript{84}

(2) Subject to sub-paragraph (4), the administrator of a company must perform his functions in the interests of the company’s creditors as a whole.

(3) The administrator must perform his functions with the objective specified in sub-paragraph (1)(a) unless he thinks either:

\begin{itemize}
\item \textsuperscript{79} Ibid. Sch B1, para 55.
\item \textsuperscript{80} Katarzyna Gromek & Rebecca Parry, \textit{Corporate Rescue: an overview of recent developments from selected countries in Europe} (The Netherlands: Kluwer Law International, 2004), p 168.
\item \textsuperscript{81} John Tribe, “Company Voluntary Arrangements and Rescue: A New Hope and a Tudor Orthodoxy” (2009) 3 \textit{The Journal of Business Law} 459.
\item \textsuperscript{82} Insolvency Act 1986, Sch 2B, para 3(1)(a).
\item \textsuperscript{83} Ibid. Sch 2B, para 3(1)(b).
\item \textsuperscript{84} Ibid. Sch 2B, para 3(1)(c).
\end{itemize}
(a) that it is not reasonably practicable to achieve that objective, or

(b) that the objective specified in sub-paragraph (1)(b) would achieve a better result for
the company’s creditors as a whole.

(4) The administrator may perform his functions with the objective specified in sub-
paragraph (1)(c) only if :

(a) he thinks that it is not reasonably practicable to achieve either of the objectives
specified in sub-paragraph (1)(a) and (b), and

(b) he does not unnecessarily harm the interests of the creditors of the company as a whole.

For the previous objective ‘the survival of the company, and the whole or any part
of its understanding, as a going concern’, in the opinion of Harman J. in Re Rowbotham
Baxter Ltd[85], it did not cover the survival of a hive-down company[86], as opposed to the
debtor company itself, so the government would like to change the new wording to
rescuing the company and to add ‘as a going concern’ in order to make it clear that the
primary objective was not to preserve an empty shell of a company but rather to rescue
the company with the whole or a substantial part of its business.[87] This would also
increase the incentive for directors of the company to enter into administration as the
objective is to rescue the company itself rather than its business.[88] The government also
knows that it is not reasonably practicable to preserve both the company and the
business and the objective of ‘rescuing the company as a going concern’ is not

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[86] That is, a specially formed subsidiary of the company in administration to whom the whole or a substantial
part of the company's business and assets are transferred but not the liabilities. It is then sold and the purchase
price paid to the company in administration as sole beneficial owner of the shares.
[88] See n 80 above, p 163.
applicable so it has the second objective - ‘Achieving a better result for the company’s creditors as a whole than would be likely if the company were wound up (without first being in administration)’.  

The second objective requires a comparison with liquidation. In *Auto Management Services Ltd v Oracle Fleet UK Ltd*[^90^], Warren J. has opined that if it is reasonably possible that there will be a better result than in liquidation and in all but the most unlikely circumstances the result will be no worse, he would view this as a significant factor in the court’s decision. In this case, administration was considered to be likely to achieve a better outcome than liquidation, primarily on the basis that it would enable the value of key assets to be maximized and it is not necessary to demonstrate on a balance of probabilities that a better outcome is likely.

A hierarchy is established under the new provisions because the previous four objectives did not provide clear direction as to the preferred outcome of the administration. Hence, it can be easy for the administrator to identify with certainty which of the three objectives will be attained. In *Hammonds v Pro-Fit USA Ltd*[^91^], Warren J. stated that: “it is enough, for instance, for the administrator to be able to say ‘I want to achieve the first objective, rescue, and I think there is a real prospect of doing so. But if that fails, I wish to achieve a better out-turn for creditors and I think I can achieve that. If even that cannot be achieved, at least I will be able to realize assets and make payments to secured creditors’.”

### 5.6 Any abuse of the objectives

The administrator was under a duty to act in the interests of the company’s creditors

[^89^] See n 87 above, p 336.
[^90^] [2007] EWHC 392 (Ch).
as a whole. In the case of *Re British American Racing (Holdings) Ltd*[^92^], the judge did not accept the arguments of a minority shareholder that the administration order was being used for the purpose of excluding the minority shareholder from participating in the company. The company was insolvent and it was considered that the only remaining interest for the majority was the realization of shares in a subsidiary held by the company. The subsidiary was a motor racing team which it was no longer economic for the majority. Hence, the case could be distinguished from other cases where claims of minority oppression had been upheld.

On the other hand, an underlying strategic purpose behind a requested administration order was shown in *Doltable Ltd v Lexi Holdings Plc*[^93^], where the judge considered that none of the three purposes for administration has been made out. The judge pointed out that the primary purpose of the application for administration was to forestall a sale of the company’s property by a receiver, as the directors thought that a better price could be obtained for the property and the property was the company’s sole asset. This was viewed as an improper purpose for the administration. In this case, the price obtained by the receiver proved inadequate and there were other processes available to the directors.

### 5.7 Conclusion

Amended statutory purposes of administration and administrators’ proposals only required a simple majority which based on the calculation of the amount of the creditors’ claim, are the factors that lead a company’s management to consider that the most appropriate form of insolvency proceeding to undertake is the new post EA 2002

[^92^]: [2004] EWHC 2497 (Ch).
[^93^]: [2005] EWHC 1804 (Ch).
administration provisions.\textsuperscript{94} Moreover, it is important that the court should scrutinize the feasibility of the purpose for administration and the administration orders are likely to bring the benefit. However, the court will accept the administrator’s view of what is reasonably practicable and will not interfere with his decision unless it is established in bad faith or he did not act in reasonably.\textsuperscript{95}

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{94}] See n 81 above, p 473.
\item[\textsuperscript{95}] Katarzyna Gromek Broc & Rebecca Parry, \textit{Corporate Rescue: an overview of recent development} (The Netherlands, Kluwer Law International, 2006), p 64.
\end{itemize}
\end{footnotesize}
Chapter 6 Provisional Supervision

The concept of “provisional supervision” was first mentioned in the LRC’s Report on Corporate Rescue and Insolvent Trading in 1996. Two bills were proposed to the LegCo in 2000 and 2001. Due to objections from various parties, the proposals were not enacted.

In response to the global financial crisis, the Government reconsidered the introduction of a corporate rescue procedure to facilitate companies with long-term business prospects, but in short term financial distress, to turn around or restructure. A consultation paper called ‘Review of Corporate Rescue Procedure Legislative Proposals’ was released by Financial Services and the Treasury Bureau in October 2009.

The Provisional Supervision is a procedure which involves a moratorium on legal actions against a company in financial difficulty. A provisional supervisor will be appointed to oversee the process and decide appropriate solutions for the company.

6.1 Who can initiate the procedure

Under the 2001 Bill, provisional supervision could be initiated by a company or its directors or provisional liquidators or liquidators by appointing a provisional supervisor. Unlike some other jurisdictions such as the UK and Australia, the provisional supervision cannot be initiated by creditors. The LRC is of the view that most creditors would not have sufficient knowledge of the financial position of a company to make a judgment on whether the company should go for provisional supervision.

6.2 Qualification of Provisional Supervisor

The LRC proposed 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 be appointed as provisional supervisors.
6.3 Objective

The objectives for provisional supervision are as follows:

(a) The survival of the company, and the whole or any part of its undertaking, as a going concern;
(b) A more advantageous realisation of the company’s property than would be effected on a winding up of the company; and
(c) The more advantageous satisfaction, in whole or in part, of the debts and other liabilities of the company.

The above objectives are adapted from those laid down in Insolvency Act 1986. In the UK, there was a reform on this part in 2002. The new objectives are included in the EA 2002.

6.4 Procedure

The company had to file a notice of appointment of provisional supervisor and documents with the Registrar of Companies. Upon appointment, the provisional supervisor takes control of the company’s assets and business. He will assess the company’s financial position and determine the feasibility of developing a voluntary arrangement in settlement of the company’s debts or a scheme of arrangement of the company’s affairs.

In the first meeting of creditors, the provisional supervisor’s remuneration will be approved. Under provisional supervision, there is no such requirement to hold the first

96 Prior to the Enterprise Act 2002 amendments taking effect an administration order could be obtained for one of four purposes which were defined in s.8 of the Insolvency Act 1986:
(a) Attempting to ensure the survival of the company, and the whole or any part of its undertaking, as a going concern;
(b) Obtaining the approval of a voluntary arrangement;
(c) Obtaining the sanction of a compromise or arrangement under the Companies Act 1985, section 425; or
(d) Effecting a more advantageous realization of assets than would be possible under winding up. Commonly two or more of these grounds will be combined.
meeting of creditors within a specified time frame. If the provisional supervisor makes application to the court to extend the moratorium, the meeting could be held anytime within the maximum of six months.

In the second meeting of creditors, creditors will vote on the voluntary arrangement proposed by the provisional supervisor or wind up the company as a creditor’s voluntary winding up. It will be approved if a majority in number and in excess of two-thirds of the value of creditors voting is obtained. If applicable, the moratorium may be extended beyond initial moratorium period up to 6 months up to 12 months with court approval.

If the provisional supervisor determines that the objectives of the provisional supervision cannot be achieved, he must call a meeting of creditors to resolve to terminate the provisional supervision and wind up the company.97

6.5 Difference with s 166

The main difference between the existing provisions in Hong Kong and provisional supervision is the concept of the moratorium, which would protect a company from actions against it by its creditors during the period of the moratorium. Similar to corporate voluntary administration in Australia98, provisional supervision calls for a statutory framework with minimal court involvement.99

It follows the idea from the consultation paper that provisional supervision should complement, and not replace, existing restructuring arrangements under the CO and non-statutory arrangements with the advantages from both of the arrangements. For example,

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the advantage of scheme of arrangement under s 166 can bind all the creditors and the court can approve any requisite reconstruction in confirming the scheme.\textsuperscript{100}

It is suggested that Hong Kong should reform its law and introduce a rescue-oriented legal regime which brings closely into line with other rescue regimes such as Australia, and the UK.\textsuperscript{101}

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\textsuperscript{100}See n 87 above, p 387-408.
\textsuperscript{101}See n 14 above, p 116.
Chapter 7 Suggestions

After studying the corporate rescue regimes in Australia and the UK, we observe that the proposed provisional supervision in Hong Kong is partly based on the voluntary administration in Australia and partly on the administration order in the UK. Undoubtedly, adopting the good features of the developed system enhances the effectiveness of the proposed provisional supervision. Yet, in our opinion, the proposal of provisional supervision can be further modified to develop a better corporate rescue approach applicable to Hong Kong.

For the objectives of provisional supervision, Hong Kong should follow the objectives of UK laid down in EA 2002 instead of the old objectives. The modified objectives of administration in the UK are designed in a hierarchy form. They are clearly stated and it will be easier for the administrator to choose the best approach. As the concept of corporate rescue is new in Hong Kong, the provisional supervisor may not have sufficient experience to determine which objectives should first be achieved. With objectives clearly stated and ranked, the process of provisional supervision will be more efficient and smooth. Therefore, Hong Kong should take this factor into consideration and adopt the same objectives as in the UK.

Regarding the qualification requirements of the provisional supervisor, we believe solicitors holding a practising certificate issued under the Legal Practitioners Ordinance (Cap 159) and certified public accountants registered under the Professional Accountants Ordinance (Cap 50) eligible to be appointed as provisional supervisors so long as they are independent from the company. Lawyers are competence in examining the legal issues encountered in the process of provisional supervision and accountants are skillful to investigate the financial status of the company. However, we do believe there should be
professional examination on provisional supervisor in the long run. With the competence of provisional supervisor and the clear objectives laid down in law, they serve as a double protection to avoid people from abusing the corporate rescue scheme. This will foster the development of a comprehensive corporate rescue regime in Hong Kong.

Apart from the benefits provided by provisional supervision, there will be high costs involved. The costs to appoint professionals can be significant. SMEs in Hong Kong may not be able to afford the high fees and they simply choose not to adopt the rescue procedure. There may not be major or immediate impact upon the number of successful corporate rescues and restructurings in Hong Kong even after the implementation of provisional supervision.¹⁰² To provide incentives for the companies to adopt the procedure, it may be a good idea to set up a fund to assist these companies to enter into provisional supervision before it is too late.

Chapter 8 Conclusion

In conclusion, we are of the view that corporate rescue procedures should be introduced in Hong Kong. The proposed provisional supervision will be an important move in Hong Kong Law. Although the proposed system may not be perfect and may be subject to further modification in the future, this proposal should not be held back again. No delays should be tolerated. In order to sustain the competitiveness of Hong Kong, we should keep pace with other parts of the world not only in terms of trade, but also the legal system.
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