

# Part 4

## Share Capital

### INTRODUCTION

Part 4 (Share Capital) of the new Companies Ordinance (Cap. 622) (“new CO”) contains provisions relating to the core concept of “share capital” and its creation, transfer and alteration.

### POLICY OBJECTIVES AND MAJOR CHANGES

2. Part 4 contains initiatives that aim at modernising the law (subparagraphs (a) and (b) below), enhancing corporate governance (subparagraphs (c) and (d)), ensuring better regulation (subparagraph (e)), and facilitating business operation (subparagraphs (f) and (g)), namely –

- (a) Adopting a mandatory system of no-par for all companies with a share capital (paragraphs 4 to 9);
- (b) Removing the power of companies to issue share warrants to bearer (paragraphs 10 to 12);
- (c) Extending the requirement of shareholders’ consent for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares (paragraphs 13 to 14);

- (d) Requiring a company to give reasons explaining its refusal to register a transfer of shares upon request (paragraphs 15 to 16);
- (e) Requiring a company to deliver to the Companies Registry (“CR”) a return or notification, including a statement of capital whenever there is a change to its capital structure (paragraphs 17 to 19);
- (f) Clarifying and simplifying the requirements relating to class rights (paragraphs 20 to 23); and
- (g) Simplifying the publication procedures for replacement of lost share certificate of a listed company (paragraphs 24 to 25).

3. The details of the above major changes in Part 4 are set out in paragraphs 4 to 25 below.

#### **Adopting a mandatory system of no-par for all companies with a share capital (Section 135 and Division 2 of Part 4 of Schedule 11)**

#### Position under the Companies Ordinance (Cap. 32) (“Cap. 32”)

4. Par value (also known as “nominal value”) is the minimum price at which shares can generally be issued. Companies incorporated in Hong Kong under Cap. 32 and having a share capital are required to have a par value ascribed to their shares.

### Position under the new CO

5. The par value does not serve the original purpose of protecting creditors and shareholders, and in fact may even be misleading because the par value does not necessarily give an indication of the real value of the shares. The new CO adopts the mandatory system of no-par and abolishes relevant concepts such as nominal value, share premium, and requirement for authorised capital. Deeming provisions are introduced to ensure that contractual rights defined by reference to par value and related concepts will not be affected by the abolition of par (see paragraph 9 below). The deeming provisions will save considerable work, expense and time for companies and reduce the possibility of disputes. It will not prevent individual companies from reviewing their documents and introducing more specific changes having regard to their own circumstances before the new CO comes into force.

### Key provisions in the new CO

6. **Section 135** abolishes the concept of nominal value. Upon the commencement of that section, a company's shares will have no nominal value. This will apply to all shares, including shares issued before that day. It is expected that the new CO will take effect in 2014 after enactment of all subsidiary legislation. The "no-par" regime will take effect at the same time. (Please also see the deeming provisions in paragraph 9 below).

7. **Section 170**, modified from section 53 of Cap. 32, empowers a company to alter its share capital in a number of ways under a no-par environment, e.g. to allow a company to capitalize its profits without issuing new shares and to allot and issue bonus shares without increasing share capital.

8. With the abolition of nominal value, "share premium" will no longer exist. Provisions based on this concept will be modified. **Section 37 of Schedule 11** (Transitional and Saving Provisions) is a legislative deeming provision for the amalgamation of the existing share capital amount with the amount in the company's share premium account (and also capital redemption reserve) immediately before the migration to no-par. **Section 38 of Schedule 11** is 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. As for the position after the migration to no-par, **section 149** of the new CO provides that a company may apply its capital in writing off the preliminary expenses of the company, commission paid or any other expenses of any issue of shares. **Sections 194 to 199** modify the merger and group reconstruction relief under sections 48C to 48E of Cap. 32, so that the two types of relief may operate in a no-par environment.

9. **Sections 35 to 41 of Schedule 11** contain transitional provisions relating to migration from shares having nominal value to shares having no nominal value. The provisions (particularly the statutory deeming provision in **section 40**) are intended to provide legislative safeguards to ensure that contractual rights defined by reference to par or nominal value and related concepts will not be affected by the migration to no-par.

### Removing the power of companies to issue share warrants to bearer (Section 139 and section 14 of Schedule 11)

#### Position under Cap. 32

10. Under section 73 of Cap. 32, a non-private company limited by shares is allowed to issue “share warrants to bearer” (i.e. a warrant stating that the bearer of the warrant is entitled to the shares specified in it, also known as bearer shares)<sup>1</sup>. It is possible for legal title to shares to be transferred merely by physical delivery of the warrant.

#### Position under the new CO

11. Share warrants are rarely issued nowadays and are undesirable from the perspective of anti-money laundering because of the lack of transparency in the recording of their ownership and the manner by which they are transferred. Under the new CO, the power of companies to issue share warrants to bearer is removed.

#### Key provisions in the new CO

12. **Section 139** repeals a company’s power to issue “share warrants to bearer” while providing that share warrants issued prior to the commencement of that section would be grandfathered, so that upon the surrender of such existing share warrants, the bearer’s name will be registered in the company’s register of members. The section partially restates section 97 of Cap. 32 to provide for the surrender of share warrants. **Section 14 of Schedule 11** provides that the records in the register of members in respect of existing share warrants would be preserved until the share warrants are surrendered.

### Extending the requirement of shareholders’ consent for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares (Sections 140 and 141)

#### Position under Cap. 32

13. The allotment of shares is generally carried out by directors. Under section 57B of Cap. 32, directors are only entitled to do that with prior approval of the company in a general meeting. The requirement of shareholders’ approval is mandatory and notwithstanding any provision in the company’s articles to the contrary. There are only two exceptions to this rule, namely, (a) a rights issue; and (b) an allotment to the founder members (section 57B(1) and (7) of

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<sup>1</sup> “Share warrants to bearer” are different from “warrants” listed on the stock exchange. “Share warrants to bearer” are an alternative form of title document evidencing the ownership of shares. “Warrants” listed on the stock exchange, on the other hand, are instruments which only give an investor the right to buy or sell the underlying shares. Moreover, “share warrants to bearer” enable the shares specified in it to be transferred by delivery of the warrant. “Warrants” listed on the stock exchange may be traded, but their transfer simply gives the transferee a right to buy or sell the underlying shares and does not make him or her a member until the option is exercised.

Cap. 32). However, section 57B only requires shareholders' approval for the allotment of shares, but not the grant of an option to subscribe for shares or a right to convert any securities into shares. It is only the subsequent exercise of the option or the right of conversion that would result in an allotment which would require shareholders' approval.

#### Position and key provisions in the new CO

14. To enhance protection of minority shareholders against dilution, **sections 140 and 141** extend the requirement of shareholders' approval for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares. If approval is given for the grant of an option, there would not be a need to obtain further approval of the allotment of shares pursuant to that option.

#### **Requiring a company to give reasons explaining its refusal to register a transfer of shares upon request (Section 151(3) and (4))**

##### Position under Cap. 32

15. Section 69(1) of Cap. 32 requires a company which refuses to register transfer of shares or debentures to send a notice of such refusal to the transferor and transferee within two months after the transfer was lodged with the company.

#### Position and key provisions in the new CO

16. Currently, there is no requirement for the notice to be accompanied by the reasons for the refusal. **Section 151(3) and (4)** require companies to give reasons explaining their refusal to register a transfer of shares upon request and within 28 days after receiving the request, so as to enhance transparency and to ensure that directors only exercise their powers for proper purposes.

#### **Requiring a company to deliver to the CR a return or notification including a statement of capital whenever there is a change to its capital structure (Section 201)**

##### Position under Cap. 32

17. A statement of capital is in essence a "snapshot" of a company's total subscribed capital at a particular point in time. Under Cap. 32, the capital structure of a company can only be ascertained by searching through a number of documents on the register, e.g. the annual return, any return of allotment filed since the annual return, any documents filed in relation to, e.g. a permitted reduction of capital. It is therefore not easy to ascertain the capital structure at a specific moment in time without a thorough check of the register.

## Position and key provisions in the new CO

18. Under Cap. 32, information on a company's share capital structure in the public register may not be up-to-date. The new CO requires a company to deliver to the CR such a statement to be contained in a return or notification, whenever there is a change to its capital, e.g. where there is an allotment of shares (**section 142**) or a permitted alteration of share capital (**section 171**). A statement of capital will show the company's share capital information as at the time the company has so changed its share capital.

19. **Section 201** sets out the information to be contained in a statement of capital. This new requirement enhances the requirements under Cap. 32 for notification to the CR of changes of a company's share capital. This will ensure that the public register contains up-to-date information on a company's share capital structure.

## **Clarifying and simplifying the requirements relating to class rights (Sections 176 to 193)**

### Position under Cap. 32

20. Sections 63A and 64 of Cap. 32 set out the requirements for a variation of class rights of shareholders. Cap. 32 does not define the concept of class rights, which gives rise to some uncertainties. Section 63A is also complicated in relation to the procedures for variation, which differ depending on where the class rights are provided for, and whether the articles contain a procedure for variation. Under section 63A, variation of class rights needs to follow any requirements set out in the articles. If the articles do not contain the requirements, then section 63A requires different types of approvals (e.g. approved by members holding 75% of the shares or approval by all members) depending on whether the rights are set out in the memorandum. Cap. 32 is silent in the case of companies without a share capital.

## Position and key provisions in the new CO

21. For companies with share capital, the provisions on class rights under **sections 176 to 184** refer to "rights attached to shares in a class of shares". This clarifies that the concept of class rights is restricted to rights attached to shares. Also, **section 177** clarifies that class rights are the rights conferred on the holder of a share as a member of the company. To provide further guidance on the meaning of a class of shares, **section 178** provides that shares are in a class if the rights attached to them are in all respects uniform, and are not regarded as different only because the shares do not carry the same rights to dividends in the first 12 months immediately after allotment.

22. **Section 180** sets out the procedural requirements for the variation of the rights of a class of members of a company having a share capital, i.e. the rights may be varied in accordance with the articles or with 75% consent or special resolution of the class members. This simplifies the Cap. 32 procedures mentioned in paragraph 20 above. **Section 181** requires the company to notify each class member if the rights of the class are varied. **Section 182** allows members holding at least 10% of the total voting rights of the class to apply to the Court of First Instance to have a variation disallowed. **Section 184** requires the company to notify the CR with a specified form (including a "statement of capital") of a variation within one month after the variation takes effect.

23. **Sections 185 to 192**, mirroring the corresponding provisions in **sections 176 to 184**, provide for variation of class rights for companies without a share capital. This fills the gap in Cap. 32 which is silent in the case of companies without a share capital.

## Simplifying the publication requirements relating to the replacement of lost share certificate of a listed company (Sections 162 to 169)

### Position under Cap. 32

24. Section 71A of Cap. 32 provides that where a person applies to the company for replacement of a lost certificate, the company has to publish a notice before issuing the new certificate. If the value of the shares does not exceed the threshold amount of \$20,000, the notice shall be published once in an English and Chinese newspaper respectively; if it exceeds \$20,000, the notice shall be published in the Gazette once in each of three consecutive months. The listed company is also required to publish a notice in the Gazette after the new certificate is issued.

### Position and key provisions in the new CO

25. Given the cost involved in publishing a notice, some consider that the threshold amount should be raised and the publication requirements streamlined. **Sections 162 to 169** based on section 71A of Cap. 32 simplify the publication requirements, taking account of developments in information technology (e.g. website publication). Under **section 164**, for cases where the value of the shares is below \$200,000 (instead of \$20,000 in Cap. 32), the notice will be published on the listed company's website for one month (instead of newspapers in Cap. 32). For cases where the value of shares is at or above \$200,000, the notice will be published on the listed company's website for three months and once in the Gazette within one month after the company has first published the notice on its own website (instead of publishing the notice in the Gazette once in each of three consecutive months under Cap. 32). For cases where the value of the shares is below \$200,000, the listed company is no longer required to publish a notice in the Gazette after the new certificate is issued. The notice may be published on its website.

## ACTIONS TO BE TAKEN BY STAKEHOLDERS

26. Despite the comprehensive transitional provisions for existing companies, individual companies may wish to review their particular situation before commencement of the new CO to determine whether or not they need to introduce more specific changes to their documents as a result of the migration to the no-par regime. For example companies may review their constitutional documents, contracts entered into by the company, trust deeds involving the company and share certificates issued by the company to see if they require to make any specific changes. Companies are advised to seek independent legal advice as they see fit.

## TRANSITIONAL AND SAVING ARRANGEMENTS

27. The transitional arrangements for migration to a mandatory system of no-par are explained in paragraphs 8 and 9. The transitional arrangements for removing the power of companies to issue share warrants to bearer are explained in paragraph 12. The other major changes described in these Highlights apply to activities carried out after the commencement date of the new CO. For activities which started under Cap. 32 and are in progress when the new CO commences, the Cap. 32 provisions will continue to apply.