

CHAPTER 1

INTRODUCTION

Background

- 1.1 The CO¹ is one of the longest and most complex pieces of legislation in Hong Kong, with over 600 sections and subsections and 24 schedules. It provides the legal framework for the operation of all companies in Hong Kong². It, dates from 1932, was last substantially reviewed in 1984, and is broadly in line with the major UK company law reforms contained in the Companies Act 1948 and some subsequent reforms, such as those contained in the Companies Act 1976.
- 1.2 The CO has been amended several times in recent years³. The piecemeal approach to amending the CO, however, has its limitations. We have reached a stage where a comprehensive rewrite of the CO is needed to modernise our company law to further enhance Hong Kong's status as a major international financial and business centre. With the support of the Legislative Council, the FSTB launched a comprehensive rewrite of the CO in mid-2006.

Benefits of Rewriting the Companies Ordinance

- 1.3 The rewrite exercise will help modernise the CO and take forward reforms in respect of those areas which have not been reviewed previously, such as the capital maintenance provisions and company names provisions dealing with the problems posed by “shadow companies”⁴. Antiquated concepts, such as the underlying assumption of paper-based communications between a company and its members and the concept of “par value”, will need to be changed, updated or simplified.

¹ Available at <http://www.legislation.gov.hk>

² As at the end of 2007, there were 655,038 companies which were formed and registered locally in Hong Kong, of which 645,986 were private companies and 9,052 were public companies. There were 8,081 non-Hong Kong companies registered under the CO.

³ The amendments were covered in several amendment ordinances, most notably the Companies (Amendment) Ordinance 2003, the Companies (Amendment) Ordinance 2004 and the Companies (Amendment) Ordinance 2005. The amendments included, among other things, allowing the formation of one-member companies, enhancing shareholders' remedies (including the introduction of a statutory derivative action); and amending the definition of the term “subsidiary” for the purposes of group accounts to make it closely align with the International Accounting Standards.

⁴ 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 or trade names when contracting with Mainland manufacturers to produce counterfeit products bearing such trademarks or trade names.

- 1.4 The rewrite will improve the structure of the parts and sections and enhance the clarity of the provisions of the CO so as to make the law more accessible to users. With streamlined and modernised provisions, our company law will meet more fully the needs of and help save compliance and business costs incurred by companies (local or non-Hong Kong) registered in Hong Kong, especially the SMEs. It will also benefit relevant stakeholders, such as company shareholders, directors, creditors and auditors. For example, by updating the provisions regarding directors' conflicts of interest and disclosure requirements, the rewrite will further strengthen corporate governance in Hong Kong. It is believed that all these will lead to enhanced market confidence in incorporating and registering companies under the new CO to undertake business in Hong Kong.
- 1.5 The rewrite also provides an opportunity for Hong Kong to leverage from the developments regarding company law in other major common law jurisdictions such as the UK, Australia, Singapore and New Zealand.

The Guiding Principles

- 1.6 The rewrite exercise is guided by the following key principles⁵:

- ***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 compliance costs of companies, particularly private companies and SMEs.

- ***Enhancing corporate governance***

The rewrite aims to strengthen corporate governance⁶, taking into account the interests of stakeholders, such as members and creditors, and considering other relevant factors, such as corporate social responsibility initiatives in the company law of comparable

⁵ In addition, there are a few guiding principles concerning drafting and format:

- To consider expressing general principles of law that have been clearly established by decided cases by way of statutory statements, where appropriate.
- To rationalise and simplify the provisions and modernise the language; to make the new CO more readable and understandable without losing certainty and precision.
- To use schedules, subsidiary legislation or non-statutory codes, where appropriate, to contain detailed requirements to facilitate the regular updating of the law in the future.

⁶ Building upon the recommendations of the SCCLR in the CGR conducted from 2000 to 2003.

jurisdictions. Public companies should be subject to enhanced regulation where appropriate. For listed companies, the new CO should complement the regulatory regime contained in the SFO and the Listing Rules.

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

The new CO should 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.

Progress Made and Future Work

- 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.
- 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 SCCLR⁷ which plays a key role in advising on all major proposals to reform the CO, as well as that of four dedicated AGs comprising representatives from relevant professional and business organisations, academics and members of the SCCLR. With thanks and due credit to the efforts and generous support of the Chairmen and Members, the four AGs have now completed most of their work. The current membership of the SCCLR and AGs respectively is at **Appendix I**.

⁷ Members of the SCCLR include representatives of the SFC, Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as individuals from relevant sectors and professions such as accountancy, legal and company secretarial. Please see <http://www.cr.gov.hk> for further information.

- 1.9 We have commissioned an external legal consultant⁸ to study and formulate proposals on certain complex areas of the CO, including the share capital and debentures (Part II of the CO), distribution of profits and assets (Part IIA) and registration of charges (Part III).
- 1.10 We conducted a three-month public consultation on proposals to reform the accounting and auditing provisions of the CO from March to June 2007. A total of 32 submissions from 30 deputations were received during the consultation period. We have considered the submissions in consultation with the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group and the SCCLR. The consultation conclusions are now available on the CO rewrite website⁹. The final proposals will be incorporated into the White Bill to be issued around mid-2009 for further public consultation.
- 1.11 The White Bill will enable the public to comment on all the proposals in a holistic manner before the Companies Bill is introduced into the Legislative Council, tentatively in the third quarter of 2010.
- 1.12 The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver's Office, will be reviewed in the second phase. We intend to start a scoping and background study in late 2008 before formulating the details of the second phase. Those parts of the CO concerning prospectuses will be dealt with in a separate review by the SFC and likely to be transferred from the CO to the SFO.

Seeking Comments

- 1.13 Meanwhile, we have identified a number of topical issues where we hope to benefit from public comments before incorporating them into the White Bill. The present consultation covers the following:
- (a) company names;
 - (b) directors' duties;
 - (c) corporate directorship; and
 - (d) registration of charges.

The key proposals are described in Chapters 2 to 5 below.

⁸ 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.

⁹ http://www.fstb.gov.hk/fsb/co_rewrite

- 1.14 The remaining issues, such as share capital, capital maintenance rules and statutory amalgamation procedures will be covered in another consultation paper to be issued in mid-2008.
- 1.15 To enhance the readability of each proposal, we will start with a brief background of the relevant issues and our considerations before presenting the details of the proposed changes or amendments. Where appropriate, we will make reference to similar provisions in other common law jurisdictions, such as the UK, Australia and Singapore. The questions for consultation are set out under different sections in each chapter and a list of all questions for consultation is extracted at the back of this document after Chapter 5.
- 1.16 As the proposed changes or amendments will have significant implications for companies and different stakeholders including the directors, shareholders, investors, creditors and relevant professionals, we would like to invite public comments before drafting the White Bill. The comments received will help us ensure that the relevant legislative proposals will suit Hong Kong's circumstances.