

# **Standing Committee on Company Law Reform**

## **The Twenty-Fifth Annual Report**

**2008/2009**

**Standing Committee on Company Law Reform (SCCLR)  
Twenty-Fifth Report  
Subjects considered by the  
Standing Committee during 2008/2009**

<b><u>Table of Contents</u></b>		<b><u>Page No.</u></b>
PREFACE		
	(i) Terms of Reference of the Standing Committee on Company Law Reform.....	1
	(ii) Membership of the Standing Committee for 2008/2009.....	1
	(iii) Meetings held during 2008/2009.....	3
EXECUTIVE SUMMARY.....		4
CHAPTER 1	Companies Registry's General Investigatory Powers.....	7
CHAPTER 2	Company Names, Directors' Duties, Corporate Directorship and Registration of Charges.....	9
CHAPTER 3	Statutory Derivative Action.....	13
CHAPTER 4	Share Capital and Miscellaneous Provisions on Shares.....	15
CHAPTER 5	Capital Maintenance Rules and Statutory Amalgamation Procedure .....	24

## **PREFACE**

(i)

### **Terms of Reference of the Standing Committee on Company Law Reform**

- (1) To advise the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary.
- (2) To report annually through the Secretary for Financial Services and the Treasury to the Chief Executive in Council on those amendments to the Companies Ordinance that are under consideration from time to time by the Standing Committee.
- (3) To advise the Financial Secretary on amendments required to the Securities Ordinance and the Protection of Investors Ordinance<sup>1</sup> with the objective of providing support to the Securities and Futures Commission in its role of administering those Ordinances.

(ii)

### **Membership of the Standing Committee for 2008/2009**

**Chairman** : Mr Benjamin YU, S.C., J.P.

**Members** : Mrs Anne CARVER  
Mr Felix CHAN Kwok-wai, M.H. (up to 8.12.2008)  
Mr CHEW Fook-aun (from 1.2.2009)  
Mr Vincent FAN Chor-wah  
Mr GOO Say-hak (from 1.2.2009)  
Mr Peter W GREENWOOD  
Mr Stephen HUI Chiu-chung, J.P.  
Ms Teresa KO Yuk-yin, J.P.  
Mr Johnson KONG Chi-how (from 1.2.2009)

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<sup>1</sup> These two Ordinances were consolidated into the Securities and Futures Ordinance which commenced on 1 April 2003.

Mr Godfrey LAM Wan-ho, S.C.  
Mrs Catherine MORLEY (from 1.2.2009)  
Mr John POON Cho-ming (up to 31.1.2009)  
Ms Edith SHIH  
Mr David P R STANNARD  
Ms Vanessa STOTT (up to 31.1.2009)  
Mr Carlson TONG, J.P. (up to 31.1.2009)  
Mr Paul F WINKELMANN  
Mr Patrick WONG Chi-kwong

**Ex-Officio**

**Members** :

Mr Andrew YOUNG  
Chief Counsel, Legal Services Division  
The Securities & Futures Commission

Mr Paul CHOW, S.B.S., J.P.  
Chief Executive  
Hong Kong Exchanges and Clearing Limited

Professor Edward L G TYLER  
Department of Justice

Mr E T O'CONNELL  
The Official Receiver

Ms Ada CHUNG  
The Registrar of Companies

Mr Stefan GANNON, J.P.  
General Counsel/Executive Director  
The Hong Kong Monetary Authority

Mr John LEUNG, J.P.  
Deputy Secretary for Financial Services and the Treasury

**Secretary** : Mr Edward LAU (up to 22.3.2009)  
Mrs Karen HO (from 23.3.2009)

(iii)

**Meetings held during 2008/2009**

Two Hundred and Eighth Meeting	-	12 April 2008
Two Hundred and Ninth Meeting	-	27 September 2008
Two Hundred and Tenth Meeting	-	1 November 2008
Two Hundred and Eleventh Meeting	-	3 January 2009
Two Hundred and Twelfth Meeting	-	7 March 2009

## **EXECUTIVE SUMMARY**

The Standing Committee on Company Law Reform (“SCCLR”) was formed in 1984 to advise the Financial Secretary on amendments to the Companies Ordinance (“CO”) and other related ordinances. The SCCLR reports annually to the Chief Executive in Council through the Secretary for Financial Services and the Treasury on amendments that are under consideration.

As in the last two years, the main focus of the SCCLR was still on the CO Rewrite exercise commenced formally in mid-2006 following the setting up of the Companies Bill Team (“CBT”). From 1 April 2008 to 31 March 2009, the SCCLR held five meetings and considered altogether 15 papers, including 6 by way of circulation, covering proposals put forward by the Advisory Groups set up to advise on specific topics in the rewrite exercise and recommendations made by the CBT upon the conclusion of public consultations.

A summary of the recommendations endorsed by the SCCLR is set out below :-

- (I) **Companies Registry’s General Investigatory Powers (Chapter 1)**
- Strengthening of the powers of the Registrar of Companies (“Registrar”) in the investigation of specified offences
  - Specifying the kind of persons required to assist in the investigation
- (II) **Company Names, Directors’ Duties, Corporate Directorship and Registration of Charges (Chapter 2)**
- Empowering the Registrar to act on a court order to direct a defendant company to change its infringing name and to substitute that name with its registration number on non-compliance
  - No discretion given to the Registrar to approve hybrid names on the ground of genuine business need
  - Codification of the standard of directors’ duty of care, skill and diligence
  - Imposition of the requirement to have at least one natural person acting as director

- Updating the list of registrable charges
- Replacement of the automatic statutory acceleration of repayment by a right to demand immediate repayment in the event of default in registering a charge
- Introduction of a new charge registration system which requires registration of the instrument of charge together with the prescribed particulars and evidence of payment/release
- Replacement of the current certificate of due registration by a certificate that the instrument of charge and prescribed particulars have been submitted for registration
- Shortening of the time limit for registration of a charge to 21 days
- No administrative mechanism for late registration of charges

**(III) Statutory Derivative Action (Chapter 3)**

- Extension of statutory derivative action provisions to cover multiple derivative actions
- Consulting the public (in the context of consultation on the draft Companies Bill) on whether common law derivative actions should be abolished

**(IV) Share Capital and Miscellaneous Provisions on Shares (Chapter 4)**

- Abolition of par value, with a review period of 24 months for existing companies to migrate to no-par
- No legislative control over the setting of issue price of no-par value shares
- Providing for merger and reconstruction reliefs, capitalization of profits and partly paid shares in a no-par environment
- Removal of requirement for authorized capital
- Introduction of provisions on denomination and redenomination of share capital
- Removal of the power to pay interest out of capital in certain cases
- Extension of the requirement of shareholders' consent for allotment to grant of rights to subscribe for or to convert security into unallotted shares
- Exclusion of rights issue, allotment to founder members and bonus issue from the requirement of shareholders' approval
- Restricting authorizations to allot shares to last only until the next annual general meeting

- Clarifying the provisions on the consequences of unauthorized allotments
- Introduction of registration requirement for allotment of shares
- Updating the requirements relating to registration of return of allotments
- Requirement for notice to transferee or transmittee of refusal to register a transfer or transmission
- Clarifying the provision on transmission of shares by operation of law
- Prohibition of the issue of share warrants
- Introduction of clear provisions on class rights, and class meeting requirements

(V) **Capital Maintenance Rules and Statutory Amalgamation Procedure (Chapter 5)**

- Adoption of the solvency test for reduction of capital, buy-backs and financial assistance and standardization of the solvency test
- Introduction of a court-free procedure for reduction of capital based on solvency test
- Allowing companies to fund buy-backs regardless of the source of funds, subject to a defined solvency requirement
- No legislative provision for treasury shares
- Streamlining the financial assistance provisions
- Introduction of a court-free statutory amalgamation procedure for amalgamation of intra-group companies



## CHAPTER 1

### Companies Registry's General Investigatory Powers

#### **Background**

- 1.1 At the 205<sup>th</sup> meeting held on 8 December 2007, the SCCLR considered the recommendations made by CO Rewrite Advisory Group 4 (“AG4”) with regard to the Companies Registry’s general investigatory power and raised concerns on the scope and extent of the proposed investigatory powers and the types and nature of offences in respect of which the proposed powers would be exercised<sup>2</sup>.
- 1.2 A paper was prepared by the Companies Bill Team, setting out revised recommendations on the scope and extent of the investigatory powers and the applicable offences, which were all substantially reduced.
- 1.3 The SCCLR considered the paper at the 209<sup>th</sup> meeting on 27 September 2008 and a follow-up paper on the same subject at the 210<sup>th</sup> meeting on 1 November 2008.

#### **Recommendation**

- 1.4 The SCCLR endorsed the recommendation that the Registrar should only have powers, in respect of likely commission of offences under sections 291AA and 349 of the CO<sup>3</sup>, to require production of records and documents, to make copies of them, and to require provision of information and explanation.
- 1.5 The proposal to empower the Registrar to do on-site inspection of statutory books was not endorsed by the SCCLR. Members were generally of the view that there was no need for the Registrar to have such power as the power to request for information and explanations, coupled with the power to require production of documents and to make copies, should be sufficient for the purposes of investigation.

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<sup>2</sup> See Chapter 8, SCCLR’s Annual Report 2007/2008

<sup>3</sup> Section 291AA(14) provides that any person who, in connection with an application for the deregistration of a company, knowingly or recklessly gives to the Registrar information that is false or misleading in a material particular commits an offence. Section 349 provides for the offence of wilfully making a statement that is false in any material particular, knowing it to be false. The offence arises in the context of false statements made in any return, report, certificate, balance sheet or other document required by, or for the purpose of, any provision of the CO.

1.6 Members generally agreed that the kind of persons who might be required to assist in the investigation should include :-

- (i) the target company or target officer (i.e. the company or officer whom the Registrar had reasonable cause to believe to have committed an applicable offence);
- (ii) any other present officer of the target company; and
- (iii) any other person who was reasonably believed to be in possession of the requested document and record, or in a position to give the requested information or explanation on, or further particulars, of the document or record.

1.7 The SCCLR had not endorsed the proposal to include past officers as persons required to provide documents, records, information and explanation. The SCCLR considered that past officers should not be subject to such powers if they were not reasonably believed to be in a position to provide the required document, information etc.

## CHAPTER 2

### **Company Names, Directors' Duties Corporate Directorship and Registration of Charges**

#### **Background**

- 2.1 Based on the SCCLR's previous recommendations<sup>4</sup>, the Financial Services and the Treasury Bureau ("FSTB") issued a Consultation Paper on Company Names, Directors' Duties, Corporate Directorship and Registration of Charges on 2 April 2008. The public consultation ended on 30 June 2008. The SCCLR considered the recommendations in the draft consultation conclusions prepared by FSTB.<sup>5</sup>

#### **Recommendation**

##### **(I) Company Names**

- 2.2 The SCCLR endorsed the following recommendations relating to company names :-
- The Registrar should be empowered to act on a court order directing a defendant company to change its infringing name, and substitute its infringing name with its registration number if the company failed to comply with the Registrar's direction to do so.
  - The proposal to provide the Registrar with a discretionary power to approve a hybrid name if there was a genuine business need should not be adopted<sup>6</sup>. The CR would allow phrases like "X光" and "卡拉OK" in company names because they had no direct Chinese equivalents and were already used in other legislation.

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<sup>4</sup> Please see Chapter 7, SCCLR's Annual Report 2006/2007 and Chapters 2, 4 and 6, SCCLR's Annual Report 2007/2008.

<sup>5</sup> The consultation conclusions were issued in December 2008 and are available at the "Companies Ordinance Rewrite" website ([www.fstb.gov.hk/fsb/co\\_rewrite](http://www.fstb.gov.hk/fsb/co_rewrite)).

<sup>6</sup> The proposal was previously endorsed by the SCCLR at its 205th meeting held on 8 December 2007. Please see Chapter 2, SCCLR's Annual Report 2007/2008. The proposal was reconsidered by the SCCLR in view of the diverse views expressed on the proposal in the consultation exercise.

## **(II) Codification of Directors' Duties**

2.3 The SCCLR also considered a supplemental paper on the subject of directors' duties of care, skill and diligence and endorsed the following recommendations with regard to the codification of directors' duties<sup>7</sup>.

- Directors' duty of care, skill and diligence should be codified along the line of section 174 of the United Kingdom Companies Act 2006 ("CA 2006") to the effect that a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that might reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and the general knowledge, skill and experience that the director had.
- The other general duties of directors should not be codified.

2.4 The SCCLR suggested that the Non-statutory Guidelines on Directors' Duties ("the Guidelines") issued by the Companies Registry ("CR") should be retitled as "A Guide on Directors' Duties". Principle 4 of the Guidelines should be amended to align with the test in section 174 of CA 2006 and a note should be added to clarify that all the Principles were of equal importance<sup>8</sup>.

## **(III) Corporate Directorship**

2.5 The SCCLR considered and endorsed the following recommendation on corporate directorship :-

- Corporate directorship should continue to be allowed and every company should, subject to a grace period, have at least one natural person acting as director.

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<sup>7</sup> The general duties of directors in Hong Kong are mainly found in case law. They can be classified into two broad categories, namely fiduciary duties and duties of care, skill and diligence.

<sup>8</sup> The Guidelines were first issued in January 2004 pursuant to SCCLR's recommendation in its Final Recommendations arising from the Corporate Governance Review Phase II. Following the latest recommendation the Guidelines were amended and retitled "A Guide on Directors' Duties" which was issued in July 2009.

#### **(IV) Registration of Charges**

2.6 The SCCLR endorsed all the recommendations on registration of charges. They are as follows :-

- It would not be necessary to make any express provision as to whether an assignment of insurance policy by way of security, a fixed charge over the shares of a company and an assignment of rental or sale proceeds by way of security should be treated as a charge over book debts.
- There should be legislative clarification expressly providing that charges on aircrafts and interests in them were registrable.
- Section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures should be deleted.
- In view of the fact that charges over personal chattels were still registrable under the reference to bills of sale in some comparable jurisdictions and that the existing system did not seem to cause any problems, section 80(2)(c) of the CO requiring the registration of a charge created or evidenced by an instrument which if executed by an individual would require registration as a bill of sale, should be retained.
- The term “book debts” should be left to the courts to define. A lien on subfreights and a charge over cash deposits should be expressly excluded from the registration requirement.
- The automatic statutory acceleration of repayment in section 80(1) of the CO should be replaced 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.
- Both the instrument of charge and prescribed particulars should be registrable and open to public inspection. The Registrar should issue a certificate as to the fact that the prescribed particulars of the charge (in a specified form) and the instrument of charge have been delivered to the CR. The certificate would show the name of the company creating the charge, the name of the specified form containing the prescribed particulars of the

charge delivered and the date on which such specified form together with the instrument of charge were submitted to the CR for registration. The reference in section 83(2) regarding “conclusive evidence” of compliance with all registration requirements will be deleted. The CR should no longer issue a certificate of due registration.

- The period to register a charge should be shortened to 21 days.
- For the purpose of section 85 of the CO, evidence for payment/release together with the specified application form should be registered and open to public inspection.
- An administrative mechanism for late registration of charges should not be introduced.

## CHAPTER 3

### Statutory Derivative Action

#### **Background**

- 3.1 The SCCLR considered a paper prepared by the Companies Bill Team on possible amendments to the statutory derivative action (“SDA”) provisions under Part IVAA (sections 168BA to 168BK) of the CO arising out of a Court of Final Appeal decision in *Waddington Ltd. v Chan Chun Hoo and others*<sup>9</sup> (“the Waddington case”).
- 3.2 The SDA provisions allow a member of a company to bring an action on behalf of the company in respect of a misfeasance<sup>10</sup> committed against the company. Only “simple” derivative actions can be made under the SDA provisions i.e. only current members of the company have the standing to seek leave to commence action or to intervene in proceedings. The SDA provisions do not operate to abolish the common law rights of members to bring proceedings on behalf of the company.
- 3.3 In the Waddington case, the Court of Final Appeal affirmed the Court of Appeal’s decision that an action by a shareholder of a parent company on behalf of a subsidiary or a second or lower tier subsidiary is maintainable under the common law. Such action is commonly referred to as “multiple” derivative action.
- 3.4 The SCCLR considered two issues :-
- (a) whether the SDA provisions should be expanded to cover multiple derivative actions
  - (b) whether common law derivative action should be abolished.

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<sup>9</sup> FACV No. 15 of 2007

The Court of Final Appeal made (inter alia) the following comments :-

(a) It is appropriate for the CO to be amended to take in “multiple” derivative actions as there is no justification for excluding them from the statutory scheme (para 26 of the judgment of Mr Justice Riberio PJ).

(b) It would appear to be appropriate for the statutory regime to replace the common law derivative action altogether (para 32 of the judgment of Mr Justice Riberio PJ).

<sup>10</sup> Misfeasance is defined as “fraud, negligence, default in compliance with any enactment or rule of law, or breach of duty” in section 168BB(2) of CO.

**Recommendation**

- 3.5 The SCCLR recommended that SDA provisions should be extended to cover multiple derivative actions<sup>11</sup>.
- 3.6 As to the question of whether common law derivative actions should be abolished, there was no consensus and the SCCLR recommended that the issue should be highlighted for public consultation in the context of consultation on the draft Companies Bill.

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<sup>11</sup> Proposed amendments to the SDA provisions to cover multiple derivative actions (by allowing a member of a related company of a Hong Kong or non-Hong Kong company to bring a SDA under the SDA provisions) have been included in the Companies (Amendment) Bill 2009 which is planned to be introduced to the Legislative Council in late 2009. The proposed amendments would also allow a shareholder in a subsidiary to take action on behalf of another subsidiary of the same holding company and a shareholder of a subsidiary to take action on behalf of the holding company.



## CHAPTER 4

### Share Capital and Miscellaneous Provisions on Shares

#### **Background**

- 4.1 Based on the SCCLR's previous recommendations, the FSTB issued a Consultation Paper covering Share Capital, the Capital Maintenance Regime and Statutory Amalgamation Procedure on 26 June 2008.<sup>12</sup> The public consultation ended on 30 September 2008. At the 211<sup>th</sup> meeting on 3 January 2009, the SCCLR considered the recommendations in the draft consultation conclusions prepared by FSTB.<sup>13</sup>
- 4.2 Furthermore, at the same meeting, the SCCLR considered the recommendations put forward by the CO Rewrite Advisory Group 1 ("AG1") relating to certain technical and miscellaneous provisions on shares in the CO which covered the following subjects :-
- Share Capital
  - Allotment of Shares
  - Certificates, Transfer and Transmissions
  - Class of Shares

#### **Recommendation**

##### **(I) Share Capital**

- 4.3 The SCCLR endorsed all the recommendations in relation to share capital in the draft consultation conclusions. The proposals are summarised below :-
- (a) **Mandatory no-par**
- A mandatory system of no-par value shares should be adopted for all companies with a share capital. There would be a period of 24 months for companies to review their arrangements before migration to

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<sup>12</sup> SCCLR's previous recommendations on share capital were summarised in Chapter 3, SCCLR's Annual Report 2007/2008. Recommendations concerning capital maintenance and statutory amalgamation procedure will be discussed in Chapter 5 below.

<sup>13</sup> The consultation conclusions were issued in February 2009 and are available at the "Companies Ordinance Rewrite" website ([www.fstb.gov.hk/fsb/co\\_rewrite](http://www.fstb.gov.hk/fsb/co_rewrite)).

no-par<sup>14</sup>.

**(b) Issue price**

- There should be no legislative control over the setting of the issue price of no-par value shares. It would be sufficient to rely on the directors' fiduciary duty in making issues only on terms that the company received adequate consideration for the issue.

**(c) Merger and reconstruction reliefs**

- In a no-par environment, where shares were issued as consideration for the transfer or cancellation of another company's shares in the context of a merger, the relief relating to share premiums<sup>15</sup> should apply to the amount in excess of the subscribed capital of the acquired company attributable to the shares acquired or cancelled.
- Where shares were issued as consideration for the transfer of assets in the context of group reconstructions, the relief<sup>16</sup> should apply to the excess of the consideration for the shares over the base value of the assets transferred.

**(d) Capitalization of profits**

- The following should be allowed in a no-par environment :-
  - (i) capitalization of profits with or without an issue of shares;
  - (ii) issuance of bonus shares without the need to transfer amounts to share capital;
  - (iii) consolidation and subdivision of shares;
  - (iv) redeemable shares.

**(e) Authorized capital**

- The requirement for authorized capital should be removed. A company with a share capital should be able to specify the maximum number of shares it could issue in its Articles of Association. As a saving provision for existing companies, the number of shares into

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<sup>14</sup> The SCCLR previously endorsed AG1's recommendation that the review period should be one year. Please see Chapter 3, SCCLR's Annual Report 2007/2008.

<sup>15</sup> Section 48C of the CO

<sup>16</sup> Section 48D of the CO

which the share capital was divided would be deemed to be the maximum number of shares that the company could issue. The companies might vary or abolish the restriction by ordinary resolution.

**(f) Partly paid shares**

- The option of having partly paid shares should be retained. The amount unpaid on partly paid shares would be defined by reference to the issue price, without a need to distinguish between shares issued before and after migration to no-par. Where partly paid shares without a par value were subdivided, there would be reallocation (by legislation) of the outstanding liability on existing shares to the new shares to maintain the pre-existing ratios.

4.4 In addition, the SCCLR endorsed a number of technical provisions relating to share capital put forward by AG1. The recommendations are summarized as follows :-.

**(a) Denomination of share capital**

- There should be a provision, like similar provisions in the CA 2006<sup>17</sup>, on denomination and redenomination of share capital by reason of a conversion of capital into another currency to put beyond doubt the common law position if Hong Kong adopts a mandatory no-par system.

**(b) Partly paid shares**

- Section 52 of the CO, which provided for an exception to the rule that a company had the right to make a call for any or all of the remainder of the agreed capital contribution for a partly paid share, was no longer useful and should be deleted.
- The liability for redenominated partly paid shares should remain in the currency in which the share was originally denominated and this should be legislated for.

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<sup>17</sup> Section 542(3) of the CA 2006 provides that shares may be denominated in any currency and different classes of shares can be denominated in different currencies. Section 622 enables any limited company, subject to contrary provision in its articles, to redenominate its shares by ordinary resolution of its members, at prevailing rates of exchange.

(c) **Consolidation and Subdivision**

- The power conferred by the CO<sup>18</sup> on companies to subdivide and consolidate its shares should be exercisable without express authorization of the articles, provided that such exercise should be subject to exclusion or restriction by the articles.

(d) **Payment of interest on capital**

- Section 57 of the CO, which provided for the power of a company to pay interest out of capital in certain cases, should be removed from the CO.

(II) **Allotment of Shares**

4.5 The SCCLR endorsed all the recommendations made by AG1 relating to allotment of shares. The recommendations are as follows :-

(a) **Shareholders' approval**<sup>19</sup>

- Shareholders' consent for allotments should remain mandatory for all Hong Kong companies.
- The requirement for shareholders' consent for allotment should be extended to the grant of rights to subscribe for, or to convert any security into, unallotted shares in the company. Specific provision should be made so that, if an approval was given to an option, such approval would be extended to approval of allotment of shares subsequently made pursuant to that option.
- A rights issue and an allotment to the founder members (both of which are exceptions to the requirement currently provided under section 57B of the CO) and a bonus issue should be excluded from the requirement of shareholders' approval in section 57B of the CO.
- The CO (section 57B) should not allow authorizations to continue for longer than the next annual general meeting.

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<sup>18</sup> Section 53 of the CO

<sup>19</sup> Section 57B of the CO provides that the directors shall not without the prior approval of the company in general meeting exercise the power of the company to allot shares except for a rights issue or allotment to founder members. The United Kingdom has generally dispensed with shareholder consent for private companies.

- An ordinary resolution of the company's members should not be sufficient for the purposes of giving, varying, revoking or renewing authority to the directors under section 57B of the CO if the effect of the resolution was to alter the company's articles of association (which would require a special resolution of members). Therefore, no change should be made to section 57B to clarify this position.

**(b) Consequences of unauthorized allotments**

- Section 57B(7) of the CO should be revised to make it clear that :-
  - (i) Nothing in section 57B should affect the validity of any allotment of shares; and
  - (ii) Nothing in section 57B should require the approval for the allotment to the subscribers of a company's memorandum of shares in the company which, by subscribing to the memorandum, they had agreed to take<sup>20</sup>.
- The SCCLR further suggested that section 57C should be amended to cover shares issued or allotted invalidly for any reason other than by reason of breach of section 57B(1).
- Members generally agreed that the proposed amendments should be included in the Companies (Amendment) Bill if it was practically possible.<sup>21</sup>

**(c) Time of allotment**

- The time of allotment should not be defined as in section 558 and 559 of CA 2006<sup>22</sup>, i.e. the status quo should be maintained<sup>23</sup>.

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<sup>20</sup> The Court of First Instance in *Wong Kam San v Yeung Wing Keung* [2007] 2 HKLRD 267 held that section 57B(7) was concerned only with the allotment to the first subscribers. This point was not challenged on appeal, which was dismissed.

<sup>21</sup> The Administration proposes to amend the Chinese text of section 57B(7) to remove any ambiguity in interpretation. The proposed amendment has been included in the Companies (Amendment) Bill 2010.

<sup>22</sup> The reason was that defining the time of allotment would introduce uncertainty and it would be difficult for the Companies Registry to know whether a return of allotment was late if the time of allotment was defined in the manner of the CA 2006. Normally the time of allotment would be the date of resolution for the allotment.

<sup>23</sup> Section 45 of the CO requires a return of allotment to be made within one month of allotment but does not define the point when allotment takes place.

(d) **Registration of allotment**

- Registration of allotments should be required in the manner of section 554 of the CA 2006<sup>24</sup>.

(e) **Return as to allotments**

- If Hong Kong moved to a no-par system and removed the requirement to state an authorized capital, the particulars of the special rights attached to each class of shares should be included in a return of allotment as required by the “prescribed information” under section 555 of the CA 2006<sup>25</sup>. There should be contained in the return of allotment an additional item as regards the updated position of the share capital and register of members of the company.

(f) **Contract for share paid otherwise than in cash**

- Section 45 of the CO should not continue to require a company to provide a copy of the contract with the allottee (where relevant) and it should be sufficient for the company to provide the particulars of the contract regardless of whether the contract for allotment is reduced in writing or not.

**(III) Certificates, Transfers and Transmissions**

4.6 The SCCLR endorsed AG1’s recommendations concerning transfers and transmissions of shares with some additional suggestions as follows :-

(a) **Refusal to register transfer**

- A company should give notice to a transferee or transmittee its refusal to register the transfer or transmission. However, whether it should be made obligatory for a company to give, together with the notice, reasons explaining its refusal to register a transfer should be put for public consultation.

(b) **Transmission by operation of law**

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<sup>24</sup> Section 554 of the CA 2006 requires a company to register an allotment of shares as soon as practicable and in any event within two months after the date of the allotment.

<sup>25</sup> Section 555 of the CA 2006 requires a company to register a return of allotment which must contain the prescribed information (i.e. prescribed in regulations or by order made under the Act) and be accompanied by a statement of capital. The information to be set out in the statement of capital includes prescribed particulars of the rights attached to each class of shares.

- Section 69(1A) of the CO should be amended by redrafting the proviso making it clear that in the case of a transmission of shares by operation of law, the shares were transmitted with any pre-emption right that might be conferred by the articles in relation to those shares, provided that the pre-emption right was construed to apply to a transmission of shares by operation of law.
- The SCCLR suggested that the revised proviso should be transferred to become a separate subsection instead of as a proviso to section 69(1A). The reason was that the present structure of section 69(1A) was conceptually misleading. The section itself focused on refusal to register a transfer, while the proviso dealt with a transmission by operation of law, which came logically before the former.

(c) **Share warrants**

- The ability to issue share warrants under the CO<sup>26</sup> should not be retained, following the Singaporean approach<sup>27</sup>. Existing share warrants would be grandfathered.

**(IV) Classes of Shares**

4.7 The SCCLR endorsed all the recommendations of AG1 relating to classes of shares, which are summarized as follows :-

(a) **Class rights**

- No changes should be made on the kinds of variation of class right that require class consent<sup>28</sup>. The matter should be left for further case law development.
- Class rights (as used in the CO) should be restricted to rights attached to shares only. The position should be explicitly set out in the manner of section 246B of the Australian Corporations Act<sup>29</sup>.

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<sup>26</sup> Section 73 of the CO

<sup>27</sup> Section 66 of the Singapore Companies Act prohibits a company from issuing any share warrant stating that the bearer of the warrant is entitled to the shares therein specified and which enables the shares to be transferred by delivery of the warrant.

<sup>28</sup> Section 63A of the CO

<sup>29</sup> Section 246B of the Australian Corporations Act provides that for companies with a share capital the rights are those attached to shares in a class of shares; and for companies without a share capital the rights are those of members in a class of members.

- The SCCLR further suggested that amendments to the terms “special rights” and “special classes” in section 63A and 64 of CO to better reflect their true nature should be considered.

**(b) Issue of further shares**

- Regulation 5 which provided that an issue of further shares ranking pair passu with the existing shares of a class was not regarded as a variation of rights of that class of shares, should not be removed from Table A of the CO<sup>30</sup>.
- A provision along the lines of section 629 of the CA 2006<sup>31</sup> should be adopted.

**(c) Variation of class rights for companies with share capital**

- Section 63A of the CO should be simplified following the UK model set out in sections 630(2) to (4) of the CA 2006<sup>32</sup>.

**(d) Class meetings**

- Class meeting requirements should be separately provided for under the Division on “Meetings” in the Companies Bill in the manner of sections 334 and 335 of the CA 2006<sup>33</sup>.
- Companies should be required to notify members of the affected class of any variation or cancellation of class rights along the line of section 246B(3) of the Australian Corporations Act<sup>34</sup>. The timeframe for notification should be 14 days. The sanction for failure to notify

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<sup>30</sup> Members of AG1 did not see any need to remove Regulation 5 even though the absence of express provision was not thought to change the position as established by case law.

<sup>31</sup> Section 629 of the CA 2006 provides that shares are of one class if the rights attached to them are in all respects uniform notwithstanding that they do not carry the same rights to dividends in the 12 months immediately following their allotment. Thus the issuance of further shares with similar rights part-way through a financial year would not create different classes of shares notwithstanding that the rights to dividends would be different.

<sup>32</sup> Section 630(2) & (4) of the CA 2006 provide that rights attached to a class of shares may be varied –

(a) in accordance with provisions in the company’s articles, or  
(b) where the articles contain no such provisions, if the holders of at least three quarters in nominal value of the issued shares of that class consent to the variation or a special resolution is passed at a separate class meeting sanctioning the variation.

<sup>33</sup> Sections 334 and 335 of the CA 2006 provide for the requirements as to quorum and poll in relation to a meeting in connection with the variation of class rights.

<sup>34</sup> Section 246B of the Australian Corporations Act requires a company to give written notice of the variation or cancellation to the members of the class.



should be similar to that for failure to fulfil other obligations to notify the Registrar.

(e) **Companies without a share capital**

- The statutory protection in the CO<sup>35</sup> for variation of class rights for companies with a share capital should be extended to companies without a share capital. The UK model<sup>36</sup> should be adopted.

(f) **Right to object to variation**

- The right to object in section 64 of the CO should be extended to variations pursuant to the statutory procedure and variations of class rights of members of companies without a share capital.

(g) **Documents relating to class rights**

- The disclosure requirements in section 64A of the CO should be extended to the variation of class rights, the cancellation of class rights and the conversion of shares in a class to shares in another class.
- The disclosure requirements in section 64A of the CO should be extended to companies without a share capital. Section 64A should continue to require the filing with the CR of documents or resolutions attaching rights to any class of shares which were not otherwise required by the CO to be filed<sup>37</sup>. A company should also be required to lodge with the CR documents or resolutions that varied or cancelled class rights attached to shares of the company.

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<sup>35</sup> Sections 63A and 64 of the CO

<sup>36</sup> Section 631 of the CA 2006

<sup>37</sup> In the United Kingdom, only the prescribed particulars are required to be registered (Sections 555 and 556 of the CA 2006).

## CHAPTER 5

### Capital Maintenance Rules and Statutory Amalgamation Procedure

#### **Background**

- 5.1 AG1 had made a number of recommendations relating to capital maintenance and the solvency test approach. The key ones are as follows :-
- The current capital maintenance regime and capital maintenance rules<sup>38</sup> should be replaced by the solvency test approach<sup>39</sup> which should be measured on a combined cash flow and balance sheet basis.
  - The solvency requirement should apply to all forms of distribution including buy-backs, reduction of capital and any transfer of money or property (other than the company's own shares) to or for the benefit of the shareholders and the incurring of a debt to or for the benefit of them.
  - All directors who voted in favour of the distribution should be required to sign a certificate setting out that they had conducted the solvency test and stating their opinion that the company was solvent.
  - There should not be any requirement for the directors' certificate of solvency to set out the grounds for the opinion. Nor should the certificate be audited, be in the form of a statutory declaration, be registered with the CR, or be made available for inspection at the company's registered office or at the general meeting for the approval of the distribution.
- 5.2 At the 208<sup>th</sup> meeting on 12 April 2008, the SCCLR considered the recommendations made by AG1. Members were mostly of the view that the current rule that dividend should be declared out of distributable profit worked well and should not be changed. There was no apparent need to change the current capital maintenance regime even though other jurisdictions had adopted

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<sup>38</sup> Sections 47A to 48, 48B to 50 and 58 to 62 of the CO contain the provisions commonly referred to as the capital maintenance rules.

<sup>39</sup> There are traditionally two types of solvency tests : the cash flow (or liquidity) test and the balance sheet (or net assets) test. The cash flow test basically requires the company to be able to meet all debts as they fall due, whilst the balance sheet solvency test requires that liabilities must not exceed assets.

the solvency test approach.

- 5.3 Members generally agreed that the proposed change from the court-based capital maintenance regime to the director-based solvency regime was a step to modernize the company law. However, the benefits of the solvency regime did not outweigh the problems and risks associated with it. The proposal should be put out for public consultation.
- 5.4 The FSTB conducted public consultation on Share Capital, the Capital Maintenance Regime and Statutory Amalgamation Procedure in the third quarter of 2008.<sup>40</sup> At the 211<sup>th</sup> meeting on 3 January 2009, the SCCLR considered the recommendations in the draft consultation conclusions prepared by FSTB.

### **Recommendation**

#### **(I) The Capital Maintenance Regime**

- 5.5 The SCCLR endorsed the recommendation that the solvency test approach to creditor protection should not be adopted across all forms of distribution. A wider use of the solvency test should, however, be adopted for reduction of capital, buy-backs and financial assistance.
- 5.6 However the SCCLR had not endorsed the recommendation that the balance sheet test should be added in the solvency test requirement for reduction of capital, buy-backs and financial assistance. Members generally agreed that the solvency test under section 49K(3) of the CO was sufficiently good for the purpose of protecting the interests of creditors. The proposal of adding a balance sheet test to the solvency test was not justified as the proper application of the cash flow test would render the balance sheet test more or less redundant.
- 5.7 The SCCLR suggested that the Companies Bill Team should carry out a study on whether the solvency test should be amended to better protect creditors and to work out how it would be applied in different provisions throughout the Companies Bill. Members agreed that the study should be carried out in consultation with a small core group of SCCLR members<sup>41</sup>.

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<sup>40</sup> Please see Chapter 4 on issues concerning share capital. For SCCLR's recommendations on the capital maintenance regime, please see paragraphs 5.2 and 5.3 above. Previous recommendations on statutory amalgamation procedure are summarised in Chapter 7, SCCLR's Annual Report 2007/2008.

<sup>41</sup> The small core group met on 7 March 2009 and recommended maintaining the status quo but standardizing the solvency test for the processes of reduction of capital, shares buy-back and

5.8 Members also endorsed the following recommendations in relation to the capital maintenance regime, subject to minor modifications :-

**(a) Reduction of share capital**

- A court-free procedure based on solvency test should be introduced as an alternative process for reduction of capital. The court-free procedure should be applicable to all companies, and all directors would be required to sign a solvency declaration.
- Members further recommended that the wording of the declaration should be changed to ensure that directors had made due and reasonable enquiries before coming to the opinion expressed in the solvency statement.

**(b) Purchase of own shares (buy-backs)**

- The current provisions in the CO on buy-backs<sup>42</sup> should be amended to allow all companies (whether listed or unlisted) to fund buy-backs regardless of the source of funds, subject to a solvency requirement in a manner similar to that of the Singapore Companies Act<sup>43</sup>.

**(c) Treatment of repurchased shares**

- There was no need to legislate for treasury shares<sup>44</sup>.

**(d) Financial assistance**

- The current financial assistance provisions in the CO should be streamlined in a manner similar to the New Zealand Companies Act<sup>45</sup> and should be applied to all companies. The detailed provisions should be set out in the Companies Bill for further consultation.

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provision of financial assistance following the approach in section 47F(1)(d) of the CO. The recommendation was subsequently endorsed by the SCCLR by circulation.

<sup>42</sup> Sections 49B to 49S of the CO

<sup>43</sup> Section 76F of the Singapore Companies Act.

<sup>44</sup> The CO requires all repurchased shares to be cancelled. A number of jurisdictions including the United Kingdom, Singapore and New Zealand give their companies the option to hold the shares bought back in treasury, so that the shares bought back are not inevitably cancelled.

<sup>45</sup> Sections 76 to 80 of the New Zealand Companies Act allow financial assistance with a solvency certification by the directors, provided that the board has resolved that the company should give the assistance, that it is in the best interest of the company and that the terms are fair and reasonable and either that :

- (1) there is unanimous shareholder approval; or
- (2) the procedure for special assistance is followed; or
- (3) the financial assistance does not exceed 5% of shareholders' funds.

## **(II) Statutory Amalgamation Procedure**

5.9 The SCCLR endorsed the recommendation that a court-free statutory amalgamation procedure for amalgamation of intra-group companies should be introduced. The elements of the procedure should follow those for “short form amalgamation”<sup>46</sup> along the lines of the Singaporean model<sup>47</sup>, except that the board of directors of each amalgamating company should make a solvency statement in relation to the amalgamating company in addition to the one in relation to the amalgamated company. As regards amalgamations involving insolvent companies or companies not within the same group, the existing requirement for court sanction should be retained.

5.10 Members also agreed that the form of solvency statements to be used in the court-free amalgamation procedure should align with those applicable to other parts of the Companies Bill, and be considered together.<sup>48</sup>

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<sup>46</sup> Under both the Singapore Companies Act and the New Zealand Companies Act, there are two forms of court-free amalgamation procedure. The “short form amalgamation” procedure applies to intra-group amalgamation i.e. amalgamation of a holding company with one or more of its wholly-owned subsidiaries, or an amalgamation of two or more wholly-owned subsidiaries of the same holding company. The “long form amalgamation” procedure applies to merger of other companies.

<sup>47</sup> Sections 215D to 215G of the Singapore Companies Act

<sup>48</sup> Subsequently, the SCCLR endorsed the following requirements to be adopted in the solvency statements :-

- (a) as regards the amalgamating company’s situation at the date of the solvency statement, there is no ground on which the amalgamating company could then be found to be unable to pay its debts; and
- (b) the amalgamated company will be able to pay its debts as they fall due during the period of 12 months immediately after the date on which the amalgamation is to become effective. In forming their opinion, the directors shall take into account the “contingent and prospective liabilities” of the amalgamated company.