CO Rewrite
重寫《公司條例》

CO Rewrite

Rewrite of the Companies Ordinance

Consultation Paper

Draft Companies Bill First Phase Consultation

December 2009

Financial Services and the Treasury Bureau
www.fstb.gov.hk

ABOUT THIS DOCUMENT

1. This paper is published by the Financial Services and the Treasury Bureau ("FSTB") as part of the Companies Ordinance ("CO") rewrite exercise to consult the public on roughly half of the draft clauses of the Companies Bill ("CB"), namely Parts 1 to 2, 10 to 12 and 14 to 18 of the CB. Several complex issues are also highlighted for consultation. The second phase of the public consultation will be conducted on the remaining parts of the CB (except the part on consequential amendments) in early 2010.

2. After considering the views and comments, we aim to issue the consultation conclusions of the two phases of consultation in the second and third quarters of 2010 respectively. We aim to introduce the CB into the Legislative Council by the end of 2010. Meanwhile, we will introduce an amendment Bill into the Legislative Council in early 2010 to amend the CO ahead of the rewrite exercise to implement a number of changes.

3. A list of questions for consultation is set out for ease of reference after Chapter 9. Please send your comments to us on or before **16 March 2010**, by one of the following means:

   By mail to: Companies Bill Team
   Financial Services and the Treasury Bureau
   15/F, Queensway Government Offices
   66 Queensway
   Hong Kong

   By fax to: (852) 2869 4195

   By email to: co_rewrite@fstb.gov.hk

4. Any questions about this document may be addressed to Mr Arsene YIU, Administrative Secretary for Financial Services and the Treasury (Financial Services), who can be reached at (852) 2528 9077 (phone), (852) 2869 4195 (fax), or arseneyiu@fstb.gov.hk (email).

5. This consultation paper is also available on the FSTB's website http://www.fstb.gov.hk/fsb and the Companies Registry's website http://www.cr.gov.hk.

6. Submissions will be received on the basis that we may freely reproduce and publish them, in whole or in part, in any form and use, adapt or develop any proposal put forward without seeking permission or providing acknowledgment of the party making the proposal.

7. Please note that names of respondents, their affiliation(s) and comments may be posted on the FSTB's website, the Companies Registry's website or referred to in other documents we publish. If you do not wish your name and/or affiliation to be disclosed, please state so when making your submission. Any personal data submitted will only be used for purposes which are directly related to consultation purposes under this consultation paper. Such data may be transferred to other Government departments/agencies for the same purposes. For access to or correction of personal data contained in your submission, please contact Mr Arsene YIU (see paragraph 4 above for contact details).

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ABBREVIATIONS

ACA	Australia Corporations Act 2001
AG	Advisory Group
AGM	Annual General Meeting
CB	Companies Bill
CCASS	Central Clearing and Settlement System
CGR	Corporate Governance Review
CO	Companies Ordinance (Cap 32)
CR	Companies Registry
FSTB	Financial Services and the Treasury Bureau
HKICPA	Hong Kong Institute of Certified Public Accountants
LegCo	Legislative Council
NZCA	New Zealand Companies Act 1993
Registrar	Registrar of Companies
SCA	Singapore Companies Act (Cap 50)
SCCLR	Standing Committee on Company Law Reform
SEHK	The Stock Exchange of Hong Kong Limited
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance (Cap 571)
SMEs	Small and Medium-sized Enterprises
UK	United Kingdom
UKCA 2006	United Kingdom Companies Act 2006

EXECUTIVE SUMMARY

1. In mid-2006, the Government launched a major and comprehensive exercise to rewrite the CO. By updating and modernising the CO, we aim to make it more user-friendly and facilitate the conduct of business to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre.

2. We conducted three public consultations in 2007 and 2008 to gauge views on a number of complex subjects. Taking into account the views received, we have prepared draft clauses of the CB for further consultation in two phases. The first phase covers Parts 1, 2, 10 to 12 and 14 to 18 of the CB. The second phase consultation, due to be launched in the first quarter of 2010, will cover Parts 3 to 9, 13 and 19 to 20. This paper will:

   (a) outline the key legislative changes proposed in the CB;

   (b) highlight several issues for consultation; and

   (c) contain explanatory notes on the relevant draft Parts.

Enhancing Corporate Governance *(Chapter 2)*

3. To enhance transparency and accountability with companies' operations, as well as to provide greater opportunity for all shareholders to engage in company business in an informed way, we will codify the standard of directors' duty of care, skill and diligence; restrict the appointment of corporate directors; improve disclosure of company information; strengthen auditors' rights; enhance shareholders' engagement in the decision-making process and foster shareholder protection in the CB.

Ensuring Better Regulations *(Chapter 3)*

4. To ensure that the regulatory regime is effective and business-friendly, we propose to introduce in the CB a number of improvements to the company incorporation and name registration procedures, the filing of information and the registration of charges. Many of these will focus on encouraging and exploiting new forms of e-communication. We will also empower the Registrar to take action on "shadow companies" and to obtain more information from companies so as to enhance enforcement of the law.

Business Facilitation *(Chapter 4)*

5. We will allow SMEs to take advantage of simplified accounting and reporting requirements, thereby saving their compliance and business costs. We will also facilitate companies to dispense with AGMs by unanimous members' consent, and simplify some of the complex rules prescribed in the CO, such as the capital maintenance rules. In addition, we will introduce cheaper and less time-consuming alternatives to court procedures to deal with more straight-forward cases, such as a statutory amalgamation procedure for wholly-owned intra-group companies.

Modernising the Law *(Chapter 5)*

6. We will update provisions in the CO which are based on old concepts that no longer meet the needs of modern business, such as the assumption of paper-based communications between a company and its members. We will also retire some antiquated concepts that no longer serve any useful purposes (such as par value of shares), modernise the language and rearrange the sequence of some of the provisions in a more logical and user-friendly order. In addition, technical changes are proposed to provide for the enabling framework for scripless securities trading.

Issues Highlighted for Consultation

7. While we welcome public views on all draft clauses of the CB, there are several specific issues which we would like to highlight for consultation:

   (a) whether the "headcount test" for approving a scheme of compromise or arrangement should be retained or abolished *(Chapter 6)*;

   (b) whether residential addresses of directors and identification numbers of directors and company secretaries should continue to be disclosed on public register *(Chapter 7)*;

   (c) whether private companies associated with a listed or public company should be subject to more stringent regulations similar to public companies for the purposes of the provisions on fair dealings by directors *(Chapter 8)*; and

   (d) whether the common law derivative action should be abolished *(Chapter 9)*.

Future Work

8. This consultation will last until 16 March 2010. A second phase consultation covering the other draft Parts of the CB will be launched in early 2010. We aim to issue the conclusions of these two phases of consultation in the second and third quarter of 2010 respectively. We will refine the CB in the light of the public comments received and introduce the CB into the LegCo by the end of 2010.

CHAPTER 1

INTRODUCTION

Background

1.1 The CO provides the legal framework which enables the business community to form and operate companies. It also sets out the parameters within which companies must operate, so as to safeguard the interests of those parties who have dealings with them, such as shareholders and creditors. As at 31 October 2009, the register of companies had 760 412 companies which were formed and registered in Hong Kong, comprising 750 294 private companies [1] and 10 118 non-private companies [2]. Meanwhile, 7 842 non-Hong Kong companies that had established a place of business in Hong Kong were also on the register.

1.2 The CO is one of the longest and most complex pieces of legislation in Hong Kong, with over 600 sections and 20 schedules. It was last substantially reviewed and amended in 1984, and is broadly in line with the UK Companies Act 1948 and some subsequent reforms, such as those contained in the UK Companies Act 1976. The SCCLR[3] was formed in 1984 to advise the Government on necessary amendments to the CO.

1.3 Over the past decade, the SCCLR and the Government have conducted several major reviews with a view to modernising the company law and upgrading its corporate governance regime, resulting in recommendations to amend various sections of the CO. In the past few years, we have implemented some of those recommendations by means of several amendment bills.[4]

1.4 The piecemeal approach to amending the CO, however, has its limitations. A comprehensive rewrite of the CO is needed to modernise our company law to further enhance Hong Kong's status as a major international business

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1 A private company is defined under section 29(1) of the CO to mean a company which by its articles:
(a) restricts the right to transfer its shares;
(b) limits the number of its members to 50; and
(c) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

2 Any company other than a private company is a non-private company. They are also commonly referred to as public companies. Public companies are subject to tighter regulation, such as the requirement to submit annual accounts to the Registrar.

3 Members of the SCCLR include representatives of the SFC, the Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as individuals from relevant sectors or professions such as accountancy, legal and company secretarial. Please see http://www.cr.gov.hk for further information.

4 A brief summary of the recent reviews and legislative amendments can be found in FSTB, "Appendix I: Summary of Recent Reviews of Company Law and Amendments to the Companies Ordinance", *Consultation Paper on Companies Ordinance Accounting and Auditing Provisions* (March 2007) (available at http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cocap32_e.pdf).

and financial centre. With the support of the LegCo, the FSTB launched a comprehensive rewrite of the CO in mid-2006.

The Guiding Principles and Benefits of the Rewrite

1.5 The rewrite exercise is guided by the following key principles:

- **Catering for SMEs - "think small first"**

  The provisions of the CO should be reframed and aligned with special regard to the needs of private companies, particularly SMEs. We aim to reduce the compliance costs of companies, particularly private companies and SMEs.

- **Enhancing corporate governance**

  The rewrite aims to strengthen corporate governance, taking into account the interests of stakeholders, such as members, directors, creditors and auditors. Various provisions, including those regarding directors' conflicts of interest and members' rights, will be reformed. In general, public companies should be subject to enhanced regulation, where appropriate.

- **Complementing Hong Kong's role as an international business and financial centre**

  The rewrite will benchmark Hong Kong against other comparable jurisdictions such as the UK, Australia and Singapore in general while taking into account Hong Kong's unique business environment and our close economic relationship with the Mainland.

- **Encouraging the use of information technology**

  We aim to promote the use of information technology, particularly in facilitating communications between companies and their shareholders as well as members of the public, and in encouraging environmentally friendly practices.

1.6 The rewrite will improve the structure of the parts and sections and enhance the clarity of the provisions so as to make the law more accessible to users.[5] It will also help modernise the CO and take forward reforms in respect of those areas which have not been reviewed previously, such as the capital

[5] An information paper on the drafting of legislation was prepared by the Law Drafting Division, Department of Justice for a meeting of the Panel on Administration of Justice and Legal Services of the LegCo held on 15 December 2009. The paper is available on the LegCo's website at http://www.legco.gov.hk.

maintenance provisions. Antiquated concepts, such as the concept of "par value" and the underlying assumption of paper-based communications between a company and its members, will be changed, updated or simplified. We believe that the reform will lead to enhanced market confidence in incorporating and registering companies to undertake business in Hong Kong.

Progress Made

1.7 In view of the extensive nature of the rewrite exercise, we have adopted a phased approach by tackling the core company provisions which affect the daily operation of live companies in Hong Kong in the first phase. The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver's Office, will be reviewed in the Phase Two of the rewrite. Those parts of the CO concerning prospectuses will be dealt with in a separate review by the SFC and will be transferred from the CO to the SFO in due course.

1.8 We consider it important to gauge the views of stakeholders and the general public in the process of the rewrite. In this connection, we have benefited from the advice of the SCCLR, as well as that of four dedicated AGs and the Joint Government/HKICPA Working Group to review the accounting and auditing provisions of the CO.[6] We have also commissioned an external legal consultant[7] to study and formulate proposals on certain complex areas of the CO, including share capital and debentures, distribution of profits and assets and registration of charges.

1.9 We conducted three public consultations in 2007 and 2008 to gauge views on more complex subjects, including:

(a) accounting and auditing provisions;

(b) company names, directors' duties, corporate directorship and registration of charges; and

(c) share capital, capital maintenance regime and court-free merger procedure.

1.10 The consultation papers and consultation conclusions are available on the

[6] The AGs were comprised of representatives from relevant professional and business organisations, government departments, regulatory bodies, academics and members of the SCCLR. The terms of reference and memberships of the AGs and Joint Government/HKICPA Working Group can be found at http://www.fstb.gov.hk/fsb/co_rewrite/eng/advisorygroup/advisorygroup.htm.

[7] Dr Maisie Ooi from the National University of Singapore was appointed the consultant for the consultancy study on the parts of the CO covering share capital, capital maintenance rules, registration of charges, debentures and remaining provisions in Part II of the CO. She is assisted by several experts from the UK, New Zealand and Singapore.

CO rewrite website.[8] The final proposals have been incorporated into the draft clauses of the CB which we now issue for further public consultation.

Future Work

1.11 Given that the draft CB is lengthy, we are conducting the public consultation on the draft clauses in two phases. The first phase covers Parts 1 to 2, 10 to 12 and 14 to 18. The second phase covers Parts 3 to 9, 13 and 19 to 20. The framework of the draft CB indicating the Parts to be covered in each phase is at **Appendix 1**. The second phase consultation paper and draft clauses will be issued in early 2010 for a three-month consultation. We will revise the draft CB, taking into account the comments received during the consultations. Our aim is to introduce the CB into the LegCo by the end of 2010.

1.12 Meanwhile, in order to tie in with the launch of CR's services for electronic incorporation of companies and filing of documents in late 2010/early 2011, we will introduce a Bill to amend the CO in early 2010. We will also make use of the opportunity to introduce a number of technical amendments to the CO ahead of the rewrite.[9]

Outline of Consultation Paper

1.13 This consultation paper should be read together with the Consultation Draft of Parts 1 to 2, 10 to 12 and 14 to 18 of the CB being published in parallel. It comprises the following:

- **Chapters 2 to 5** outline how the key legislative changes proposed in the CB will contribute to the following objectives:

  (a) enhancing corporate governance (*Chapter 2*);

  (b) ensuring better regulation (*Chapter 3*);

  (c) business facilitation (*Chapter 4*); and

  (d) modernising the law (*Chapter 5*).

- **Chapters 6 to 9** highlight specific issues for consultation. They are:

[8] http://www.fstb.gov.hk/fsb/co_rewrite.

[9] The proposed amendments are summarised in the LegCo Panel on Financial Services paper CB(1)1829/08-09(01) available at http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa0611cb1-1829-1-e.pdf.

(a) the "headcount test" for approving a scheme of compromise or arrangement (*Chapter 6*);

(b) disclosure of directors' residential addresses and identification numbers of directors and company secretaries (*Chapter 7*);

(c) treatment of private companies associated with a listed or public company for the purposes of the provisions on fair dealings by directors (*Chapter 8*);

(d) whether the common law derivative action should be abolished (*Chapter 9*).

- A **list of all the questions** for consultation will be set out after Chapter 9.

- **Explanatory notes** on the draft clauses of Parts 1 to 2, 10 to 12 and 14 to 18.

Seeking Comments

1.14 As the proposed changes will have significant implications for company directors, management, shareholders, investors, creditors, and relevant professionals, we would like to invite public comments on the draft clauses and the specific questions raised in Chapters 6 to 9, so that we can further refine the CB before introducing it into the LegCo. Any other views on how the CB should be improved to meet Hong Kong's needs will also be welcome.

CHAPTER 2

ENHANCING CORPORATE GOVERNANCE

2.1 The SCCLR conducted an overall review of corporate governance in Hong Kong (CGR) in 2000 to 2004.[10] Major recommendations arising from the CGR to enhance shareholders' remedies, including the introduction of a statutory derivative action and enhancement of shareholders' access to company records, were implemented in July 2005 by means of the Companies (Amendment) Ordinance 2004. Some other recommendations of the CGR, such as the proposal to set up a body with authority to investigate financial statements and enforce necessary changes to the companies' financial statements, have been implemented through other legislative initiatives.[11] The remaining recommendations that would require legislative changes are being taken forward in the CO rewrite.

2.2 In the course of the rewrite, the SCCLR has further explored a number of corporate governance issues. The key proposals include:

(a) codifying the standard of directors' duty of care, skill and diligence with a view to clarifying the duty under the law and providing guidance to directors;

(b) restricting the appointment of corporate directors by requiring every private company to have at least one natural person as director so as to enhance transparency and accountability;

(c) providing greater transparency and improving disclosure of company information, such as new requirements for listed and certain unlisted companies to prepare a directors' remuneration report and business review;

(d) strengthening auditors' rights, such as providing auditors with a right to require information from a wider group of persons;

(e) enhancing shareholders' engagement in the decision-making process, such as reducing the threshold requirement for shareholders to demand a poll from 10% to 5% of the total voting rights; and

(f) fostering shareholder protection, such as introducing more effective rules to deal with directors' conflicts of interests and enabling

[10] Two consultation papers on proposals made in the CGR and the final recommendations are available at http://www.cr.gov.hk/en/standing/consultation.htm.

[11] The Financial Reporting Council Ordinance (Cap 588) was enacted in 2006.

shareholders of a company to commence a statutory derivative action on behalf of a related company.

2.3 We believe that the above proposals will ensure greater transparency and accountability within the company's operations and greater opportunity for all shareholders to engage in company business in an informed way.

Strengthening Accountability of Directors

Codifying directors' duty of care, skill and diligence

2.4 The issue of whether directors' general duties (including fiduciary duties[12] and duty of care, skill and diligence) should be codified was put to public consultation in the second quarter of 2008. Responses were highly divided. We conclude that it would be premature to go down the route of comprehensive codification at this stage.[13]

2.5 Nevertheless, we see some merit in clarifying the directors' standard of care, skill and diligence as proposed by some respondents. The standard in the old case law[14] focusing on the knowledge and experience which a particular director possesses is too lenient nowadays. Other comparable jurisdictions like the UK have developed a so-called "mixed objective/subjective test" with an objective standard of care expected of directors and a subjective test looking at the personal attributes of a particular director on top of the objective standard.[15]

2.6 In the absence of a clear authority under the common law in Hong Kong in this respect, there is some uncertainty as to how far the "mixed objective/subjective test" will be applied by the Hong Kong courts. We therefore recommend introducing a statutory statement on the duty of care, skill and diligence in the CB (**Clause 10.13**) to clarify the law and provide guidance to directors.

2.7 We believe that the adoption of the statutory statement would be conducive to enhancing corporate governance in Hong Kong. We propose that the statutory statement should replace the corresponding common law rules and equitable principles as the retention of such rules and principles may result in dual standards and hinder the development of the statutory provision.

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[12] Fiduciary duties that apply to directors include: (i) duty to act in good faith in the interests of the company, (ii) duty to exercise powers for proper purpose, (iii) duty to refrain from fettering his own discretion, (iv) duty to avoid conflicts of duty and interest, and (v) duty not to compete with the company. They arise from equitable principles.

[13] See FSTB, *Consultation Conclusions on Company Names, Directors' Duties, Corporate Directorship and Registration of Charges* (December 2008), paragraphs 17 to 20 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

[14] The subjective test is based on Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 at 428.

[15] Section 174 of the UKCA 2006.

Restricting the appointment of corporate directors

2.8 Since 1985, all public companies and private companies which are members of a group of companies of which a listed company is a member have been prohibited from appointing a body corporate as their director, whereas other private companies can continue to have corporate directors.

2.9 After consulting the public in the second quarter of 2008, we propose to restrict corporate directorship by requiring every company to have at least one natural person as its director after a grace period as in the UK.[16] We believe this will strike an appropriate balance between enhancing corporate governance and transparency and the legitimate commercial need for flexibility. It should also be able to meet the anti-money laundering and counter-terrorist financing concerns of the Financial Action Task Force to a large extent.

Improving Transparency and Disclosure of Company Information

Directors' remuneration report[17]

2.10 In recent years, there has been increasing public concern over the remuneration of directors, particularly those of listed companies. The SCCLR has recommended raising the level of transparency in respect of directors' remuneration packages so as to enhance accountability to members.

2.11 We propose that a separate directors' remuneration report should be prepared by:

(a) all listed companies incorporated in Hong Kong; and

(b) unlisted companies where holders of not less than 5% of the total voting rights of all the members so request.

2.12 The directors' remuneration report should cover various types of benefits given to the individual directors by name, including the basic salary, fees, housing and other allowances, benefits in kind, pension contributions, bonuses, payment for loss of office and long-term incentive schemes including share options. It should be approved by the board of directors and signed on behalf of the board by a director. With the exception of service contracts, the information in the report should be subject to audit requirements.

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[16] See **Clause 10.5** of the CB and paragraphs 2 to 4 of Explanatory Notes on Part 10.

[17] Provisions will be included in Part 9 of the CB to be covered in the second phase consultation paper.

2.13 We propose that detailed provisions on directors' remuneration report should be prescribed in subsidiary legislation so as to facilitate regular updating in the future. The subsidiary legislation will be prepared in due course in consultation with the SFC and SEHK to ensure that the requirements on the directors' remuneration report will be in line with similar rules applicable to all listed companies under the Listing Rules.

Business review[18]

2.14 We propose that public companies and those private and guarantee companies that are not eligible for preparing simplified accounts and simplified directors' reports (see paragraphs 4.2 to 4.4 below) should be required to prepare a more analytical and forward-looking business review as part of the directors' report. Specifically, the business review should include, among other things:

(a) a fair review of the business of the company;

(b) a description of the principal risks and uncertainties facing the company;

(c) particulars of any important events affecting the company which have occurred since the end of the financial year;

(d) an indication of likely future developments in the business of the company; and

(e) a balanced and comprehensive analysis of the development, performance or position of the business of the company and, to the extent necessary for an understanding thereof, include:

(i) analysis using financial key performance indicators; and

(ii) if having a significant impact on the company,

- a discussion on the company's environmental policies and performance, including compliance with the relevant laws and regulations; and

- an account of the company's key relationships with employees, customers, suppliers and others, on which its success depends.

[18] Provisions will be included in Part 9 of the CB to be covered in the second phase consultation paper.

2.15 The proposed requirement to include in the business review information relating to environmental and employee matters that have a significant impact on the company is in line with international trends to promote corporate social responsibility.

2.16 We expect the new requirement to prepare a business review will not impose a significant burden on private companies as only a small number of larger private companies where the shareholders have not opted for the simplified accounts and simplified directors' report would be subject to that requirement. Detailed provisions on the directors' report including business review will be stipulated in subsidiary legislation to be made after the CB is passed by the LegCo, so as to facilitate regular updating in the future.

Measures to enhance the timeliness and transparency of company information and proceedings

2.17 The CB will introduce a number of measures to enhance the timeliness and transparency of company information and proceedings. For example:

(a) a comprehensive set of rules for proposing and passing written resolutions will be introduced in Part 12.[19] This is expected to benefit shareholders of SMEs in particular, as SMEs often use written resolutions for their decision-making; and

(b) members of a company will be given a right to inspect voting records and documents (including proxies and voting papers) after a general meeting so as to improve the transparency of the voting process.[20]

Strengthening Auditors' Rights[21]

2.18 In view of the increasingly important functions that auditors are required to perform on the corporate governance front, we propose to strengthen auditors' rights in the following aspects:

(a) auditors will be provided with qualified privilege for statements made in the course of their duties as auditors and in respect of their ceasing to hold office as auditors under the CO. Auditors will not, in the absence of malice on their part, be liable to any action for defamation at the suit of any person in respect of any oral or written statement which they make in the course of their duties as auditors and in respect of their ceasing to hold office as auditors;

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[19] See paragraphs 4 to 7 of Explanatory Notes on Part 12.
[20] See paragraphs 19 to 20 of Explanatory Notes on Part 12.
[21] Provisions will be included in Part 9 of the CB to be covered in the second phase consultation paper.

(b) auditors will be empowered to require from a wider range of persons, including, among others, the employees of the company and the officers and employees of its Hong Kong subsidiaries, and any person holding or accountable for any of the company's or subsidiaries' accounting records,[22] to provide them with information, explanations or other assistance as they think necessary for the performance of their duties as auditors;

(c) where a holding company has a subsidiary undertaking which is not a company incorporated in Hong Kong, the auditor may also require the holding company to obtain from the relevant persons or parties, such as the undertaking concerned or the officer, employee or auditor of the undertaking, such information, explanations or other assistance as the auditor may reasonably require for the purposes of his duties as auditor; and

(d) an outgoing auditor[23] will be required to provide a statement of any circumstances connected with his ceasing to hold office that he considers should be brought to the attention of the members or creditors of the company or a statement of no such circumstances.

Enhancing Shareholders' Engagement in Decision-making Process

2.19 Shareholders have a key role to play in driving company performance and economic prosperity. We aim to promote wider participation of shareholders and ensure that they are informed and involved. The Bill will introduce a number of measures to enhance shareholders' rights in the decision-making process. These include, among others:

(a) providing members with a right to propose a resolution to be moved at a meeting which they have requested to be convened;[24]

(b) requiring companies to circulate at their expense members' statements relating to the business of general meetings and proposed resolutions for AGMs, if they are received in time for sending together with the notice of the meeting;[25]

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[22] The auditors' current rights to information as set out in sections 133(1) and 141(5) of the CO are considered to be too restrictive. For example, under section 133(1), only a Hong Kong subsidiary and its auditor have the duty to give information and explanation. Under section 141(5), the auditor may request only the officers of the company, but not company employees, for information and explanation.

[23] An "outgoing auditor" covers an auditor who ceases to hold office owing to removal from office, resignation or not being reappointed upon expiration of the term of office. The right is broader than the current right of a resigning auditor under section 140A of the CO to make a similar statement.

[24] See paragraphs 8 to 9 of Explanatory Notes on Part 12.

[25] See paragraphs 10 to 13 of Explanatory Notes on Part 12.

(c) lowering the threshold requirement for the right to demand a poll from 10% to 5% of the total voting rights;[26] and

(d) clarifying the rights of a proxy and enhancing members' rights to appoint proxies, such as removing the restriction for a proxy to vote on a show of hands unless provided by the articles, and enhancing shareholders' rights to appoint multiple proxies.[27]

2.20 The use of new information technology will facilitate timely access to company information by shareholders and their communications with the company. The CB will introduce rules to facilitate communications between a company and its members in electronic form or by means of a website. All companies, subject to members' approval, will be able to use electronic communications with members as a default position, permitting companies to use email and websites to communicate with their members. Individuals will be able to request communication in paper form if they wish.[28]

2.21 To keep up with technological development, the CB will also permit a company to hold a general meeting at two or more places using any audio-visual technology that enables the members of the company to exercise their right to speak and vote at the meeting.[29]

Fostering Shareholder Protection

2.22 We will reform the rules in the CO on directors' self-dealing and connected transactions involving directors to make them more effective. On the one hand, we will remove restrictions that are excessive or unnecessary. For example, there will be a general members' approval exception permitting all companies to make loans or enter into similar transactions in favour of their directors or connected persons, if those transactions are approved in a general meeting.[30] We will also decriminalise provisions which restrict loans and similar transactions in favour of directors and connected persons (section 157H of the CO) to avoid the danger of over-deterrence as civil remedies are more appropriate for cases involving directors' duties of loyalty.[31]

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[26] See paragraphs 16 to 18 of Explanatory Notes on Part 12.

[27] See paragraphs 21 to 24, 40 to 41 of Explanatory Notes on Part 12.

[28] See paragraphs 36 to 37 of Explanatory Notes on Part 12 and paragraphs 7 to 16 of Explanatory Notes on Part 18.

[29] See paragraphs 14 to 15 of Explanatory Notes on Part 12.

[30] In the case of public companies, disinterested members' approval will be required. We are consulting in Chapter 6 on whether any private companies associated with a public or listed company should be subject to the same requirement.

[31] See paragraphs 6 to 12 of Explanatory Notes on Part 11.

2.23 On the other hand, more stringent rules will be introduced to plug possible loopholes and to safeguard the interests of minority shareholders.[32] These include:

(a) requiring companies to keep directors' service contracts available for members' inspection and requiring members' approval for director's long-term employment exceeding 3 years;

(b) extending the loss of office payment provisions to include payment to a connected person and payment by a company to a director of its holding company;

(c) requiring members' approval for substantial property transactions; and

(d) widening the ambit of disclosure currently under section 162 of the CO, for example, to cover "transactions" and "arrangements" instead of just "contracts", and to disclose the "nature and extent" of one's interest instead of just disclosing the "nature" of the interest.

2.24 While shareholder remedies under the CO have been substantially enhanced in 2005 as noted in paragraph 2.1 above, there is room for further improvement. In addition to consolidating all existing provisions concerning shareholder remedies into a distinct part (Part 14) of the CB, some changes are proposed to improve the operation of the unfair prejudice remedy and statutory derivative action, including:

(a) extending the scope of the unfair prejudice remedy to cover "proposed acts and omissions";

(b) enhancing the court's discretion in granting relief in cases of unfair prejudice; and

(c) allowing a member of a company to bring a statutory derivative action on behalf of a related company ("multiple derivative action").[33]

2.25 We are consulting in Chapter 9 below whether there is still a need to preserve the common law derivative action as a shareholder remedy.

[32] See Explanatory Notes on Part 11.
[33] See Explanatory Notes on Part 14.

CHAPTER 3

ENSURING BETTER REGULATION

3.1 To ensure that the regulatory regime is effective and business-friendly, the Government will introduce a number of improvements to the company incorporation and name registration procedures, the filing of information, and the registration of charges. Many of these will focus on encouraging and exploiting new forms of e-communication. We will also enhance enforcement against "shadow companies"[34] by empowering the Registrar to act on court orders by directing a "shadow company" to change its name and to substitute its name with the company registration number if the company fails to comply with the direction. Meanwhile, we will also improve the effectiveness of the enforcement regime by giving the Registrar power to obtain documents, records and information for enforcement of certain provisions in the CB and the power to compound certain offences under the CB, and refining the definition of "officer who is in default".

Electronic Company Incorporation

Introducing electronic incorporation and expediting company name approval process

3.2 Starting from late 2010/early 2011, the CR will introduce in phases new services for electronic incorporation of companies and delivery of documents. As noted in paragraph 1.12 above, legislative amendments will be introduced into the LegCo in early 2010 to tie in with the implementation of the new electronic services. Such amendments will cover, among other things, the use of digital signatures and passwords, and signing of the incorporation form and issuance of the certificate of incorporation by electronic means.

Company Name Registration

Expediting company name approval process

3.3 As part and parcel of the company incorporation process, we will introduce changes to the company name registration system with a view to expediting the company name approval process. At present, the performance pledge for incorporation of companies is four working days. Most of the

[34] These refer to those companies incorporated in Hong Kong at the CR with names which are very similar to existing and established trademarks or trade names of other companies and pose themselves as representatives of the owners of such trademarks and/or trade names or produce counterfeit products bearing such trademarks or trade names.

processing time is spent on scrutinising proposed company names to ensure that they are not objectionable for various reasons.[35] To expedite the company name registration system, we will bring forth the approval of company names prior to the company incorporation process, whereby a company name would be accepted for registration if it satisfies certain preliminary requirements, namely, that it is not identical to another name on the register and does not contain words or expressions on a specified list.[36] Thereafter, if the company's name is found to be objectionable as being offensive, likely to give the impression of a government connection or contrary to the public interest upon further checking, the Registrar will be empowered to direct within a specified period the company in question to change its name and to substitute its name with the company registration number if the company fails to comply with the direction. The revised procedures would shorten the company incorporation processing time from four to one working day. The legislative changes will be incorporated into the CB.

Empowering the Registrar to act on a court order requiring an infringing company to change its name

3.4 At present, the Registrar has only very limited power under the CO to deal with "shadow companies". There have been strong requests in recent years from the business community especially trademark/brand name owners in Hong Kong to strengthen our company name registration system to tackle possible abuses by "shadow companies". A proposal to enhance enforcement against "shadow companies" was put forward for public consultation in the second quarter of 2008.[37] Under the proposal, the Registrar would be empowered to act on a court order requiring a company to change its name by directing the "shadow company" to change its name, or substituting its name with the company registration number if the company fails to comply with the direction. The proposal received overwhelming support from the respondents. The amendments will be incorporated into the amendment Bill to be introduced into the LegCo in early 2010.

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[35] For example, a proposed company name must not be identical to the name of an existing company, its use must not constitute a criminal offence nor be offensive or contrary to the public interest. In addition, names that would be likely to give the impression that the company is connected with the Central People's Government or with the Hong Kong Government or any department of either Government or that contain certain words or expressions such as "Chamber of Commerce" and "Trust" require official approval.

[36] Separately, we will review the list of words and expressions in the Companies (Specification of Names) Order in consultation with relevant Bureaux as some of the words may be outdated and should no longer be regulated (e.g. "Municipal" and "Building Society").

[37] The consultation conclusions were issued in December 2008 and are available at www.fstb.gov.hk/fsb/co_rewrite.

Ensuring Accuracy of Information on the Public Register

Clarifying and enhancing the Registrar's powers in relation to registration of documents and keeping of the register

3.5 We will clarify and enhance the Registrar's powers to help ensure the accuracy and timeliness of information on the public register.[38] The new measures will include:

(a) clarifying that the Registrar's powers to specify the form of documents and the form of delivery include requirements as to authentication and the manner of delivery of documents;

(b) giving the Registrar a power to refuse registration of documents if the document is not properly delivered or is unsatisfactory;

(c) empowering the Registrar to withhold the registration of an unsatisfactory document and request the person who delivered the document to take certain remedial actions, such as producing further information or evidence;

(d) empowering the Registrar to require a company or its officers to resolve inconsistencies in information on the register or to provide updated information; and

(e) empowering the Registrar to annotate information on the register to provide supplementary information, such as the fact that the document in question has been replaced or corrected.

Introducing a new court-based procedure for removing from the register information that is inaccurate, forged or derived from anything invalid, ineffective or done without the authority of the company

3.6 At present, it is unclear if the court has general inherent jurisdiction to order the Registrar to remove information which has been provided in compliance with statutory requirements. There is no clear means for a company to remove from the register information which has been placed on the register but subsequently proves to be inaccurate and misleading. As the Registrar is not in a position to determine whether a piece of information is inaccurate or forged, we will introduce a new court-based procedure for the removal of such information. The Registrar will, upon an order of the court, rectify or remove any material on the register that derives from anything invalid or ineffective or that is done without the authority of the company.[39]

[38] See paragraphs 2 to 9 and 12 to 13 of Explanatory Notes on Part 2.
[39] See paragraphs 10 to 11 of Explanatory Notes on Part 2.

Streamlining Regulation

3.7 We have looked for ways to streamline existing regulatory requirements in the CO which no longer serve any practical purpose or overlap with other regulatory measures. Some examples are cited below.

Abolishing the licence system for keeping a branch register of members outside Hong Kong

3.8 Under section 103 of the CO, a company is required to apply and pay for an annual licence if it wishes to keep its register of members in a place at or near which it transacts its business outside Hong Kong. This licence system will be abolished. Instead, if a company transacts business outside Hong Kong, it may keep at such a place a branch register of its members resident there provided that a notice is given to the Registrar of the address where the branch register is kept.

Removing the share qualification requirement for directors

3.9 Section 155 of the CO requires that a director who has not satisfied his share qualification provision in accordance with the company's articles shall do so within a prescribed period. If he does not do so or if a director ceases to retain his share qualification, the director is deemed to have vacated his office. Any unqualified person who acts as a director after the expiration of the prescribed period is liable to criminal sanction.[40]

3.10 The share qualification requirement was originally designed to ensure that directors would act in the interests of the company. However, it is now uncommon for companies to require directors to have or obtain a number of qualifying shares. The criminal penalty provision is also outmoded. The similar requirement in the UK has been repealed.[41] We will remove the requirement in the CB.

Removing disclosure requirements in the Tenth and Eleventh Schedules of the CO that duplicate with financial reporting standards

3.11 The Tenth Schedule of the CO comprises a detailed list of disclosure requirements as to the contents of the balance sheet and profit and loss account. The schedule is now out of date as a result of the significant developments in financial reporting, which are reflected in the Hong Kong Financial Reporting Standards. The Eleventh Schedule of the CO comprises a list of relatively simple disclosure requirements regarding the contents of the balance sheet of companies applying section 141D of the CO.

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[40] The maximum penalty is a Level 3 fine and a daily default fine of $200.

[41] Section 291 of the UK Companies Act 1985 was repealed by section 1295 of the UKCA 2006.

There is an overlap between the Eleventh Schedule and the SME-Financial Reporting Standard.

3.12 In order to avoid any potential conflicts between the applicable financial reporting standards and the Tenth and Eleventh Schedules respectively, the Tenth and Eleventh Schedules will be repealed except for a small number of public interest or corporate governance disclosure requirements which are not covered by the applicable financial reporting standards.[42] Companies will be required to continue to follow the overriding principle that their accounts must give a true and fair view of their state of affairs and will be required to state in their accounts as to whether the accounts have been prepared in accordance with the applicable accounting standards, and the particulars of and the reasons for any departure from those standards.

Registration of Charges

3.13 Taking into account the public's views received during the consultation conducted in the second quarter of 2008[43], we will introduce a number of changes to the registration of charges regime in the CB.[44] These will include:

(a) updating the list of registrable charges, including expressly providing that a charge on an aircraft or any share in an aircraft is registrable and removing the requirement for registration of a charge for the purpose of securing any issue of debentures;

(b) replacing the automatic statutory acceleration of repayment in section 80(1) of the CO with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time;

(c) making both the prescribed particulars of the charge and the instrument creating or evidencing a charge registrable and open to public inspection, in order to streamline the registration process and enhance transparency; the same also applies to the application for registration of repayment / release and the supporting evidence thereof; and

(d) shortening the period to register a charge from 5 weeks to 21 days.

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[42] Such disclosures include auditors' remuneration (which applies to companies other than those preparing simplified accounts), the aggregate amount of any outstanding loans to directors and employees to acquire shares in the employing company made under the authority of sections 47C(4)(b) and (c) of the CO and information regarding a company's ultimate parent undertaking required under section 129A of the CO.

[43] See footnote 37 above.

[44] Provisions will be included in Part 8 of the CB to be covered in the second phase consultation paper.

Improving the Enforcement Regime

Giving the Registrar powers to obtain documents, records and information for the enforcement of certain provisions

3.14 Currently, the CR has limited investigatory powers under the CO and has encountered difficulty in performing its regulatory role. In the interest of promoting compliance with provisions under the CB and enhancing the enforcement regime, we intend to empower the CR to obtain documents, records and information to ascertain whether certain acts or omissions by a company or its officers would give rise to the following offences in the CB:

(a) giving the CR false or misleading information in connection with an application for the deregistration of a company; and

(b) making a false, misleading or deceptive statement knowingly or recklessly in any return, report, certificate, balance sheet or other document, required by or for the purposes of any provision of the CB.[45]

The provisions have a strong public interest dimension because any default would impair the integrity of the CR's register and adversely affect the interests of third parties.

3.15 The powers include requiring the company, its officers and any other person who is reasonably believed to be in possession of the relevant documents or records, to produce the documents and records and to provide information and explanation on them.[46]

Updating provisions on company investigations

3.16 Currently, the CO provides for two forms of investigation into the affairs of a company authorised by the Financial Secretary:

(a) formal investigations (known as "inspections") where the Financial Secretary appoints an inspector with extensive powers to conduct the investigation (sections 142 to 150); and

(b) preliminary fact finding, where the Financial Secretary or a person authorised by him may require a company and its present or past directors and employees etc. to produce the company's books and papers and provide explanation of them (sections 152A to 152F).

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[45] Based on the offences under section 291AA(14) and section 349 of the CO.

[46] Provisions will be included in Part 19 of the CB to be covered in the second phase consultation paper.

3.17 Over the past 38 years, there have been 38 appointments of inspectors under the CO, the most recent one was *Peregrine Investments Holdings Ltd* and *Peregrine Fixed Income Ltd* case in 1999-2000 where the Financial Secretary appointed the inspector upon the recommendation of the SFC for an investigation, having regard to the narrow scope of SFC's powers prevailing at that time. Since the SFO came into operation in 2003, the SFC has greater investigatory powers and is able to impose a broader range of sanctions under the SFO. The need for invoking the CO to investigate a listed company has greatly diminished. No preliminary enquiry under section 152A has ever been undertaken since the relevant sections were added in 1984.

3.18 Although the CO investigation regime is now very rarely used, we believe that the two forms of investigation should be retained to give the Financial Secretary "reserve" powers to investigate into the affairs of a company formed or operating in Hong Kong in case there are appropriate grounds to do so in the future. Some updating of the provisions will be made, mainly in the light of similar provisions in the SFO and the Financial Reporting Council Ordinance which are more modern. The significant changes include:

(a) giving the Financial Secretary express powers to define the terms of the appointment of an inspector, limit or expand the scope of an inspection and suspend an inspection at his discretion pending criminal proceedings or otherwise. Provisions will also be added to deal with situations like the resignation or replacement of an inspector and the revocation of an inspector's appointment by the Financial Secretary;

(b) providing an express obligation to inform or remind a person required to assist of the limitations on the use of self-incriminating evidence in proceedings;

(c) giving protection to persons who volunteered information to facilitate investigation by granting immunity from liability for disclosure; and

(d) enhancing the confidentiality of information obtained from an investigation and defining more clearly how such information might be disclosed to other regulatory authorities.[47]

Empowering the Registrar to compound specified offences

3.19 The majority of companies in Hong Kong are SMEs. In many cases, filing defaults may be due to oversight. Nevertheless, we believe that criminal

[47] Provisions will be included in Part 19 of the CB to be covered in the second phase consultation paper.

sanctions should be retained as the last resort.

3.20 To enhance compliance, the Registrar will be given a new power to compound, at her discretion, certain offences under the CB. This means that the Registrar may offer a person who is reasonably suspected of having committed an offence an opportunity to avoid prosecution of that offence by paying an amount to the Registrar as a compounding fee and, where appropriate, remedying the breach constituting the offence within a specified period. If that person accepts such an offer and complies with the terms of such offer, no prosecution will be initiated against him for that offence.

3.21 Compoundable offences will be set out in a Schedule to the CB and generally confined to those offences which are:

(a) related to non-compliance with filing obligations and with obligations for affixture of names or the like;

(b) punishable only by a fine or a fine and a daily default fine (i.e. not by imprisonment); and

(c) triable summarily only.[48]

Replacing the phrase "officer who is in default" with "responsible person" and refining the definition to strengthen the enforcement regime

3.22 Many offence provisions under the CO punish not only a company but also those officers[49] of the company who are in default. An "officer who is in default" is currently defined under section 351(2) of the CO as "any officer of the company, or any shadow director of the company, who knowingly and wilfully authorizes or permits the default, refusal or contravention mentioned in such provision".

3.23 To strengthen the enforcement regime, the following changes will be made to the definition:

(a) replacing the reference to "knowingly and wilfully authorizes or permits the default, refusal or contravention" with "authorizes or permits, participates in, or fails to take all reasonable steps to prevent, the contravention", thus lowering the threshold for a breach or contravention and extending it to negligent acts or omission;

[48] Provisions will be included in Part 20 of the CB to be covered in the second phase consultation paper.

[49] Under section 2(1) of the CO, "officer", in relation to a body corporate, includes a director, manager or secretary.

(b) extending the punishment to an officer of a corporate officer which commits an offence as an officer who is in default, where the first mentioned officer has caused the corporate officer to be in default; and

(c) using the term "responsible person" in place of "officer who is in default" [50].

Adjusting the penalties for offences

3.24 There are three types of penalties provided in the CO, namely, imprisonment, fines and daily default fines[51]. Where appropriate, adjustments will be made to the maximum penalties as prescribed for offences under the CO to ensure consistency and adequate deterrent effect. For instance, the maximum penalties of similar offences applicable to Hong Kong companies and non-Hong Kong companies will be aligned.

3.25 Currently, offences which are punishable by the same level of fine may be subject to different daily default fines. For example, the daily default fines for offences which are punishable by a Level 3 fine range from $200 to $700. Adjustments will be made so that each applicable level of fine will only carry one corresponding amount of daily default fine in the CB as follows[52]:

Level of fine	**Maximum fine amount**	**Proposed daily default fine**
Level 3	$10,000	$300
Level 4	$25,000	$700
Level 5	$50,000	$1,000
Level 6	$100,000	$2,000
Maximum fine amount above $100,000		$2,000

[50] See paragraphs 7 to 12 of Explanatory Notes on Part 1.

[51] A daily default fine is applicable to certain offences where the offender is liable, in addition to a lump sum fine and imprisonment (if any), to a fine each day on which the default, refusal or contravention continues. See section 351(1A)(d) of the CO.

[52] Please note that the amount of daily default fine is only a maximum amount that may be imposed for continued contravention of an offence. The court has discretion to order an amount of such fine well below the maximum in the light of the circumstances of the case.

CHAPTER 4

BUSINESS FACILITATION

4.1 One of the guiding principles of the rewrite exercise is to cater for the needs of SMEs. The Government believes that SMEs should generally be allowed to take advantage of simplified accounting and reporting requirements, thereby saving their compliance and business costs. Another means to save costs is to facilitate companies to dispense with AGMs by unanimous members' consent. We have also looked into ways to simplify some of the complex rules prescribed in the CO, such as the capital maintenance rules. In some cases, the solution involves introducing cheaper and less time-consuming alternatives to court procedures to deal with more straight-forward cases. The new measures include a court-free procedure for reduction of capital based on the solvency test and a court-free statutory amalgamation procedure for wholly-owned intra-group companies. Such alternative procedures should save costs and time.

Saving Costs

Allowing more private companies and small guarantee companies to take advantage of simplified reporting requirements[53]

4.2 At present, section 141D of the CO provides that a private company (other than a company which is a member of a corporate group, a banking company, a deposit-taking company, an insurance company, a stock-broking company, a shipping company or an airline company) may, with the written agreement of all the shareholders, prepare simplified accounts in respect of one financial year at a time.[54] These companies may also prepare simplified directors' reports.

4.3 We will relax the restrictive qualifying criteria to enable more private companies (including those which are members of a group of companies) to prepare simplified financial and directors' reports to save business and compliance costs. The relaxation will be along the following lines:

(a) a private company (other than a banking company, a deposit-taking company, an insurance company, or a stock-broking company) that

[53] Provisions will be included in Part 9 of the CB to be covered in the second phase consultation paper.

[54] The simplified accounts are prepared in accordance with the SME Financial Reporting Standard issued by the HKIPCA.

qualifies as a "small company" [55] will be allowed to prepare simplified financial and directors' reports automatically without any requirement for shareholders' consent;

(b) other private companies may also prepare simplified financial and directors' reports, if shareholders holding at least 75 % of the total voting rights agree in writing and no other shareholder object. The agreement will remain in force until the agreement is revoked by a shareholder;

(c) the current prohibition for a private company which has any subsidiary or is a subsidiary of another company formed and registered under the CO to prepare simplified accounts and reports will be removed. In addition, a private company which is the holding company of a group of private companies may prepare simplified group accounts provided that the criteria of a "small group" [56] or the shareholders' consent requirement are met; and

(d) the current prohibition which prevents a company that owns and operates ships or aircraft engaged in the carriage of cargo between Hong Kong and a place outside Hong Kong from relying on section 141D will be removed. It is considered to be an anachronism which is no longer appropriate.

4.4 We believe that small guarantee companies should be allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies. Nevertheless, the total assets and number of employees may not be suitable criteria to distinguish large guarantee companies from small ones. We suggest using a total annual revenue of not more than HK$25 million as a bright line rule for guarantee companies. Those guarantee companies with a total annual revenue of HK$25 million or less can take advantage of the simplified accounting and reporting requirements.

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[55] A company is considered to be a 'small company' if it satisfies at least two of the following conditions:
- Total annual revenue of not more than HK$ 50 million.
- Total assets of not more than HK$ 50 million at the balance sheet date.
- No more than 50 employees.

The details will be set out in subsidiary legislation.

[56] A group of companies will qualify as a "small group" in a year if it satisfies at least two of the following conditions:
- Aggregate total annual revenue of not more than HK$50 million net for that year.
- Aggregate total assets of not more than HK$50 million net at the balance sheet date.
- No more than 50 employees.

The detailed criteria will be formulated in consultation with the HKICPA and prescribed in subsidiary legislation.

Allowing companies to dispense with AGMs by unanimous members' consent.

4.5 For many private companies, the obligation to hold AGMs could be redundant and potentially burdensome. In order to simplify the decision-making process, all companies will be allowed to dispense with AGMs if unanimous members' consent is obtained, and that dispensation should be in force unless a member, by notice, requires an AGM to be held in a particular year, or until the dispensation is revoked by passing an ordinary resolution to that effect.[57] A company is also not required to hold an AGM if the company has only one member.

4.6 At present, there is an exception under section 111(6) of the CO for a company to dispense with AGMs if everything that is required to be done at the meeting is done by way of a written resolution or resolutions in accordance with section 116B. The written resolution procedure will be retained in case a company might wish to dispense with an AGM on a specific occasion by a written resolution.

Facilitating Business Operation

Introducing an alternative court-free procedure for reduction of capital based on solvency test[58]

4.7 At present, the CO only allows reduction of share capital by a court sanction procedure, save for the re-designation of the nominal value of shares to a lower amount. Shareholders must agree by special resolution, and the court, after settling the list of creditors and considering creditor objections (if any), has to be satisfied that alternative protections are in place.

4.8 We will introduce a court-free procedure based on a cash flow solvency test[59], as an alternative process in addition to the current rules. The new procedure should be faster and cheaper and will be applicable to all companies.

Allowing all companies to purchase their own shares regardless of the source of funds, subject to a solvency test[60]

4.9 The current rules on buy-backs in the CO, which distinguish between financing a purchase out of distributable profits or the proceeds of a new issue of shares and that out of capital, are fairly complex and restrictive. Also, financing by payment out of capital based on a solvency test is

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57 See paragraphs 25 to 27 of Explanatory Notes on Part 12.

58 Provisions will be included in Part 5 of the CB to be covered in the second phase consultation paper.

59 Generally following the approach in section 47F(1)(d) already provided in the CO in relation to the case of financial assistance.

60 Provisions will be included in Part 5 of the CB to be covered in the second phase consultation paper.

currently provided as an exception available to private companies only. We will streamline the rules and allow all companies to fund buy-backs regardless of the source of funds, subject to a solvency requirement.

Streamlining financial assistance provisions

4.10 Section 47A of the CO imposes broad prohibitions (subject to certain exceptions) on a company and its subsidiaries giving financial assistance to a third party for the purpose of acquiring shares in the company. The rules on financial assistance and the exemptions that are available are overly complex. Also the prohibitions are so wide that it is generally accepted that they are capable of capturing potentially beneficial, or at least innocuous transactions. As a result, companies may spend a disproportionate amount of time and money structuring transactions in such a way that they do not contravene the prohibition. We will attempt to streamline the financial assistance provisions in a manner similar to the NZCA.[61] Nevertheless, as the reformed rules may still be considered to be difficult for companies to comprehend and apply, and the mischief arising from financial assistance can arguably be tackled effectively by rules other than those for financial assistance, we will also consult on the alternative of abolishing the rules in the second phase consultation paper to be issued in early 2010.

Introducing a court-free statutory amalgamation procedure for wholly-owned intra-group companies[62]

4.11 The current procedure for amalgamation by means of a court-sanctioned scheme of compromise or arrangement under sections 166 to 167 of the CO is both complex and costly. We will introduce a voluntary, court-free option to simplify the amalgamation process for intra-group companies, thereby reducing business costs. To minimise the risk of the new statutory procedure being abused, we propose to confine it only to an amalgamation either between a holding company with one or more of its wholly-owned subsidiaries or between two or more wholly-owned subsidiaries of the same holding company, where minority shareholders' interests would normally not be an issue. For amalgamations involving insolvent companies or companies not within the group, the existing requirement for court sanction should be retained so as to ensure that their terms are just and fair to all shareholders and creditors.

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[61] See sections 76 to 80 of the NZCA. Provisions will be included in Part 5 of the CB to be covered in the second phase consultation paper.

[62] Provisions will be included in Part 13 of the CB to be covered in the second phase consultation paper.

4.12 As a safeguard for creditors, the board of directors of each amalgamating company must make statements to verify the solvency of the amalgamating company as well as the amalgamated company.

Introducing a new procedure of "administrative restoration" of dissolved companies by the Registrar

4.13 Presently under section 291 of the CO, a company can be struck off the register by the Registrar if the company is not in operation or carrying on business. There have been some cases where a company struck off seeks to be restored on the ground that, contrary to the Registrar's belief, it was actually in operation or carrying on business at the time of its striking off. This may occur because a company fails to file its annual returns, moves without notifying the CR of a change of registered office and is unaware of the proposed strike-off. While restoration is often straightforward in such circumstances as it is unlikely to be contested, it still requires an application to the court. We will introduce a simplified administrative restoration procedure to allow companies to be restored to the register in straightforward cases without the need for recourse to the court.[63]

Making the keeping and use of a common seal optional

4.14 Section 93(1)(b) the CO stipulates that every company "shall have as its common seal a metallic seal on which it shall have its name engraven in legible characters". The use of the common seal by companies is required generally for executing deeds (particularly in conveyancing transactions), and, for the purposes of sections 71, 73 and 73A of the CO, in issuing a certificate as evidence of title to shares, a share warrant and sealing securities.[64]

4.15 We consider that where the seal is not used, the CB should provide for the requirements governing the mode of due execution of documents to facilitate companies entering into and executing business transactions and contracts which are increasing rapidly in volume and value. In this respect, we will allow a company to execute a document as a deed without using a common seal.[65] Companies can still use a common seal if they wish. This gives flexibility to companies which would have the option of either retaining or dispensing with the common seal.

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[63] See paragraphs 14 to 17 of Explanatory Notes on Part 15.

[64] Please note that the CB will remove the power of a company to issue share warrants, see paragraph 5.7 below. An "official seal" which is a facsimile of the common seal with the addition of the word "securities" or "證券" may be used for sealing securities.

[65] We are considering the mode of due execution of documents without using a common seal. Provisions will be included in Part 3 of the CB to be covered in the second phase consultation paper.

CHAPTER 5

MODERNISING THE LAW

5.1 Some of the provisions in the CO are based on old concepts that no longer meet the needs of modern business. An obvious example is the underlying assumption of paper-based communications between a company and its members. As noted in paragraph 2.20 above, the CB will facilitate communications between a company and its members by electronic means. In addition, we will take the opportunity of the rewrite to retire some antiquated concepts that no longer serve any useful purposes such as par value of shares and authorised capital. Moreover, we will modernise the language and re-arrange the sequence of some of the provisions in a more logical and user-friendly order so as to make the CB more readable and comprehensible.[66] We will also introduce technical changes to provide for the enabling framework for scripless trading by removing, or providing exceptions to, the limitations arising from the provisions on scrip-based shares presently found in the CO.

Share Capital

Retiring the concept of par value[67]

5.2 The current rules relating to share capital require companies having a share capital to have a par value ascribed to their shares. Par value is an antiquated concept which may arguably give rise to one or more of the following practical problems:

(a) unnecessarily complex accounting system;

(b) inhibits raising of new capital;

(c) unnecessary work for share registries and added costs; and

(d) being misleading to the unsophisticated investor.[68]

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66 See footnote 5 above.

67 Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

68 See FSTB, *Consultation Paper on Share Capital, the Capital Maintenance Regime and Statutory Amalgamation Procedure* (June 2008), paragraphs 2.1 to 2.8 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

5.3 In a public consultation conducted in the third quarter of 2008, the majority of the respondents supported the proposal to abolish the par value regime and to adopt a mandatory system of no-par.[69] We will adopt a mandatory system of no-par for all companies with a share capital, subject to a transition period (tentatively 24 months from the date the CB is passed by the LegCo) in case companies wish to review their documents before the conversion is effected.

5.4 Other changes arising from the move to a no-par environment include:

(a) to provide a legislative deeming provision for the amalgamation of the existing share capital amount with the amount of share premium (and also capital redemption reserve) immediately outstanding in a company's account before the migration to no-par share capital;

(b) to preserve substantially the currently permitted uses of the share premium for the amount standing to the credit of the share premium account before the migration to no-par, so as to avoid hardship to companies arising from any loss of the permitted uses of share premium that they enjoyed prior to the migration to no-par;

(c) to provide a statutory deeming provision to preserve contractual rights defined by reference to par value;

(d) to repeal the power of a company to convert shares into "stock"[70] which no longer serves any practical purpose while allowing stock created before the commencement of the CB to be reconverted into paid-up shares;

(e) to apply the merger relief to the amount in excess of the subscribed capital of the acquired company attributable to the shares acquired or cancelled. Group reconstruction relief will apply to the excess of the consideration for the shares over the base value of the assets transferred; and

(f) to allow capitalisation of profits with or without an issue of shares, issuance of bonus shares without the need to transfer amounts to share capital, consolidation and subdivision of shares, and make appropriate provisions in relation to redeemable shares.

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[69] The consultation conclusions were issued in February 2009 and are available at www.fstb.gov.hk/fsb/co_rewrite.

[70] 'Stock' is a fund that has a nominal value equivalent to that of the total of the shares so that a member, instead of holding particular identified shares of 100 shares of $10 each numbered 1 to 100, holds $1000 stock.

Removing the requirement for authorised capital[71]

5.5 Authorised capital is the maximum amount, usually specified in monetary terms, that a company is permitted by its constitutional document[72] to raise by issuing shares. The protection against dilution which authorised capital is thought to provide is far from absolute as most companies are able to increase the authorised capital by an ordinary resolution.

5.6 We will remove the requirement for authorised capital as it no longer serves any useful purpose. Nevertheless, companies can still be given the option to retain the provision for authorised capital in the company's Articles of Association, or to delete or amend it by resolution. If retained, the authorised capital will be deemed to be specified in terms of number of shares to be issued instead of monetary value. The companies may vary or abolish the restriction by ordinary resolution.

Removing the power of company to issue share warrants

5.7 Companies are permitted to issue share warrants to bearer under section 73 of the CO, provided the same is authorised by the company's articles. Share warrants are rarely issued by companies nowadays and are considered to be undesirable from the perspective of anti-money laundering. Consequently, the ability for a company to issue share warrants will be removed in the CB. Nevertheless, existing share warrants should be grandfathered, without setting any time limit for surrender of the warrants.[73]

Enabling Scripless Securities Trading

5.8 The SFC is currently working with the SEHK and the Federation of Share Registrars on the operational model for the proposed scripless environment, with a view to putting forward proposals for public consultation in late 2009. The limitations arising from the provisions on scrip-based shares in the CO will have to be removed to enable the scripless holding and trading of shares and debentures issued by, among others, Hong Kong incorporated listed companies.

5.9 To tie in with the scripless securities market reform, technical amendments to the CO will be introduced into the LegCo in early 2010. The proposed amendments will be commenced only when the market has agreed to, and is

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[71] Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

[72] Under the CO, the constitutional document of a company formed in Hong Kong are the Memorandum of Association and Articles of Association. A company's authorised capital is set out in its Memorandum of Association. We will propose in the CB that a company incorporated in Hong Kong will only be required to have Articles of Association. The Memorandum of Association will be abolished and essential information contained in a Memorandum of Association can be set out in the Articles of Association.

[73] Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

ready to implement, an operational model for a scripless securities market. The CB will also incorporate those technical amendments.[74] Further legislative amendments including amendments to the SFO would be pursued as necessary as the operational model takes shape.

[74] Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

CHAPTER 6

"HEADCOUNT" TEST FOR APPROVING A SCHEME OF COMPROMISE OR ARRANGEMENT

6.1 A recent court case[75] has drawn public attention to the current requirement under section 166(2) of the CO, namely, in order for a compromise or arrangement between a company and its members or creditors (hereinafter referred to as "a scheme") to be approved at a meeting ordered by the court under section 166(1), a majority in number of those who cast votes in person or by proxy at the meeting must have voted in favour of the compromise or arrangement. Some commentators and market practitioners have argued that the "majority in number" requirement or "headcount" test, which is originally intended to protect the minority interests in a scheme of arrangement, deviates from the "one share one vote" principle and is prone to be circumvented by share splitting. The background to the headcount test and the policy options for reforming it are set out below. The Government would like to hear the views of various stakeholders before taking a final view.

Background

Current Position

6.2 Section 166 provides that where a scheme is proposed between a company and its members or creditors or any class of them, the court may, on the application of the company, or any member or creditor, order a meeting of the members or creditors of the company or a class of them to be summoned in such manner as the court directs. The section also provides that if the statutory majority of members, or creditors, or a class of them agree to any scheme of arrangement, the scheme shall, if sanctioned by the court, be binding on all members, or creditors, or a class of them as the case may be, and also on the company.

6.3 In recent years, section 166 has been used in the following circumstances:

(a) listed companies changing their status to that of a private company (privatisation);

[75] *Re PCCW* Ltd, HCMP 2382/2008 and CACV 85/2009.

(b) listed companies in liquidation selling their listing status; and

(c) a group of companies reorganising to create a new holding company.

6.4 Under section 166(2), the procedure to sanction a scheme involves the following:

(a) an application, usually by the company ex-parte, is made to the court for an order that a meeting be summoned pursuant to section 166(1);

(b) at least a majority in number of the members, creditors, or the relevant class, present and voting in person or by proxy in favour of the scheme (headcount test);

(c) that number must hold at least three-fourths in value of the holdings (or claims in the case of creditors) of those present and voting in person or by proxy ("share value" test); and

(d) the proposals, if approved by the requisite majority, may be sanctioned by court.

6.5 The law implies that the court has the discretion not to sanction a scheme even though it has been approved under both the share value test and the headcount test (for instance, where there is doubt that the process has been unfairly administered, such as where the approval under the headcount test was achieved by share splitting).[76] Nonetheless, the court does not have the jurisdiction to sanction a scheme where the headcount test had not been passed even in the event that share splitting has increased the headcount of members opposing the scheme.

6.6 Apart from complying with section 166 of the CO, any person who seeks to use a scheme to acquire or privatise a listed company must also comply with the Code on Takeovers and Mergers ("Takeovers Code") issued by the SFC under the SFO. Under the Takeovers Code, there are additional requirements to protect the interests of minority shareholders, including:

(a) under Rule 2 of the Takeovers Code, an independent board committee comprising all non-executive directors who have no conflict of interest in the scheme has to be established to give advice to disinterested

[76] *Re PCCW Ltd*, CACV 85/2009.

shareholders about its recommendation of voting. The independent board committee would seek advice from an independent financial adviser who will set out its recommendation and the details of its analysis of the merits of the scheme in its letter to the independent board committee reproduced in the scheme document; and

(b) Rule 2.10(b) of the Takeovers Code stipulates that the number of votes cast against the resolution shall not be more than 10% of the voting rights attached to all disinterested shares, i.e. shares not held by the controlling shareholders or their connected parties. This requirement, which renders an additional safeguard for minority shareholders, is not provided in other jurisdictions adopting similar rules on takeovers and mergers such as the UK, Australia and Singapore.

6.7 A table summarising the thresholds under section 166 of the CO and the Takeovers Code is at **Appendix 2**.

Other Jurisdictions

6.8 Other common law jurisdictions such as the UK, Australia, Singapore, Bermuda and Cayman Islands, all have legislative provisions similar to section 166 of the CO, including the headcount test. The headcount test originated from the days when the procedure applied only to insolvent company schemes with creditors, presumably to place a check on the ability of creditors with large claims to carry the day. When the provision was extended to non-insolvent schemes with members in 1900, the composition of the required majority remained unchanged.[77]

6.9 In the UK, the Company Law Review Steering Group ("CLRSG") has reviewed the "majority in number" requirement (i.e. headcount test) under section 425(2) of the UK Companies Act 1985. The CLRSG recommended that the test should be abolished as the widespread use of nominees had made it an irrelevant test, and that no other meeting of members of a company required a majority otherwise than by reference to value or voting powers.[78] However, the UK Government did not adopt the

[77] UK Company Law Review Steering Group, *Modern Company Law: Completing the Structure* (November 2000), paragraph 11.34.

[78] *Ibid.* See also UK Company Law Review Steering Group, *Final Report on Modern Company Law for a Competitive Economy* (July 2001), paragraph 13.10.

recommendation in the UKCA 2006 as it considered that the headcount approval was still an important investor safeguard.[79]

6.10 In Australia, in order to tackle the problem of share splitting by parties opposing a scheme, section 411(4) of the ACA was amended in December 2007 to give the court a discretion to approve a members' scheme if it was approved by a 75 percent majority in value even though approval by a majority in number of those members present and voting at the scheme meeting was not obtained. The reasons for the amendment, as stated in the Explanatory Statement to the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007, were that:

> *"A members' scheme could be defeated by parties opposed to the scheme engaging in 'share splitting', which involves one or more members transferring small parcels of shares to a large number of other persons who are willing to attend the meeting and vote in accordance with the wishes of the transferor. By splitting shares to increase the number of members voting against the scheme, an individual or small group opposed to the scheme may cause the scheme to be defeated. This may occur even though a special majority is achieved in terms of voting rights attaching to share capital, and if the share split had not occurred, the majority of members were in favour of the scheme."*

6.11 The Australian Corporations and Markets Advisory Committee has recently conducted a review of various matters relating to members' schemes, including whether the headcount test in a members' scheme should be removed. A consultation paper was issued in June 2008.[80] So far, no decision has been made by the Australian Government.

Concerns

6.12 Recently, there has been some public debate concerning the headcount test and the issue of share splitting. Some commentators have suggested that the headcount test should be removed.[81] Their main arguments are:

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79 *Hannigan and Prentice – The Companies Act 2006 – A Commentary* (Butterworths, 2007), paragraph 8.76.

80 Corporations and Markets Advisory Committee (CAMAC), *Members' Schemes of Arrangement – Discussion Paper* (June 2008) ("CAMAC Discussion Paper").

81 See, for example, Civic Party, *Policy Proposals to the SFC in relation to the various issues arising from the PCCW Privatisation Scheme of Arrangement under s. 166 of the CO* (12 February 2009) (available at http://www.civicparty.hk/cp/pages/cpnews-e.php?p=10) and Webb-site.com, *Vote-rigging plan for PCCW meeting* (1 February 2009) (available at http://www.webb-site.com/articles/pccwrig.asp).

(a) the headcount test is inconsistent with the "one share one vote" principle in other provisions dealing with shareholder meetings in the CO[82];

(b) as a very large proportion of shares in listed companies are held by nominees and custodians, the headcount test is not indicative of the decisions of the beneficial owners of the shares (see paragraph 6.14 below);

(c) the headcount test requirement attracts attempts to manipulate the outcome of the vote (for or against a scheme) by share splitting.

6.13 At present, shares in listed companies can be held in the following ways:

(a) within the CCASS,[83] in which case the shares are registered in the name of HKSCC Nominees Limited and the investor holds only a beneficial interest in them, i.e. his name does not appear in the Register of Members ("ROM"); or

(b) outside CCASS, in which case the shares are registered in the name of the investor (or his nominee, if he chooses to hold the shares through a nominee), i.e. the name of the investor (or his chosen nominee) appears in ROM.

6.14 A vast majority of investors have chosen to hold their shares within CCASS through their brokers, banks or custodians, mainly because that facilitates electronic trading and transfer of their shareholdings within CCASS. However, this has given rise to concerns about the exercise of voting rights by beneficial owners. The concerns may be summarised as follows:

(a) Investors holding shares through CCASS are in effect disenfranchised unless they take the step in (b) or (c) below;

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[82] The other exception in the CO that makes reference to a similar headcount test is under section 114 which concerns the extension of the length of notice for calling meetings.

[83] CCASS is a computerised book-entry settlement system. Shares in CCASS are registered in the name of HKSCC Nominees Limited, which is a nominee of Hong Kong Securities and Clearing Company Limited, which in turn is a recognised clearing house under the SFO. Investors who hold their shares within CCASS may hold them directly as investor participants or indirectly through brokers/banks/custodians that are CCASS participants. As of June 2009, HKSCC Nominees Limited held approximately 72% of all issued shares of companies listed in Hong Kong (i.e. irrespective of whether they are incorporated in Hong Kong or not) and its holdings represented some 48% of market capitalisation.

(b) Beneficial owners of shares may request (directly as investor participants or indirectly through their brokers, banks or custodians that are CCASS participants) Hong Kong Securities and Clearing Limited to authorise themselves or another person to act as a corporate representative so as to attend and vote at a meeting in respect of the number and class of shares they own. However, it appears that many beneficial owners have chosen not to express their views; and

(c) As an alternative, a beneficial owner may choose to withdraw their shareholdings from CCASS and become a registered shareholder, but this would involve considerable processing time and cost. In gist, they must first apply to withdraw their shares from CCASS and the process may take a few days (depending on the availability of the required denomination of the share certificates to be withdrawn). Share certificates thus withdrawn from CCASS will be in the name of HKSCC Nominees Limited. They must then be re-registered with the share registrar in the investor's (or his nominee's) name and this normally takes 10 days (although the share registrars also offer an expedited service, where operationally feasible, at a higher charge). There is also a charge for both withdrawal from CCASS and re-registration with the share registrar[84].

6.15 The SFC, the SEHK and the Federation of Share Registrars have scheduled to conduct a consultation shortly on a proposed operational model for implementing a scripless securities market in Hong Kong. It is understood that the proposed model will provide options for investors to hold shares in their own names within CCASS without the need to hold physical certificates. This could help enhance shareholder transparency and facilitate shareholder participation (for instance, facilitating individual shareholders to vote at company's meetings and to receive corporate information). However, if the widespread use of nominees/custodians continues, the concerns about beneficial owners exercising voting rights would remain.

Policy Options for Members' Schemes of Listed Companies

6.16 In view of the above concerns, we have considered **three possible options** for dealing with the headcount test in respect of members' schemes of listed

[84] Hong Kong Securities and Clearing Limited charges $3.50 per board lot of shares withdrawn from CCASS and share registrars generally charge $2.50 for each certificate to be re-registered or issued, whichever is greater.

companies, namely, (a) no change to the status quo, (b) retain the headcount test but give the court discretion to dispense with the test, or (c) abolish the headcount test. The arguments for or against each of the options are set out in paragraphs 6.17 to 6.22 below. In considering these policy options, we believe that the following factors should be taken into account:

(a) whether the drawbacks of applying a headcount test have outweighed its intended benefits; and

(b) whether there is sufficient safeguard for small shareholders and creditors if the headcount test is removed.

Option 1: no change

6.17 An argument for retaining the headcount test is that it gives minority shareholders an opportunity to have a significant say in the future nature and structure of a company under a scheme.[85] It may reduce the possibility of schemes being oppressive to, or ignoring the interests of, minority shareholders, particularly under a provision like section 166, whereby a sanctioned scheme has the capacity to bind all members or creditors including the dissenting or apathetic ones.[86] We also note that the headcount test has been retained in most other common law jurisdictions including the UK, Australia and Singapore as well as some off-shore jurisdictions such as Bermuda and Cayman Islands.

6.18 A contrary view is that the headcount test places significant veto power in the hands of small shareholders, out of proportion to their financial involvement in the company. It can result in a group of persons, who together have contributed only a small proportion of the company's equity capital, having the capacity to block a scheme that is supported by shareholders who have contributed a much larger portion of equity. This may deter companies from proposing a scheme, given the time and cost involved in preparing the documentation and holding a shareholder meeting. By contrast, the outcome of a vote by shares may be easier to predict.[87] There are also practical concerns over the difficulties for beneficial owners to express their views in a headcount test as outlined in paragraph 6.14 above.

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85 CAMAC Discussion Paper, paragraph 4.2.4.

86 This view is shared by the Court of Appeal in its judgment in *Re PCCW* case, CACV 85/2009, see in particular Rogers VP and Barma J's remarks in paragraphs 40 and 177 respectively.

87 CAMAC Discussion Paper, paragraph 4.2.4.

Option 2: retain the headcount test but give the court discretion to dispense with the test

6.19 Another option is to refine the legislation so as to enable the court to look into the true headcount position both for and against the proposal in cases where there is reason to believe that the apparent headcount either way is not fairly reflective of the class concerned.[88] A possible model for legislative amendment may be section 411(4) of the ACA mentioned in paragraph 6.10 above. The proposed amendment will give the court a discretion to make an order that the requirement for a majority of members present and voting (i.e. the headcount test) may be dispensed with.

6.20 It is expected that the court would only exercise the discretion to disregard the headcount test in circumstances where there is evidence that the result of the vote has been unfairly influenced by activities such as share splitting.[89] Nevertheless, there may be concern over the uncertainty as to when the court would exercise its discretion. Companies may still be deterred from proposing a members' scheme, given the time, cost and uncertainty involved.

Option 3: abolish the headcount test

6.21 The main arguments for abolishing the headcount test have been set out in paragraphs 6.12 to 6.15 above. One should also note the difference in the shareholding structure between Hong Kong and other jurisdictions like the UK and Australia which retain the headcount test. Both the UK and Australia have implemented a scripless market albeit to different degrees and both have a higher percentage of publicly traded shares being held by institutional investors than in Hong Kong.[90] This may explain why disenfranchisement of individual beneficial owners in the headcount test is less a concern in those jurisdictions.

6.22 If the headcount test for members' schemes of listed companies is to be abolished, there may be a concern over the adequacy of safeguards for minority shareholders under the CO or the Takeovers Code. The CO is not the appropriate tool to provide safeguards specifically for minority

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88 CACV 85/2009, paragraph 192.

89 Explanatory Statement to the Exposure Draft of the Australian Corporations Amendment (Insolvency) Bill 2007.

90 Institutional investors play a more active role in corporate governance and they may be more willing to express their views through brokerage firms, banks and custodians even if they are beneficial owners.

shareholders of listed companies. As noted in paragraph 6.6(b) above, the Takeovers Code already stipulates that the number of votes cast against the resolution shall not be more than 10% of the voting rights attached to all disinterested shares. This requirement already renders an additional safeguard for minority shareholders beyond similar rules in comparable common law jurisdictions. If any additional safeguard is considered necessary, it should be tackled separately by the SFC and the Takeovers Panel through the normal consultation process on Takeovers Code amendments.

Question 1

In respect of members' schemes of listed companies, which of the following options do you prefer? Please explain the reasons.

Option 1: retain the headcount test;

Option 2: retain the headcount test but give the court a discretion to dispense with the test; or

Option 3: abolish the headcount test.

Policy Options for Members' Schemes of Non-Listed Companies

6.23 Private companies with a small shareholder base are unlikely to use a scheme for reorganisation. Members' schemes among public non-listed companies are also uncommon. If either Option 1 (retention) or Option 2 (retention but give the court a discretion to dispense with the test) for members' schemes of listed companies is adopted, we believe the same approach should apply to members' schemes of non-listed companies. It should be noted that the court's discretion applies to both listed and non-listed companies under section 411(4) of the ACA in Australia.

6.24 If Option 3 (abolition) is adopted in respect of members' schemes of listed companies, there may be conflicting arguments as to whether the same should apply to non-listed companies. On the one hand, as using nominees to hold shares is much less common in non-listed companies, the case for abolishing the headcount test in respect of members' schemes of non-listed companies may appear to be less persuasive. On the other hand, one may

still argue for abolition of the test on the grounds of inconsistency with the "one share one vote" principle and the potential problem of share splitting.

6.25 If there is public support for abolishing the headcount test in respect of members' schemes of non-listed companies, a further question is whether any additional protection for small shareholders is needed. On the one hand, since non-listed companies do not commonly use the scheme provisions in section 166 of the CO and the court already has a general discretionary power to reject a scheme that improperly prejudices the interests of small shareholders, there does not appear to be a strong case for introducing any alternative safeguard in place of the headcount test. On the other hand, some may believe that certain additional protection would be useful because small shareholders often lack resources in making representations before the court.

6.26 We have considered the possibility of codifying the requirement of Rule 2.10(b) of the Takeovers Code (i.e. the number of votes cast against the resolution shall not be more than 10% of the voting rights attached to all disinterested shares) and extending it to members' schemes of non-listed companies. However, we do not favour such an approach. There may be difficulties in defining "disinterested shares" in the absence of administration by the SFC. Moreover, as the majority of non-listed companies are private companies having a small number of shareholders, the application of Rule 2.10(b) may give too strong a veto power to a few shareholders.

Question 2

(a) If your answer to Question 1 is Option 3, do you think that the headcount test should also be abolished in respect of members' schemes of non-listed companies?

(b) If your answer to (a) is yes, do you think that some form of additional protection should be provided for small shareholders? If so, what should such protection be?

Policy Options for Creditors' Schemes

6.27 Some similar factors come into play in the headcount test of members' schemes and creditors' schemes. Like share splitting in members' schemes, there is a possibility of manipulation of the outcome of voting by assigning part of one's debts to other persons. Nevertheless, certain considerations may be different. These include:

(a) it is possible in a creditors' scheme for major creditors to buy out the debts from small creditors to ensure the smooth sailing of a proposed scheme in a creditors' meeting;

(b) it is less likely for small creditors who oppose a proposed scheme to manipulate the outcome of voting by assigning part of their debts to other persons because of the difficulty in finding assignees who are willing to take on the debts especially as the chance of recovery as small creditors is relatively slim; and

(c) those creditors who are not satisfied can always petition to the court for the winding up of the company where the court may stay the process.

The problems arising from the headcount test are thus less evident in the creditors' scheme.

6.28 If Option 1 (retention) is adopted in respect members' scheme, there seems no reason for treating creditors' schemes differently. If Option 2 is adopted in respect of members' schemes, we are not inclined to extend the court's discretion to cover creditors' schemes in view of paragraph 6.27(b) above. It is noted that the court's discretion to dispense with the headcount test in section 411(4) of ACA only applies to members' schemes and not creditors' schemes.

6.29 If Option 3 (abolition) is adopted in respect of members' schemes, we are open to and would appreciate views on whether creditors' schemes should be treated differently. There are both arguments for and against abolishing the headcount test in respect of creditors' schemes. Some may see the headcount test as a means to ensure that the voices of small creditors (including employees who are owed wages or other entitlements by the company) are heard. On the other hand, some query the need for a headcount test as small creditors already stand in a better position than

minority shareholders as they can always petition to court for winding-up in the last resort.

6.30 We have incorporated views expressed by the SCCLR to facilitate discussion on this topic.

Question 3

If your answer to Question 1 is Option 2 or Option 3, do you think that the same approach should apply to creditors' scheme?

CHAPTER 7

DISCLOSURE OF DIRECTORS' RESIDENTIAL ADDRESSES AND IDENTIFICATION NUMBERS OF DIRECTORS AND COMPANY SECRETARIES

7.1 At present, directors and secretaries of companies incorporated or registered in Hong Kong (including non-Hong Kong companies) are required by the CO to provide their residential addresses and identity card or passport numbers ("identification numbers") to the CR for incorporation and registration purposes. Such information is considered important for regulatory authorities or relevant stakeholders (such as shareholders, creditors and liquidators) to locate the directors and company secretaries, particularly in cases where service of documents and legal proceedings is involved. However, as such information is available on the CR's register or can be inspected and copied by members of the public, by paying a small fee, there may be concerns over data privacy and possible abuses. While we consider that there is no longer a need to require company secretaries to disclose their residential address, we would like to hear public views before deciding on the disclosure of directors' residential addresses and identification numbers of directors/ company secretaries.

Background

Current Position

7.2 There are various sections in the CO which require the disclosure of and provision for inspection of information covering residential addresses and identification numbers of directors and secretaries of a company incorporated in Hong Kong, namely:

(a) section 14A stipulates that an incorporation form submitted to the Registrar should contain, among other information, the usual residential address and identification number of each of the prospective directors and the prospective company secretary;

(b) section 158 requires every company to keep a register of its directors and secretaries, containing such particulars such as their names, usual residential addresses and identification numbers, and to allow the inspection of the register by members of the company free of charge and by non-members upon the payment of a fee; and also every company must send to the Registrar such information containing the

particulars specified in the register within 14 days from the appointment of a new director/secretary or from the occurrence of any change in the particulars of the company's directors/secretaries that are contained in the register;

(c) section 158C stipulates that the Registrar shall keep and maintain an index of directors of companies containing their name, address and latest particulars. The index is open for inspection by any person upon the payment of a prescribed fee;

(d) sections 107 and 109 require every company to submit a return to the Registrar annually containing all particulars of its directors and secretaries that are required to be kept in the register of the company; and

(e) section 305 provides that any person may inspect a copy of documents kept by the Registrar subject to the payment of a fee.

7.3 Non-Hong Kong companies registered under the CO are subject to similar requirements as stipulated under sections 333, 333C, 334 and 335 of the CO.

7.4 In the interest of protection of personal data in public registers, section 305 of the CO has been amended so that the purposes for which documents kept or maintained by the Registrar under the CO are made available for public inspection are stated in sub-section (1A). The CR has also implemented various measures to comply with the requirements of the Personal Data (Privacy) Ordinance (Cap 486), including stating a Personal Information Collection Statement in each specified form, its homepage and information leaflets to publicise the purposes of the register and the collection of personal data.

Concerns

7.5 While there are occasional complaints to the CR concerning the disclosure of personal data of directors/company secretaries in the public register, there have not been major problems thus far concerning the misuse of personal data. Nevertheless, as it is now relatively easy to access the personal data through the Internet and as there is increasing public concern over protection of personal data, there is a case to review the need for disclosure of directors/company secretaries' personal data on the public register.

Other Jurisdictions

7.6 Other comparable jurisdictions such as the UK, Australia and Singapore have provisions in their company law governing the disclosure of personal data of directors and company secretaries to the public. These provisions are summarised below.

Singapore

7.7 Singapore adopts a disclosure regime very similar to that in Hong Kong. The identification and usual residential addresses of directors and the identification of company secretaries are disclosed in the public register[91].

Australia

7.8 The ACA requires the personal particulars of new directors and company secretaries, including their name, date and place of birth and usual residential address to be lodged with the Australian Securities and Investments Commission ("ASIC") (there is, however, no requirement for a passport number or other identification). Such information collected is on the public register kept by the ASIC and available for public inspection. Section 205D(2) of the ACA, however, allows a director/company secretary to have an alternative address to be substituted for his usual residential address if the ASIC determines, upon application of the director, that including his residential address in the public register will put at risk the director or his family members' personal safety.[92]

7.9 A person taking advantage of the alternative address provisions is still required to lodge with the ASIC notice of his usual residential address (as well as any change in the address subsequently) and information concerning his usual residential address may be disclosed to the court for purposes of enforcing a judgment debt ordered by the court.

The UK

7.10 In the UK, the issue of disclosure of directors and company secretaries' residential addresses had been reviewed and hotly debated in its recent company law review. As there had been a number of cases of directors of companies, and in some cases members of their families, being harassed or

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91 Section 173 of the SCA.

92 Another alternative condition is the director/secretary's name is already on an electoral roll under the Commonwealth Electoral Act 1918 but this is not directly relevant to our consideration.

intimidated by extremists (e.g. animal rights activists), the UK Companies Act was amended twice in the past decade:

(a) in 2002, a scheme of confidentiality orders was introduced to protect those directors and company secretaries who could show that they were at serious risk of violence and intimidation. A director or company secretary might apply to the Secretary of State for a confidentiality order. If the order is granted, he might substitute the usual residential address with a service address in the public register although the order would have no retrospective effect (i.e. the authority was not obliged to remove an address from existing records);

(b) there were concerns that the scope of protection was not wide enough, for example, it did not protect directors of companies whose customers or suppliers became controversial.[93] Under the UKCA 2006[94], every director is given the option of providing a service address for the public record with the residential address being kept on a separate record to which access is restricted to specified public authorities and credit reference agencies.[95] Existing addresses already on the public record would be purged upon application.[96] Similar protection is provided for directors' residential addresses in respect of overseas companies.[97] Meanwhile, the requirement to file the company secretaries' residential addresses has been abolished.

Considerations

Company secretaries' residential addresses

7.11 We will maintain the existing requirement in section 154 of the CO that a company secretary, being an individual, should ordinarily reside in Hong Kong.[98] However, unlike directors, company secretaries do not owe fiduciary duties to the company and are not personally subject to legislation relating to disqualification. There does not seem to be any strong

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93 For example, the supplier or customer of a company may be alleged of being engaged in controversial practices such as using forced or child labour or infringing animal rights.

94 Sections 240-246 of UKCA 2006.

95 Section 243 of UKCA 2006. "Public authority" includes any person or body having functions of a public nature and "credit reference agency" means a person carrying on a business comprising the furnishing of information relevant to the financial standing of individuals, being information collected by the agency for that purpose.

96 Section 1088 of UKCA 2006. The UK government explained that since pre-2003 information is held on microfiche, it is therefore particularly difficult to remove and since many existing records held on a microfiche are of poor quality, the purging process will be likely to cause loss of information, not just that which is intended to be removed from the public record.

97 Section 1055 of UKCA 2006.

98 See **Clause 10.24(4)** of the CB.

justification for continuing the requirement for a company secretary's residential address to be publicly available. Under the CB, company secretaries may file a service address.

Directors' residential addresses

7.12 There may be conflicting arguments as to whether the residential addresses of directors should continue to be publicly available. Some may prefer adopting either the Australian or the UK approach to restrict public access to directors' residential addresses as a means for protection of personal data.

7.13 On the other hand, there are arguments for maintaining the current disclosure requirement, including:

(a) directors of a company are personally subject to legislation relating to disqualification, fraudulent trading, and other enforcement and regulatory actions but are not always contactable through the registered office. It is in the public interest that regulatory and enforcement agencies, and also stakeholders such as creditors and liquidators, be able to contact directors easily through their residential addresses, in particular when the company is being wound up or dissolved;

(b) unlike in the UK where extremists' harassment and intimidation of directors of certain "controversial" companies has become a social concern, that is not a phenomenon or issue in the Hong Kong society;

(c) there would be considerable practical problems involved in following either the Australian or the UK approaches. The Australian approach requires discretion as to whether particular addresses should or should not be placed on the public record. The CR staff would be put in a very difficult position to assess claims of personal safety risks. The scheme could easily be abused by those who do not have any genuine claim of safety risks;

(d) the UK approach also presents tremendous practical challenges. First, it would be a considerable challenge for the CR to maintain a confidential register for a single category of information and to ensure that it is kept up to date. Many directors might fail, inadvertently or otherwise, to inform the CR of changes in their residential addresses. Second, it would be difficult for the CR to decide who should have access to information in the confidential register. If access is only

confined to public authorities and credit reference agencies, some current legitimate data users like creditors and liquidators will be disadvantaged. On the other hand, if the net is cast wide (e.g. covering also shareholders, creditors, employees who are owed outstanding entitlements and liquidators), the CR would have difficulty in handling numerous requests for access to the confidential register. We understand that the UK Companies House has encountered practical difficulties in handling such requests even though access to their confidential register is fairly restrictive; and

(e) another major practical difficulty is how to deal with the numerous existing records of directors' residential addresses embedded in a huge number of documents filed with the CR over the past decades. These documents are kept either as scanned copies or microfiche. The removal of residential addresses would mean deleting the text from every public record held with the CR while retaining the information for the confidential register. Moreover, it would be wholly impracticable for the information stored on microfiche to be removed. The UK has tried to contain the problem by removing data only upon application. The workload would still be considerable if there is a large number of applications coming in at roughly the same time.

7.14 We have to strike a balance between protection of personal data and the need to allow access to such data by relevant stakeholders for legitimate purposes. Having considered the pros and cons of retaining the current disclosure regime and adopting the UK or Australian approaches, we are inclined to retaining the current regime. Nevertheless, we would like to listen to the views of all the stakeholders before taking a final view.

Question 4

(a) Do you agree that directors' residential address should continue be made available for inspection on the public register?

(b) If your answer to (a) is in the negative, do you think that either:

(i) the Australian approach (paragraphs 7.8 and 7.9); or

(ii) the UKCA 2006 approach (paragraph 7.10(b)) should be adopted?

(c) If you consider that either the Australian or the UKCA 2006 approaches should be adopted, do you have any suggestions on how to tackle the practical problems highlighted in paragraph 7.13(c) to (e) above?

Identification numbers of directors and company secretaries

7.15 There may also be conflicting arguments on whether identification numbers of directors and company secretaries should continue to be available for public inspection. The arguments for maintaining the status quo are:

(a) in view of the fact that different persons having the same name are quite common in Hong Kong, restricting access to identification numbers may deprive the public of a means of uniquely identifying individuals, and might make it easier for the dishonest to escape creditors or otherwise engage in fraudulent activity. The option of masking 3 or 4 digits of an identification number would not serve the purpose of identifying a person as there are cases of persons with the same name having similar identity card numbers;

(b) misuse of identification numbers is not perceived to be a major problem in Hong Kong;

(c) similar to the problem regarding directors' residential addresses cited in paragraph 7.13(e) above, purging of or masking certain digits from all identification numbers embedded in existing records filed with the CR would present an insurmountable practical problem; and

(d) it would be difficult for the CR to decide who should have access to the full identification numbers. Other than public and regulatory authorities who may need full identification numbers for enforcement actions, some private parties such as liquidators may also need the information for legitimate purposes.

7.16 On the other hand, there are arguments for masking certain digits in identification numbers at least in respect of new records of directors/company secretaries on the public register. These arguments are:

(a) there is a risk that personal identification numbers could be misused as identity card numbers are often used in electronic or telephone transactions involving the verification of the identity of an individual;

(b) purging of past records could be undertaken by a phased approach if this cannot be accomplished in one go; and

(c) the CR can issue guidelines on who can have access to the full identification numbers upon application. If necessary, the guidelines can be put on a statutory basis.

7.17 We would like to hear public views on whether public availability of identification numbers is a major problem before deciding on the way forward.

Question 5

(a) Do you think that there is a need to mask certain digits from the identification numbers of new records of directors and company secretaries on the public register?

(b) If your answer to (a) is yes, do you have any views on how to deal with personal identification numbers on existing records?

CHAPTER 8

REGULATING DIRECTORS' FAIR DEALINGS OF PRIVATE COMPANIES ASSOCIATED WITH A LISTED OR PUBLIC COMPANY

8.1 Currently, a private company that is a member of a group of companies which includes a listed company (a "relevant private company"[99]) is in essence treated in the same manner as a public or listed company in the CO in respect of prohibitions on loans, quasi-loans and credit transactions in favour of directors or directors of its holding company or another company controlled by one or more of its directors.[100] The relevant private companies are thereby subject to more stringent restrictions than other private companies. In Part 11 of the CB, we propose relaxing the prohibitions on public companies in respect of these transactions. A new exemption will be introduced to enable public companies to make a loan, a quasi-loan or enter into a credit transaction in favour of a director or connected entity subject to disinterested members' approval.[101] Private companies will generally continue to be subject to less stringent regulations. There are, however, different views as to whether private companies associated with a public or listed company should be subject to more stringent restrictions similar to a public company. We would like to hear the public's views on this matter, before taking a final view.

Background

8.2 Sections 157H and 157HA of the CO deal with prohibitions on loans, quasi-loans and credit transactions in favour of directors, directors of a holding company and certain connected persons and exceptions to these prohibitions. Public companies and relevant private companies are subject to more stringent restrictions than other private companies in the following aspects:

(a) they are subject to additional prohibitions relating to quasi-loans and credit transactions[102];

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99 See section 157H(10) of the CO.

100 The prohibitions are extended to cover certain connected persons (e.g. spouse, child and step-child) of the directors in the case of listed companies and relevant private companies.

101 See paragraphs 24 to 27 of Explanatory Note on Part 11.

102 Sections 157H(3) and (4), which was introduced in 2003 to include more modern forms of credit, prohibits public companies and relevant private companies from making quasi-loans or entering into credit transactions in favour of their directors or other persons specified in the section.

(b) the prohibitions are extended to making loans, quasi-loans to or entering into credit transactions with persons connected with a director[103]; and

(c) they are not eligible for the members' approval exception in section 157HA(2) under which other private companies may be exempted from the prohibitions on making loans to a director etc. if the transaction is approved by members at a general meeting.

8.3 A relevant private company may be a subsidiary, holding company or fellow subsidiary of a listed company. This can include a private company owned by a holding company of a listed company although the private company falls outside the listed group under the Listing Rules.[104]

8.4 The SCCLR has recommended that the general exception of members' approval to the prohibitions on loans and similar transactions currently applicable to private companies other than "relevant private companies" should be extended to all companies (see paragraphs 7 to 9 of the Explanatory Notes on Part 11 for details). Nevertheless, as a safeguard against possible abuse by those in control, public companies will be subject to the requirement of disinterested members' approval, i.e. the resolution of a public company is passed only if every vote in favour of the resolution by the specified interested members is disregarded (see paragraphs 24 to 27 of the Explanatory Notes on Part 11). We have to consider whether "relevant private companies" should be subject to the same disinterested members' approval requirement as well as the additional restrictions stated in paragraph 8.2(a) and 8.2(b) above. Other than abolishing the concept of "relevant private company" and treating all private companies in the same manner, four possible options are set out below for consideration.

Options

Option 1: Retaining the concept of "relevant private company"

8.5 It may be argued that a private company associated with a listed company should continue to be subject to tighter regulation, given that a more stringent regulation of such private companies is desirable to further protect the interests of the shareholders, particularly minority shareholders of the

[103] It should be noted that the additional prohibitions do not apply to a public non-listed company unless it is a member of a group of companies which includes a listed company, see section 157H(8) of the CO.

[104] c.f. the terms "group" and "subsidiaries" as defined in Chapter 1 of the Main Board Listing Rules. A "group" means the issuer or guarantor and its subsidiaries, if any, and "subsidiaries" includes the meaning attributed to it in section 2 of the CO and any entity which is or will be accounted for and consolidated in the audited consolidated accounts of another entity as a subsidiary pursuant to the applicable financial reporting standards.

listed companies. It is also noted that there is similar concept of "relevant private companies" in the UK CA 2006 where "companies are associated if one is a subsidiary of the other or both are subsidiaries of the same body corporate".[105] The concept of "companies associated with a public company" in the UK is therefore similar to that of "relevant private companies" in Hong Kong. The only difference between Hong Kong and the UK approaches is that the Hong Kong provisions refer to a group of companies in which a member is a "listed" company whereas the UK model refers to companies which are in the same group as a "public" company. Notwithstanding the disinterested members' voting requirement, the extension of the members' approval exception to "relevant private companies" is already a relaxation of the existing law.

Option 2: Extending the concept of "relevant private company" to cover companies associated with non-listed public companies

8.6 As an alternative to Option 1, instead of covering private companies which are in the same group as a "listed company", we can consider following the UK approach which covers companies associated with a "public company" instead. This would extend the extra protection of shareholders of listed companies to shareholders of non-listed public companies. Nevertheless, the impact is likely to be insignificant as the number of non-listed public companies is relatively small in Hong Kong.

Option 3: Modifying the concept of "relevant private company" by disapplying it to private companies having a common holding company with a listed/public company

8.7 The current definition of "relevant private company" does not only cover private companies which are subsidiaries or holding companies of a listed company, but also any private company which has a common holding company with a listed company. This means that tighter restrictions are imposed on a private company whose holding company happens to be a majority shareholder of a listed company. There is some doubt as to whether this is justified because the listed company and its public investors have no interests in such a private company although the two companies happen to have a common majority shareholder which is a company. It can be argued that such a private company should be excluded from the concept of "relevant private company".

8.8 On the other hand, we note that any loss suffered by the sibling private company may indirectly impact on the listed company depending on the

[105] Section 256(b) of UKCA 2006.

circumstances. For instance, where the listed company had provided security for the private company's liabilities under other transactions, the damage to the financial position of the private company can trigger the listed company's liabilities. It may therefore be argued that more stringent regulation of any private company in a group containing a listed company seems justified.

Option 4: Modifying the concept of "relevant private company" to cover only private companies which are subsidiaries of a listed/public company

8.9 Another alternative is to modify the concept of "relevant private company" to cover only the subsidiaries of a public company, whether listed or unlisted. The rationale is that the shareholders of all types of public companies should be given the same level of protection and it is fair and justified to include subsidiaries of all public companies in view of the number of shareholders that may be involved.[106] Where the private company is the subsidiary, then any loss suffered by the private company (as a result of the quasi-loans, etc.) impacts on the shareholders of the listed/public holding company since the subsidiary is an asset of the holding company and there would be a diminution in the holding company's assets, with flow-on effects for the shareholders of the holding company. On the other hand, if the holding company is a private company, any loss suffered by the holding company would not have the same type of impact on the position of the minority shareholders of the listed/public company subsidiaries. Meanwhile, targeting only subsidiaries will avoid casting the net too wide to cover private companies whose holding company happens to be a majority shareholder of a listed company. As noted in paragraph 8.7 above, there is some doubt as to whether such private companies should be subject to tighter restrictions.

Question 6

On the assumption that a new disinterested members' approval exception to prohibitions on loan and similar transactions in favour of directors and their connected persons will be introduced in respect of public companies, which of the following options do you prefer?

Option 1: "relevant private companies" as defined in section 157H(10) of the CO should continue to be subject to more stringent regulations similar to public companies (including restrictions relating to quasi-loans and credit transactions, restrictions

[106] It is noted that private companies associated with a public company are subject to tighter regulation under the UKCA 2006. See sections 198(1), 200(1) and 201(1) of the UKCA 2006.

relating to connected persons and disinterested members' approval requirement);

<u>Option 2</u>: extending the concept of "relevant private company" to cover companies associated with non-listed public companies;

<u>Option 3</u>: modifying the concept of "relevant private company" by disapplying it to private companies having a common holding company with a listed/public company;

<u>Option 4</u>: modifying the concept of "relevant private company" to cover only private companies which are subsidiaries of a listed/public company; or

<u>Option 5</u>: abolishing the concept of "relevant private companies", i.e. all private companies should be subject to the same treatment.

Any other option (please elaborate)?

CHAPTER 9

COMMON LAW DERIVATIVE ACTION

9.1 We need to consider if the existing right to take a common law derivative action ("CDA") as preserved under section 168BC(4) of the CO should be abolished in Part 14 of the CB.

Background

Current Position

9.2 Shareholder remedies provisions were substantially revised by the Companies (Amendment) Ordinance 2004 with a view to enhancing legal remedies available to members of a company. One of the significant changes was to provide a new statutory derivative action (SDA) procedure that may be taken on behalf of a company by a member of the company in Part IVAA of the CO. By section 168BC(4), the right to take a CDA was specifically preserved.

9.3 At present, section 168BC(1) only allows a member of a specified corporation (i.e. a Hong Kong or a non-Hong Kong company) to bring or to intervene into an action on behalf of the company in respect of "misfeasance" (i.e. fraud, negligence, default in complying with any statutory provision or rule of law or breach of duty) committed against the company. In response to the comments made by the Court of Final Appeal in *Waddington Limited v Chan Chun Hoo and Others*[107] that the scope of the SDA should be extended to cover "multiple" derivative actions, the Government intends to amend the relevant provisions in the CO through a Companies (Amendment) Bill to allow also a member of an associated company of the specified corporation[108] to take a SDA (see also the Explanatory Notes on Part 14 below).

Concerns

9.4 There had not been major concerns over preserving the right to take a CDA after the introduction of the SDA in the CO. However, in its judgment, the Court of Final Appeal suggested that once the legislation had been extended to cover multiple derivative actions, there seemed no need to retain the CDA. The CDA had been preserved mainly because of concerns that its abolition

[107] (2008) 11 HKCFAR 370.

[108] An "associated company" in relation to a specified corporation means any company that is the specified corporation's subsidiary or holding company, or a subsidiary of that specified corporation's holding company.

might deprive shareholders of companies incorporated outside Hong Kong of common law rights which would otherwise be available to them. But the Court of Final Appeal was of the view that such concerns were unfounded because if the question whether a derivative action would be available to such a company was a question of substantive law, then such a question together with the rules of internal management would be governed by the law of the place of incorporation of the company and not by the common law of Hong Kong.

Considerations

9.5 The question of whether the CDA should continue to be preserved after the extension of the SDA to cover multiple derivative actions has been considered by the SCCLR recently. The SCCLR recommended that the public should be consulted before a final view is taken on the issue. The main arguments for and against the abolition of the CDA are set out below for reference:

Arguments for abolishing CDA

9.6 The arguments for abolishing the CDA are:

(a) it is unusual in an international context for both the SDA and the CDA to co-exist. In Australia, Canada, New Zealand and the UK, the statutory regime has replaced the common law regime; and

(b) co-existence of the SDA and the CDA is a source of confusion and complication. The continued existence of two parallel regimes will serve no discernible purpose. One of the major reasons given for such an arrangement is to allow members of non-Hong Kong companies to bring a CDA in Hong Kong in circumstances where the rules on standing and internal management in the law of the place of incorporation would allow such members to bring an action. The reason is based on the view that the rules on derivative actions are procedural rules which are governed by the *lex fori* (i.e. Hong Kong law, for present purposes). If the CDA is abolished in Hong Kong, then members of the foreign company would not be able to bring a CDA in Hong Kong even though the law in the place of incorporation would have allowed that. This view is arguable but may not be correct, as suggested in the *Waddington* case.

Arguments for preserving CDA

9.7 The arguments for preserving the CDA are:

(a) to preserve the ability of members of foreign companies to bring a CDA in Hong Kong, if indeed the correct view is that the rules on derivative actions are procedural rules and are governed by the *lex fori*, while the law of the place of incorporation governs the right of a shareholder to bring a CDA. There are a large number of companies incorporated outside Hong Kong but with Hong Kong resident shareholders, which have no place of business in Hong Kong and therefore are not non-Hong Kong companies within the meaning of Part XI of the CO. These foreign companies are therefore not within the definition of "specified corporation" and not able to bring a SDA. To abolish the common law right for these foreign companies may deprive their shareholders of rights they currently enjoy, because even if the law of incorporation of such companies gives analogous rights to a CDA, they would not be enforceable in the courts of Hong Kong if the CDA were to be abolished. Indeed a CDA may be needed as a fall back position for those non-Hong Kong companies who may bring a SDA pursuant to CO section 168BC, but whose relevant internal management rules do not match the definition of "misfeasance" in CO section 168BB;

(b) the abolition of the CDA may create unnecessary difficulties for the Hong Kong shareholders of these foreign companies to seek derivative actions in the Hong Kong courts, even though the Hong Kong courts may, under the principle of *forum conveniens*, consider themselves to be the natural and appropriate forum for resolving the issues, as there is nothing in Hong Kong under the Rules of the High Court to regulate such derivative actions;

(c) the co-existence arrangement has been in place for over four years. It has not caused any major legal problem, notwithstanding the comments made by the Court of Final Appeal in the *Waddington* case. In particular, if not because of the co-existence arrangement, applicants in a case like the *Waddington* case would not have been able to bring a “multiple” derivative action. In any event, there are safeguards in the

CO to prevent duplicative CDA and SDA under CO section 168BE and section 168BC(5) and these safeguards will be preserved in the CB; and

(d) there are still uncertainties as to what other issues about derivative actions may arise in the future or how some uncertainties of the SDA provision will be resolved. It is therefore safer to keep the CDA at this stage. In any event, it will be safer to maintain the CDA so that members of Hong Kong or non-Hong Kong companies will not be in any way prejudiced or be deprived of any beneficent developments at common law.

Question 7

Do you consider that the common law derivative action currently preserved in section 168BC(4) of the CO should be abolished in the CB?

LIST OF QUESTIONS FOR CONSULTATION

Question 1 In respect of members' schemes of listed companies, which of the following options do you prefer? Please explain the reasons.

Option 1: retain the headcount test;

Option 2: retain the headcount test but give the court a discretion to dispense with the test; or

Option 3: abolish the headcount test.

Question 2 (a) If your answer to Question 1 is Option 3, do you think that the headcount test should also be abolished in respect of members' schemes of non-listed companies?

(b) If your answer to (a) is yes, do you think that some form of additional protection should be provided for small shareholders? If so, what should such protection be?

Question 3 If your answer to Question 1 is Option 2 or Option 3, do you think that the same approach should apply to creditors' scheme?

Question 4 (a) Do you agree that directors' residential address should continue be made available for inspection on the public register?

(b) If your answer to (a) is in the negative, do you think that either:

(i) the Australian approach (paragraphs 7.8 and 7.9); or

(ii) the UKCA 2006 approach (paragraph 7.10(b)) should be adopted?

(c) If you consider that either the Australian or the UKCA 2006 approaches should be adopted, do you have any suggestions on how to tackle the practical problems highlighted in paragraph 7.13(c) to (e) above?

Question 5 (a) Do you think that there is a need to mask certain digits from the identification numbers of new records of directors and company secretaries on the public register?

(b) If your answer to (a) is yes, do you have any views on how to deal with personal identification numbers on existing records?

Question 6 On the assumption that a new disinterested members' approval exception to prohibitions on loan and similar transactions in favour of directors and their connected persons will be introduced in respect of public companies, which of the following options do you prefer?

Option 1: "relevant private companies" as defined in section 157H(10) of the CO should continue to be subject to more stringent regulations similar to public companies (including restrictions relating to quasi-loans and credit transactions, restrictions relating to connected persons and disinterested members' approval requirement);

Option 2: extending the concept of "relevant private company" to cover companies associated with non-listed public companies;

Option 3: modifying the concept of "relevant private company" by disapplying it to private companies having a common holding company with a listed/public company;

Option 4: modifying the concept of "relevant private company" to cover only private companies which are subsidiaries of a listed/public company; or

Option 5: abolishing the concept of "relevant private companies" , i.e. all private companies should be subject to the same treatment.

Any other option (please elaborate)?

Question 7 Do you consider that the common law derivative action currently preserved in section 168BC(4) of the CO should be abolished in the CB?

Appendix 1

FRAMEWORK OF DRAFT COMPANIES BILL

Part		First Phase	Second Phase
1	Preliminary	✓	✓
2	Registrar of Companies and Register	✓	
3	Company Formation and Related Matters, and Re-registration of Company		✓
4	Share Capital		✓
5	Transactions in relation to Share Capital		✓
6	Distribution of Profits and Assets		✓
7	Debentures		✓
8	Registration of Charges		✓
9	Accounts and Audit		✓
10	Directors and Secretaries	✓	
11	Fair Dealing by Directors	✓	
12	Company Administration and Procedure	✓	
13	Arrangements, Amalgamation, and Share Acquisition on Takeovers and on Share Repurchases		✓
14	Remedies for Protection of Companies' or Members' Interests	✓	
15	Dissolution by Striking Off or Deregistration	✓	

16	Non-Hong Kong Companies	✓	
17	Companies not Formed, but Registrable, under this Ordinance	✓	
18	Communications To and By Companies	✓	
19	Investigation		✓
20	Miscellaneous		✓

SCHEME OF COMPROMISE OR ARRANGEMENT — THRESHOLDS UNDER THE COMPANIES ORDINANCE AND TAKEOVERS CODE

CO / Takeovers Code	Test	Threshold
CO s 166(2)	Headcount	**Majority in number** of the members, creditors, or the relevant class, present and voting in person or by proxy at the meeting of members or creditors.
CO s 166(2)	Share value	**75% in value** of the members, creditors, or the relevant class, of those present and voting in person or by proxy at the meeting of members or creditors.
Takeovers Code Rule 2.10	Voted disinterested shares	**75% of the votes attaching to the disinterested shares** that are **cast** either in person or by proxy at a duly convened **meeting of the holders of the disinterested shares.**
Takeovers Code Rule 2.10	No substantial objection of disinterested minorities	Number of votes cast against the scheme at the meeting of the holders of the disinterested shares is **not more than 10 % of the votes attaching to all disinterested shares**.
CO s 166(1) and case law	Court sanction	In exercising its power of sanction the court must be satisfied with the following matters: (a) compliance with the statutory provision; (b) the class of members is fairly represented and the statutory majority are acting bona fide and not coercing

CO / Takeovers Code	Test	Threshold
		the minority in order to promote interests adverse to those of the class; and (c) the scheme may reasonably be approved by an intelligent and honest man of that class acting in respect of his interest.

EXPLANATORY NOTES ON THE DRAFT PARTS

PART 1

PRELIMINARY

Introduction

1. Part 1 is an introductory part that sets out the title of the new Ordinance, its commencement date, and the interpretation and definitions of various terms and expressions that are used throughout the Ordinance, including the types of companies that can be formed under the Ordinance and the meaning of terms such as subsidiaries, parent companies, parent undertaking and subsidiary undertaking, etc. Part 1 will be further reviewed in the course of preparing the draft provisions of the CB for the second phase consultation in early 2010.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Reducing the types of companies that can be formed to five, namely, (i) private companies limited by shares; (ii) public companies limited by shares; (iii) private unlimited companies with a share capital; (iv) public unlimited companies with a share capital; and (v) guarantee companies that do not have share capital; and

  (b) Replacing the phrase "officer who is in default" with "responsible person" and refining the definition to strengthen the enforcement regime (such as lowering of the threshold for a breach or contravention by removing wilfulness as an element of the offence, inclusion of negligent acts or omissions and expansion of the categories of persons to be caught).

Significant Changes

(a) Types of companies formed under the CO

Background

2. At present, under the combined effect of sections 4(2) and (4) and section 29 of the CO, eight different types of companies can, in theory, be formed according to their capacity to raise funds from outside sources, the ability of members to freely transfer their shares and the methods by which the liability of members are determined. They are:

   (a) private companies limited by shares;

   (b) non-private companies limited by shares;

   (c) private companies limited by guarantee without share capital;

   (d) non-private companies limited by guarantee without share capital;

   (e) private unlimited companies with a share capital;

   (f) non-private unlimited companies with a share capital;

   (g) private unlimited companies without share capital; and

   (h) non-private unlimited companies without share capital.

3. Based on the SCCLR's recommendations[1], we propose to streamline the types of companies along the following lines:

   (a) the category of unlimited companies without share capital (i.e. (g) and (h) in paragraph 2 above) should be abolished because it is very unlikely that such type of companies will be formed in the future and there is currently no such company on the register;

[1] See SCCLR, *Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance* (February 2000), paragraph 5.78 (available at http://www.cr.gov.hk/en/standing/docs/Rpt_SCCLR(E).pdf) and SCCLR, "Chapter 4: Types of Company and Definitions of Private and Public Companies", *2006-07 Annual Report*, (available at http://www.cr.gov.hk/en/standing/docs/23anrep_e.pdf).

(b) companies limited by guarantee should become a separate category of companies (i.e. (c) and (d) in paragraph 2 above will be merged into one category of companies limited by guarantee without share capital). They should be treated in a manner similar to public companies with appropriate modifications. For example, like public companies, all guarantee companies should be required to file annual reports and audited accounts;

(c) non-private companies should be renamed "public companies" which are defined to mean companies other than private companies or guarantee companies. No change should be made to the definition of private companies in section 29 of the CO;

4. As a result, the types of companies permissible under the new CO will be reduced to five, namely:

(a) private companies limited by shares;

(b) public companies limited by shares;

(c) private unlimited companies with a share capital;

(d) public unlimited companies with a share capital; and

(e) companies limited by guarantee without share capital.

Proposal

5. **Clause 1.9** defines an unlimited company and **Clause 1.7** defines a company limited by shares. Under the definitions, both types of companies must be companies having a share capital. **Clause 1.10** sets out the required characteristics of a private company which are the same as those currently provided under section 29 of the CO (i.e. a company is a private company if its articles restricts members' rights to transfer shares, limits the number of members to 50, and prohibits any invitation to the public to subscribe for any shares or debentures), but clarifies that a private company must have share capital. **Clause 1.11** provides that a company is a public company if it has a share capital and is neither a private company nor a guarantee company.

6. **Clause 1.8(1)** provides that a company is a company limited by guarantee if it does not have a share capital and if the liability of its members is limited by the company's constitution to the amount that the members undertake to contribute to the assets of the company in the event of its being wound up. **Clause 1.8(2)** makes it clear that a company limited by guarantee and having a share capital formed on or before 14 February 2004 under the CO, will be regarded as a guarantee company under the CB although it has a share capital.

(b) Replacing the phrase "officer who is in default" with "responsible person" and refining the definition to strengthen the enforcement regime

Background

7. Many offence provisions under the CO punish not only a company but also every officer of the company who is in default. The phrase "officer who is in default" is currently defined by section 351(2) as meaning any officer of the company, or any shadow director of the company, who knowingly and wilfully authorises or permits the default, refusal or contravention mentioned in relevant provisions of the CO.

8. There are a few problems with this definition. They are:

(a) the present formulation of "officer who is in default" does not cover negligence of officers; and

(b) where a company having a corporate officer commits an offence, the present provision does not punish, in addition to such corporate officer who has caused the default, any officer or shadow director of such a corporate officer who has caused the corporate officer to be in default.

9. In view of the above deficiencies, we consider it necessary that the enforcement regime under the new CO should be strengthened. In this respect, we propose to follow section 1121(3) of the UKCA 2006 by replacing the reference to "knowingly and wilfully authorises or permits the default, refusal or contravention" with "authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention", thus lowering the threshold for a breach or contravention and extending it to negligent acts or omission. We propose also to extend the punishment to

an officer of a corporate officer of a company who has caused the default where such corporate officer commits an offence as an "officer in default", similar to section 1122(2) of the UKCA 2006. In view of these proposed changes, the term "responsible person" is, in our view, a better name than "officer who is in default".

Proposal

10. For the reasons stated in paragraph 9, a new term "responsible person" will be used in the new CO to replace the phrase "officer who is in default". **Clause 1.3(2)** defines a person as a "responsible person" of a company or non-Hong Kong company if he is an officer or shadow director of the company or non-Hong Kong company who authorises or permits, participates in, or fails to take all reasonable steps to prevent the contravention or failure in question.

11. **Clause 1.3(3)** extends the scope of responsible person of a company or non-Hong Kong company to cover an officer or shadow director of a body corporate that is an officer or shadow director of the company or non-Hong Kong company. Where the body corporate is liable as a responsible person, an officer or shadow director of the body corporate who caused the default will also be liable as a responsible person of the company or non-Hong Kong company.

12. The proposals will strengthen the enforcement regime in relation to breaches of obligations, or contraventions of requirements, under the CO by an officer (including shadow director) of a company or a non-Hong Kong company.

PART 2

REGISTRAR OF COMPANIES AND REGISTER

Introduction

1. Part 2 deals with the general functions and powers of the Registrar. It groups the existing provisions relating to the office of the Registrar and the register being maintained by the Registrar under a distinct part and expressly states the functions of the Registrar. The amendments introduce new provisions, which aim primarily at providing the Registrar with necessary powers to maintain and safeguard the integrity of the register, having regard to the development of the CR's information system which will enable the electronic delivery of documents to or by the Registrar. In addition, some of the CR's existing administrative practices will be put on a statutory footing to improve transparency and provide greater clarity in relation to the CR's operations.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Clarifying and enhancing the Registrar's powers in relation to the registration of documents, such as specifying requirements as to the authentication of the documents to be delivered to the CR and manner of delivery and withholding registration of unsatisfactory documents pending further particulars; and

  (b) Clarifying and enhancing the Registrar's powers in relation to the keeping of the register, such as rectifying typographical or clerical errors, making annotations, and requiring a company to resolve any inconsistency or provide updated information; and

  (c) Introducing a new court-based procedure for removing from the register information that is inaccurate, forged or derived from anything invalid, ineffective or done without the authority of the company.

Significant Changes

(a) Clarifying and enhancing the Registrar's powers in relation to the registration of documents

Background

2. At present, under section 2A of the CO, the Registrar has the power to specify the form of documents to be delivered to the CR. Moreover, under section 347 of the CO, the Registrar may accept the information delivered to her in a form approved by her. This will enable documents to be delivered to the CR in electronic form after the CR's new information system comes on stream in late 2010/early 2011. Nevertheless, it would be desirable if the Registrar's powers to specify the form of documents and the form of delivery is clarified to include requirements as to authentication and the manner of delivery of documents.

3. Under section 348 of the CO, the Registrar may refuse to register a document if it is manifestly unlawful or ineffective, or is incomplete or altered; or any signature on the document, or digital signature accompanying the document is incomplete or altered. It is not entirely beyond doubt whether the grounds for refusal could cover cases, for example, where the information contained in it is internally inconsistent or inconsistent with information already on the register. It is proposed that the grounds of refusal should be set out in clearer terms. In addition, the current right of a person aggrieved by the Registrar's decision to refuse registration to appeal to the court under section 348(3) should be limited to situations where the document is regarded as unsatisfactory. Where the Registrar refuses to receive the document (for reasons other than that the document is regarded as unsatisfactory) or where the document is not properly delivered, no right of appeal is proposed on the grounds that the Registrar's decision is mostly based on objective considerations.

Proposal

4. **Clause 2.12** gives the Registrar a power to specify requirements about form, authentication and manner of delivery of documents, including the physical form and means of communication, the format and the address to which they are to be sent, and where appropriate, technical specification. **Clause 2.12(5)(a)** empowers the Registrar to require the document to be in hard

copy form, electronic form or any other form. But **Clause 2.12** does not empower the Registrar to require a document to be delivered to the Registrar only by electronic means (see **Clause 2.12(6)**). The power to require delivery by electronic means lies with the Financial Secretary with regulations made under **Clause 2.15**.

5. **Clause 2.17** makes it clear that if the Registrar refuses to accept a document under certain circumstances, the document is to be regarded as not having been delivered to the Registrar for registration. **Clause 2.18** empowers the Registrar to refuse to register a document delivered to her if the document is not properly delivered or is unsatisfactory. If the Registrar refuses to register a document, the document is to be regarded as not having been delivered to the Registrar for registration. Under **Clause 2.21**, the Registrar may send a notice of the refusal and the reasons for the refusal to the person who delivered the document for registration. **Clause 2.19** further provides that the Registrar may withhold the registration of an unsatisfactory document and request the person who delivered the document to take certain remedial actions within a specified period, such as producing further information or evidence, amending or completing the document or applying for a court order. The conditions for a document to be considered as "properly" delivered to the Registrar and the situations where a document is considered to be unsatisfactory are set out in **Clause 2.11** and **Clause 2.16** respectively.

(b) Clarifying and enhancing the Registrar's powers in relation to the keeping of the register

Background

6. Regarding the power on the part of the Registrar to rectify any documents on the register, the Registrar presently adopts an administrative measure to accept the filing of "amended" documents and explanatory or correction letters from companies to rectify documents containing errors. It would be preferable for such power to be put on an express statutory footing.

7. It is proposed that the following powers be provided for expressly:

(a) power to annotate information on the register to provide supplementary information such as the fact that the document in question has been replaced or corrected; and

(b) power to request companies or their officers to resolve inconsistencies in information on the register or to provide updated information.

Proposal

8. **Clause 2.24** gives the Registrar power to, either on her own initiative or on an application by a company, rectify a typographical or clerical error contained in any information on the register. If the rectification is made upon an application by a company, the Registrar may rectify the error by registering a document showing the rectification delivered by the company. **Clause 2.27** provides that the Registrar may make a note in the register for the purpose of providing information in relation to such a rectification.

9. **Clause 2.22** enables the Registrar to notify a company of an apparent inconsistency in the information on the register and to require it to take steps to resolve the inconsistency within a specified period. **Clause 2.23** empowers the Registrar to require a person to update his or her information on the register. Under both clauses, failure of the company and every responsible person concerned to comply with the Registrar's requirements is an offence.

(c) Introducing a new court-based procedure for removing information on the register that is inaccurate, forged or derived from anything invalid, ineffective or done without the authority of the company

Background

10. At present, it is unclear if the court has general inherent jurisdiction to order the Registrar to remove information which has been provided in compliance with statutory requirements. There is no clear means for a company to remove from the register information which has been placed on the register but subsequently proves to be inaccurate and misleading. As the Registrar is not in a position to determine whether a piece of information is inaccurate or forged, a new court-based procedure for ensuring that such information can be removed is called for.

Proposal

11. **Clause 2.25** provides that the court may, on application by any person, direct the Registrar to rectify any information on the register or to remove

any information from it, if the court is satisfied that the information is inaccurate or forged, or derives from anything that is invalid or ineffective or that has been done without the company's authority. When making an order of removal of any information from the register, the court may make any consequential order that appears just with respect to the legal effect, if any, to be accorded to the information by virtue of its having appeared on the register.

Other Changes

(a) Registrar empowered to issue guidelines

12. **Clause 2.6** provides that the Registrar may issue guidelines indicating the manner in which the Registrar proposes to perform any function or exercise any power, or providing guidance on the operation of any provision of the CB. The guidelines are not subsidiary legislation, but may be admissible in evidence in any legal proceedings if they are relevant to determine a matter in issue. Non-compliance with them would not of itself result in any civil or criminal liability, but may be relied on by any party to any legal proceedings as tending to establish or negate the matter to which they are relevant.

(b) Registrar may agree with a company that documents to be delivered by the company for registration would be delivered by electronic means on terms specified in the agreement

13. **Clause 2.14** provides that the Registrar may agree with a company that documents to be delivered by the company for registration would be delivered by electronic means on such terms as specified in the agreement. The clause allows the Registrar to agree with a company detailed arrangements or requirements (e.g. electronic payment of fees) for the electronic delivery of documents to the Registrar. The clause is different from **Clause 2.12** which sets out the general provisions for the Registrar to require documents to be delivered in electronic form and/or, by electronic means.

(c) Financial Secretary may make regulations requiring delivery of documents to the Registrar by electronic means

14. **Clause 2.15** provides that the Financial Secretary has a new power to provide for electronic delivery of documents by regulations subject to the approval of LegCo. This allows for flexibility for the future introduction of electronic delivery of certain classes of documents.

(d) Registrar to certify delivery or non-delivery of documents

15. **Clause 2.31** provides that the Registrar may, on his or her initiative or on request by a person upon payment of a fee, issue a certificate as to whether a document has or has not been delivered to the CR on a particular date for registration. The certificate shall be admissible as prima facie evidence of the fact of delivery or non-delivery of the document in question in any proceedings but will not be taken as evidence of compliance or non-compliance with an obligation under the Bill.

(e) Rules on discrepancy between an original and a certified translation of a document delivered to the Registrar

16. The Registrar may, from time to time, receive documents in a language other than English or Chinese, such as documents comprising the constitution from a non-Hong Kong company. Such documents are required to be accompanied by a certified translation. **Clause 2.34** sets out the rule where there is a discrepancy between the document and its certified translation. It provides that the company cannot rely on the translation where there is a discrepancy as against a third party whereas a third party may rely on the translation if he has actually relied on the translation and has no knowledge of the true contents of the document.

17. The new rule aims at promoting the accuracy of translations submitted by companies and at protecting members of the public from being misled by any discrepancy in a translated document on the register.

PART 10

DIRECTORS AND SECRETARIES

Introduction

1. Part 10 deals with directors and secretaries of a company. It mainly reorganises, with some modifications, the existing provisions of the CO relating to the appointment, removal and resignation of directors and secretaries, and directors' liabilities. The Part also introduces a new statutory statement on directors' duty of care, skill and diligence. Some miscellaneous provisions concerning directors and secretaries under sections 119, 153B, 153C, 154B and 156 of the CO are restated in **Division 5** (Miscellaneous provisions relating to directors and secretaries). These include provisions on directors' vicarious liability for the acts of their alternates, the avoidance of acts done by a person in a dual capacity as director and secretary, prohibition of undischarged bankrupts from acting as director, recording of minutes of directors' meetings, the status of such minutes as evidence of proceedings at the meetings and provision of written records of decisions of sole directors of private companies. Provisions concerning fair dealing by directors are covered in Part 11.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Restricting corporate directorship in private companies;

  (b) Enabling the Registrar to give directions to a company relating to the appointment of directors and secretaries;

  (c) Codifying directors' duty of care, skill and diligence;

  (d) Setting out rules on indemnification of directors against liabilities to third parties; and

  (e) Requiring ratification of conduct of directors by disinterested shareholders' approval.

Significant Changes

(a) Restricting corporate directorship in private companies

Background

2. Since 1985, all public companies and private companies which are members of a group of companies of which a listed company is a member have been prohibited from appointing a body corporate as their director, whereas other private companies can continue to have corporate directors.

3. In April 2008, we consulted the public on whether corporate directorship should be abolished altogether in Hong Kong, subject to a reasonable grace period, or should be restricted by requiring every company to have at least one natural person as its director, as in the UK. The respondents' views were diverse.[1] In view of the equally strong opinions on the need to enhance corporate governance and transparency and the legitimate commercial need for flexibility, the UK approach appears to strike an appropriate balance between the two. We therefore recommend its adoption.

Proposal

4. **Clause 10.5** implements the proposal to restrict corporate directorship in private companies by requiring a private company (other than one within the same group of a listed company) to have at least one director who is a natural person. The existing provision in section 154A of the CO prohibiting a public company and a private company within the same group of a listed company from appointing a body corporate as their director is restated in **Clause 10.4**.

[1] See FSTB, *Consultation Conclusions on Company Names, Directors' Duties, Corporate Directorship and Registration of Charges* (December 2008), paragraphs 26 to 29 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

(b) Enabling the Registrar to give directions to a company relating to the appointment of directors and secretaries

Background

5. At present, the CO requires a private company to have at least one director and a public company at least two directors.[2] In default, the company and every officer in default are liable to a fine. In addition, every company should appoint a secretary though there is no offence provision for failure to appoint one.[3]

6. We consider provisions empowering the Registrar to give direction to the company requiring it to appoint a director or secretary useful for better enforcement of the requirement relating to the appointment of directors and secretaries. There are similar provisions in the UK and Singapore.[4]

Proposal

7. **Clause 10.6** introduces a new provision to enable the Registrar to give directions to a company requiring it to appoint a director or directors in compliance with the statutory requirements. Non-compliance with the direction is an offence. The company and every responsible person will be liable to a fine.

8. Currently, failure to comply with the appointment requirement would immediately lead to an offence. With the introduction of **Clause 10.6**, there seems to be no need to retain the offence provisions relating to the appointment of directors in sections 153(3) to (4) and 153A(3) to (5) of the CO.

9. **Clause 10.26** introduces a similar provision to enable the Registrar to give directions to a company requiring it to appoint a secretary in compliance with the statutory requirements. Non-compliance with the direction will be an offence. The company and every responsible person will be liable to a fine.

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2 Sections 153 and 153A of the CO.
3 Section 154 of the CO.
4 Sections 156 and 272 of the UKCA 2006 and Section 145(7) of the SCA.

(c) Codifying directors' duty of care, skill and diligence

Background

10. At present, the general duties of directors in Hong Kong are mainly found in case law.[5] They can be classified into two broad categories, namely fiduciary duties[6] and duty of care, skill and diligence.[7]

11. The issue of whether directors' general duties should be codified was raised for public consultation during April to June 2008. Responses were highly divided. We concluded that it would be premature to go down the route of comprehensive codification at this stage.[8]

12. Nevertheless, we see some merit in clarifying the directors' standard of care, skill and diligence as proposed by some respondents. The standard in the old case law focusing on the knowledge and experience which a particular director possesses is too lenient nowadays. Other comparable jurisdictions such as the UK have developed a so-called "mixed objective/subjective test" with a minimum objective standard of care expected of all directors and a subjective test looking at the personal attributes of a particular director that can raise the standard expected of the director above the minimum objective standard. In the absence of a clear case authority in Hong Kong in this respect, there is some uncertainty as to how far the test will be applied by the Hong Kong court under the common law. We therefore recommend introducing a statutory statement on the duty of care, skill and diligence along the lines of section 174 of the UKCA 2006 to clarify the law and provide appropriate guidance to directors.

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5 Other sources of directors' duties can be found in the company's memorandum and articles of association, directors' contracts with the company, specific provisions under the statutes (e.g. the CO) or the Listing Rules.

6 Fiduciary duties that apply to directors include: (i) duty to act in good faith in the interests of the company, (ii) duty to exercise powers for proper purpose, (iii) duty to refrain from fettering his own discretion, (iv) duty to avoid conflicts of duty and interest, and (v) duty not to compete with the company. Such fiduciary duties arise in equity.

7 Duty of care, skill and diligence requires directors to exercise reasonable care, skill and diligence in the performance of the functions and the exercise of the powers of the directors. The duty arises both in equity and from the common law principles of negligence.

8 See FSTB, Consultation Conclusions on *Company Names, Directors' Duties, Corporate Directorship and Registration of Charges* (December 2008), paragraphs 17 to 20 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

Proposal

13. **Clause 10.13(1) and (2)** defines the standard of care, skill and diligence as the standard that would be exercised by a reasonably diligent person with:

    (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and

    (b) the general knowledge, skill and experience that the director has.

14. Paragraph (a) provides an objective test whereas paragraph (b) a subjective test. The objective test is the minimum standard. It can be adjusted upwards to reflect any special skill, knowledge and experience possessed by a particular director but cannot be adjusted downwards to accommodate someone who is incapable of attaining the basic standard of what can reasonably be expected of the reasonably diligent person carrying out the same function.

15. **Clause 10.13(4)** provides that the statutory duty has effect in place of the corresponding common law rules and equitable principles as the retention of the latter may result in differing standards and hinder the development of the statutory provision.

16. **Clause 10.13(5)** provides that **Clause 10.13** (directors' duty to exercise reasonable care, skill and diligence) applies to a shadow director as it applies to a director. "Shadow director" is defined in **Clause 1.2(1)** to mean, in relation to a body corporate, a person in accordance with whose directions or instructions (excluding advice given in a professional capacity) the directors, or a majority of the directors, of the body corporate are accustomed to act.

17. The corresponding section in the UK is section 170(5) of the UKCA 2006 which provides that the statutory general duties of directors (which comprise both fiduciary duties and duty of care, skill and diligence) apply to shadow directors where, and to the extent that, the common law rules or equitable principles which they replace so apply. The subsection was enacted against the background of the decision in the case of *Ultraframe* which indicated that directors' fiduciary duties might not also apply to

shadow directors[9]. It was so drafted to allow the law to develop as the UK government was of the view that the law was unclear on the subject and it was right to leave this undeveloped area of law to the courts.[10]

18. Section 170(5) of the UKCA 2006 is not adopted in **Clause 10.13(5)** as we consider that the case of *Ultraframe* and the UK government's concern are basically on directors' fiduciary duties instead of on the duty of care, skill and diligence and therefore, it is not necessary to adopt the complicated concept under section 170(5) of the UKCA 2006.

19. Directors have powers to manage a company's business and exercise the company's power and thereby owe a duty of care, skill and diligence to the company in the performance of the functions and the exercise of the powers of directors. There is little common law authority on the application of directors' duty of care, skill and diligence to shadow directors. We consider that it is the right approach to subject shadow directors to the same statutory duty of care, skill and diligence as a duly appointed director, because anyone who interferes in the affairs of a company to the extent that makes him fall within the definition of a shadow director must take on the same responsibilities and duties as those of a director. This indeed tally with the other provisions relating to directors in the Companies Bill which extend to shadow directors the same prohibitions and obligations imposed on directors (see, for example, clauses 11.7, 11.32, 11.46, 11.54, 11.66, 11.68 and 11.69).

20. **Clause 10.14** preserves the existing civil consequences of breach (or threatened breach) of the statutory duty. The remedies for breach of the statutory duty will be exactly the same as those that are currently available following a breach of the common law rules and equitable principles that the statutory duty replaces.

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9 *Ultraframce (UK) Ltd v Fielding* [2005] EWHC 1638(Ch) at [1284] and [1286]: the mere fact that a person falls within the statutory definition of shadow director is not enough to impose on him the same fiduciary duties to a company as are owed by a *de jure* or *de facto* director and the facts must go further and suggest that there is a fiduciary relationship.

10 Hansard (House of Commons cols 525 to 526, 6 July 2006).

(d) Setting out the rules on indemnification of directors against liabilities to third parties

Background

21. A director may incur liabilities to third parties in the course of performing his duties. The law regulating his right to be indemnified against such liabilities is not found in the CO but in case law,[11] which is fairly difficult for lay directors to understand. Practitioners have raised concerns over the absence of statutory provisions confirming the ability of companies to provide indemnities for liabilities incurred by directors to others in the course of performing their duties.

22. The uncertainty over the right to be indemnified against liabilities to third parties may deter competent persons from accepting directorships and is therefore undesirable. We note that the UK has reformed the law on directors' liability in recent years. In view of the recent increase in legal actions against directors personally and the costs of lengthy court proceedings, the UK has permitted indemnification of directors against most of the liabilities to third parties, so as to maintain a diverse pool of qualified individuals willing to assume directorship and a willingness of directors to take informed and rational risks.[12] To enhance transparency, any such permitted indemnity provision should be disclosed in a directors' report and made available for inspection by shareholders. The UK has also removed the prohibition on a company to exempt a non-director officer (i.e. a manager or company secretary) from, or to indemnify him against, any liability for the reason that it is ultimately a matter for the board to determine the conditions of employment of senior employees. We see merit in following the UK approach in setting out and clarifying the rules. Some technical amendments are also proposed to improve the existing provisions in section 165 of the CO.

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[11] Section 165 declares void any provision in a company's articles or in any contract with the company or otherwise, exempting a director or any other officer from, or indemnifying him against, any liability to the company or a related company in respect of any negligence, default, breach of duty or breach of trust in relation to the company or a related company. Indemnification of directors' liability to third parties is not prohibited but subject to the common law rules.

[12] See UK Department of Trade and Industry, *White Paper on Company Law Reform* (March 2005), page 23.

Proposal

23. **Clause 10.16** extends the current prohibition under section 165(1) of the CO to include any indemnity provided by a related company.[13] This is intended to close a loophole under that sub-section which does not prohibit a company from providing an indemnity for a director of a related company. Consequential to the change in **Clause 10.16**, **Clause 10.17** extends the scope of liability insurance allowed to cover the directors of a related company.

24. **Clause 10.18** defines the scope of permitted indemnities against liability incurred by a director to third parties. It provides that any indemnity must not cover the following:

(a) criminal fines or penalties imposed in respect of non-compliance with any requirement of a regulatory nature;

(b) liability incurred in defending criminal proceedings in which the director is convicted;

(c) liability incurred in defending civil proceedings brought by the company or a related company in which judgment is given against the director; and

(d) liability incurred in connection with an application for relief in which the Court of First Instance refuses to grant the director relief.

25. **Clause 10.19** adds a new provision to require a company which provides any permitted indemnity to its directors to disclose it in the directors' report. **Clauses 10.20** and **10.21** further require the company to make the permitted indemnity provision available for inspection by its shareholders and to provide a copy to any shareholder on request and upon the payment of a fee to be prescribed in subsidiary legislation.

[13] The term "related company" under section 165 of the CO has been changed to "associated company" in the CB. The definition is essentially the same.

(e) Requiring ratification of conduct of directors by disinterested shareholders' approval

Background

26. At present, the ratification of acts or omissions of directors is subject to the common law rules, which generally require shareholders' approval to release the directors from their fiduciary duties in a general meeting. Ratification would have the effect of barring the company from bringing actions against the director for damages it suffered as a result of the ratified act or omission, albeit it might not prevent dissenting minorities from pursuing unfair prejudice claims or statutory derivative claims.

27. The UK has introduced a significant change to its law on the ratification of conduct of directors by adding a disinterested shareholders' approval requirement.[14] The new requirement aims to prevent conflicts of interests, in particular, possible manoeuvring of the rule by majority shareholders to ratify any unauthorised conduct of directors appointed by them. We recommend following the UK approach in this respect.

Proposal

28. **Clause 10.22** provides that any ratification by a company of conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be approved by resolution of the members of the company disregarding votes in favour of the resolution by the director, any entity connected with him and any person holding shares of the company in trust for him or for the connected entity. This preserves the current law on ratification with an additional requirement of disinterested shareholders' approval.

[14] See section 239 of the UKCA 2006. Any decision by a company to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be taken by the members (but not the directors), and without reliance on the votes in favour of the resolution by the director (if he is also a member of the company) or any member connected with him.

Other Changes

(a) Minimum age requirement for appointment as director

29. **Clause 10.7** generally restates the existing minimum age requirement for appointment as director under section 157C of the CO, i.e. the age of 18 years or above. In addition, two new provisions are added:

(a) Sub-clause (2) – to provide for the consequence of contravention of the requirement; and

(b) Sub-clause (3) – to clarify that the minimum age requirement does not exempt an underage director from criminal prosecution or civil liability if he or she purports to act as director, or acts as a shadow director, although he or she could not, by virtue of the section, be validly appointed as a director .

Clause 10.7(3) aims to deter any company from appointing underage directors in order to exploit their immunity from prosecution or the reluctance of enforcement authorities to pursue young persons.

(b) Validity of acts of directors

30. **Clause 10.9** restates with modifications part of section 157 of the CO to provide that the acts of a director shall be valid notwithstanding any defect that may afterwards be discovered relating to his appointment or qualification etc. It does not, however, restate the similar provision regarding the validity of the acts of a manager. We are of the view that, as there is no provision in the CO governing the appointment and qualifications of a manager, the validity of the acts of managers should best be left to be dealt with by the common law rules.

PART 11

FAIR DEALING BY DIRECTORS

Introduction

1. Part 11 covers fair dealing by directors and deals with particular situations in which a director is perceived to have a conflict of interest. It governs transactions involving directors or their connected entities which require members' approval (namely loan transactions, long-term service contracts, substantial property transactions and payments for loss of office), and covers disclosure by directors of material interests in transactions, arrangements or contracts.

2. Part 11 introduces a definition of "connected entity" and introduces new statutory provisions requiring members' approval for director's long-term employment and for substantial property transactions entered into by a company. It also restates relevant sections of the CO, namely sections 157H to 157J (prohibition of loan transactions with directors and other persons), sections 163 to 163D (requirement for company's approval for loss of office payments to directors) and section 162 (disclosure by directors of material interests in contracts) with some changes.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Expanding the prohibitions on transactions to cover a wider category of persons connected with a director;

  (b) Introducing new exemptions from prohibitions on loans and similar transactions in favour of directors and connected entities;

  (c) Repealing the criminal sanction provisions in section 157J of the CO;

  (d) Extending the application of the prohibitions on payments for loss of office;

  (e) Requiring members' approval for a director's employment exceeding 3 years and requiring a company to keep directors'

service contracts available for members' inspection;

(f) Requiring members' approval for substantial property transactions;

(g) Requiring disinterested members' approval in the case of public companies; and

(h) Widening the ambit of disclosure currently under section 162 of the CO.

Significant Changes

(a) Expanding the prohibitions on transactions to cover a wider category of persons connected with a director

Background

3. At present, there are individual sections in the CO which extend the application of the relevant prohibition provisions to persons connected with a director. For example, in the case of loan transactions, section 157H(8) and (9) of the CO extends the references to "director" in section 157 to a spouse, child and step-child (including illegitimate child) under the age of 18, and specified categories of trustees and partners, and section 157H(2)(c), (3)(c) and (4)(c) extends the prohibition provisions to a company in which a director holds a controlling interest. We consider that the current references are not comprehensive enough to cover all parties who are closely associated with directors. Taking into account similar provisions in the UKCA 2006[1], we consider it necessary to expand the prohibitions on transactions to cover a wider category of persons connected with a director.

Proposal

4. In Part 11, there are a number of prohibitions on transactions with an entity connected with a director or past director. In particular, a public company must not make a loan or quasi-loan etc. to, or enter into a credit transaction etc. as creditor for, a connected entity (**Clauses 11.18 and 11.19**), and a company must not make payment to a connected entity for a director's loss

[1] Sections 252 to 255 of the UKCA 2006.

of office (**Clauses 11.37 to 11.39**). **Clauses 11.2 to 11.4** provide that an entity connected with a director or past director of a company means:

(a) a family member;

(b) an associated body corporate;

(c) a specified category of trustees;

(d) a specified category of partners.

5. The categories of person classified as "connected entity" are broader than those currently under the CO. For example, **Clause 11.3** defines "family members" to cover a director's child, step-child and adopted child of any age whereas under the CO, only a director's child and step-child under the age of 18 are caught. The proposed definition in **Clause 11.3** also covers any other person (whether of a different sex or the same sex) with whom the director or past director lives as a couple in an enduring family relationship.

(b) Introducing new exemptions from prohibitions on loans and similar transactions in favour of directors and connected entities

Background

6. The decision whether to make a loan is normally taken by the directors. Section 157H of the CO prohibits, subject to certain exceptions, a company from entering into any direct or indirect loan transactions in favour of its directors, directors of its holding company or any of their connected persons. These rules are intended to protect shareholders and creditors. However, there are situations in which the prohibitions may not serve any meaningful purpose. For example, where the directors hold all or a majority of the shares and creditors are not prejudiced. There are exemptions from prohibitions under section 157HA of the CO which apply to all companies.[2] In addition, a private company, which is not a member of a group which includes a listed company, is exempted from the prohibitions if the loan transaction is approved by shareholders in general meeting.[3]

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[2] Exceptions for intra-group transactions (section 157HA(1)), funds to meet company expenditure incurred (section 157HA(3)(a)), home loan (section 157HA(3)(b)), hire or lease on not more favorable terms (section 157HA(3)(c)) and ordinary business transactions (section 157HA(6) and (7)).

[3] Section 157HA(2) of the CO.

7. The exceptions are fairly complex. Members' approval is a simple method of ensuring compliance but is currently applicable only to private companies not associated with a listed company. The narrow application of the members' approval exception is arguably too restrictive. For example, private companies owned by majority shareholders of a listed company cannot rely on the exception even though they might not be regarded as a member of the listed group under the Listing Rules.[4] To facilitate business operation, there is a case to extend the members' approval exception to all other companies. Nevertheless, the new exemption would have to contain appropriate safeguards for minority shareholders. In the case of public companies, we propose that the transactions must be approved by disinterested members (see section (g) below). As regards private companies within the same group of a listed company, we ask in Chapter 8 of the Consultation Paper whether they should also be subject to the requirement of disinterested members' approval.

Proposal

8. **Clauses 11.16 to 11.20** provide generally that a company must not make a loan, a quasi-loan or enter into a credit transaction in favour of a director of the company or of its holding company without the prescribed approval of members.[5] The prohibitions are extended to persons connected with a director (connected entities) in the case of public companies.

9. Two new exceptions from prohibiting a company from making a loan are also introduced :

(a) exception for small loan, quasi-loan and credit transaction (**Clause 11.21**);

(b) exception for funds to meet expenditure, incurred or to be incurred by a director, on defending proceedings or in connection with an investigation or regulatory action (**Clauses 11.23 and 11.24**).

These new exceptions are subject to conditions as to financial limit and requirements as to repayment.

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[4] c.f. the terms "group" and "subsidiaries" as defined in Chapter 1 of the Main Board Listing Rules. "Group" means the issuer or guarantor and its subsidiaries, if any, and "subsidiaries" includes the meaning attributed to "subsidiary undertaking" in the 23rd Schedule of the CO and any entity which is or will be accounted for and consolidated in the audited consolidated accounts of another entity as a subsidiary pursuant to the applicable financial reporting standards.

[5] "prescribed approval of members" is defined in clause 11.11.

(c) Repealing the criminal sanction provisions in section 157J of the CO

Background

10. Section 157J of the CO provides for criminal sanction where there is a breach of section 157H (prohibition of loans, etc., to directors and other persons) and imposes the penalty of a fine and imprisonment. The liability extends to the company and directors who wilfully permitted or authorised the transaction and other persons who knowingly procured the company to enter into the transaction.

11. In the UK, the UKCA 2006 decriminalised the provisions which restrict loans etc. to directors and connected persons. The criminal sanction was therefore abolished. The rationale is that there is a danger of over-deterrence if criminal sanctions are attached to general directors' duties of loyalty rather than closely defined wrongdoing, and that enforcement of such duties should be a civil matter for the companies.[6] We agree with the rationale.

Proposal

12. We are of the view that the civil consequences under **Clause 11.29** are sufficient and the criminal sanction provisions in section 157J of the CO should be repealed.

(d) Extending the application of the prohibitions on payments for loss of office

Background

13. It is unlawful under sections 163 to 163D of the CO to make payments to directors or past directors of a company, as compensation for loss of office or as consideration for retirement from office, without the company's prior approval. However, since the provisions only apply to payments to directors or past directors of the company, there are concerns that such payments can be made indirectly via other parties, thus defeating the purpose of the prohibition provisions.

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[6] UK Company Law Review Steering Group, *Modern Company Law: Completing the Structure* (November 2000), paragraphs 13.4 and 13.36.

Proposal

14. We consider there is a need to plug any loophole in the case of payments via other parties by extending the loss of office payment provisions to include:

    (a) payment to an entity connected with a director or past director of a company or of its holding company (**Clause 11.32(3)**);

    (b) payment by a company to a director of its holding company (**Clause 11.37(2)**).

15. Section 163A of the CO only applies to situations where a payment for loss of office is made to a company's director or past director in connection with a transfer of a company's undertaking or property. **Clause 11.38(2)** extends the provisions to include a transfer of the undertaking or property of the company's subsidiary.

16. Section 163B of the CO only applies to a payment for loss of office made to a company's director or past director in connection with certain types of transfers of shares as provided in section 163B(1). By virtue of **Clause 11.32(1)** (definition of "takeover offer" for Division 3)[7] and **Clause 11.39(1)**, the prohibitions in connection with a share transfer are extended to include all transfers of shares in a company or in its subsidiary resulting from a takeover offer.

(e) Requiring members' approval for a director's employment exceeding 3 years and requiring a company to keep directors' service contracts available for members' inspection

Background

17. At present, there is no provision in the CO requiring members' approval for long-term employment of a director or requiring a company to keep directors' service contracts available for members' inspection. There is a risk that directors may arrange for themselves long-term employment with their companies which entrenches them in office or makes it too expensive for the company to remove them from office before their contract expires (as the director might be entitled to damages for the company's breach of

[7] "Takeover offer" means a takeover offer within the meaning of Part 13 of the Companies Bill, draft clauses of which will be released for consultation in the second phase consultation for the Companies Bill.

contract arising from the early termination). Also there is a lack of transparency in relation to directors' service contracts.

Proposal

18. **Clause 11.50** requires the approval of the members of a company and / or of its holding company for any contracts under which the guaranteed term of employment of a director with the company, or of employment of its holding company's director within the group, exceeds or may exceed 3 years.

19. **Clauses 11.52 and 11.53** require a company to keep available directors' service contracts, or a written memorandum of terms of any such contract if the contract is not in writing, for members' inspection and copying. Non-compliance with these provisions will be an offence. The company and every responsible person will be liable to a fine.

(f) Requiring members' approval for substantial property transactions

Background

20. There is currently no specific provision in the CO which requires members' approval for a company to enter into a transaction for the purchase of a major asset from a director or the sale of such an asset to a director. In the UK, provisions requiring members' approval were introduced by the Companies Act 1980 in response to reports of fraudulent asset stripping by directors. The SCCLR has recommended the enactment of provisions based on the relevant sections in the UK.[8]

Proposal

21. **Clause 11.59** provides that a company shall not enter into arrangements where it acquires a substantial non-cash asset from or sells such an asset to a director of the company or of its holding company or a person connected with such directors, unless with the approval of the members of the company and / or of its holding company. However, the arrangement may be entered into by the company conditional on such approval being obtained.

[8] Sections 190 to 196 of the UKCA 2006 (formerly under sections 320 to 322 of the UK Companies Act 1985). See SCCLR, *Annual Report 2003 / 2004*, pages 14 to 16.

The company is not subject to any liability by reason of a failure to obtain the members' approval for the conditional arrangement.

22. Non-cash asset is defined in **Clause 11.55** to mean any property other than cash and any reference to an acquisition of a non-cash asset includes the creation or extinction of an estate or interest in, or a right over, any property and also the discharge of a liability of any person, other than a liability for a liquidated sum.

23. **Clause 11.56** sets out the thresholds for triggering the operation of the substantial property transaction provisions. For a private company or a company limited by guarantee, the value of a non-cash asset is substantial if it exceeds 10% of the company's asset value and is over $100,000, or exceeds $1,500,000. For a public company, the value is substantial if it exceeds 10% of the company's asset value and is over $750,000, or exceeds $10,000,000.

(g) Requiring disinterested members' approval in the case of public companies

Background

24. Currently, except for some specified transactions[9], there is no provision in the CO restricting members' rights to vote or requiring members to abstain from voting in relation to transactions in which they have an interest. For listed companies, the Listing Rules provide generally that, when a transaction or arrangement of an issuer is subject to shareholders' approval under the provisions of the Listing Rules, any shareholder that has a material interest in the transaction or arrangement shall abstain from voting on the resolution approving the transaction or arrangement at the general meeting.[10]

25. The SCCLR has recommended disinterested members' voting for connected transactions to ensure procedural fairness. The recommendation does not apply to private companies.[11]

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9 Sections 49BA(1)(c) and (5), 49D(4) and (6), 49E(2) and (3), 49F(2) and (3), 49L(2) (purchase or redemption of the company's own shares) and 163D(4)(c) (payment to director for loss of office or retirement) of the CO.

10 The chapters of the Listing Rules which deal with notifiable transactions and connected transactions impose additional requirements relating to abstention from voting by interested persons at a general meeting.

11 SCCLR, *Annual Report 2003 / 2004*, pages 14, 15, 25 and 26.

Proposal

26. **Various clauses in Divisions 2 to 5,** which set out the requirements for members' approval for the four types of prohibited transactions covered by Part 11[12], have incorporated the disinterested members' voting requirement for public companies.[13] The clauses provide that if the company concerned is a public company, the resolution of such a company is passed only if every vote in favour of the resolution by the interested members is disregarded.

27. Whose voting right shall be restricted will depend on which type of prohibited transaction is in issue. In general, the members whose right may be restricted include the following categories of person :

(a) the relevant director;

(b) the relevant connected entity;

(c) the recipient of the payment for loss of office, if he is not the relevant director;

(d) a person who makes the takeover offer and his associates, where a payment for loss of office is made in connection with a share transfer;

(e) in the case of a resolution for affirming a transaction that contravenes Part 11 (where the company elects to adopt the transaction despite the contravention), any other directors of the company who authorised the contravening transaction;

(f) any person who holds any shares in the company concerned in trust for the above categories of person.

[12] The types of transactions are (a) loans, quasi-loans and credit transactions; (b) payment for loss of office; (c) directors' service contracts; and (d) substantial property transactions.

[13] Clauses 11.11(2) and (5); 11.31(1) and (4); 11.34(2), (4) and (5); 11.48(2) and (4); 11.57(2) and (5); and 11.62(1) and (4) of the CB.

(h) Widening the ambit of disclosure currently under section 162 of the CO

Background

28. Section 162 of the CO requires a director, who has a material interest, directly or indirectly, in a contract or proposed contract with the company, to disclose to the board of directors the nature of such interest at the earliest meeting of directors that is practicable. We are of the view that the current application of the section is relatively narrow and there is a need to widen the ambit.

Proposal

29. **Division 6 (Clauses 11.63 to 11.67)** restates the provisions of section 162 of the CO which are modified to be in line with those of other common law jurisdictions such as the UK and Australia,[14] and to widen the ambit of the section as follows:

(a) the ambit of disclosure is widened to cover "transactions" and "arrangements" instead of just "contracts" (**Clause 11.63(1) and (2)**);

(b) for a public company, the ambit of disclosure is widened to include disclosure by a director of any material interest of entities connected with him (**Clause 11.63(2)**);[1]

(c) a director is required to disclose the "nature and extent" of his interest instead of just disclosing the "nature" of his interest (**Clause 11.63(1) and (2)**);

(d) the disclosure requirements are extended to shadow directors (**Clause 11.66**).

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[14] SCCLR, *Corporate Governance Review by the Standing Committee on Company Law Reform – A Consultation Paper on Proposals made in Phase I of the Review* (July 2001), paragraph 7.11.

[15] Clause 11.63(5)(a) contains an exception providing that a director is not required to declare an interest if he is not aware of the interest or the transaction in question.

PART 12

COMPANY ADMINISTRATION AND PROCEDURE

Introduction

1. Part 12 contains provisions on company administration and procedure. The provisions are grouped into five divisions:

   - Division 1: Resolutions and meetings;
   - Division 2: Registers (including registers of members, directors and secretaries);
   - Division 3: Company records;
   - Division 4: Registered office and publication of company names; and
   - Division 5: Annual return.

2. In relation to resolutions and meetings, a number of significant changes are proposed with a view to:

   (a) enhancing shareholder engagement in the decision-making process of a company;

   (b) simplifying and deregulating the decision-making process of a company; and

   (c) improving the transparency of the decision-making process of a company.

3. We also update the provisions relating to registers, registered offices and annual returns so that they are commensurate with the needs of the modern economy and on par with similar legislation in other jurisdictions.

- The significant changes to be introduced under this Part are highlighted below:

  <u>Resolutions and meetings</u>

  (a) Introducing a comprehensive set of rules for proposing and passing a written resolution;

(b) Enhancing members' powers to require directors to circulate members' resolutions;

(c) Requiring a company to bear the expenses of circulating members' statements relating to business of, and proposed resolutions for, AGMs, if they are received in time for sending with the notice of the meeting;

(d) Permitting a general meeting to be held at more than one location by using audio-visual technology;

(e) Reducing the threshold requirement for members to demand a poll from 10% to 5% of the total voting rights;

(f) Giving members a right to inspect voting documents (including proxies and voting papers);

(g) Clarifying the rights and obligations of a proxy;

(h) Allowing companies to dispense with AGMs by unanimous shareholders' consent;

Registers

(i) Clarifying that the court may refuse to compel compliance with a request for inspection or a copy of the register of members, directors or secretaries if the right is being abused;

Registered office and publication of company names

(j) Empowering the Financial Secretary to make regulations to require a company to display its name and related information in certain locations and state prescribed information in documents or communications.

Significant Changes

(a) Introducing a comprehensive set of rules for proposing and passing a written resolution

Background

4. At present, section 116B of the CO provides that anything which may be done by a company by resolution in a general meeting may be done, without a meeting and without any previous notice, by a resolution signed by all members of a company. We note the widespread use of such written resolutions, especially by SMEs, for their decision-making process. However, there are no established statutory rules for proposing and passing a written resolution, for example, who may propose a written resolution, and how a written resolution is to be circulated among the members.

Proposal

5. **Subdivision 2 of Division 1** provides for the procedures for proposing, passing and recording written resolutions. **Clause 12.3** provides that the directors of a company or the members of a company representing not less than 2.5% of the total voting rights or a lower percentage specified in the company's articles may propose a resolution as a written resolution. In addition, members of the company who propose the resolution may also require the company to circulate with the resolution a statement of not more than 1,000 words on the subject matter of the resolution (**Clause 12.5**). Once a written resolution is proposed, the company has a duty to circulate the resolution to every member for agreement. In circulating a resolution proposed as a written resolution, the company may send either a hard copy form or electronic form or by making the copies available on a website **(Clauses 12.6 and 12.7)**. It is proposed that the period for agreeing to the proposed written resolution be 28 days or such period as specified in the company's articles (**Clause 12.12**). Members may signify their agreement to a proposed written resolution and send it back to the company either in hard copy or electronic form (**Clause 12.10**).

6. The procedures set out in this subdivision will not replace the common law doctrine of unanimous consent or so-called *Duomatic* principle[1] that, if all the members of a company actually agree on a particular decision which can

[1] See *Re Duomatic Ltd* [1969] 2 Ch 365.

be made at a general meeting, the decision is binding and effective without a meeting. (**Clause 12.1(3)**). In addition, a company's articles may also set out alternative procedures for passing a resolution without a meeting, provided that it cannot replace the procedures set out in the CB **(Clause 12.15)**.

7. The new procedures concerning written resolutions would facilitate the use of written resolutions for decision-making, which is often more expeditious and less costly than passing a resolution in a general meeting.

(b) Enhancing members' powers to require directors to circulate members' resolutions

Background

8. Under section 113 of the CO, members of a company holding not less than 5% of the paid-up capital of the company shall have the right to require the directors of the company to convene a general meeting. The request must state the objects of the meeting. However, the section does not expressly provide members with the right to propose a resolution to be moved at the meeting. As such, directors may refuse to circulate any resolution proposed by members for consideration in a general meeting. This will defeat the purpose of requesting a meeting to be convened.

Proposal

9. **Clauses 12.22 to 12.23** restate section 113 of the CO with some improvements. **Clause 12.22** provides that a request may include the text of a resolution that may properly be moved and is intended to be moved at the meeting. If such a resolution is included in a request, the directors will be obliged to include the proposed resolution in the notice of the meeting to be circulated among members.

(c) Requiring a company to bear the expenses of circulating members' statements relating to business of, and proposed resolutions for, AGMs, if they are received in time for sending with the notice of the meeting

Background

10. Section 115A of the CO enables members representing at least 2.5% of the total voting rights of a company or 50 or more members who have paid up

an average sum of not less than $2000 per member, to request the company to circulate a proposed resolution for the next AGM or a statement of not more than 1000 words relating to any proposed resolution or business to be dealt with at any general meeting. Under section 115A(1), members making the requisition need to bear the expenses unless the company resolves otherwise.

11. To strengthen the right of minority shareholders, we propose that the expenses of circulating members' proposed resolutions for AGMs and members' statements relating to the proposed resolution or the business to be dealt with at AGMs should be borne by the company if such documents are received in time for sending with the notice of the meeting.

Proposal

12. **Clause 12.37** provides members a power to request circulation of statements concerning the business to be dealt with at general meetings along the lines of section 115A of the CO. **Clause 12.38** imposes a duty on the company to circulate members' statements in the same manner as the notice of meeting. Under **Clause 12.39**, if the meeting concerned is an AGM and a members' statement is received in time for sending with the notice of the meeting, the expenses will be borne by the company. Otherwise, the expenses will be paid by the members concerned.

13. **Clauses 12.78** and **12.79** contain similar provisions in respect of members' proposed resolutions for AGMs. A circulation request must be received by the company not later than 6 weeks before the AGM, or if later, before the time at which notice of meeting is given. The company is obliged to circulate the resolution at the company's expense.

(d) Permitting general meeting to be held at more than one location by using audio-visual technology

Background

14. With the development of electronic communications, it is not uncommon for a company to hold its general meeting at two or more venues with audio-visual links. The CO does not have express provision permitting a general meeting to be held at two or more places.

Proposal

15. To keep up with technological development, **Clause 12.42** is introduced to permit a company to hold a general meeting at two or more places using any audio-visual technology that enables the members of the company to exercise their right to speak and vote at the meeting. The section has effect subject to any provision of the company's articles. A company may set out rules and procedures for holding a dispersed meeting.

(e) Reducing the threshold requirement for members to demand a poll from 10% to 5% of the total voting rights

Background

16. Under section 114D of the CO, members have the right to demand a poll and such right cannot be excluded by the articles. It may be exercised on any question except the election of the chairman of the meeting or the adjournment of the meeting and is effectively demanded if made by:

(a) not less than 5 members having the right to vote at the meeting;

(b) members representing not less than 10% of the total voting rights; or

(c) members holding not less than 10% of the total paid up share capital of the company carrying the right to vote at the meeting.

A proxy has the same right as the member for whom he is proxy to join in demanding a poll.

17. It is proposed that the threshold requirement should be lowered from 10% to 5% of the total voting rights. This is in line with the provision that shareholders holding not less than 5% of the voting rights are able to requisition an extraordinary general meeting.

Proposal

18. **Clause 12.50** basically restates section 114D of the CO, except reducing the threshold requirement for demanding a poll to 5% of the total voting rights of all the members having the right to vote at the meeting.

(f) Giving members a right to inspect voting documents (including proxies and voting papers)

Background

19. There is no legislative provision for inspection of voting documents in the CO.

Proposal

20. To improve the transparency of the voting process, **Clause 12.54** requires a company to keep record or document relating to a vote cast at a general meeting on a resolution, including the instrument appointing a proxy to vote at the meeting, and if a poll is taken at the meeting, the voting paper relating to the poll. The record or document must be made available for inspection by members. In addition, **Clause 12.55** allows any member of the company to inspect the record or document without charge.

(g) Clarifying the rights and obligations of a proxy

Background

21. The rights of a proxy are subject to certain limitations under the CO:

(a) unless the articles otherwise provide, a proxy is not entitled to vote on a show of hands (section 114C(1A)(a) of the CO); and

(b) there is no statutory provision expressly providing that a proxy may be elected as a chairman of a meeting.

22. At present, there is no requirement for any person put forward by the company board as a proxy to vote the proxies on any poll according to their terms. The SCCLR has recommended introducing such a statutory requirement so as to overcome the possibility of the shareholders being disenfranchised by a person, who is put forward by the board as a proxy deliberately failing to vote that proxy in accordance with the shareholders' instructions.[2]

[2] SCCLR, *Corporate Governance Review by the Standing Committee on Company Law Reform – A Consultation Paper on Proposals made in Phase II of the Review* (June 2003), paragraphs 21.95 to 21.98.

23. In the absence of any contractual obligation, a member retains the right, after appointing a proxy, to attend and vote in person to give his own vote according to his own volition. If the member does so, the proxy may implicitly be regarded as revoked. The common law principle that the appointment of a proxy will be revoked if the appointor attends and votes at the meeting is not currently set out in the CO.

Proposal

24. The CB clarifies the rights and obligations of a proxy in the following manner:

(a) **Clause 12.58(1)** provides that a proxy may exercise all or any of the member's rights to attend and to speak and vote at a general meeting (i.e. including voting on a show of hands);

(b) **Clause 12.64** provides that a proxy may be elected as the chairperson of the general meeting, subject to any provisions of the company's articles;

(c) Where a proxy put forward by a company is appointed by a member to be his proxy, **Clause 12.65** requires the proxy to vote in the way specified in the appointment of the proxy; and

(d) **Clause 12.67** codifies the common law principle that the appointment of a proxy will be revoked if the appointor attends and votes at the meeting.

(h) Allowing all companies to dispense with the holding of AGMs by unanimous members' consent

Background

25. Every company is required to hold AGMs. Under section 111(6) of the CO, a company may dispense with holding AGMs if everything that is required or intended to be done at the meeting is done by written resolutions in accordance with section 116B of the CO, provided that a copy of each of the documents (including any accounts or records) which under the CO would be required to be laid before the meeting is provided to each member of the company.

26. For many private companies, the obligation to hold AGMs could be redundant and potentially burdensome. In order to simplify the decision-making process, we suggest that all companies should be allowed to dispense with AGMs if unanimous members' consent is obtained, and that dispensation should be in force unless a member, by notice, requires an AGM to be held in a particular year or until the dispensation is revoked by passing an ordinary resolution to that effect. In practice, it is much less likely for public and guarantee companies to dispense with holding AGMs by unanimous members' consent but the possibility could not be ruled out. The written resolution procedure under section 111(6) is retained in case a company might wish to dispense with an AGM on a specific occasion by a written resolution.

Proposal

27. **Clause 12.76** allows a company to dispense with the requirement for holding of AGMs by passing a written resolution or a resolution at a general meeting by all members. After passing such a resolution, the company will no longer be required to hold any subsequent AGMs. However, the financial statements and reports originally required to be laid before an AGM will still need to be sent to the members under Part 9. Also any member may request the company to convene an AGM for a particular year. The company may revoke the resolution by passing an ordinary resolution to that effect and in which case, the company will be required to hold subsequent AGMs. For a single member company, **Clause 12.75(2)(a)** provides that such a company is not required to hold an AGM.

(i) Clarifying that the court may refuse to compel compliance with a request for inspection or a copy of the register of members, directors or secretaries if the right is being abused

Background

28. Under section 98(1) of the CO, the register of members of a company and the index of members' names are open to inspection by any member without charge and by any other person on a payment of a fee. Upon receipt of a request for a copy of the register of members, the company must send the copy within 10 days after the date on which the request is received.

29. Section 98 of the CO was constitutionally challenged by the Democratic Party in *The Democratic Party v The Secretary for Justice*[3] on the ground that the public availability of the register of members is, in so far as it applies to a political party, inconsistent with the freedom of association and freedom from arbitrary or unlawful interference with the privacy of its members, which are guaranteed by Articles 27 and 30 of the Basic Law and articles 14 and 18 of the Hong Kong Bill of Rights.

30. In his judgment, Mr Justice Hartmann held that the restrictions on the right to privacy imposed by section 98 of the CO, insofar as they may affect political parties that have chosen to incorporate, are no more than necessary. The court has discretion not to make an order under section 98(4) of the CO to compel inspection or production if it considers that the purposes of the request amount to an abuse. We propose to specifically provide for the court's discretion in the CB.

31. We have considered but decided against introducing changes along the lines of sections 116 to 118 of the UKCA 2006. Under section 117, a company may apply to the court for an order directing the company not to comply with a request for inspection or a copy of the register of members if the request was not made for a proper purpose. We believe such a proposal would unnecessarily increase the compliance costs of companies, especially SMEs, as companies would have to apply to court every time they wanted to refuse a request. Under the existing arrangement, the burden rests with the person making the request to apply to the court if his request is refused. In addition, in case a company refuses a request for inspection, the enquirer could still search the information from the CR, with the exception of companies limited by guarantee and listed companies. For the latter, we have proposed to only require listed companies to file with the Company Registry particulars of members who held 5% or more of the issued shares in any class of the company's shares at any time since the return date of the last annual return (please see paragraph [51]).

Proposal

32. **Clause 12.96(8)** states that the court must not make an order to direct a company to provide a copy of the register of members or index of members' names to the person requesting it if it is satisfied that the right to request the copy is being abused. There are similar provisions in respect of the

[3] HCAL 84/2006.

register of directors and the register of secretaries (**Clauses 12.110(7) and 12.117(7))**. The court's power not to direct inspection of the registers where there is abuse will be set out in the regulations made by the Financial Secretary under **Clause 12.125(4)(e)**.

(j) Empowering the Financial Secretary to make regulations to require a company to display its name and related information in certain locations and to state prescribed information in documents or communications

Background

33. Under section 93(1) of the CO, every company shall display its name on the outside of every office or place in which its business is carried on and mention its name in its public documents (e.g. business letters, notices, official publications, and contracts).

34. The SCCLR has recommended some changes to the rules on publication of company names:

(a) every company should also display its name on the company's website and the outside of the company's registered office;

(b) basic rules for electronic display of company names should be set along the lines that where an office is shared by more than six companies, each of such companies is only required to display its registered name in such a manner that it can be read for at least twenty continuous seconds at least once in every four minutes or, where impracticable, the electronic system used for the display should be capable of calling up such information on request within 4 minutes; and

(c) every company should also be required to mention its company registration number in its public documents, in addition to the current requirement of mentioning its registered name in such documents.

Proposal

35. As the rules involve technical details and may change with developments in technology, they should be stated in subsidiary legislation to facilitate future

amendments. **Clause 12.127** and **12.128** empowers the Financial Secretary to make the relevant regulations, including the offence provisions. The regulations will be made after the enactment of the CB and will be subject to negative vetting by the LegCo.

Other Changes

(a) Facilitating the use of electronic communications between the company and members

36. Part 18 of the CB introduces rules to facilitate communications between a company and its members in electronic form or by means of a website. Part 12 contains provisions to the effect that a company is regarded as having agreed that certain documents or information may be sent by electronic means to an electronic address if the company has given an electronic address when sending a relevant document to its members.[4]

37. **Clause 12.30** specifies how a company may give notice of a general meeting by making it available on a website in addition to the provisions on website communications in Part 18. The notice should be available on the website throughout the period beginning on the date of the notification and ending on the conclusion of the meeting.

(b) Shortening the notice period for passing a special resolution

38. At present, section 114 of the CO provides that a company must give at least 21 days' notice to every member of the company for convening an AGM, and 14 days' notice for convening a meeting other than either an AGM or a meeting for the passing of a special resolution. Under section 116 of the CO, a company is required to give at least 21 days' notice for a general meeting in which a special resolution is proposed to be passed.

39. To simplify the notice requirement, **Clause 12.28** only provides for the notice requirements in respect of AGMs and for other general meetings. The notice requirement under section 116 is abolished. In effect, a company may convene a meeting other than an AGM for passing a special resolution by giving 14 days' notice only.

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[4] See for example, in the CB, **Clause 12.14** concerning written resolutions, **Clause 12.29(2)** concerning documents and information relating to proceedings at a general meeting, and **Clause 12.61** concerning documents relating to proxies.

(c) Giving members a right to appoint a proxy irrespective of whether the company has share capital, while allowing a company limited by guarantee to impose certain restrictions by it articles

40. The system of proxy voting helps to ensure that the views of members who are unable to attend a meeting in person will still be voiced and considered. Under section 114C of the CO, the right to appoint a proxy is effectively limited to companies having a share capital. Members of companies limited by guarantee ("guarantee companies") may have a right to appoint a proxy only if it is provided in the company's articles. We note that some guarantee companies may wish to exclude non-members from attending their meetings and to confine a proxy to another member. Nevertheless, a better way to protect the right of members of guarantee companies would be to give all members, irrespective of whether the company has share capital or not, a right to appoint a proxy while allowing guarantee companies to confine a proxy to another member. The amendment is reflected in **Clause 12.58(1) and (2)**.

(d) Enhancing the right of members of a company having a share capital to appoint multiple proxies

41. Unless the articles otherwise provide, the number of proxies that may be appointed by a shareholder to attend on the same occasion is limited to two (section 114C(2) of the CO). Such a default cap on the maximum number of proxies that a shareholder may appoint on the same occasion is considered to be unnecessarily restrictive. **Clause 12.58(3)** allows multiple proxies without imposing any cap on the number of proxies that may be appointed.

(e) Application of provisions relating to general meetings to class meetings

42. Section 63A(6) of the CO provides that subject to certain exceptions, sections 114, 114A, 114AA and 115A of the CO relating to general meetings shall, so far as applicable, apply with necessary modifications in relation to any meeting of shareholders in connection with the variation of rights attached to a class of shares. Currently, there is no separate provision under the CO on class meetings or variation of class rights that relate to companies without a share capital.

43. **Clause 12.88** provides that subject to certain exceptions and with necessary modifications, the provisions in relation to a general meeting apply in relation to a class meeting. Examples of the exceptions are **Clause 12.22** (please see paragraph 9), members' power to call general meeting at company's expense, power of court to order meeting, and the provisions in relation to quorum and right to demand a poll for a variation of class rights meetings. **Clause 12.89** provides for class meetings of companies without a share capital in a similar way.

(f) Shortening the period for keeping the records of past members from 30 years to 20 years

44. Under section 95(1) of the CO, a company is required to keep not only the records of present members, but also records of past members for 30 years after they ceased to be members. We consider that a period of 30 years is unnecessarily long. **Clause 12.92(6)** reduces the period for which a company should keep the record of a past member to 20 years after that person ceased to be a member.

(g) Exempting listed companies from giving notice of closure of register of members by newspaper advertisement

45. Section 99(1) of the CO requires a Hong Kong incorporated company to give notice of closure of its register of members/debenture holders by advertisement in a newspaper. The Listing Rules have been amended in 2007 to require a listed company to publish notices (including a notice of closure of register of members) on the SEHK's website instead of in a newspaper.[5] As a result, a Hong Kong incorporated listed company has to publish its notice of closure of register of members both in a newspaper and on the SEHK's website. To streamline the requirements and to ensure a level playing field between listed companies incorporated in Hong Kong and elsewhere, **Clause 12.98** allows listed companies to give notice in accordance with the Listing Rules instead of by advertisement in a newspaper.

[5] See Rule 2.07C and Rule 13.66 of the Main Board Listing Rules which were implemented on 25 June 2007.

(h) Empowering the Financial Secretary to make regulations for keeping, inspection and provision of copies of company records

46. At present, every company must keep and make its registers (including registers of members, debenture holders, charges, directors and secretaries) available for public inspection. In addition, every company must make its minute books available for members' inspection.[6] The registers and minute books must be open for inspection during business hours. Though a company may impose reasonable restriction, the minimum inspection time should not be less than 2 hours in each day.[7] The maximum fees that a company may charge for inspection and copy of the registers or minutes are prescribed in the CO.[8] However, there is no legal requirement for prior appointment.

47. We propose to streamline the provisions in the CB and put the technical details in subsidiary legislation. This will also facilitate regular updating of the law in the future. There will be a requirement for prior appointment before inspection in the subsidiary legislation.

48. **Clause 12.122** defines "company records" to mean any register, index, agreement, memorandum, minutes or other document required by the Ordinance to be kept by a company, but does not include accounting records. The provisions on accounting records will be dealt with in Part 9. **Clause 12.123** allows the company records to be kept in hard copy form or electronic form. **Clause 12.125** empowers the Financial Secretary to make regulations for the keeping, inspection and provision of copies of any company records, such as alternative locations for keeping and inspection of registers and minute books, time, duration and manner of inspection, and the amount of fee payable on production of copies.

(i) Prescribing the contents of annual returns and the accompanying documents in a Schedule which may be amended by the Registrar by order published in the Gazette

49. Every company is required to file an annual return with the Registrar to update information of the company, including its share capital, registered

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[6] See sections 95(2) (register of members), 158A(1) (registers of directors and secretaries), 74A(2) (register of debentures holders), 89(2) (register of charges) and 119A(1) (minute books) of the CO.

[7] See sections 98(1) (register of members), 158(7) (registers of directors and secretaries), 75(1) (register of debenture holders), 90(1) (register of charges), 120(1) (minute books) of the CO.

[8] See sections 75(1) (register of debenture holders), 98(1) of and item 1 of 14th Sch (register of members), 90(1) (register of charges), 158(7) (registers of directors and secretaries), 120(1) and (2) (minute books) of the CO.

office, members, directors and secretaries. In the case of public companies, the balance sheet and auditor's report must also be filed. Sections 107 and 109 of the CO prescribe the contents of an annual return and deal with the general administrative provisions relating to annual returns.

50. The information that should be contained in annual returns may change over time. To facilitate regular updating of the law in the future, we propose to prescribe the technical details in a Schedule and empower the Registrar to amend the Schedule by order published in the Gazette. The order will be subject to negative vetting by the LegCo.

51. **The Schedule** in Part 12 sets out the details of the information to be contained in annual returns and the required accompanying documents. The requirements are essentially the same as the current provisions in the CO, except that the requirement for listed companies to file all the members' details in their annual returns will be relaxed. Given the frequent share transactions of listed companies, a snapshot of the membership of a listed company at a particular point of time is not very meaningful. Instead, paragraph 2 of Part 1 of the Schedule will only require listed companies to file particulars of members who held 5% or more of the issued shares in any class of the company's shares at any time since the return date of the last annual return. It would still be possible for anyone to have access to information regarding all the listed company's shareholders by inspecting the company's own register at its registered office.

PART 14

REMEDIES FOR PROTECTION OF COMPANIES' OR MEMBERS' INTERESTS

Introduction

1. Shareholder remedies provisions were substantially revised by the Companies (Amendment) Ordinance 2004 with a view to enhancing legal remedies available to members of a company. The amendments included providing for a statutory derivative action that may be taken on behalf of a company by a member of the company; facilitating members to exercise their rights to obtain access to company records; and empowering the court, on application by an affected person or the Financial Secretary, to grant an injunction restraining any person from engaging in conduct which constitutes contravention of the CO or a breach of his fiduciary or other duties owed to a company. The unfair prejudice remedy in section 168A of the CO has also been improved. It provides the court with a power to award damages to the members of a company where it was found that their interests had been unfairly prejudiced and to award such interest on the damages as the court thinks fit. The scope of the remedy has been extended to allow past members (and their personal representatives) of local companies and members and past members (and their personal representatives) of non-Hong Kong companies to commence legal action under that section.

2. Part 14 groups the existing provisions concerning shareholder remedies under the CO into a distinct part of the Companies Bill. These include:

   (a) unfair prejudice remedy (section 168A of the CO);

   (b) injunction order (section 350B of the CO);

   (c) statutory derivative action (sections 168BA to 168BK of the CO); and

   (d) court order for inspection of company records (sections 152FA to 152FE of the CO).

3. Some changes are proposed to improve the operation of the unfair prejudice remedy and statutory derivative action provisions. The existing common law derivative action is preserved in Part 14. We are consulting separately in Chapter 9 on whether the common law derivative action regime should still be maintained.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Extending the scope of the unfair prejudice remedy to cover "proposed acts and omissions";

  (b) Enhancing the court's discretion in granting relief in cases of unfair prejudice; and

  (c) Allowing a member of an associated company to bring a statutory derivative action on behalf of the company ("multiple derivative action").

Significant Changes

(a) Extending the scope of the unfair prejudice remedy to cover "proposed acts and omissions"

Background

4. Section 168A(1) of the CO provides that a member of a company may petition to the court if the affairs of the company are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members. There is some uncertainty whether, under the current provisions, a member can bring an action for unfair prejudice where a course of action is only at the proposal stage, or where there is only a threat to do or not to do something. We propose to clarify the scope of the unfair prejudice provision to cover "proposed acts or omissions" along the lines of a similar provision in the UKCA 2006.[1]

[1] Section 994(1) of the UKCA 2006.

Proposal

5. **Clauses 14.1 to 14.7** restate the unfair prejudice remedy provisions under section 168A of the CO. **Clause 14.3(1)(b)** provides that the court may exercise the power to grant remedies under these provisions if there is any actual or proposed act or omission of the company (including one done or made on behalf of the company) which is or would be prejudicial to the interests of the members. The provision is intended to cover threatened or proposed conduct which has not yet taken place. As such, the remedies that may be granted by the court under **Clause 14.4** are also extended to cover an order restraining the proposed act or requiring the doing of an act that the company has proposed to omit to do.

(b) Enhancing the court's discretion in granting relief in cases of unfair prejudice

Background

6. Section 168A(2) of the CO provides that orders made by the court (other than damages and interest awarded) must be "with a view to bringing to an end the matter complained of". This may prevent the court from granting a remedy which is unable to meet that requirement. The corresponding provision in the UKCA 2006 is more flexible and allows the court to make such order "as it thinks fit for giving relief in respect of the matter complained of"."[2]

7. Section 168A(6) of the CO states that section 296 shall apply in relation to a petition under section 168A as it applies in relation to a winding-up petition. Section 296 empowers the Chief Justice to make rules relating to the winding-up of companies. Currently the rules in the Companies (Winding-up) Rules made under section 296 apply to proceedings under section 168A in so far as they are applicable. In the interest of plain language drafting an express rule making power is desirable and the Judiciary will be consulted on the matter.

Proposal

8. **Clause 14.4** provides that the court may make any order that it thinks fit for giving relief in respect of the matter complained of. **Clause 14.6** provides

[2] Section 996(1) of the UKCA 2006.

for an express rule making power on the Chief Justice in relation to unfair prejudice proceedings under Part 14.

(c) Allowing a member of an associated company to bring a statutory derivative action on behalf of the company ("multiple derivative action")

Background

9. Statutory derivative action ("SDA") provisions in Part IVAA of the CO allow a member of a company to bring an action or intervene in proceedings on behalf of the company in respect of "misfeasance" committed against the company. "Misfeasance" means fraud, negligence, default in complying with any statutory provision or rule of law or breach of duty. Unlike some comparable jurisdictions[3], only members of the company (vis-à-vis members of a related company of the company) have standing under section 168BC(1) of the CO to seek leave to commence a SDA. In other words, only "simple" derivative actions, as opposed to "multiple" derivative actions, can be brought under the SDA provisions.

10. However, in a recent case *Waddington Ltd v Chan Chun Hoo and Others*[4], both the Court of Appeal and the Court of Final Appeal ruled that a "multiple" derivative action is maintainable in Hong Kong under the common law. The reasons for allowing members to bring a simple derivative action also justify a multiple derivative action, as the wrongdoers' control of both a parent company and its subsidiary can preclude the subsidiary from taking action against the wrongdoers. Giving standing to a member of the parent company to bring an action on behalf of the subsidiary company is appropriate since the member may otherwise suffer a real loss if no action on behalf of the subsidiary is taken. In addition to allowing a multiple derivative action under the common law, the Court of Final Appeal stated that it was appropriate for the CO to be amended to take in "multiple" derivative actions as there was no justification for excluding them from the statutory scheme.[5]

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[3] For example, in Australia, provision is made (subject to leave of the court) for proceedings to be brought by a person who is "a member… of the company or of a related body corporate (section 236(1)(a), ACA). New Zealand has taken the same approach under NZCA, section 165(1)(a). In Canada, a complainant bringing a derivative action may be a shareholder of the corporation or any of its affiliates and may sue on behalf of the corporation or any of its subsidiaries (Canadian Business Corporations Act 1985, sections 238 and 239(1)). In Singapore, the immediate members of the corporation and any other person who in the discretion of the court is a proper person may apply for leave to sue on behalf of the relevant company (SCA, section 216A(1)).

[4] [2006] 2 HKLRD 896; (2008) 11 HKCFAR 370.

[5] Paragraph 26 of the Court of Final Appeal judgment per Ribeiro PJ.

11. Following the *Waddington* case the SCCLR recommended that the SDA provisions in the CO should be expanded to allow a multiple derivative action by a shareholder of a parent company on behalf of a subsidiary or on behalf of a second or lower tier subsidiary.

12. The *Waddington* case was concerned with a multiple derivative action in the context of a parent-subsidiary relationship and the reasoning of the Court of Final Appeal was discussed in that context. The same reasoning can however be applied to situations where a member of a subsidiary seeks to bring a derivative action on behalf of another subsidiary of the same holding company.

13. Based on the SCCLR's recommendation and in order to bring the position of Hong Kong more in line with the legislation of comparable jurisdictions, we propose to extend the scope of the SDA provisions to allow a member of a related company to bring or to intervene in an action on behalf of the company.

Proposal

14. **Clause 14.13** will give standing to members of associated companies[6] and thereby expand the scope of SDA to cover "multiple" derivative actions which would provide a simple and effective mechanism for members of an associated company to commence SDA on behalf of the company. The proposal would further enhance the protection of the interests of minority shareholders.

15. To expedite implementation of the amendments, the proposal on enabling multiple statutory derivative actions will be incorporated into a Companies (Amendment) Bill scheduled to be introduced into the LegCo in early 2010.

[6] An "associated company" in relation to a company (which includes both a company incorporated in Hong Kong and a non-Hong Kong company) means any company that is (a) a subsidiary of the company; (b) a holding company of the company; or (c) the subsidiary of such a holding company.

PART 15

DISSOLUTION BY STRIKING OFF OR DEREGISTRATION

Introduction

1. At present, there are two ways in which a defunct company may be dissolved without formally being wound up:

   (a) striking off the register by the Registrar or by the court; or

   (b) deregistration upon application to the Registrar.

2. There are two routes available for companies which have been dissolved to be restored or reinstated to the register by application to the court under sections 291(7) or 291AB(2) of the CO.[1]

3. Part 15 sets out provisions on striking off and deregistration of defunct companies, restoration of companies that have been struck off or deregistered, and related matters, including treatment of the property of dissolved companies. The amendments aim at streamlining the existing procedures for striking-off and restoration of companies while imposing certain new requirements to prevent possible abuse of the deregistration procedure.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Extending the voluntary deregistration procedure to public non-listed and guarantee companies with some exceptions;

  (b) Imposing additional conditions for deregistration of defunct companies*;*

  (c) Streamlining the procedures for restoration of dissolved companies by court order; and

[1] In the liquidation context, companies which have been dissolved pursuant to winding-up proceedings may, by order of the court made under section 290 of the CO, have the dissolution declared void. The provisions will be reviewed in Phase II of the CO Rewrite exercise.

(d) Introducing a new procedure of "administrative restoration" of a dissolved company by the Registrar.

Significant Changes

(a) Extending the voluntary deregistration procedure to public non-listed and guarantee companies with some exceptions

Background

4. At present, an application may be made to the Registrar under section 291AA of the CO to deregister a private company if the following three conditions are met:

   (a) the company has not commenced operation or business or has not been in operation or carried on business for 3 months;

   (b) it has no outstanding liabilities;[2]

   (c) all the members agree to the deregistration.

   The company will be dissolved upon deregistration without going through the winding-up process.

5. There has been a suggestion that non-private companies, particularly small guarantee companies which are social or community organisations, should be allowed to deregister voluntarily. Currently, they cannot apply for voluntary deregistration under section 291AA even if they satisfy the conditions in paragraph 4 above. It would be costly for them to apply to court for a members' voluntary winding-up instead. It is noted that the UK has extended the facility of voluntary striking-off procedure to public companies under the UKCA 2006.[3]

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[2] A "no-objection" notice from the Commissioner of Inland Revenue certifying that the company has no outstanding tax liabilities is required.

[3] See section 1003 of UKCA 2006. This was proposed in UK Department of Trade and Industry, *White Paper on Company Law Reform* (March 2005), paragraph 4.9.

Proposal

6. We believe that flexibility should be allowed for small non-private companies, particularly guarantee companies, to apply for voluntary deregistration. However, it would not be prudent to allow listed companies and certain categories of regulated businesses which have a public interest nature and are subject to regulation by relevant authorities (such as banks, insurance and securities companies, Mandatory Provident Fund Schemes trustees) from applying for deregistration. As trust companies registered under Part VIII of the Trustee Ordinance (Cap 29) may act as executors or administrators of estates in respect of which it may not be easy to identify all relevant beneficiaries, they should also be excluded from applying for voluntary deregistration to avoid prejudicing the beneficiaries' interests.

7. **Clause 15.6** excludes listed companies and certain categories of businesses from applying for voluntary deregistration. The conditions for applying voluntary deregistration, particularly the requirement of consensus by all members and the additional conditions proposed in section (b) below, would prevent any possible abuse of the procedure by other public non-listed or guarantee companies.

(b) Imposing additional conditions for voluntary deregistration of defunct companies

Background

8. As noted in paragraph 4 above, voluntary deregistration of private companies may be allowed if certain conditions are met. There have been cases where some companies applying for deregistration were parties to legal proceedings or were in possession of immovable property in Hong Kong with high maintenance costs attached (such as retaining walls). As a consequence, the deregistration proved to have adverse impact on third parties or the Government. For instance, the "deregistered" company might have outstanding liabilities contingent upon the outcome of the legal proceedings. The Government might have to bear high maintenance costs as the immovable property became vested in the Government as bona vacantia following dissolution of the company. To prevent the potential abuse of the deregistration procedure, we are of the view that additional conditions should be imposed on companies applying for deregistration.

Proposal

9. **Clauses 15.7 to 15.8** mainly restate the existing deregistration provisions under section 291AA of the CO. **Clause 15.7** imposes two additional conditions for deregistration, namely that the applicant must confirm that the company is not a party to any legal proceedings and that it has no immovable property in Hong Kong. Any person who knowingly or recklessly gives false or misleading information to the Registrar in an application commits an offence.

(c) Streamlining the procedures for restoration of dissolved companies by court order

Background

10. At present, there are two routes available for companies which have been struck off or deregistered to be restored or reinstated to the register by application to the court. They are respectively under sections 291(7) and 291AB(2) of the CO. The time of application for such a restoration or reinstatement may be up to 20 years after the company's dissolution. These two routes are very similar in nature. They should be merged into one procedure.

11. The current period of application (20 years) seems too lengthy. Under section 292(3) of the CO, former directors of a dissolved company are only obliged to keep the books and papers of the company for not less than 5 years after the dissolution. Although there are provisions in sections 291(7) and 291AB(5) to the effect that a company restored or reinstated shall be deemed to be continued in existence as if it had not been dissolved, an odd situation may arise where a dissolved company is restored or reinstated to the register more than 5 years from its dissolution when all its books and papers were destroyed. Consideration should be given to shorten the period of application.

Proposal

12. **Clauses 15.23 to 15.26** replaces the two existing routes in sections 291(7) and 291AB(5) with one restoration procedure by court order. Where a company has been struck off the register by the Registrar or deregistered upon its own application, and thereby dissolved, any director or member or

creditor of the company or any interested person, including the Government, may make an application to the court for restoration of the company.

13. The application period will be shortened to within 6 years of dissolution of the company in general (**Clause 15.24**).[4] However, where an application is intended to enable a person to bring legal proceedings against the company for damages for personal injury, the limitation period will not apply. This will avoid jeopardising the interests of the deceased or injured persons. Under **Clause 15.16**, the period for which former directors of a dissolved company must keep the company's books and papers will be aligned to 6 years. It will reduce any uncertainty arising from the restoration procedure.

(d) Introducing a new procedure of "administrative restoration" of a dissolved company by the Registrar

Background

14. At present, where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, she may adopt the procedure set out in section 291 of the CO and strike the name of the company off from the register**.** Under section 291(4), the procedure may also be used where a company is being wound up and the Registrar has reasonable cause to believe either that no liquidator is acting or that the affairs of the company are fully wound up, and the returns required to be made by the liquidator (under sections 239 and 248 of the CO) have not been made for a period of six consecutive months.

15. There have been some cases where a company struck off seeks to be restored on the ground that, contrary to the Registrar's belief, it was actually in operation or carrying on business at the time of its striking off. This may occur because a company fails to file its annual returns, moves without notifying the CR of a change of registered office and is unaware of the proposed strike-off.[5] While restoration is often straightforward in such circumstances as it is unlikely to be contested, it still requires an application to the court. We believe that a simplified restoration procedure should be introduced to allow companies to be restored to the register in straightforward cases without the need for recourse to the court.

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[4] Companies which have been struck off or deregistered under the existing CO will be grandfathered.

[5] Elaborate procedures are provided for in section 291 of the CO before a company is struck off and gazette notices are published before any striking off.

Proposal

16. **Clauses 15.18 to 15.22** enable the Registrar to restore a company which has been struck off under **Clause 15.3 or 15.4** (where it appears that the company is not in operation or carrying on business or, in the case of a company being wound up, the circumstances in section 291(4) of the CO apply). The Registrar may, on an application by a director or member of a company, restore a company having being struck off by her. In this connection, three conditions must be met:

(a) the company must be in operation or carrying on business at the time its name was struck off;

(b) the applicant must bring up to date the company's records kept by the Registrar; and

(c) if the company has any immovable property situated in Hong Kong which has become vested in the Government as bona vacantia, the Government has no objection to the restoration.

17. The administrative restoration procedure does not apply to companies which were deregistered upon applications to the Registrar. For those cases, application for restoration should be made to the court under **Clauses 15.23 to 15.24**.

Other Changes

(a) Streamlining striking off procedure

18. The current process of striking off a company not in operation or carrying on business under section 291 of the CO takes approximately 5.5 months to complete. The Registrar must take the following steps before striking off a company:

(a) send to the company by post a letter inquiring whether it is carrying on business or in operation;

(b) if no answer is received within one month from the date of the first, the Registrar should within 14 days send to the company a second letter by registered post;

(c) if no answer is received within one month from the date of the second letter, a notice will be published in the Gazette stating that at the expiration of three months from the date of that notice, the company will, unless cause is shown to the contrary, be struck off the register and the company will be dissolved. The notice will also be sent to the company by post.

19. **Clauses 15.1 to 15.3** mainly restate the existing striking off procedure with some streamlining. **Clause 15.2** streamlines the procedure by synchronising the publication of the Gazette notice with the sending of the second letter. It will shorten the striking off procedure by about one month's time.

(b) Requiring company to change name if it has been used by another company upon restoration

20. **Clause 15.28** supplements the existing restoration procedure. It requires a company which is restored to the register by court order to change its name within 28 days after restoration if the name has already been used by another company or is otherwise prohibited from use under the Ordinance. If the company does not change its name, the company and every responsible person will be liable to a fine. The Registrar may substitute the name with a name comprising its registered number with the words "Company Registration Number" as the prefix. The provision addresses the situation where a company fails to change its former name after restoration where required to do so.

(c) Reimbursing Government reasonable costs of disposal on restoration of bona vacantia property

21. **Clause 15.29** restates section 292A of the CO to provide that any property vested in the Government as bona vacantia will be revested in the company upon its restoration, subject to any liability, interest or claim that was attached to the property. If the Registrar has disposed of the property, she must pay the company the amount of the consideration, or if no consideration was received, an amount equal to the value of the property. A new provision is added in this clause to allow the Registrar to deduct from the amount payable to the company the reasonable costs in connection with the disposition of the property.

PART 16

NON-HONG KONG COMPANIES

Introduction

1. Part 16 deals with companies incorporated outside Hong Kong which have established a place of business in Hong Kong. It essentially restates the existing Part XI of the CO which has been substantially amended by the Companies (Amendment) Ordinance 2004, mainly with a view to simplifying the filing requirements. No substantive amendment to the existing registration regime of non-Hong Kong companies is proposed. Nevertheless, we aim to improve the clarity of the provisions and make them more user-friendly. Where appropriate, the procedural and technical details concerning the registration of and returns to be made by non-Hong Kong companies are moved to subsidiary legislation to facilitate updating of the provisions in future.

- The significant changes to be introduced under this Part are highlighted below:

  (a) Clarifying provisions for striking non-Hong Kong companies off the register and their restoration to the register; and

  (b) Modifying the penalty provisions to align with those of Hong Kong incorporated companies.

Significant Changes

(a) Clarifying provisions for striking non-Hong Kong companies off the register and their restoration to the register

Background

2. At present, section 339A of the CO empowers the Registrar to remove the name of a non-Hong Kong company from the register if there is reasonable cause to believe that the company has ceased to have a place of business in Hong Kong, by applying the CO provisions relating to the striking off of

local defunct companies, with such adaptations as are necessary. Such a legislative provision by way of reference is considered unsatisfactory and may give rise to uncertainty as to which provisions would apply. For example, whether there is a right for a non-Hong Kong company that has been struck off the register or its directors or members to apply for its restoration to the register. To avoid such uncertainty, express provisions are introduced in Part 16 to clarify the matters.

Proposal

3. **Clauses 16.23 to 16.28** expressly set out the steps that the Registrar should take before striking a non-Hong Kong company off the register, the procedures for a director or member of a non-Hong Kong company that has been struck off the register to apply to the Registrar for its restoration to the register, and the conditions for granting such an application.

(b) Modifying the penalty provisions to align with those of Hong Kong incorporated companies

Background

4. Section 340 of the CO imposes liability on a non-Hong Kong company that is in default of any provisions under Part XI as well as every officer or agent of that company who authorises or permits the default. Under the Twelfth Schedule to the CO, a fine of up to $50,000 (level 5) may be imposed summarily upon any of these persons and a daily default fine of $700 may also be imposed for any continued default in compliance with these provisions. The imposition of a uniform level of penalty for different types of offences is considered unsatisfactory. It would also result in an offence of similar nature being subject to different penalty levels, depending on whether the company is a locally incorporated or a non-Hong Kong company.

Proposal

5. The offence provisions are set out in individual clauses of Part 16. The penalty levels are generally aligned with comparable offence provisions for Hong Kong incorporated companies.

Other Changes

(a) Moving certain procedural details to subsidiary legislation

6. Currently, the procedural and technical details concerning the registration of and returns to be made by non-Hong Kong companies are set out in sections 333, 334 and 335 of the CO. These include the particulars to be contained in the applications or returns and the accompanying documents. Such procedural or technical details are likely to require updating over time. To facilitate future updating, they should be moved from primary into subsidiary legislation.

7. **Clause 16.31** empowers the Financial Secretary to make regulations to prescribe certain procedural and technical details. Such details include, among others:

(a) the particulars to be contained in applications for registration of non-Hong Kong companies and the documents to accompany such applications;

(b) the particulars to be contained in annual returns or returns of change of certain particulars by registered non-Hong Kong companies and the documents to accompany such returns; and

(c) the documents to accompany a notice of the termination of the authorisation of an authorised representative by a registered non-Hong Kong company to the Registrar.

(b) Clarifying provisions on change of corporate name of non-Hong Kong companies

8. At present, section 335(2) of the CO requires a non-Hong Kong company to notify the Registrar of any change of its corporate name. The provision is fairly general. There may be uncertainty as to whether notification is required in certain scenarios, such as where there is a change to the registered name of the company in its place of incorporation without a change in the translation appearing on our register which is being used as the company's corporate name in Hong Kong. **Clause 16.5** clarifies the notification requirements in various scenarios relating to the change of

corporate name of non-Hong Kong companies. **Clause 16.6** clarifies the registration procedures for change of corporate name.

PART 17

COMAPNIES NOT FORMED, BUT REGISTRABLE, UNDER THIS ORDINANCE

Introduction

1. Part 17 deals with companies not formed under the new Ordinance or a former Companies Ordinance but eligible to be registered under the new Ordinance. It mainly restates, with some modifications, Part IX of the CO, except sections 324 and 325. Part IX provides for the registration of companies (consisting of one or more members) which are/have been formed in pursuance of any Ordinance other than the CO or a former CO (i.e. Companies Ordinance 1865 and Companies Ordinance 1911); or otherwise constituted according to law. Sections 324 and 325 are closely related to sections 181 and 186 of the CO on winding-up and will be tackled in Phase II of the CO rewrite exercise together with other winding-up related provisions.

2. There is no significant change to be introduced under this Part. Nevertheless, we have taken the opportunity to remove the archaic provisions on "joint stock company" under sections 310 to 312 of the CO as there does not appear to be a practical need for them.

Proposed Changes

Removing archaic provisions on "joint stock company"

3. At present, under section 310 of the CO, a joint stock company with limited liability, formed pursuant to any Ordinance (other than the CO or any of its predecessors), or letters patent, or being otherwise duly constituted according to law, and consisting of one or more members, may at any time register under the CO as a company limited by shares. A joint stock company is defined in section 311 of the CO as "a company having a permanent paid-up or nominal share capital of fixed amount divided into shares, also of fixed amount, or held and transferable as stock, or divided and held partly in one way and partly in the other, and formed on the principle of having for its members the holders of those shares or that stock,

and no other persons…". Section 312 sets out the requirements for registration by such a company.

4. The origin of sections 310 to 312 of the CO can be traced back to the CO enacted in Hong Kong in 1911, presumably as a transplantation from the UK Companies (Consolidation) Act 1908. The UK provisions were aimed, in part, at allowing joint stock companies formed under the earlier Joint Stock Companies Acts to register as a company under the subsequent UK Companies Acts. The UK Joint Stock Companies Acts did not apply in Hong Kong, and there was no equivalent legislation in Hong Kong. The only incorporated "joint stock companies" that could be in existence in Hong Kong would be companies incorporated under the Companies Ordinances (of 1865, 1911 and 1932) (which are excluded from the scope of sections 310 to 312 under section 310(1)(a)) or joint stock companies incorporated under some other Ordinances in Hong Kong, or Acts of Parliament or letters patent applicable to Hong Kong.

5. We have done research in order to find out if there are still in existence in Hong Kong any limited liability joint stock companies incorporated under an Ordinance (other than the CO or any of its predecessors), an Act of Parliament which has application to Hong Kong, or letters patent. As far as can be ascertained, no such company exists.

6. The position with regard to unincorporated joint stock companies is less certain although the chances of such companies being in existence are rather remote. If there had been any such companies in existence which wished to register under the CO, they would have done so by now.

7. On the basis of the above, and for the sake of simplicity, we consider it justified to have the set of complicated rules on registration of joint stock companies removed from the CB. If, despite the remote possibility, there are still in existence some unincorporated joint stock companies, they could simply dissolve the company and incorporate as a new one if they wish to become a company under the new Ordinance.

PART 18

COMMUNICATIONS TO AND BY COMPANIES

Introduction

1. Part 18 introduces a new set of rules governing communications between a company and its members, debenture holders, and other persons in electronic or hard copy form. The rules, modelled on similar provisions in the UKCA 2006[1], will also facilitate communications sent by companies (particularly listed companies) to their shareholders by means of a website. Some of the proposed changes will be incorporated into a Companies (Amendment) Bill to be introduced into the LegCo in early 2010, so that they can be implemented ahead of the CO rewrite exercise.

2. The Part also restates section 356 of the CO regarding service of documents on a company (**Clause 18.7**) and adopts regulations 133 (notice given by a company to the joint holders of a share) and 134 (notice given by a company to the persons entitled to a share in consequence of the death or bankruptcy of a member) in Table A of the First Schedule to the CO to be the default rules in the CB (**Clauses 18.15** and **18.16**).

- The significant changes to be introduced under this Part are highlighted below:

  (a) Setting out the rules governing communications to and by companies in electronic form; and

  (b) Facilitating communications sent by companies to their members by means of a website

[1] Sections 1144 to 1148 of and Schedules 4 and 5 to the UKCA 2006.

Significant Changes

(a) Setting out the rules for communications with companies in electronic form

Background

3. As a result of the rapid growth of new information technology over recent years, communications by electronic means have presented opportunities to reduce costs and increase the efficiency of communications with companies. In this regard, both the CO and Electronic Transactions Ordinance (Cap 553) ("ETO") contain some general provisions which enable electronic communications with companies. Specifically, Regulation 1 of Table A in the First Schedule to the CO provides that, wherever any provision of Table A (except a provision for appointment of a proxy) requires that a communication as between a company, its directors or members be effected in writing, the requirement may be satisfied by the communication being given in the form of an electronic record if the person to whom the communication is given consents to it being given to him in that form.[2]

4. The ETO is permissive and facilitatory in nature, and where applicable, it confers on electronic records the same legal status as that of their paper-based counterparts. However, consent of the recipient is required for receiving electronic records. Under the ETO (section 15), where neither the provider nor the recipient of information is (or is acting on behalf of) a government entity, if the recipient consents to the information being given in the form of an electronic record, then sections 5 and 5A of the ETO shall apply (unless otherwise specifically excepted or excluded by reason of sections 11(1), 13, 14 and 16(1) of the ETO). Section 5 of the ETO provides that if a rule of law requires or permits information to be given in writing, the use of electronic records satisfies the rule of law if the information contained in the records is accessible so as to be usable for subsequent reference. Section 5A of the ETO further provides that if a rule of law requires or permits a document to be served on a person by personal service or by post, the service of the document in the form of an electronic record to an information system designated by the recipient satisfies the rule of law if the information contained in the records is accessible so as to be usable for subsequent reference.

[2] This provision was inserted into regulation 1, effective for companies adopting Table A on or after 13 February 2004.

5. However, while section 23 of the CO provides that the articles of a company shall have effect as a contract between the company and each member and shall be deemed to contain covenants on the part of the company and of each member to observe all the provisions of the articles, it is unlikely that a provision in the articles in the form of Regulation 1 of Table A would itself be sufficient to constitute a consent on the part of the recipient for the purposes of the ETO.

6. Furthermore, there is a lack of ground rules in the CO, which comprehensively deal with electronic communications (as well as non-electronic communications)[3] to or by companies. There is a need to provide a set of comprehensive rules in the CB to govern electronic communications to and by companies in order to encourage more widespread use of electronic communications in Hong Kong.

Proposal

7. Division 3 (**Clauses 18.8 to 18.10**) contains provisions dealing with communications from natural persons to a company. **Clause 18.8** deals with documents or information sent to the company in electronic form. It provides that a document may be sent to a company in electronic form if the company has so agreed, generally or specially, or is regarded as having so agreed under a provision of the CB. There are provisions in Part 12 of the CB which deem the company to have agreed to receive a document sent in electronic form. For example, under **Clause 12.14**, if a company has given an electronic address when sending to its members a document containing or accompanying a proposed written resolution, it is regarded as having agreed that any document or information relating to that resolution may be sent by electronic means to that address. **Clauses 12.29(2) and 12.61** contain similar provisions in respect of a notice calling a meeting and an instrument of proxy or an invitation to appoint a proxy in relation to a meeting respectively.

8. Division 4 (**Clauses 18.11 to 18.13**) contains provisions dealing with communications by a company to other persons (whether a company or natural person). **Clause 18.11** provides that a document may be sent by a

[3] There are some provisions in the CO which deal with non-electronic communications with a company under the CO, such as section 356 (service of documents on company), section 338 (service of documents on non-Hong Kong company), regulations 132 (notice given by a company to its member), 133 (notice given by a company to the joint holders of a share) and 134 (notice given by a company to the persons entitled to a share in consequence of the death or bankruptcy of a member) of Table A in the First Schedule of the CO.

company to another person in electronic form if the recipient has agreed, generally or specifically, that it be sent in electronic form or, where the recipient is a company, is regarded as having so agreed under a provision of the CB. Under **Clause 18.3**, a document is deemed to have been received by the recipient 48 hours after it is sent by electronic means, or any longer period as specified in the company's articles (for members), instrument creating the debenture (for debenture holders) or any other agreement (for other persons).

9. Any person who has agreed to receive electronic communications may revoke the agreement at any time. Under **Clause 18.2**, the agreement may be revoked by the recipient by giving a notice of revocation of at least 7 days or such longer period as specified in the articles of association (for members), instrument creating the debenture (for debenture holders) or any other agreement (for other persons).

10. **Clauses 18.8** and **18.11** also provide for the manner of authentication of a document sent in electronic form. A document will be sufficiently authenticated if the sender's identity is confirmed in a manner specified by the recipient or where no such manner has been specified, the communication contains or is accompanied by a statement of the sender's identity and the recipient has no reason to doubt the truth of the statement.

11. It should be noted that a document in electronic form may also be sent by hand or by post (e.g. by sending a diskette or CD containing the document in electronic form).

(b) Facilitating communications sent by companies to their members by means of website

Background

12. At present, the CO requires companies to send to every shareholder the full annual report and accounts or a summary version thereof. Unless the shareholder positively opts for electronic communication, this must be in paper. Recent amendments to the Listing Rules[4] have allowed a listed company, subject to the applicable laws in its home jurisdiction, to send corporate communications to its shareholders by making them available on the listed company's website if the shareholders agree, or are deemed to

[4] See Main Board Listing Rule 2.07A and GEM Rule 16.04(2A) which came into effect on 1 January 2009.

have so agreed. In the absence of enabling provisions in the CO, listed companies which are incorporated in Hong Kong would not be able to make use of such flexibility. There is a need to amend the law so that companies incorporated in Hong Kong can take advantage of the new procedure relating to website communications as companies incorporated outside Hong Kong .

Proposal

13. **Clause 18.13** provides that a company may communicate with its members, debenture holders and other persons by means of a website, if so permitted by its articles or a members' resolution and if the recipient consents to the use of website communications. If the recipients are members or debenture holders, they will be taken to have agreed to receive information from the company via a website if they have been asked individually for their acceptance and have not responded within 28 days of the company's request. Where a member or debenture holder has not agreed to accept website communications, the company may not ask the member or debenture holder again within a period of 12 months. Companies are required to notify intended recipients each time material is published on a website. The document or information should be available on the website throughout the period specified by the applicable provision of the CB, or where no such period is specified, a period of 28 days.

Other Changes

(a) Providing members and debenture holders a right to require hard copy version of documents

14. **Clause 18.17** allows the members or debenture holders to require information to be provided in hard copy form within 28 days from the date of receipt of a document otherwise than in hard copy form. This will enable a member or debenture holder to obtain a paper copy of the document in case of temporary failure to access the document through the website or other electronic devices. A company is required to send a paper copy of the document or information within 21 days of receiving the request; or if the document or information requires an action to be taken by the member or debenture holder on or before a date, at least 7 days before that date. If the company fails to comply with the request, the company and every responsible person will be liable to a fine.

(b) Stating rules for communications with company in hard copy and other agreed forms

15. **Clauses 18.9** and **18.12** state the existing practice that a document may be sent to a company or by a company to another person in hard copy form by hand or by post. If the recipient is a company, the document can be sent to the company's registered office, an address specified by the company, or an address authorised or required under the relevant provision of the CB. **Clause 18.5** lists the addresses to which a company may send documents to other persons. Where the company does not have the intended recipient's address as specified in **Clause 18.5**, the company may use the recipient's last known address.

16. **Clauses 18.10** and **18.14** provide that communications between a company and another person may be effected by any other means as agreed between the parties. These provisions contemplate oral communications and such other kinds of communications as may be developed in the future arising from new information and telecommunications technologies.