

CO Rewrite

Rewrite of the Companies Ordinance

Consultation Paper

Draft Companies Bill
Second Phase Consultation

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 the draft clauses of the Companies Bill (“CB”). The first phase of the public consultation, covering Parts 1 to 2, 10 to 12 and 14 to 18 of the CB, was conducted between 17 December 2009 and 16 March 2010. The second phase consultation now covers the remaining parts of the CB, namely Parts 3 to 9, 13 and 19 to 20*. Several issues are also highlighted for consultation.
2. After considering the views and comments, we will refine the CB. We aim to introduce it into the Legislative Council by the end of 2010.
3. A list of questions for consultation is set out for ease of reference after Chapter 5. Please send your comments to us on or before **6 August 2010**, by one of the following means:

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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.

* A revised Part 1 with some added and revised definitions is also included in the Consultation Draft.

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 Nick AU YEUNG (see paragraph 4 above for contact details).

ACKNOWLEDGEMENT

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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
FRC	Financial Reporting Council
FRCO	Financial Reporting Council Ordinance (Cap 588)
FS	Financial Secretary
FSTB	Financial Services and the Treasury Bureau
HKEx	Hong Kong Exchanges and Clearing Limited
HKICPA	Hong Kong Institute of Certified Public Accountants
LegCo	Legislative Council
Listing Rules	Non-statutory rules made by the Stock Exchange of Hong Kong, as contractual obligations that listed companies undertake to the Stock Exchange of Hong Kong to fulfill
NZCA	New Zealand Companies Act 1993
Registrar	Registrar of Companies
SCA	Singapore Companies Act (Cap 50)
SCCLR	Standing Committee on Company Law Reform

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 consultation, covering Parts 1, 2, 10 to 12 and 14 to 18 of the CB, was conducted from 17 December 2009 to 16 March 2010. This current second phase consultation covers the remaining Parts, namely Parts 3 to 9, 13, 19 and 20*.
3. This paper will:
 - (a) highlight several issues for consultation; and
 - (b) contain explanatory notes on the relevant draft Parts.

Issues Highlighted for Consultation

4. While we welcome public views on all draft clauses of the CB contained in this second phase consultation, there are several specific issues which we would like to highlight in particular for consultation:
 - (a) we have attempted to streamline the rules on giving financial assistance by a company for the purpose of acquiring its own shares in a manner similar to the NZCA. The details are set out in Division 5 of Part 5 of the CB. However, the New Zealand model does not completely address the issue of the provisions being "a trap for the unwary", particularly for private companies. We therefore propose to revisit the option of abolishing the financial assistance rules for private companies (*Chapter 2*);
 - (b) we propose to drop the proposal to impose a requirement for all listed companies and unlisted companies where members holding not less than 5% of voting rights have so requested to prepare separate directors' remuneration reports along the lines of those prepared under the UKCA 2006. The main concerns are (a) improvements to the

* A revised Part 1 with some added and revised definitions is also included in the Consultation Draft.

disclosure of the remuneration of directors of listed companies is better pursued through amendments to the Listing Rules and/or the SFO and (b) the requirements on directors' remuneration reports are designed primarily for listed companies and would be too onerous for private companies (*Chapter 3*);

- (c) we propose some minor changes to the provisions concerning the investigation of a company's affairs and enquiry into a company's affairs that may be exercised by the FS, as well as new provisions empowering the Registrar to obtain documents, records and information in certain circumstances (*Chapter 4*); and
- (d) we would like to seek views on whether a company should be required to give reasons explaining its refusal to register a transfer of shares (*Chapter 5*).

Future Work

5. This consultation will last until 6 August 2010. We will refine the CB in the light of public comments received and introduce the CB into LegCo by the end of 2010.

CHAPTER 1

INTRODUCTION

Background

- 1.1 In mid-2006, the FSTB 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.
- 1.2 In rewriting the CO, we have conducted extensive consultation on major reform proposals. We have benefited from the advice of the SCCLR, as well as that of four dedicated AGs and the Joint Government/HKICPA Working Group¹. We have also commissioned an external legal consultant² to study and formulate proposals on certain complex areas of the CO. Furthermore, we conducted three public consultations in 2007 and 2008 to gauge views on certain complex subjects.
- 1.3 Based on the views received as well as the recommendations of the SCCLR and AGs, we have prepared the draft CB for further public consultation. Given that the draft CB is lengthy, we are conducting the public consultation on the draft clauses in two phases. We issued the consultation document and the draft clauses of the first phase consultation on 17 December 2009³. Details about the background and the guiding principles of the CO rewrite have already been set out in the first phase consultation paper⁴. The first phase consultation covered Parts 1 to 2, 10 to 12 and 14 to 18 of the CB.

¹ 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.

² 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.

³ FSTB, *Consultation Paper on Draft Companies Bill – First Phase Consultation and Companies Bill – Consultation Draft: Parts 1, 2, 10-12 & 14-18* (December 2009) (available at http://www.fstb.gov.hk/fsb/co_rewrite).

⁴ FSTB, "Chapter 1: Introduction", *Consultation Paper on Draft Companies Bill – First Phase Consultation* (December 2009).

- 1.4 The second phase consultation now covers **Parts 3 to 9, 13 and 19 to 20**⁵. The framework of the draft CB indicating the Parts covered in each phase is at **Appendix 1**.
- 1.5 As set out in the first phase consultation paper, the key legislative changes in the CB that are relevant to this second phase consultation includes:

Enhancing Corporate Governance

- Improving disclosure of company information by requiring public companies and larger private companies to furnish more analytical and forward-looking business review as part of the directors' report (Part 9);
- Strengthening auditors' rights to obtain information for performing their duties (Part 9).

Ensuring Better Regulations

- Removing disclosure requirements in the Tenth and Eleventh Schedules of the CO that duplicate with financial reporting standards (Part 9);
- Streamlining and updating the regime of registration of charges (Part 8);
- Giving the Registrar powers to obtain documents, records and information for the enforcement of certain provisions (Part 19);
- Updating the provisions on company investigations (Part 19);
- Empowering the Registrar to compound specified offences (Part 20).

Business Facilitation

- Allowing more private companies and small guarantee companies to take advantage of simplified accounting and reporting requirements so as to save their compliance and business costs (Part 9);
- Introducing an alternative court-free procedure for the reduction of share capital based on a solvency test (Part 5);
- Allowing all companies to purchase their own shares out of capital subject to a solvency test (Part 5);

⁵ A revised Part 1 with some added and revised definitions is also included in the Consultation Draft. Some savings/transitional provisions and the consequential amendments to other Ordinances are not covered in the Consultation Draft. These provisions and amendments will be added to the CB when it is finalised for introduction into LegCo.

- Streamlining the financial assistance provisions (Part 5) (We are inviting comments on whether the financial assistance rules should be further streamlined in Chapter 2);
- Introducing a court-free statutory amalgamation procedure for wholly-owned intra-group companies (Part 13);
- Making the keeping and use of a common seal optional (Part 3).

Modernising the Law

- Abolishing the par value regime and adopting a mandatory system of no-par for all companies with a share capital (Part 4);
- Removing the requirement for authorised capital (Part 4).

Other Relevant Legislative Initiatives

Companies (Amendment) Bill 2010

- 1.6 To tie in with the launch of CR's services for electronic incorporation of companies and filing of documents in late 2010/early 2011, the Companies (Amendment) Bill 2010⁶ was introduced into LegCo on 3 February 2010. Amendments will also be made to the Business Registration Ordinance (Cap 310) to facilitate one-stop simultaneous application for company incorporation and business registration. With simultaneous application in place, processing of an electronic application for incorporation of a local company and business registration will be shortened from an average of four working days under the existing system to within one day. This will put Hong Kong on a par with comparable jurisdictions like the UK and Singapore. The proposed amendments are being examined by a LegCo Bills Committee.
- 1.7 The Bill also introduces a number of other amendments to the CO to facilitate business and enhance corporate governance. The significant amendments include:
- (a) expediting the company name approval process while giving the Registrar new powers to enhance enforcement against abuses of the company name registration system, including acting upon a court order

⁶ The Companies (Amendment) Bill 2010 is available at <http://www.legco.gov.hk/yr09-10/english/bills/b201001221.pdf>.

to direct a company to change its infringing name, and substituting that name with the company's registration number if it fails to comply with the Registrar's direction;

- (b) facilitating companies to communicate with their members through electronic means and websites;
- (c) expanding the scope of statutory derivative action by allowing a member of a related company to commence or intervene in a statutory derivative action on behalf of the company; and
- (d) introducing technical amendments to the CO to remove, or provide exceptions to, the limitations arising from provisions in the CO that compel the use of paper documents of title and paper instruments of transfer in relation to shares and debentures.

Phase Two of CO Rewrite

1.8 In view of the extensive nature of the CO rewrite exercise, we have adopted a phased approach by first tackling the core company provisions which affect the daily operation of 790 000 live companies in Hong Kong. The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver's Office, will be reviewed in Phase Two of the rewrite exercise which is expected to be launched after the CB has been enacted by LegCo. Pending the Phase Two rewrite, a number of Parts in the current CO (e.g. Part IVA - Disqualification of Directors and Part V - Winding Up) will remain in Cap 32 which will be renamed the Companies (Winding-up Provisions) Ordinance⁷. Upon the completion of the entire rewrite exercise, the remaining provisions in Cap 32 which are covered by the Phase Two rewrite will be merged into the new Companies Ordinance.

1.9 Other than the CO rewrite exercise, there are several reviews relating to the CO being undertaken in parallel. These reviews are briefly outlined below.

The Prospectus Regime

1.10 The rewrite exercise does not cover provisions concerning prospectus in the CO (namely sections 37 to 44B, section 48A, sections 342 to 343, the Third and Fourth Schedules as well as the Seventeenth to the Twenty-second Schedules) as the prospectus regime in the CO is under separate review by the SFC.

⁷ This is a provisional title and is subject to change. The CB, upon passage by LegCo, will be assigned a new chapter number.

- 1.11 The SFC has proposed to transfer the regulation of public offers of shares or debentures which are structured products currently under the CO prospectus regime to the offers of investments regime in the SFO⁸. Under the proposal, unless an exemption applies, unlisted structured products (regardless of their legal form), their offering documents and marketing materials will have to be authorised under the SFO before being offered to the public. This will allow the SFC greater flexibility to regulate public offers of unlisted structured products by setting out appropriate standards in the new Code on Unlisted Structured Investment Products. We intend to introduce the relevant legislative amendments into LegCo within 2010.
- 1.12 The SFC is also examining other reform proposals concerning the prospectus regime (including transferring the whole prospectus regime from the CO to the SFO, changing the regulatory focus of the prospectus regime from the documents containing the offer to the act of offering, and other measures to modernise the regime). The SFC aims to issue a public consultation paper in the first half of 2011 before finalising the proposals.

Scripless Securities

- 1.13 The SFC, the HKEx and the Federation of Share Registrars Limited jointly issued a consultation paper on 30 December 2009 on a proposed operational model to introduce a scripless securities market in Hong Kong⁹. The scripless consultation closed on 31 March 2010. Meanwhile, as a first step in the entire legislative process for implementing a scripless securities market, we have included technical amendments in the Companies (Amendment) Bill 2010 to remove, or provide exceptions to, the limitations arising from the provisions on scrip-based shares and debentures presently found in the CO (see paragraph 1.7(d) above). These technical amendments will lay the foundation for implementing a scripless securities market in Hong Kong. They also aim to help the market focus discussions on specifics of the proposed operational model which was the subject of the scripless consultation. The proposed amendments, if approved by LegCo, will come into operation only when the market is ready to implement a scripless model.
- 1.14 Additionally, further legislative amendments, including to the SFO and the CO, will be pursued as necessary to provide for the regulation of the scripless environment and persons who play a key role in that environment.

⁸ See SFC, *Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance* (October 2009) (available at www.sfc.hk).

⁹ SFC, HKEx and Federation of Share Registrars Limited, *Joint Consultation Paper on a Proposed Operational Model for Implementing a Scripless Securities Market in Hong Kong* (December 2009) (available at <http://www.sfc.hk>, <http://www.hkex.com.hk/index.htm> and <http://www.fedsrltd.com/index.php>).

These amendments will need to take into account the operational model that is eventually agreed upon, and must therefore be developed in light of responses to the scrippless consultation. Any such further amendments will be aligned with and incorporated into the CB as appropriate.

Insolvent Trading

- 1.15 The FSTB issued a consultation paper on 29 October 2009 on the review of the legislative proposals to introduce a corporate rescue procedure in Hong Kong¹⁰. The public consultation ended on 28 January 2010. One of the proposals is to make directors and shadow directors of a company personally liable for the debts of the company which traded while insolvent if they knew or ought reasonably to have known that the company was insolvent or there was no reasonable prospect that the company could avoid becoming insolvent. Under the proposal, the liquidator of a company will be empowered to make an application to the court to seek a declaration that a responsible director or shadow director is liable for insolvent trading when the company goes into liquidation.
- 1.16 The proposed insolvent trading provisions are intended to be applicable to companies in general and not only in the context of companies undergoing the proposed corporate rescue procedure. Subject to the outcome of the consultation, the provisions may be introduced by way of amendments to the CO.

Outline of Consultation Paper

- 1.17 This consultation paper should be read together with the Consultation Draft of Parts 1, 3 to 9, 13 and 19 to 20 of the CB being published in parallel. It comprises the following:
- **Chapters 2 to 5** highlight specific issues for consultation. They are:
 - (a) financial assistance by a company for acquisition of its own shares (*Chapter 2*);
 - (b) directors' remuneration report (*Chapter 3*);
 - (c) investigations and enquiries (*Chapter 4*); and
 - (d) notice of refusal to register a transfer of shares (*Chapter 5*).

¹⁰ FSTB, *Consultation Paper on Review of Corporate Rescue Procedure Legislative Proposals* (October 2009) (available at <http://www.fstb.gov.hk/fsb/ppr/consult/index.htm>).

- A **list of all the questions** for consultation will be set out after Chapter 5.
- **Explanatory notes** on the draft clauses of Parts 1, 3 to 9, 13 and 19 to 20.

Seeking Comments

1.18 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, 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.

Future Work

1.19 This consultation will last until 6 August 2010. We will revise the draft CB, taking into account the comments received during the consultation. Our aim is to introduce the CB into the LegCo by the end of 2010.

CHAPTER 2

FINANCIAL ASSISTANCE BY A COMPANY FOR ACQUISITION OF ITS OWN SHARES

- 2.1 We have streamlined the financial assistance provisions in a manner similar to the NZCA in the CB. The details can be found in the Explanatory Notes on Part 5 and the draft clauses in Division 5 of Part 5 of the CB. We would however like to seek comments on the option of abolishing the prohibition on financial assistance¹¹ for private companies, as an alternative to the said new rules on financial assistance.

Background

- 2.2 Section 47A of the CO imposes a broad prohibition on a Hong Kong company (and its subsidiaries) giving financial assistance to a party (other than the company itself) for the purpose of acquiring shares in the company. Certain exceptions are set out in section 47C and special restrictions apply to listed companies (section 47D). Unlisted companies are provided with an additional exception premised upon passing a solvency test and subject to a special resolution of the shareholders (section 47E)¹². One of the purposes of the prohibition is to prevent the resources of a company and its subsidiaries being used to assist a purchaser of the shares in the company which might be prejudicial to the interests of creditors or shareholders not involved in the relevant acquisition.
- 2.3 However, the rules on financial assistance have become so complex and the case law has imposed an increasingly broad interpretation on the prohibition such that companies would have to incur substantial costs and expenses to try to understand the rules so as to ensure that the rules are not violated. In some cases, directors acting in good faith involved in transactions intended for the benefit of the company but unwary of the prohibition may be caught without even knowing that they had violated the law. We believe this is particularly relevant to private companies which have relatively fewer resources and may not always be able to afford the cost of obtaining legal advice.

¹¹ The financial assistance prohibition referred to in this Chapter is the prohibition under the CO against the provision by a Hong Kong company (or any of its subsidiaries) of financial assistance for the purpose of acquiring the shares in the Hong Kong company. This is different from the requirements relating to the giving of "financial assistance" in Listing Rules (e.g. in chapters 13, 14 & 14A), which are requirements imposed on the giving of "financial assistance" in a general sense (e.g. granting credit, lending money, providing security for, or guaranteeing a loan) and not just relating to the acquisition of a company's own shares.

¹² The assistance must be provided out of distributable profits to the extent that the net assets are reduced by the assistance.

- 2.4 The possibility of innocuous transactions being penalised by the prohibition has caused some concern. A case in point is where a payment by a company's subsidiary of a small fee for preparing an accountant's report for a genuine arms length acquisition of its holding company's shares was considered to be unlawful for breach of the rule prohibiting financial assistance¹³. The acquisition was clearly in the shareholders' interest, was not prejudicial to the company, and carried no additional risks for its creditors¹⁴. The directors in this case were found to be in breach of their fiduciary duties to the company and held personally liable to restore the amount of the assistance to the company. As seen in this case, the most difficult area of the financial assistance rules is identifying financial assistance (which may sometimes be referred to as "a trap for the unwary"), rather than what to do about it once it has been identified¹⁵. Indeed, if the fee concerned had been paid by the holding company, no question of financial assistance would probably have arisen¹⁶.
- 2.5 In the topical public consultation¹⁷ conducted in the third quarter in 2008, we asked whether the current financial assistance provisions should be streamlined in a manner similar to the NZCA. While respondents generally considered that the current provisions should not be retained as they are, views were divided on the changes to be introduced, with a slight majority proposing that the current financial assistance provisions should be streamlined in a manner similar to the NZCA. Quite a number of respondents supported the abolition of the prohibition in respect of private companies (as the UK has done) to remove complex and costly procedures.
- 2.6 We have attempted to streamline the financial assistance provisions in a manner similar to the NZCA. The details are set out in Division 5 of Part 5 of the CB and the relevant Explanatory Notes on Part 5. Generally

¹³ *Chaston v SWP Group Ltd* [2003] 1 BCLC 675.

¹⁴ See Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (London: Sweet & Maxwell, 8th edn, 2008), page 347, at paragraph 13 to 30.

¹⁵ See Nigel Davis, "Financial Assistance: Time for a Little Recap and a Lot of Reform", *Hong Kong Lawyer*, August 2007, pages 49 to 55, which discusses the problems associated with the financial assistance rules.

¹⁶ This is because the fees only came within the statutory definition of "financial assistance" because the assistance was of a type which materially reduced the net assets of the company. The subsidiary held few assets and so the fees were relatively significant compared with the subsidiary's assets. But the fees would not have been significant compared with the assets of the holding company. So if the holding company had paid the fees, the assistance would not have been caught by the statutory definition. See Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (London: Sweet & Maxwell, 8th edn, 2008), page 346, at footnote 248.

¹⁷ See FSTB, *Consultation Paper on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (July 2008), paragraphs 3.35 to 3.41 and *Consultation Conclusions on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (February 2009), paragraphs 48 to 51 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

speaking, a company will be allowed to give financial assistance¹⁸, regardless of the source of funds, subject to satisfaction of the solvency test and compliance with requisite procedures applicable to the following three scenarios where:

- (a) the amount of financial assistance will not exceed 5% of the shareholders' fund (**Clause 5.79**);
- (b) unanimous approval of the shareholders is obtained for the financial assistance (**Clause 5.80**); or
- (c) a notice is given to shareholders regarding the financial assistance and allowing shareholders to object to the court (**Clauses 5.81 to 5.85**).

In each case, the financial assistance must also be in the interests of the company.

2.7 Adopting the New Zealand model does not completely address the issue of the provisions being “a trap for the unwary”, particularly for private companies which have fewer resources and the costs of obtaining legal advice could be a heavy burden for them. While we are open to comments on how the financial assistance rules can be further streamlined, there appears to be grounds for revisiting the option of abolishing the financial assistance rules for private companies. We would like to invite further public views on the option of abolishing the restrictions on financial assistance for private companies before taking a final decision.

Considerations

2.8 We need to strike a reasonable balance between two concerns, namely (a) addressing the problem of a “trap for the unwary”, particularly for private companies; and (b) preserving the protection for small investors, which is particularly relevant to public companies.

2.9 It may be argued that only the abolition option can offer a satisfactory solution to the problem of “a trap for the unwary”, especially for private companies. Streamlining the provisions would simplify the “whitewash” procedures and benefit the well advised, but probably not private companies which may not always be able to afford the costs of obtaining legal advice.

¹⁸ There are certain qualifications and exceptions to financial assistance (such as the principal purpose exception, the distribution of dividends lawfully made, the lending of money in the ordinary course of business or pursuant to an employee share option scheme). Financial assistance within these exclusions or carve-outs are not prohibited, and consequently do not need authorisation via the solvency based procedures in subdivision 4 in Division 5 in Part 5. See subdivision 3 in Division 5 in Part 5 for these exceptions.

- 2.10 Some jurisdictions have opted for abolition of the financial assistance prohibition. The financial assistance prohibition has long been abolished in the United States and a number of provinces in Canada (British Columbia, Alberta, Ontario and Québec). It was repealed in its entirety in the federal Canada Business Corporations Act in 2001. More recently the UK abolished it for private companies. It has been retained for public companies, largely because the Second European Community Directive was thought to stand in the way of a full elimination¹⁹.
- 2.11 In considering whether the financial assistance rules should be abolished for private companies, it is worth mentioning that the prohibition on financial assistance was a statutory development and was not enunciated by the 19th century judges as part of the capital maintenance regime and may not have any impact on the company's legal capital. If a company lends money to someone to purchase its shares, the company's share capital, share premium account and capital redemption reserve²⁰ will not be in any way altered by that loan or by the subsequent purchase of the shares. Nor does the rule on financial assistance necessarily reduce the company's net asset position. If the borrower is able to repay the loan, the company is simply replacing one asset (cash) with another (loan) and possibly the latter will earn the company a higher rate of return²¹.
- 2.12 There are two propositions that we need to consider before deciding whether to keep the financial assistance rules in respect of private companies in the statute. First, can we identify any problem that would not be effectively dealt with by other company law rules? Second, even if a problem or a gap is identified and the only way to deal with this gap is by the financial assistance rules, are we sure that the benefit is not outweighed by the cost of striking down innocuous transactions?
- 2.13 For the first question, it may be argued that the risks posed by unwise or unscrupulous financial assistance are, currently, sufficiently covered by other more targeted legal provisions, such as directors' fiduciary duties and the duty of care, the requirements for exercise of directors' powers for proper purposes and minority shareholder remedies²².

¹⁹ Maisie Ooi, "The Financial Assistance Prohibition: Changing Legislative and Judicial Landscape", [2009] *Singapore Journal of Legal Studies* 135, 142.

²⁰ We proposed in Part 4 of the CB to adopt a mandatory system of no-par for all companies with a share capital, with a transition period of not less than 24 months. Without par, there will no longer be share premium and capital redemption reserve. See Explanatory Notes on Part 4 for details.

²¹ See Paul L Davies, Gower and Davies' *Principles of Modern Company Law* (London: Sweet & Maxwell, 8th edn, 2008), page 342, at paragraphs 13 to 26.

²² This view is shared by the UK Company Law Review Steering Group; see UK Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (March 2000), pages 232 to 234.

- 2.14 It should be noted that a number of improvements to be made to these provisions in the CB are being considered. These improvements include:
- (a) codifying directors' duty of care, skill and diligence;
 - (b) enhancing corporate governance such as in the area of connected transactions involving directors and their associates; and
 - (c) enhancing the rules on shareholder remedies, including improving the operation of the unfair prejudice remedy and statutory derivative action²³.

Moreover, we intend to introduce a duty on directors to prevent insolvent trading under the legislative proposals for a corporate rescue procedure²⁴. The insolvent trading provisions, if adopted, will create a substantial disincentive for directors to sanction financial assistance which reduces the company's assets in a way that endangers creditors. When these improvements are in place, there would be a more robust regulatory scheme to tackle the risks currently dealt with by the financial assistance rules.

- 2.15 For the second question, as the UK Company Law Review Steering Group has noted, it seems anomalous to target specifically one possible violation of directors' duties or oppression of minorities, particularly where to do so may well inhibit a range of transactions which do not harm third parties and which benefit the company²⁵. Taking into account the developments mentioned in paragraphs 2.13 and 2.14 above, it follows that there is a strong argument for abolishing the financial assistance rules for private companies. Abolition of the restrictions on financial assistance would result in savings to private companies in time and costs that would be incurred in carrying out the "whitewash" procedure, without adversely affecting the protections for their shareholders and creditors.
- 2.16 The considerations for public companies (including both listed and unlisted public companies) may be somewhat different. When reviewing the CO in 2000, the SCCLR noted that the rationale of the financial assistance provisions was to prevent looting of a company by bidders in leveraged takeovers and that the primary concern was for minority shareholders who

²³ See FSTB, "Chapter 2, Enhancing Corporate Governance", *Consultation Paper on Draft Companies Bill First Phase Consultation* (December 2009), particularly paragraphs 2.4 to 2.7 and 2.22 to 2.24.

²⁴ FSTB, "Chapter 6: Insolvent Trading", *Consultation Paper on Review of Corporate Rescue Procedure Legislative Proposals* (October 2009).

²⁵ See footnote 22, paragraph 7.24 at page 233.

remained in the company after a successful takeover²⁶. As a safeguard for small investors, it seems doubtful whether we should go so far as abolishing the financial assistance rules in respect of public companies altogether. Moreover, the concern about the provisions being “a trap for the unwary” is less relevant to public companies as they should have the resources to obtain legal advice, where necessary.

2.17 There appears to be two possible options for public companies:

- (a) maintaining the status quo, i.e. listed companies would continue to be prohibited from giving financial assistance except for certain exceptions as set out in sections 47C and 47D of the CO (largely equivalent to Subdivision 3 of Division 5 in Part 5 of the CB) while unlisted public companies may give financial assistance subject to a solvency test and a special resolution of the shareholders (section 47E of the CO); or
- (b) adopting the streamlined approach using a solvency test as currently drafted in Division 5 in Part 5 of the draft CB for both listed and unlisted public companies.

We are inclined towards (b). Nevertheless, we would like to listen to public comments before taking a final view.

2.18 On the other hand, if it is considered that financial assistance restrictions are still a useful regulatory tool to protect the interests of creditors and minority shareholders in all public and private companies, comments on whether the draft clauses in Division 5 in Part 5 would achieve the purpose and whether they could be further streamlined are welcome.

Question 1

- (a) Do you agree that the restrictions on financial assistance should be abolished for private companies?**
- (b) If your answer to (a) is positive, which of the following options concerning regulation of listed and unlisted public companies would you prefer –**

²⁶ SCCLR, *The 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 9.92. On the other hand, the SCCLR also noted in the Report the defects of the existing provisions: they are cumbersome, difficult to apply and result in unnecessary costs; they sometimes result in the non-completion of transactions which would be economically beneficial; and parties determined to circumvent the current prohibitions can succeed in so doing.

(i) existing rules for listed and unlisted public companies in the CO be retained (i.e. listed companies cannot give financial assistance except for certain exceptions as set out in sections 47C and 47D of the CO while unlisted public companies may give financial assistance subject to solvency test and a special resolution of the shareholders (section 47E of the CO));

(ii) the rules for both listed and unlisted public companies to be streamlined using a solvency test as set out in the draft clauses in Division 5 of Part 5; or

(iii) any other option (please elaborate),

having regard to the need to protect small investors of public companies?

(c) If your answer to (a) is negative (i.e. you believe that private companies should still be subject to certain restrictions on financial assistance), do you have any specific comments on the draft clauses in Division 5 of Part 5? Please elaborate.

CHAPTER 3

DIRECTORS' REMUNERATION REPORT

- 3.1 We would like to seek further views on whether the CB should require (a) all listed companies incorporated in Hong Kong, and (b) unlisted companies incorporated in Hong Kong where members holding not less than 5% of the total voting rights have so requested, to prepare separate directors' remuneration reports, before taking a final decision on the matter.

Background

- 3.2 At present, section 161 of the CO requires all companies to set out the aggregate amount of the emoluments and pensions of, and compensation paid in relation to loss of office to directors and past directors in the accounts of the company.
- 3.3 All listed companies in Hong Kong are required under the Listing Rules²⁷ to disclose in its financial statements, on a named basis, details of directors' and past directors' emoluments. Such details include the directors' fees for the financial year, their basic salaries as well as other allowances (e.g. housing allowances) and benefits in kind, contributions to pension schemes and bonuses paid for directors, etc.
- 3.4 In view of the increasing public concern over the remuneration of directors, the SCCLR has recommended during Phase II of the CGR that the level of transparency in respect of the disclosure of directors' remuneration packages should be enhanced. To this end, the SCCLR suggested that the CO should be amended to:
- (a) require listed companies to disclose individual directors' remuneration packages by name in their annual accounts; and
 - (b) require unlisted public companies or private companies incorporated in Hong Kong to disclose full details of all elements of individual directors' remuneration packages by name in their annual accounts if members holding not less than 5% of the issued share capital so request.

²⁷ See paragraph 17.07 in Chapter 17 and paragraphs 24 and 28 of Appendix 16 of the Listing Rules (Main Board).

- 3.5 To take forward SCCLR's recommendations, the Joint Government/HKICPA Working Group²⁸ ("Working Group") proposed that a separate directors' remuneration report should be prepared by all listed companies and those unlisted companies whose members have so requested, subject to the thresholds in paragraph 3.4(b).
- 3.6 The Working Group further proposed that the requirements under the CB should be similar to the requirements in Schedule 7A to the UK Companies Act 1985. The requirements are substantially re-enacted in Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("UK Regulations"), relevant extract from the UK Regulations is at **Appendix 2**. The requirements under the UK Regulations are detailed and prescriptive in nature. In gist, the report covers various types of benefits given to individual directors by name, including the basic salary, fees, expenses allowances, benefits in kind, pension benefits and contributions, bonuses, compensation for loss of office, share options and long-term incentive schemes. The information in relation to the directors' benefits is subject to audit and the report should be approved by the board of directors and signed on behalf of the board by a director.
- 3.7 We consulted the public in 2007 on whether the Working Group's proposal should be adopted²⁹. A majority of the respondents supported the proposal regarding the preparation of a separate directors' remuneration report while some of them highlighted the need to strike a balance between transparency and privacy. Views were, however, diverse on the details of disclosure and whether disclosure should be made by name of individual directors³⁰.

Considerations

- 3.8 In Part 9 of the draft CB, we have tentatively provided for a requirement for all listed companies incorporated in Hong Kong and unlisted companies incorporated in Hong Kong if the required number of members have so requested to prepare separate directors' remuneration reports³¹. The detailed requirements would be set out in regulations to be made by the FS

²⁸ It was established in March 2002 to undertake a comprehensive review of the accounting and auditing provisions in Part IV of the CO, which, to a large extent, were not examined in the context of the SCCLR's report on the recommendations of a consultancy report of the review of the CO published in February 2000.

²⁹ See FSTB, *Consultation Paper on Accounting and Auditing Provisions* (March 2007), paragraphs 4.9 to 4.12 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

³⁰ Most respondents supported the proposal in principle. However, views on the details of disclosure were divided. Some respondents considered that all shareholders should have the right to require full disclosure of remuneration packages to directors while others suggested that the disclosure could be limited to remuneration bands rather than by name of each individual director.

³¹ See **Clauses 9.34** and **9.35** in Part 9.

after the CB is enacted. Nevertheless, we have reflected on the desirability of such an approach in consultation with the SFC and HKEx. Our concerns are two-fold.

- 3.9 First, the CO should provide for a legal framework which is applicable to both listed and unlisted companies. Additional requirements on listed companies due to their nature should be set out in the Listing Rules, or if statutory backing is considered necessary, in the SFO³². Currently, all listed companies are already required to disclose in their financial statements detailed information concerning the remuneration of individual directors and past directors under the Listing Rules³³. If regulations based on the UK Regulations are introduced under the CO, listed companies incorporated in Hong Kong would be subject to statutory and prescriptive rules while those incorporated outside Hong Kong would continue to be regulated by non-statutory Listing Rules which are more principle-based. Such a complex regulatory framework with two different sets of rules is difficult to justify, especially as the majority of listed companies are incorporated outside Hong Kong. To avoid confusion and to ensure a level-playing field, any improvements to the disclosure of the remuneration of directors of listed companies is better pursued through amendments to the Listing Rules and/or SFO.
- 3.10 Second, the requirements on directors' remuneration reports under the UK Regulations are designed primarily for listed companies and might be too onerous for unlisted companies. It would increase the compliance costs as most of the information in the directors' remuneration report has to be audited. While the mechanism for members holding not less than 5% of issued shares/voting rights to request a company to prepare such a report is intended to protect the interests of minority shareholders, it could be used as a means to impose an extra burden on the directors or management in case of shareholder disputes. The existing requirements under section 161 of the CO for accounts to include information on directors' emoluments, pensions and compensation for loss of office will be modified to include new disclosures³⁴. Such requirements will be set out in regulations to be made under **Clause 9.27** of Part 9. As the vast majority of unlisted companies in Hong Kong are SMEs and most of them are closely held, the disclosures required under the new regulations should be sufficient.

³² This may involve amending the SFO to empower the SFC to make relevant rules.

³³ HKEx has been conducting a Financial Statements Review Programme, which is a continuous programme of review of a sample of 100 financial reports of listed issuers each year. In the latest report on the programme's findings issued in June 2009, HKEx did not identify any significant non-compliance with the Listing Rules in respect of directors' remuneration disclosures.

³⁴ The additional information required to be disclosed includes the amount of money or benefits received or receivable by directors under the long term incentive schemes and share options, or by third parties in respect of directors' services; and the nature and value of any benefit in kind, or damages or settlement sum for breach of contract, made to directors for loss of office.

3.11 Subject to the public's views, we are inclined not to introduce any requirement in the CB for listed or unlisted companies incorporated in Hong Kong to prepare separate directors' remuneration reports. Any improvements to the disclosure of the remuneration of directors of listed companies may be considered under the Listing Rules and/or the SFO. We would keep under review the need for introducing any statutory disclosure requirements for listed companies in the light of local and international market experience.

Question 2

Do you agree that there is no need to impose a statutory requirement in the CB for all listed companies incorporated in Hong Kong and unlisted companies incorporated in Hong Kong where members holding not less than 5% of voting rights have so requested to prepare separate directors' remuneration reports?

CHAPTER 4

INVESTIGATIONS AND ENQUIRIES

4.1 In Part 19 of the CB, we propose to enhance the provisions relating to company investigations and enquiries currently set out in sections 142 to 152F of the CO and to explicitly provide a new power for the Registrar to obtain documents, records and information for the purposes of ascertaining, as a start, whether any conduct that would constitute an offence relating to false or misleading statements has taken place. This chapter provides background information on the proposals in Part 19 and invites comments on the proposals.

Powers exercised by the FS

Background

4.2 Currently, the CO provides the following:

- (a) **investigation of a company's affairs:** the FS may appoint an inspector with extensive powers to conduct an investigation into the affairs of a company (sections 142 to 151). The appointment may be made under section 142 on members' application (in the case of a company having a share capital, by either not less than 100 members or members holding not less than one-tenth of the shares issued; in the case of a company not having a share capital, by not less than one-tenth in number of the members) or under section 143 in the following circumstances: (i) on the FS's own initiative where there is fraud or mismanagement involved, (ii) upon an order made by the court³⁵ or (iii) on application by a company which passed a special resolution to make the request; and
- (b) **inspection of books and papers:** the FS or a person authorised by him may, in specified circumstances, require a company and any person who appears to be in possession of the company's books and papers to produce those documents and to provide an explanation of them (sections 152A to 152F). This power may provide a discreet and less costly way to assess whether an investigation is warranted upon receiving an application from members under section 142 of the CO. The FS may also invoke the power where there is "good reason" to do so.

³⁵ The appointment must be made under this scenario.

4.3 According to our records, the FS has in the past invoked section 142 or 143 of the CO to appoint inspectors to investigate the affairs of 38 companies. The last appointment was made in 1999. The power to inspect books and papers has never been invoked.

Need for the powers

4.4 Many of the previous investigations undertaken by inspectors involve listed companies or their related companies. Developments in the regulatory framework of listed companies in recent years have reduced the need for the FS to appoint inspectors under the CO to investigate into the affairs of listed companies. Since the coming into operation of the SFO in April 2003, the SFC has greater powers to investigate into market misconduct involving listed companies. The FRC was established in 2006 to conduct independent investigations of possible auditing and reporting irregularities in relation to listed companies. This may help explain the absence of any new investigation by inspectors appointed under the CO in recent years.

4.5 Nonetheless, we cannot rule out the possibility of FS using the investigation and enquiry powers³⁶ in future cases where there are sufficient grounds to do so, especially since the investigation and enquiry powers could cover all types of companies formed or operating in Hong Kong. The provisions should be retained in the CB as “reserve” or “last resort” powers as a supplement to the powers contained in specialised Ordinances, such as the SFO and the Banking Ordinance (Cap 155)) targeting certain types of companies.

Enhancing the provisions

4.6 The SFO and the FRCO both have provisions which empower the SFC and the FRC respectively to carry out investigations. We have made reference to these two pieces of legislation in modernising the provisions in the CB³⁷.

Strengthening investigatory powers of an inspector

4.7 We propose to enhance the investigatory powers of an inspector. For example, we propose to require a person under investigation to preserve records or documents and, by statutory declaration, to verify statements made to the inspector.

³⁶ In Part 19 of the CB, the power to inspect books and papers under the CO is referred to as power to “enquire into company’s affairs” (or “enquiry power” in short) to better described the nature of the power.

³⁷ There has been no major amendment to the relevant provisions in the CO since 1994.

Extending scope to cover companies incorporated elsewhere

- 4.8 We also propose to extend the categories of companies that may be subject to investigation to cover companies incorporated elsewhere that are doing business in Hong Kong.
- 4.9 As regards the appointment of inspectors on the application of members, we will also extend the right to cover registered non-Hong Kong companies, i.e. those companies registered under Part 16 of the CB.

Improving safeguards for confidentiality

- 4.10 In line with similar provisions provided for in SFO and FRCO, we consider it appropriate to provide better safeguards for confidentiality of information and protection of informers.
- 4.11 Details on the three proposals above can be found in the Explanatory Notes on Part 19 and the draft clauses in Divisions 1 to 3 and 5 in Part 19.

Threshold for application to FS for appointment of an inspector

- 4.12 Currently, the threshold for members of a company with share capital to apply to the FS for the appointment of an inspector under section 142 of the CO is:
- (a) members holding not less than one-tenth of the shares issued; or
 - (b) not less than 100 members.

For a company without share capital, the threshold is one-tenth in number of the persons of the company's register of members.

- 4.13 The SCCLR had previously recommended that the number of members making a request under (b) above should be reduced from 100 to 50 while the other thresholds should remain unchanged. The current threshold of 100 members is already lower than similar thresholds in the UK and Singapore (both requiring at least 200 members). Nevertheless, the SCCLR's recommendation had taken into account the current shareholding structure and regime. Currently, a vast majority of the shares in listed companies are held in CCASS, and hence in the name of HKSCC Nominees Limited rather than in the name of the investor that actually holds the beneficial interest in the shares. Moreover, considerable processing time and cost is needed for the beneficial owner to withdraw the shares from

CCASS and register them in his/her own name³⁸. We note that the SFC, HKEx and Federation of Share Registrars Limited have recently put forward a joint proposal for implementing a scripless securities market in Hong Kong which, if implemented, will facilitate investors to hold shares in their own names³⁹. In view of this, we have retained the existing threshold of “not less than 100 members” in **Clause 19.3** of the draft Bill.

Question 3

Do you have any comments on the proposed changes to the provisions concerning the investigation of a company’s affairs and enquiry into company’s affairs that may be exercised by the FS described in paragraphs 4.6 to 4.13, the Explanatory Notes on Part 19 and Divisions 1 to 3 and 5 in Part 19 of the CB?

Enquiries by Registrar

- 4.14 We will also explicitly provide for a new but limited power for the Registrar to obtain documents, records and information for the purposes of ascertaining whether any conduct that would constitute certain offences under the CB, as a start, in relation to **Clauses 15.7(7)** (the equivalent of section 291AA(14) in the CO concerning giving false or misleading information in connection with an application for deregistration of a company) and **20.1(1)** (the equivalent of section 349 in the CO concerning making a statement that is misleading, false or deceptive in any material particular) has taken place.
- 4.15 The two offences, which relate to the provision of false information in documents delivered to the CR help safeguard the integrity of the Companies Register and the quality of information disclosed to the public.
- 4.16 The proposed power would enhance the CR’s enforcement efforts and facilitate the handling of public complaints by improving the quality of the evidence needed for successful prosecution against breaches of the relevant obligations under the CB. As the focus would be on breaches related to filing and routine operational requirements (e.g. complaints against incorrect particulars in a notification of change of particulars of secretary and director, annual return, etc), such enforcement work falls strictly within CR’s purview, and would not duplicate efforts of other regulatory bodies.

³⁸ The issues involving CCASS are discussed in greater details in FSTB, *Consultation Paper on Draft Companies Bill – First Phase Consultation* (December 2009), paragraphs 6.13 and 6.14.

³⁹ SFC, HKEx and Federation of Share Registrars Limited, *Joint Consultation Paper on a Proposed Operational Model for Implementing a Scripless Securities Market in Hong Kong* (December 2009).

4.17 The details of the proposed new power can be found in the Explanatory Notes on Part 19 and the draft clauses in Divisions 1, 4 and 5 in Part 19.

Question 4

Do you have any comments on the proposed new powers for the Registrar to obtain documents, records and information as described in paragraphs 4.14 to 4.17, the Explanatory Notes on Part 19 and Divisions 1, 4 and 5 in Part 19 of the CB?

CHAPTER 5

NOTICE OF REFUSAL TO REGISTER A TRANSFER OF SHARES

- 5.1 Section 69(1) of the CO requires a company which refuses to register a transfer of shares or debentures to send a notice of such refusal to the transferor and transferee within 2 months of the lodgement of the transfer with the company. There is no requirement for the notice to be accompanied by the reasons for refusal to register the transfer. The existing provision for shares is essentially restated in **Clause 4.19** of the CB. Nevertheless, we would like to hear public views on whether we should introduce a new requirement for a company to give reasons explaining its refusal to register a transfer of shares.

Background

- 5.2 At common law, directors of private companies need not give reasons for their decision whether to accept or reject a transfer,⁴⁰ and their failure to give their reasons, either in the resolution embodying their decision or in evidence at the trial, will not be construed against them⁴¹. A dissatisfied transferor or transferee can attack the directors' decision only if he or she can show that they exercised their discretion for an improper purpose or for a reason outside the grounds for rejecting transfers which are specified in the articles⁴². Unless reasons are voluntarily given by the directors, it may be difficult to challenge the directors' decision.
- 5.3 The position is similar under the CO. Although the right of the transferee to apply to the court to have a transfer of shares registered is provided under section 69(1B), the burden of proving that directors have wrongfully disapproved a transfer would be equally difficult as directors are not required to provide grounds for their refusal.
- 5.4 The position of a transmittee of shares by operation of law is different. That person is entitled under section 69(1A) of the CO to call on the company to provide reasons for a refusal to register him or her as member. The company is required to register the transfer if it fails to furnish reasons within 28 days of the request.

⁴⁰ *Duke of Sutherland v British Dominion Land Settlement Corpn* [1926] Ch 746.

⁴¹ *Re Coalport China Co* [1895] 2 Ch 404; Robert R. Pennington, *Pennington's Company Law* (London: Butterworths, 7th edn, 1995), page 1002.

⁴² Robert R. Pennington, *Pennington's Company Law* (London: Butterworths, 7th edn, 1995), page 1002.

Position in the UK

- 5.5 The UKCA 2006 requires a company which refuses to register a transfer (whether of shares or debentures) to give the transferee notice of refusal *accompanied by reasons* as soon as practicable and in any event within two months of lodgement of the transfer (section 771(1)). The transferee has a right to request further information about the reasons for the refusal but such request has to be reasonable, and cannot include a request for copies of meetings of directors (section 771(2)).

Considerations

- 5.6 Where there is a discretion to refuse registration of a transfer of shares, it is for consideration whether directors who refuse to register a transfer should either be required to give reasons (in the manner of the UKCA 2006), or be required upon request to provide reasons (which is currently the position under the CO for transmissions by operation of law).

Pros and Cons

- 5.7 The company's constitution may give directors power in their absolute discretion, or in prescribed circumstances, to refuse to register a transfer of shares, but the discretion is a fiduciary one that must not be exercised fraudulently, capriciously or for a collateral purpose. It is however for the person alleging that the directors' decision is improper to prove it, and this is difficult to discharge if directors are not obligated and do not provide reasons for their refusal to register a transfer. The proposal to require directors to give reasons rectifies this problem, thereby providing for transparency. Giving the reasons may also be helpful to transferors and transferees, particularly when the reason was just because there were pre-emptive rights or the forms were not completed correctly.
- 5.8 However, there is a concern about the proposal in that it will impose a statutory obligation on directors to justify a refusal and would unduly restrict the directors' entrenched right to reject a transfer. This new requirement may encourage litigation, and directors may feel compelled to obtain legal advice before refusing a transfer on discretionary grounds thereby increasing costs. At the same time, it might open a floodgate to dissatisfied transferees, particularly in cases of family disputes. But weighed against this is the transferor's right to transfer the shares, and the transferee's right (as an incident of the transferee's property in the shares) against the company to be registered, which should only be restricted to the extent provided for in the company's constitution and by law, and not otherwise.

- 5.9 The requirement for directors to provide reasons does not mean that family companies can no longer control who can or cannot buy into the shares of the company. It will not interfere with a decision made legitimately, or substitute the court's decision for the directors', made in good faith, as to the interests of the company. The new requirement does not change the legal principles as to whether the directors' refusal to register a transfer is valid or not.
- 5.10 We would like to hear public views before deciding whether to introduce the requirement for a company to give reasons explaining its refusal to register a transfer of shares. In the case of debentures, ownership does not depend on registration and so the debt constituted or evidenced by the debenture is transferred in a manner similar to other choses in action⁴³. For a legal transfer, this will be governed by section 9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23), subject to any restrictions in the terms of the trust deed or agreement. Hence we believe that it is not necessary to introduce the requirement for debentures⁴⁴.

Question 5

- (a) Do you think the CB should make it obligatory for a company to give reasons explaining its refusal to register a transfer of shares?**
- (b) If your answer to (a) is in the affirmative, should the company be required to provide reasons with the refusal:**
- (i) in the manner of the UKCA 2006 (i.e. mandatory whenever there is a refusal); or**
 - (ii) upon request, as in the case of transmissions by operation of law under section 69(1A) of the CO?**

⁴³ Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (London: Sweet & Maxwell, 8th edn, 2008), page 1147.

⁴⁴ For comparison, under section 69(1A) of the CO, a person to whom shares have been transmitted by operation of law is entitled to call on the company to provide reasons for a refusal to register him or her as member. This requirement does not apply to debentures and this position is preserved in the CB.

LIST OF QUESTIONS FOR CONSULTATION

- Question 1
- (a) Do you agree that the restrictions on financial assistance should be abolished for private companies?
- (b) If you answer to (a) is positive, which of the following options concerning regulation of listed and unlisted public companies would you prefer –
- (i) existing rules for listed and unlisted public companies in the CO be retained (i.e. listed companies cannot give financial assistance except for certain exceptions as set out in sections 47C and 47D of the CO while unlisted public companies may give financial assistance subject to solvency test and a special resolution of the shareholders (section 47E of the CO));
 - (ii) the rules for both listed and unlisted public companies to be streamlined using a solvency test as set out in the draft clauses in Division 5 of Part 5; or
 - (iii) any other option (please elaborate),
- having regard to the need to protect small investors of public companies?
- (c) If your answer to (a) is negative (i.e. you believe that private companies should still be subject to certain restrictions on financial assistance), do you have any specific comments on the draft clauses in Division 5 of Part 5? Please elaborate.
- Question 2
- Do you agree that there is no need to impose a statutory requirement in the CB for all listed companies incorporated in Hong Kong and unlisted companies incorporated in Hong Kong where members holding not less than 5% of voting rights have so requested to prepare separate directors' remuneration reports?
- Question 3
- Do you have any comments on the proposed changes to the provisions concerning the investigation of a company's affairs and enquiry into company's affairs that may be exercised by the FS described in paragraphs 4.6 to 4.13, the Explanatory Notes on Part 19 and Divisions 1 to 3 and 5 in Part 19 of the CB?

- Question 4 Do you have any comments on the proposed new powers for the Registrar to obtain documents, records and information as described in paragraphs 4.14 to 4.17, the Explanatory Notes on Part 19 and Divisions 1, 4 and 5 in Part 19 of the CB?
- Question 5 (a) Do you think the CB should make it obligatory for a company to give reasons explaining its refusal to register a transfer of shares?
- (b) If your answer to (a) is in the affirmative, should the company be required to provide reasons with the refusal:
- (i) in the manner of the UKCA 2006 (i.e. mandatory whenever there is a refusal); or
- (ii) upon request, as in the case of transmissions by operation of law under section 69(1A) of the CO?
- Question 6 Do you have any comments on the draft provisions in the CB Consultation Draft – Parts 1, 3 to 9, 13 and 19 to 20? If so, please elaborate.

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 Compulsory Share Acquisition in Takeover and Share Buy-Back		✓
14	Remedies for Protection of Companies' or Members' Interests	✓	
15	Dissolution by Striking Off or Deregistration	✓	

* The titles of some Parts have been revised since the first phase consultation. The titles of Parts are provisional and subject to change.

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

**PART 4
DIRECTORS' REMUNERATION REPORT**

Directors' remuneration report (quoted companies)

11.—(1) The remuneration report which the directors of a quoted company are required to prepare under section 420 of the 2006 Act (duty to prepare directors' remuneration report) must contain the information specified in Schedule 8 to these Regulations, and must comply with any requirement of that Schedule as to how information is to be set out in the report.

(2) In Schedule 8—

Part 1 is introductory,

Part 2 relates to information about remuneration committees, performance related remuneration, consideration of conditions elsewhere in company and group and liabilities in respect of directors' contracts,

Part 3 relates to detailed information about directors' remuneration (information included under Part 3 is required to be reported on by the auditor (see subsection (3)), and

Part 4 contains interpretative and supplementary provisions.

(3) For the purposes of section 497 in Part 16 of the 2006 Act (auditor's report on auditable part of directors' remuneration report), "the auditable part" of a directors' remuneration report is the part containing the information required by Part 3 of Schedule 8 to these Regulations.

**PART 5
INTERPRETATION**

Definition of "provisions"

12. Schedule 9 to these Regulations defines "provisions" for the purposes of these Regulations and for the purposes of—

- (a) section 677(3)(a) (Companies Act accounts: relevant provisions for purposes of financial assistance) in Part 18 of the 2006 Act,
- (b) section 712(2)(b)(i) (Companies Act accounts: relevant provisions to determine available profits for redemption or purchase by private company out of capital) in that Part, and
- (c) sections 831(3)(a) (Companies Act accounts: net asset restriction on public company distributions), 832(4)(a) (Companies Act accounts: investment companies distributions) and 836(1)(b)(i) (Companies Act accounts: relevant provisions for distribution purposes) in Part 23 of that Act.

General interpretation

13. Schedule 10 to these Regulations contains general definitions for the purposes of these Regulations.

Gareth Thomas
Parliamentary Under Secretary of State for Trade and
Consumer Affairs,
Department for Business, Enterprise and Regulatory
Reform

19th February 2008

SCHEDULE 8
QUOTED COMPANIES: DIRECTORS' REMUNERATION REPORT

Regulation 11

PART 1
INTRODUCTORY

1.—(1) In the directors' remuneration report for a financial year ("the relevant financial year") there must be shown the information specified in Parts 2 and 3.

(2) Information required to be shown in the report for or in respect of a particular person must be shown in the report in a manner that links the information to that person identified by name.

PART 2
INFORMATION NOT SUBJECT TO AUDIT

Consideration by the directors of matters relating to directors' remuneration

2.—(1) If a committee of the company's directors has considered matters relating to the directors' remuneration for the relevant financial year, the directors' remuneration report must—

- (a)** name each director who was a member of the committee at any time when the committee was considering any such matter;
- (b)** name any person who provided to the committee advice, or services, that materially assisted the committee in their consideration of any such matter;
- (c)** in the case of any person named under paragraph (b), who is not a director of the company, state—
 - (i)** the nature of any other services that that person has provided to the company during the relevant financial year; and
 - (ii)** whether that person was appointed by the committee.

(2) In sub-paragraph (1)(b) "person" includes (in particular) any director of the company who does not fall within sub-paragraph (1)(a).

Statement of company's policy on directors' remuneration

3.—(1) The directors' remuneration report must contain a statement of the company's policy on directors' remuneration for the following financial year and for financial years subsequent to that.

(2) The policy statement must include—

- (a)** for each director, a detailed summary of any performance conditions to which any entitlement of the director—
 - (i)** to share options, or
 - (ii)** under a long term incentive scheme,is subject;
- (b)** an explanation as to why any such performance conditions were chosen;
- (c)** a summary of the methods to be used in assessing whether any such performance conditions are met and an explanation as to why those methods were chosen;
- (d)** if any such performance condition involves any comparison with factors external to the company—

- (i) a summary of the factors to be used in making each such comparison, and
 - (ii) if any of the factors relates to the performance of another company, of two or more other companies or of an index on which the securities of a company or companies are listed, the identity of that company, of each of those companies or of the index;
- (e) a description of, and an explanation for, any significant amendment proposed to be made to the terms and conditions of any entitlement of a director to share options or under a long term incentive scheme; and
- (f) if any entitlement of a director to share options, or under a long term incentive scheme, is not subject to performance conditions, an explanation as to why that is the case.
- (3) The policy statement must, in respect of each director's terms and conditions relating to remuneration, explain the relative importance of those elements which are, and those which are not, related to performance.
- (4) The policy statement must summarise, and explain, the company's policy on—
- (a) the duration of contracts with directors, and
 - (b) notice periods, and termination payments, under such contracts.
- (5) In sub-paragraphs (2) and (3), references to a director are to any person who serves as a director of the company at any time in the period beginning with the end of the relevant financial year and ending with the date on which the directors' remuneration report is laid before the company in general meeting.

Statement of consideration of conditions elsewhere in company and group

4. The directors' remuneration report must contain a statement of how pay and employment conditions of employees of the company and of other undertakings within the same group as the company were taken into account when determining directors' remuneration for the relevant financial year.

Performance graph

- 5.—(1) The directors' remuneration report must—
- (a) contain a line graph that shows for each of—
 - (i) a holding of shares of that class of the company's equity share capital whose listing, or admission to dealing, has resulted in the company falling within the definition of "quoted company", and
 - (ii) a hypothetical holding of shares made up of shares of the same kinds and number as those by reference to which a broad equity market index is calculated,
 a line drawn by joining up points plotted to represent, for each of the financial years in the relevant period, the total shareholder return on that holding; and
 - (b) state the name of the index selected for the purposes of the graph and set out the reasons for selecting that index.
- (2) For the purposes of sub-paragraphs (1) and (4), "relevant period" means the five financial years of which the last is the relevant financial year.
- (3) Where the relevant financial year—
- (a) is the company's second, third or fourth financial year, sub-paragraph (2) has effect with the substitution of "two", "three" or "four" (as the case may be) for "five"; and
 - (b) is the company's first financial year, "relevant period", for the purposes of sub-paragraphs (1) and (4), means the relevant financial year.
- (4) For the purposes of sub-paragraph (1), the "total shareholder return" for a relevant period on a holding of shares must be calculated using a fair method that—
- (a) takes as its starting point the percentage change over the period in the market price of the holding;

- (b) involves making—
 - (i) the assumptions specified in sub-paragraph (5) as to reinvestment of income, and
 - (ii) the assumption specified in sub-paragraph (7) as to the funding of liabilities, and
 - (c) makes provision for any replacement of shares in the holding by shares of a different description;
- and the same method must be used for each of the holdings mentioned in sub-paragraph (1).

(5) The assumptions as to reinvestment of income are—

- (a) that any benefit in the form of shares of the same kind as those in the holding is added to the holding at the time the benefit becomes receivable; and
- (b) that any benefit in cash, and an amount equal to the value of any benefit not in cash and not falling within paragraph (a), is applied at the time the benefit becomes receivable in the purchase at their market price of shares of the same kind as those in the holding and that the shares purchased are added to the holding at that time.

(6) In sub-paragraph (5) "benefit" means any benefit (including, in particular, any dividend) receivable in respect of any shares in the holding by the holder from the company of whose share capital the shares form part.

(7) The assumption as to the funding of liabilities is that, where the holder has a liability to the company of whose capital the shares in the holding form part, shares are sold from the holding—

- (a) immediately before the time by which the liability is due to be satisfied, and
- (b) in such numbers that, at the time of the sale, the market price of the shares sold equals the amount of the liability in respect of the shares in the holding that are not being sold.

(8) In sub-paragraph (7) "liability" means a liability arising in respect of any shares in the holding or from the exercise of a right attached to any of those shares.

Service contracts

6.—(1) The directors' remuneration report must contain, in respect of the contract of service or contract for services of each person who has served as a director of the company at any time during the relevant financial year, the following information—

- (a) the date of the contract, the unexpired term and the details of any notice periods;
- (b) any provision for compensation payable upon early termination of the contract; and
- (c) such details of other provisions in the contract as are necessary to enable members of the company to estimate the liability of the company in the event of early termination of the contract.

(2) The directors' remuneration report must contain an explanation for any significant award made to a person in the circumstances described in paragraph 15.

PART 3 INFORMATION SUBJECT TO AUDIT

Amount of each director's emoluments and compensation in the relevant financial year

7.—(1) The directors' remuneration report must for the relevant financial year show, for each person who has served as a director of the company at any time during that year, each of the following—

- (a) the total amount of salary and fees paid to or receivable by the person in respect of qualifying services;
- (b) the total amount of bonuses so paid or receivable;
- (c) the total amount of sums paid by way of expenses allowance that are—

- (i) chargeable to United Kingdom income tax (or would be if the person were an individual), and
- (ii) paid to or receivable by the person in respect of qualifying services;
- (d) the total amount of—
 - (i) any compensation for loss of office paid to or receivable by the person, and
 - (ii) any other payments paid to or receivable by the person in connection with the termination of qualifying services;
- (e) the total estimated value of any benefits received by the person otherwise than in cash that—
 - (i) do not fall within any of paragraphs (a) to (d) or paragraphs 8 to 12,
 - (ii) are emoluments of the person, and
 - (iii) are received by the person in respect of qualifying services; and
- (f) the amount that is the total of the sums mentioned in paragraphs (a) to (e).

(2) The directors' remuneration report must show, for each person who has served as a director of the company at any time during the relevant financial year, the amount that for the financial year preceding the relevant financial year is the total of the sums mentioned in paragraphs (a) to (e) of sub-paragraph (1).

(3) The directors' remuneration report must also state the nature of any element of a remuneration package which is not cash.

(4) The information required by sub-paragraphs (1) and (2) must be presented in tabular form.

Share options

8.—(1) The directors' remuneration report must contain, in respect of each person who has served as a director of the company at any time in the relevant financial year, the information specified in paragraph 9.

(2) Sub-paragraph (1) is subject to paragraph 10 (aggregation of information to avoid excessively lengthy reports).

(3) The information specified in sub-paragraphs (a) to (c) of paragraph 9 must be presented in tabular form in the report.

(4) In paragraph 9 "share option", in relation to a person, means a share option granted in respect of qualifying services of the person.

9. The information required by sub-paragraph (1) of paragraph 8 in respect of such a person as is mentioned in that sub-paragraph is—

- (a) the number of shares that are subject to a share option—
 - (i) at the beginning of the relevant financial year or, if later, on the date of the appointment of the person as a director of the company, and
 - (ii) at the end of the relevant financial year or, if earlier, on the cessation of the person's appointment as a director of the company,
 in each case differentiating between share options having different terms and conditions;
- (b) information identifying those share options that have been awarded in the relevant financial year, those that have been exercised in that year, those that in that year have expired unexercised and those whose terms and conditions have been varied in that year;
- (c) for each share option that is unexpired at any time in the relevant financial year—
 - (i) the price paid, if any, for its award,
 - (ii) the exercise price,
 - (iii) the date from which the option may be exercised, and
 - (iv) the date on which the option expires;

- (d) a description of any variation made in the relevant financial year in the terms and conditions of a share option;
- (e) a summary of any performance criteria upon which the award or exercise of a share option is conditional, including a description of any variation made in such performance criteria during the relevant financial year;
- (f) for each share option that has been exercised during the relevant financial year, the market price of the shares, in relation to which it is exercised, at the time of exercise; and
- (g) for each share option that is unexpired at the end of the relevant financial year—
 - (i) the market price at the end of that year, and
 - (ii) the highest and lowest market prices during that year, of each share that is subject to the option.

10.—(1) If, in the opinion of the directors of the company, disclosure in accordance with paragraphs 8 and 9 would result in a disclosure of excessive length then, (subject to sub-paragraphs (2) and (3))—

- (a) information disclosed for a person under paragraph 9(a) need not differentiate between share options having different terms and conditions;
- (b) for the purposes of disclosure in respect of a person under paragraph 9(c)(i) and (ii) and (g), share options may be aggregated and (instead of disclosing prices for each share option) disclosure may be made of weighted average prices of aggregations of share options;
- (c) for the purposes of disclosure in respect of a person under paragraph 9(c)(iii) and (iv), share options may be aggregated and (instead of disclosing dates for each share option) disclosure may be made of ranges of dates for aggregation of share options.

(2) Sub-paragraph (1)(b) and (c) does not permit the aggregation of—

- (a) share options in respect of shares whose market price at the end of the relevant financial year is below the option exercise price, with
- (b) share options in respect of shares whose market price at the end of the relevant financial year is equal to, or exceeds, the option exercise price.

(3) Sub-paragraph (1) does not apply (and accordingly, full disclosure must be made in accordance with paragraphs 8 and 9) in respect of share options that during the relevant financial year have been awarded or exercised or had their terms and conditions varied.

Long term incentive schemes

11.—(1) The directors' remuneration report must contain, in respect of each person who has served as a director of the company at any time in the relevant financial year, the information specified in paragraph 12.

(2) Sub-paragraph (1) does not require the report to contain share option details that are contained in the report in compliance with paragraphs 8 to 10.

(3) The information specified in paragraph 12 must be presented in tabular form in the report.

(4) For the purposes of paragraph 12—

- (a) "scheme interest", in relation to a person, means an interest under a long term incentive scheme that is an interest in respect of which assets may become receivable under the scheme in respect of qualifying services of the person; and
- (b) such an interest "vests" at the earliest time when—
 - (i) it has been ascertained that the qualifying conditions have been fulfilled, and
 - (ii) the nature and quantity of the assets receivable under the scheme in respect of the interest have been ascertained.

(5) In this Schedule "long term incentive scheme" means any agreement or arrangement under which money or other assets may become receivable by a person and which includes one or more qualifying

conditions with respect to service or performance that cannot be fulfilled within a single financial year, and for this purpose the following must be disregarded, namely—

- (a) any bonus the amount of which falls to be determined by reference to service or performance within a single financial year;
- (b) compensation in respect of loss of office, payments for breach of contract and other termination payments; and
- (c) retirement benefits.

12.—(1) The information required by sub-paragraph (1) of paragraph 11 in respect of such a person as is mentioned in that sub-paragraph is—

- (a) details of the scheme interests that the person has at the beginning of the relevant financial year or if later on the date of the appointment of the person as a director of the company;
- (b) details of the scheme interests awarded to the person during the relevant financial year;
- (c) details of the scheme interests that the person has at the end of the relevant financial year or if earlier on the cessation of the person's appointment as a director of the company;
- (d) for each scheme interest within paragraphs (a) to (c)—
 - (i) the end of the period over which the qualifying conditions for that interest have to be fulfilled (or if there are different periods for different conditions, the end of whichever of those periods ends last); and
 - (ii) a description of any variation made in the terms and conditions of the scheme interests during the relevant financial year; and
- (e) for each scheme interest that has vested in the relevant financial year—
 - (i) the relevant details (see sub-paragraph (3)) of any shares,
 - (ii) the amount of any money, and
 - (iii) the value of any other assets,that have become receivable in respect of the interest.

(2) The details that sub-paragraph (1)(b) requires of a scheme interest awarded during the relevant financial year include, if shares may become receivable in respect of the interest, the following—

- (a) the number of those shares;
- (b) the market price of each of those shares when the scheme interest was awarded; and
- (c) details of qualifying conditions that are conditions with respect to performance.

(3) In sub-paragraph (1)(e)(i) "the relevant details", in relation to any shares that have become receivable in respect of a scheme interest, means—

- (a) the number of those shares;
- (b) the date on which the scheme interest was awarded;
- (c) the market price of each of those shares when the scheme interest was awarded;
- (d) the market price of each of those shares when the scheme interest vested; and
- (e) details of qualifying conditions that were conditions with respect to performance.

Pensions

13.—(1) The directors' remuneration report must, for each person who has served as a director of the company at any time during the relevant financial year, contain the information in respect of pensions that is specified in sub-paragraphs (2) and (3).

(2) Where the person has rights under a pension scheme that is a defined benefit scheme in relation to the person and any of those rights are rights to which he has become entitled in respect of qualifying services of his—

- (a) details—
 - (i) of any changes during the relevant financial year in the person's accrued benefits under the scheme, and
 - (ii) of the person's accrued benefits under the scheme as at the end of that year;
- (b) the transfer value, calculated in a manner consistent with "Retirement Benefit Schemes – Transfer Values (GN 11)" published by the Institute of Actuaries and the Faculty of Actuaries and dated 6th April 2001, of the person's accrued benefits under the scheme at the end of the relevant financial year;
- (c) the transfer value of the person's accrued benefits under the scheme that in compliance with paragraph (b) was contained in the directors' remuneration report for the previous financial year or, if there was no such report or no such value was contained in that report, the transfer value, calculated in such a manner as is mentioned in paragraph (b), of the person's accrued benefits under the scheme at the beginning of the relevant financial year;
- (d) the amount obtained by subtracting—
 - (i) the transfer value of the person's accrued benefits under the scheme that is required to be contained in the report by paragraph (c), from
 - (ii) the transfer value of those benefits that is required to be contained in the report by paragraph (b),

and then subtracting from the result of that calculation the amount of any contributions made to the scheme by the person in the relevant financial year.

(3) Where—

- (a) the person has rights under a pension scheme that is a money purchase scheme in relation to the person, and
- (b) any of those rights are rights to which he has become entitled in respect of qualifying services of his,

details of any contribution to the scheme in respect of the person that is paid or payable by the company for the relevant financial year or paid by the company in that year for another financial year.

Excess retirement benefits of directors and past directors

14.—(1) Subject to sub-paragraph (3), the directors' remuneration report must show in respect of each person who has served as a director of the company—

- (a) at any time during the relevant financial year, or
- (b) at any time before the beginning of that year,

the amount of so much of retirement benefits paid to or receivable by the person under pension schemes as is in excess of the retirement benefits to which he was entitled on the date on which the benefits first became payable or 31st March 1997, whichever is the later.

(2) In subsection (1) "retirement benefits" means retirement benefits to which the person became entitled in respect of qualifying services of his.

(3) Amounts paid or receivable under a pension scheme need not be included in an amount required to be shown under sub-paragraph (1) if—

- (a) the funding of the scheme was such that the amounts were or, as the case may be, could have been paid without recourse to additional contributions; and
- (b) amounts were paid to or receivable by all pensioner members of the scheme on the same basis;

and in this sub-paragraph "pensioner member", in relation to a pension scheme, means any person who is entitled to the present payment of retirement benefits under the scheme.

(4) In this paragraph—

- (a) references to retirement benefits include benefits otherwise than in cash; and
- (b) in relation to so much of retirement benefits as consists of a benefit otherwise than in cash, references to their amount are to the estimated money value of the benefit,

and the nature of any such benefit must also be shown in the report.

Compensation for past directors

15. The directors' remuneration report must contain details of any significant award made in the relevant financial year to any person who was not a director of the company at the time the award was made but had previously been a director of the company, including (in particular) compensation in respect of loss of office and pensions but excluding any sums which have already been shown in the report under paragraph 7(1)(d).

Sums paid to third parties in respect of a director's services

16.—(1) The directors' remuneration report must show, in respect of each person who served as a director of the company at any time during the relevant financial year, the aggregate amount of any consideration paid to or receivable by third parties for making available the services of the person—

- (a) as a director of the company, or
- (b) while director of the company—
 - (i) as director of any of its subsidiary undertakings, or
 - (ii) as director of any other undertaking of which he was (while director of the company) a director by virtue of the company's nomination (direct or indirect), or
 - (iii) otherwise in connection with the management of the affairs of the company or any such other undertaking.

(2) The reference to consideration includes benefits otherwise than in cash; and in relation to such consideration the reference to its amount is to the estimated money value of the benefit.

The nature of any such consideration must be shown in the report.

(3) The reference to third parties is to persons other than—

- (a) the person himself or a person connected with him or a body corporate controlled by him, and
- (b) the company or any such other undertaking as is mentioned in sub-paragraph (1)(b)(ii).

PART 4 INTERPRETATION AND SUPPLEMENTARY

17.—(1) In this Schedule—

"amount", in relation to a gain made on the exercise of a share option, means the difference between—

- (a) the market price of the shares on the day on which the option was exercised; and
- (b) the price actually paid for the shares;

"company contributions", in relation to a pension scheme and a person, means any payments (including insurance premiums) made, or treated as made, to the scheme in respect of the person by anyone other than the person;

"defined benefit scheme", in relation to a person, means a pension scheme which is not a money purchase scheme in relation to the person;

"emoluments" of a person—

- (a) includes salary, fees and bonuses, sums paid by way of expenses allowance (so far as they are chargeable to United Kingdom income tax or would be if the person were an individual), but
- (b) does not include any of the following, namely—
 - (i) the value of any share options granted to him or the amount of any gains made on the exercise of any such options;
 - (ii) any company contributions paid, or treated as paid, in respect of him under any pension scheme or any benefits to which he is entitled under any such scheme; or
 - (iii) any money or other assets paid to or received or receivable by him under any long term incentive scheme;

"long term incentive scheme" has the meaning given by paragraph 11(5);

"money purchase benefits", in relation to a person, means retirement benefits the rate or amount of which is calculated by reference to payments made, or treated as made, by the person or by any other person in respect of that person and which are not average salary benefits;

"money purchase scheme", in relation to a person, means a pension scheme under which all of the benefits that may become payable to or in respect of the person are money purchase benefits in relation to the person;

"pension scheme" means a retirement benefits scheme within the meaning given by section 611 of the Income and Corporation Taxes Act 1988;

"qualifying services", in relation to any person, means his services as a director of the company, and his services at any time while he is a director of the company—

- (a) as a director of an undertaking that is a subsidiary undertaking of the company at that time;
- (b) as a director of any other undertaking of which he is a director by virtue of the company's nomination (direct or indirect); or
- (c) otherwise in connection with the management of the affairs of the company or any such subsidiary undertaking or any such other undertaking;

"retirement benefits" means relevant benefits within the meaning given by section 612(1) of the Income and Corporation Taxes Act 1988;

"shares" means shares (whether allotted or not) in the company, or any undertaking which is a group undertaking in relation to the company, and includes a share warrant as defined by section 779(1) of the 2006 Act;

"share option" means a right to acquire shares;

"value", in relation to shares received or receivable on any day by a person who is or has been a director of the company, means the market price of the shares on that day.

(2) In

this Schedule "compensation in respect of loss of office" includes compensation received or receivable by a person for—

- (a) loss of office as director of the company, or
- (b) loss, while director of the company or on or in connection with his ceasing to be a director of it, of—
 - (i) any other office in connection with the management of the company's affairs, or
 - (ii) any office as director or otherwise in connection with the management of the affairs of any undertaking that, immediately before the loss, is a subsidiary undertaking of the company or an undertaking of which he is a director by virtue of the company's nomination (direct or indirect);
- (c) compensation in consideration for, or in connection with, a person's retirement from office; and
- (d) where such a retirement is occasioned by a breach of the person's contract with the company or with an undertaking that, immediately before the breach, is a subsidiary undertaking of the

company or an undertaking of which he is a director by virtue of the company's nomination (direct or indirect)—

- (i) payments made by way of damages for the breach; or
- (ii) payments made by way of settlement or compromise of any claim in respect of the breach.

(3) References in this Schedule to compensation include benefits otherwise than in cash; and in relation to such compensation references in this Schedule to its amounts are to the estimated money value of the benefit.

(4) References in this Schedule to a person being "connected" with a director, and to a director "controlling" a body corporate, are to be construed in accordance with sections 252 to 255 of the 2006 Act.

18.—(1) For the purposes of this Schedule emoluments paid or receivable or share options granted in respect of a person's accepting office as a director are to be treated as emoluments paid or receivable or share options granted in respect of his services as a director.

(2) Where a pension scheme provides for any benefits that may become payable to or in respect of a person to be whichever are the greater of—

- (a) such benefits determined by or under the scheme as are money purchase benefits in relation to the person; and
- (b) such retirement benefits determined by or under the scheme to be payable to or in respect of the person as are not money purchase benefits in relation to the person,

the company may assume for the purposes of this Schedule that those benefits will be money purchase benefits in relation to the person, or not, according to whichever appears more likely at the end of the relevant financial year.

(3) In determining for the purposes of this Schedule whether a pension scheme is a money purchase scheme in relation to a person or a defined benefit scheme in relation to a person, any death in service benefits provided for by the scheme are to be disregarded.

19.—(1) The following applies with respect to the amounts to be shown under this Schedule.

(2) The amount in each case includes all relevant sums paid by or receivable from—

- (a) the company; and
- (b) the company's subsidiary undertakings; and
- (c) any other person,

except sums to be accounted for to the company or any of its subsidiary undertakings or any other undertaking of which any person has been a director while director of the company, by virtue of section 219 of the 2006 Act (payment in connection with share transfer: requirement of members' approval), to past or present members of the company or any of its subsidiaries or any class of those members.

(3) Reference to amounts paid to or receivable by a person include amounts paid to or receivable by a person connected with him or a body corporate controlled by him (but not so as to require an amount to be counted twice).

20.—(1) The amounts to be shown for any financial year under Part 3 of this Schedule are the sums receivable in respect of that year (whenever paid) or, in the case of sums not receivable in respect of a period, the sums paid during that year.

(2) But where—

- (a) any sums are not shown in the directors' remuneration report for the relevant financial year on the ground that the person receiving them is liable to account for them as mentioned in paragraph 19 (2), but the liability is thereafter wholly or partly released or is not enforced within a period of 2 years; or
- (b) any sums paid by way of expenses allowance are charged to United Kingdom income tax after the end of the relevant financial year or, in the case of any such sums paid otherwise than to an

individual, it does not become clear until the end of the relevant financial year that those sums would be charged to such tax were the person an individual,

those sums must, to the extent to which the liability is released or not enforced or they are charged as mentioned above (as the case may be), be shown in the first directors' remuneration report in which it is practicable to show them and must be distinguished from the amounts to be shown apart from this provision.

21. Where it is necessary to do so for the purpose of making any distinction required by the preceding paragraphs in an amount to be shown in compliance with this Part of this Schedule, the directors may apportion any payments between the matters in respect of which these have been paid or are receivable in such manner as they think appropriate.

22. The Schedule requires information to be given only so far as it is contained in the company's books and papers, available to members of the public or the company has the right to obtain it.

**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. It has been included in the first phase consultation on the draft CB.
2. With this second phase consultation launched, some definitions have to be added to Part 1 while some others are revised to take into account the requirements of the draft provisions in this second phase consultation.
3. The major changes to Part 1 are:
 - I. Deleting the definitions of “constitution” and “memorandum”**
 4. Upon review, we consider that the definitions of “constitution” and “memorandum” are not necessary, and hence they are deleted. It should be noted that a condition of an existing company’s memorandum of association is to be regarded as a provision of the company’s articles (see **Clause 3.36**) (please refer to the Explanatory Notes on Part 3 for details).
 5. Some of the provisions in the first phase consultation (i.e. those in Parts 2, 10 to 12 and 14 to 18) contain the term “constitution” and they will be changed to “articles” accordingly, except for those provisions where the term “constitution” is used in the general sense, like **Clauses 13.3, 14.5 and 14.8(4)(c)**.
- II. The use of “example” and “note” in the draft Bill**
6. We are committed to plain language drafting and to making the law more accessible. The use, where appropriate, of read aids such as notes and examples is an aspect of this.

7. **Clause 1.2(4)** is added to explain that where the draft Bill includes an example of the operation of a provision (e.g. **Clauses 4.28(1), 5.7(1) and 5.9(3)**), the example is not exhaustive and if the example is inconsistent with the provision, the provision prevails.
8. **Clause 1.2(5)** is added to explain that a note located in the text of the draft Bill (e.g. **Clauses 4.35(3), 5.19(1) and 8.15(4)**) is provided for information only and has no legislative effect.

Other Changes

9. The following definitions are added to Part 1: “articles” with a note added to it; “financial year”; “listing rules”; “share warrant”; and “special notice”.
10. The definition of “incorporation form” is deleted because it is considered unnecessary to have this definition in Part 1. The requirement to deliver an incorporation form is set out in **Clause 3.2(1)(b)(i)**.
11. **Clause 1.2(3)(a)(i)** now reads as “in paper form; or” instead of “in paper copy form; or” as the word “copy” is considered unnecessary, but there is no need to revise the Chinese text.

PART 3

COMPANY FORMATION AND RELATED MATTERS, AND RE-REGISTRATION OF COMPANY

Introduction

1. Part 3 deals with company formation and registration, re-registration of unlimited companies as companies limited by shares and related matters. The part contains provisions setting out the types of company¹ that may be formed, and their formation procedure. There is also an improved company name registration system which will be introduced ahead of the CO rewrite through the Companies (Amendment) Bill 2010. Part 3 also provides for new requirements for the articles of association (“AA”) of a company following the proposed abolition of the memorandum of association (“MA”), and modifies the provisions governing the execution of documents.

There are certain provisions that will apply only in the transition period between the enactment of the CB and the commencement of the no-par regime. Since these provisions will only be relevant during the transition period, they are not currently included in the draft CB but they will be finalised and included in the CB, when it is introduced in the LegCo.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) **Expediting the company name registration process and enhancing enforcement against “shadow companies”²;**
 - (b) **Abolishing the MA ;**

¹ Under the CB, five types of companies can be formed, 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) guarantee companies that do not have share capital (see the Explanatory Notes on Part 1 of the draft CB contained in FSTB, *Consultation Paper on Draft Companies Bill - First Phase Consultation* (December 2009), pages 76 to 78.

² “Shadow companies” refer to those companies incorporated in Hong Kong with names which are very similar to existing and established trademarks or trade names of other companies and which pose themselves as representatives of the owners of such trademarks or trade names to produce counterfeit products in Mainland China bearing such trademarks or trade names.

(c) Making the keeping and the use of a common seal optional and relaxing the requirements for a company to have an official seal for use abroad; and

(d) Reforming company re-registration provisions.

Significant Changes

(a) Expediting the company name registration process and enhancing enforcement against “shadow companies”

2. In February 2010, we introduced the Companies (Amendment) Bill 2010 into LegCo. One of the key proposals in the Bill is to expedite the company name registration process. A company name will be accepted for registration instantaneously if it satisfies certain requirements, including, among others, that it is not identical to another name on the register and does not contain certain specified words or expressions. A new criterion for registration has been added so that where a proposed name is the same as a name for which a direction to change name has been given, such name cannot be registered except with the consent of the Registrar. After incorporation, if a company’s name is found to be objectionable, the Registrar will be empowered to direct the company in question to change its name within a period specified by the Registrar. The relevant provisions in the Companies (Amendment) Bill 2010 are restated in **Clauses 3.39(2)(c), 3.48 and 3.49** of the CB. The revised procedures will shorten the processing time for company incorporation from four working days to one day. This will put Hong Kong on a par with comparable jurisdictions such as the UK and Singapore.

3. To address concerns of the business community, especially trademark/trade name owners, we also propose in the Companies (Amendment) Bill 2010 to strengthen our company name registration system to enhance enforcement against possible abuses by “shadow companies” by empowering the Registrar to act pursuant to court orders to direct a “shadow company” to change its name. The provision is restated in **Clause 3.48(2)(a)** of the CB. The Registrar may substitute the company’s name with its registration number if it fails to comply with the Registrar’s direction to change name. The same power to substitute a company name will also be given to the

Registrar where a company fails to comply with a direction to change its name that is too similar to that of another company on the register; gives the impression that the company is connected with the Hong Kong Government or the Central People's Government; constitutes a criminal offence; or is contrary to the public interest. This provision is restated in **Clause 3.50** of the CB.

4. The Companies (Amendment) Bill 2010 is being scrutinised by LegCo. The relevant clauses in the CB may have to be amended subject to amendments made to the Companies (Amendment) Bill 2010, if any.

(b) Abolishing the MA

Background

5. Under the CO, the MA and the AA together comprise the constitution of a company. Broadly, the MA includes basic information about a company which the outside world needs to know, while the AA deal with the internal regulations of the company. The MA used to contain important information about the company, particularly its objects. However, the objects clause is now less significant, given the 1997³ abolition of the doctrine of ultra vires in relation to corporate capacity, with all companies now having the capacity and the rights and powers of a natural person⁴.
6. In 2008, the CR introduced streamlined incorporation procedures where persons wishing to incorporate a company are required to deliver to the Registrar a duly completed incorporation form together with copies of the MA and AA, if any. The incorporation form requires information including, among other things, the company name, address of the registered office, the type of company, particulars of the founder members, directors and secretaries, a statement of capital and initial shareholdings and a statement that all the requirements of the CO on the registration of the company have been complied with.

³ The Companies (Amendment) Ordinance 1997 (Ordinance No.3 of 1997).

⁴ Since the 1997 amendments, objects clauses are optional except for the so-called "section 21 companies" which are found subject to section 21 of the CO. "Section 21 companies" are allowed to dispense with the word "Limited" in their names. Such companies are formed for promoting commerce, art, science, religion, charity or any other useful object, and are required to apply their profits, if any, or other income in promoting their objects. The similar provisions are reinstated in **Clause 3.42** of the draft CB.

7. We note that the information provided by the incorporation form and the AA contains virtually all the information required by the MA, with the exception of the objects clause and the authorised capital⁵. The need to retain the MA as a separate constitutional document is therefore diminished. In some common law jurisdictions such as Australia and New Zealand, companies have only a single constitutional document.
8. Under the CO, there are provisions in section 8 and section 25A respectively governing the alteration of object clauses in the MA and the alteration of the provisions contained in the MA which were originally intended to be contained in the AA (the “section 25A type of conditions”). Both provisions permit, in the case of private companies, applications by their members to the court to object to the alteration. With the abolition of the MA, provisions will be made in the CB to cater for the alteration of object clauses and of section 25A type of conditions as they would be contained in the AA and to provide for the members’ right of objection.

Proposal

9. It is proposed that the MA of a company should be abolished altogether. **Clause 3.2** states that person(s) may form a company by delivering to the Registrar for registration an incorporation form in the specified form and a copy of the company’s articles. **Clauses 3.3 to 3.8** and **3.14 to 3.24** set out the requirements of the incorporation form and the AA respectively, which should include information currently contained in the MA. In particular, the incorporation form will contain the name, address and type of company (**Clause 3.5(1)**), the particulars of the founder member(s) (**Clause 3.5(2)**), director(s) and officer(s) (**Clause 3.6**), information on the shares and share capital (**Clause 3.7**) and a statement of compliance (**Clause 3.8**). The AA will contain the company name (**Clause 3.20**), members’ liabilities or contributions, (**Clauses 3.22** and **3.23**) and information on capital and initial shareholdings (**Clause 3.24**). As a result of the migration to no-par, the authorised capital requirement will be removed but **Clause 3.24(3)** provides that a company having a share capital may state in its articles the maximum number of shares that the company may issue. “Section 21 companies”⁶ must also state the company’s objects in the AA (**Clause 3.21**), while other companies have the option of doing so.

⁵ See paragraph 9.

⁶ See footnote 4.

10. Upon the abolition of the MA, references to the MA in various provisions of the CO are removed or amended to mean the AA in the CB. In respect of companies which are formed before the CB comes into force, **Clause 3.36** states that conditions that are contained in a company's MA would be deemed to be regarded as provisions of the company's AA after the commencement of the new CO.
 11. **Clause 3.17** empowers the FS to prescribe different model articles for different types of companies. These model articles replace Table A and the other tables in Schedule 1 of the current CO for companies incorporated after the commencement of the new CO.
 12. **Clauses 3.27, 3.34 and 3.35** will require companies to notify the Registrar of any alterations to the AA, including alterations by an order of the court or other Ordinance(s).
 13. **Clause 3.28** will allow a company's alteration to its objects under its AA and **Clause 3.30(1)** will permit the right of members of a company to apply to the court to object to the resolutions for altering the conditions of the company's AA with respect to its objects.
 14. **Clause 3.29** provides for the alteration of the CO section 25A type of conditions in an existing company's AA and **Clause 3.30(3)** preserves the right of members of an existing company to object to the resolutions for altering such conditions.
- (c) **Making the keeping and the use of a common seal optional and relaxing the requirements for a company to have an official seal for use abroad**

Background

15. Section 93(1)(b) of the CO stipulates that every company shall have a common seal with the company name engraved 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 share certificates and share warrants.

16. With the rapid increase in both volume and value of modern day business transactions and contracts, we consider it necessary to simplify the mode of execution of documents. In this respect, both the UK and Australia have given companies the choice of not keeping or using a common seal to execute documents and deeds.
17. Also in relation to the company's seal, section 35(1) of the CO provides that a company may have an official seal for use outside Hong Kong, provided that it is authorised by the AA of the company and that the objects of the company require or comprise the transaction of business outside Hong Kong. We note that there are no such requirements in common law jurisdictions such as the UK.

Proposal

18. It is proposed that the keeping and the use of a common seal should be optional. **Clause 3.63** states that a company may have a common seal. This gives flexibility to companies and does not prejudice those companies which may still wish to keep and use their common seals.
19. In connection with the change, **Clause 3.66** sets out the requirements for execution of documents by a company. In particular, **Clause 3.66(2)** allows a company to execute a document by having the document signed by a director (in the case of one-director company) or by two authorised signatories (in the case of a company having two or more directors). **Clause 3.66(4)** provides that a document signed in accordance with **Clause 3.66(2)** and expressed to be executed by the company has effect as if the document had been executed under the company's common seal.
20. As for the use of official seals outside Hong Kong, we propose to follow the relevant provisions in the UKCA 2006. **Clause 3.64** states that a company may have an official seal for use outside Hong Kong. The existing requirements concerning the objects of the company and authorisation by the AA have been abolished.

(d) **Reforming company re-registration provisions**

Background

21. Under the CO, there are only two statutory provisions which have the effect of bringing about a change in company type. Under section 19 of the CO, unlimited companies may be re-registered as limited companies by shares or by guarantee. Section 30 of the CO stipulates that, if a private company alters its AA in such a manner that it no longer fulfils the conditions of being a private company, it shall, as on the date of the alteration, cease to be a private company and must file with the Registrar documents and information as required in the Second Schedule to the CO.
22. We note that the format and the information required by the Second Schedule are outdated, unnecessarily detailed and complicated. There is a need to simplify the requirements. There is also scope for improving the provisions on changing an unlimited company to a limited company.

Proposal

23. **Clause 3.33** provides for alteration of the AA which affects the status of a private company. In particular, the requirement to file a prospectus or a statement in lieu of prospectus (i.e. the Second Schedule) under section 30 of the CO has been removed. However, the company must deliver to the Registrar within 15 days an annual financial statement for the financial year immediately preceding the financial year in which the alteration of the AA is made.
24. **Clause 3.69** provides for the matters in section 19(1) of the CO with the modification that an unlimited company may only re-register as a company limited by shares under the new CO. There must be a statement on the share capital structure, which after re-registration must conform to the requirements in the CB. **Clause 3.70** deals with how the application for re-registration should be made, and **Clause 3.71** provides for a fresh certificate of incorporation to be issued by the Registrar to the company after the re-registration.

Other Changes

(a) Providing statutory protection for persons dealing with a company

25. Under **Clause 3.55**, a company's exercise of powers will be limited by its AA after the elimination of the MA. To supplement the provision, we have made reference to sections 40 to 42 of the UKCA 2006, and propose to add **Clauses 3.56 to 3.58** with a view to providing statutory protection for persons dealing with a company in addition to the common law indoor management rule⁷. **Clause 3.56** is introduced to provide that in favour of a person dealing with a company in good faith, the power of the directors to bind the company will be deemed to be free of any limitation under the AA, any resolutions of the company or any agreement between the members of the company. Under **Clause 3.56**, a person dealing with a company is presumed, unless the contrary is proven, to have acted in good faith. **Clauses 3.57 and 3.58** set out the exception to **Clause 3.56**. **Clause 3.57** provides that transactions or act entered into by a company involving directors or their associates are voidable. **Clause 3.58** states that **Clause 3.56** does not apply to transaction or act of company permitted to be registered by name without "Limited", i.e. "section 21 companies".

(b) Allowing an attorney to execute not only deeds but also other documents on behalf of the company locally or outside Hong Kong

26. Under section 34 of the CO, a company may empower any person, to act generally or in respect of specified matters, as its attorney to execute deeds on its behalf outside Hong Kong. A deed signed by the attorney on behalf of the company and under his seal binds the company and has the same effect as if it were under the common seal. In view of the increasing volume of local and overseas business activities of Hong Kong companies, the current provision may be unduly restrictive.

27. It is proposed that the scope of the current section 34 of the CO be widened. **Clause 3.68** states that a company may authorise any person as its attorney to execute a deed or any other document on its behalf in Hong Kong or elsewhere. This clause is in line with section 47 of UKCA 2006.

⁷ Also known as "rule in *Turquand's* case". It refers to the common law rule that a third party dealing in good faith with a company is not bound to inquire whether any internal procedures contained in the company's constitution regulating the conferment of authority have been complied with and is entitled to presume that a person held out by the company has the necessary authority to act on behalf of the company, see *Royal British Bank v Turquand* (1856) 119 ER 886.

PART 4

SHARE CAPITAL

Introduction

1. **Share capital** means the money paid into the company (or legally promised as being available on call) by members for shares in the company. The current rules relating to share capital require companies having a share capital to have a **par value (or a nominal value)** ascribed to their shares (the requirement for par value). The rules also require that the capital so raised must be kept in the company, and used for the purposes of its business only, and must not be returned to shareholders except in restricted circumstances (the **capital maintenance rules**).
2. The complex provisions on “share capital” and “debentures” are currently set out in Part II (sections 37 to 79) of the CO. To make the law more user-friendly and readable, the provisions will be reorganised into three smaller parts in the CB. The core concepts about “share capital”, its creation, transfer and alteration will be set out in Part 4. Those provisions relating to capital maintenance rules and debentures will be transferred to Part 5 and Part 7 respectively. The provisions on prospectuses in the CO (sections 37 to 44B, 48A in Part II and Part XII) will be dealt with in a separate review by the SFC and will be transferred to the SFO in due course.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) **Adopting a mandatory system of no-par for all companies with a share capital, with a transition period of 24 months;**
 - (b) **Removing the power of companies to issue share warrants to bearer;**
 - (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;**
 - (d) **Clarifying certain concepts relating to class rights;**

- (e) Extending the statutory provisions for variation of class rights to cover companies without a share capital; and**
- (f) Requiring a company to deliver to the Companies Registry a return or notification including a statement of capital whenever there is a change to its capital structure.**

Significant Changes

- (a) Adopting a mandatory system of no-par for all companies with a share capital, with a transition period of not less than 24 months**

Background

3. Par value (also known as nominal value) is the minimum price at which shares can generally be issued. Currently, companies incorporated in Hong Kong and having a share capital are required to have a par value ascribed to their shares¹. There is no essential difference between a share of no par value and one having a par value. The par value does not serve the original purpose of protecting creditors and shareholders, and may, to some extent, even be misleading.
4. Retiring the concept of par would create an environment of greater clarity and simplicity, particularly in accounting treatment of share capital, that would be desirable for the business community generally. Jurisdictions that have adopted mandatory no-par shares include Australia, New Zealand and Singapore. During the public consultation conducted during June to September 2008, there was majority support for the proposal to adopt a mandatory system of no-par. We intend to give companies at least 24 months from the enactment of the CB to review their documents before the conversion is effected².

¹ Section 5(4) of the CO.

² FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (February 2009), paragraphs 5 to 10 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

Proposal

5. **Clause 4.2** effectively abolishes the concept of nominal value. From the “appointed day” (see **Clause 4.71**), a company’s shares will have no nominal value. This will apply to all shares, including shares issued before the appointed day which is to be appointed by the FS by notice in the Gazette. The appointed day is intended to be at least 24 months after the enactment of the CB. This is to allow companies time to review and amend their documents where necessary.
6. **Clause 4.38** empowers a company, by resolution in general meeting, to alter its share capital in a number of ways set out in sub-clause (2). The clause is a modified version of existing section 53 of the CO. In addition to the alterations allowed under section 53, the new provision allows a company to capitalise its profits without issuing new shares and to allot and issue bonus shares without increasing share capital. This is one of the advantages of no-par shares.
7. Companies will continue to be able to effectively consolidate and subdivide shares. Whilst there is no nominal amount to be divided for no-par shares, a similar result to subdivision can be achieved by increasing the number of shares. The process of consolidating shares into a smaller number should be considerably simplified where there are no par values to contend with. The number of shares will just reduce with no visible effect on the share capital.
8. Without par, there will no longer be share premium and there will no longer be a need to distinguish between share capital and share premium, and consequently to account for them separately. **Clause 4.78** 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 share capital.
9. To avoid hardship to companies existing before the appointed day which would lose the permitted uses of share premium that they enjoyed prior to the migration to no-par, a transitional provision **Clause 4.79** is introduced 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,

Clause 4.17 provides that on or after the appointed day, 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.

10. **Subdivision 2 of Division 9 (Clauses 4.76 to 4.81)** contains transitional provisions relating to the move from nominal value shares to shares having no nominal value. The provisions are intended to provide legislative safeguards to ensure that contractual rights defined by reference to par value and related concepts will not be affected by the abolition of par. For example, **Clause 4.81** is a statutory deeming provision, which will save considerable work, expense and time for companies and reduce the possibility of disputes. Nonetheless, even with the transitional provisions, individual companies may still wish to review their particular situation to determine if they need to introduce more specific changes to their documents having regard to their own unique circumstances.
11. There will also be modifications to the provisions on merger and group reconstruction relief following the migration to a no-par regime as there will no longer be any share premium in a no-par environment³. **Clauses 4.62 to 4.66** modify sections 48C to 48E to apply the merger relief to any excess of the value of the equity shares acquired or cancelled over the subscribed capital of the acquired company attributable to the shares acquired or cancelled. Group reconstruction relief will apply to the excess of the value of the assets transferred over the net base value of the assets transferred⁴.
12. The proposal to legislate for no-par will not affect companies incorporated off-shore as they will continue to be governed by the law of their place of incorporation. Where there are Hong Kong legislation or rules that apply to these companies, such as the SFO and Listing Rules, these can be amended to accommodate both par and no-par value shares to address the fact that the shares of some of these off-shore incorporated companies could still have par value.

³ Sections 48C to 48E of the CO provide relief from a company's obligation to transfer amounts to the share premium account where:

- (i) shares are issued at a premium as consideration for the transfer or cancellation of another company's shares in the context of a merger; and
- (ii) shares are issued at a premium as consideration for the transfer of assets in the context of a group reconstruction.

In the case of mergers, the relief extends to the whole of the premium. However, in the case of group reconstructions, it is limited to any excess over the base value of the assets transferred.

⁴ The proposal was supported by the majority of respondents in the public consultation conducted in June to September 2008. See the Consultation Conclusions mentioned in footnote 2, paragraphs 14 to 17.

13. The proposal to remove the requirement for authorised capital which is also related to the migration to no-par is discussed in the Explanatory Notes on Part 3. There are certain provisions that will apply only in the 24-month transition period between the enactment of the CB and the commencement of the no-par regime. These provisions will be the equivalent provisions of the CO that refer to or are based on the concepts of nominal value, share premium, capital redemption reserves and authorised capital. For example, sections 49A(1)(b), 49A(2), 49A(4), 49G(1), 49H, 49I(4) and (5), 49Q(2)(b), 49R(2) and (3), 58(1A) and (3). Since these provisions will only be relevant during the transition period, they are not currently included in the draft CB but they will be finalised and included in the CB, when it is introduced in the LegCo.

(b) Removing the power of companies to issue share warrants to bearer

Background

14. Under section 73 of the CO, a 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. It is possible for legal title to shares to pass merely on the delivery of the warrant. Share warrants 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.

Proposal

15. **Clause 4.7** repeals a company’s power to issue “share warrants to bearer” but provides that such share warrants issued prior to the commencement of that clause 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 clause partially re-enacts section 97 of the CO, to provide for the surrender of share warrants. **Clause 4.72** provides that the records in the register of members in respect of existing share warrants would be preserved until the share warrants are surrendered.

- (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**

Background

16. The allotment of shares is generally carried out by directors, but under section 57B of the CO, they are only entitled to do that with the prior approval of the company in general meeting. There are only two exceptions to this rule, namely: (i) a rights issue; and (ii) an allotment to the founder members (sections 57B(1) and (7)). The requirement of shareholder approval (save in the two circumstances set out above) is mandatory and notwithstanding any provision in the company's articles to the contrary.
17. However, section 57B only requires shareholder approval for the allotment of shares. The grant of an option to subscribe for shares or a right to convert any security into shares would not be within the scope of section 57B, but the subsequent exercise of the option or the right of conversion which would result in an allotment would require shareholders' approval.
18. It would not be prudent for a company to issue an option for unissued shares or a security convertible into new shares without the prior approval of its shareholders for the subsequent allotment, but strictly the CO does not require shareholders to give such prior approval. To enhance the protection of minority shareholders against dilution, it is proposed that the requirement of shareholder approval for allotments of shares be extended 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.

Proposal

19. **Clause 4.8** provides that the power of the directors of a company to allot shares, as well as to grant rights to subscribe for, or convert any security, into shares cannot be exercised except in accordance with **Clause 4.9**. Apart from the two original exceptions (i.e. rights issue and allotment to founder members), there is an additional exception that applies to an allotment of shares, or grant of rights, on a bonus issue of shares. **Clause 4.9** provides for a company to give approval for its directors to allot shares,

or grant rights to subscribe for, or convert any security, into shares. This is done by resolution of the company in general meeting, in advance of the allotment or grant of rights. Similar to section 57B(3), the approval would expire at the conclusion of the next AGM. As all companies are now allowed to dispense with AGMs subject to meeting certain conditions, **Clause 4.9(3)(b)** has also provided for the time when an approval will expire in case a company is not required to hold an AGM.

(d) Clarifying certain concepts relating to class rights

Background

20. Sections 63A and 64 of the CO set out the requirements for a variation of class rights of shareholders. The CO does not presently define the concept of class rights. There may be an issue as to whether class rights: (1) are rights attached to shares only⁵; (2) include rights conferred on individuals in a capacity other than as a member or shareholder of the company⁶; or (3) include rights that are not attached to any particular shares but are conferred on the beneficiary in the capacity as member or shareholder of the company⁷.

Proposal

21. For companies with share capital, the provisions on class rights under **Subdivision 1 of Division 7** refer to “rights attached to shares in a class of shares” (e.g. **Clause 4.48**). **Clause 4.45** clarifies that references to the rights attached to a share in a class of shares are references to the rights of the holder of the share as a member of the company. The intention is that the second and third categories of rights referred to in the preceding paragraph are excluded from the concept of class rights under the CB. To provide further guidance on the meaning of a class of shares, **Clause 4.46** provides that shares are in a class if the rights attached to them are in all respects uniform. However, they 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.

⁵ These are rights attached to particular shares which are not enjoyed by others, for example, ‘dividends and rights to participate in surplus assets on a winding up’.

⁶ *Eley v Positive Government Security Life Assurance Co Ltd* (1875) 1 Ex D 20, is an instance of this. There the articles stipulated that Eley shall be the company’s solicitor.

⁷ An example of this would be pre-emptive rights conferred upon a shareholder where these rights are not attached to any particular shares but conferred on the shareholder by name.

22. For a company without a share capital, **Clause 4.54** clarifies that references in the CB to the rights of members of a company are references to the rights of the members in their capacity as members of the company. **Clause 4.55** establishes when members of a company are in a class. Members are in a class if the rights of the members are in all respects uniform.
- (e) **Extending the statutory provisions for variation of class rights to cover companies without a share capital**

Background

23. Sections 63A, 64 and 64A of the CO only provide for variation of class rights for companies with a share capital. The CO is silent on how members' rights may be varied in the case of companies without a share capital. It would seem that this would largely depend on whether provision has been made in the articles of association⁸ for their variation but this is clearly less than satisfactory.
24. The same problem existed in the UK Companies Act 1985 but this was remedied in the UKCA 2006 which extends the statutory provisions on variation of class rights of companies with a share capital to companies without a share capital (section 631). The CB will likewise provide for the variation of class rights for companies without a share capital.

Proposal

25. **Subdivision 2 of Division 7 (Clauses 4.53 to 4.60)** provides for variation of class rights for companies without a share capital. The provisions mirror the corresponding provisions in **Subdivision 1 of Division 7 (Clauses 4.44 to 4.52)**, which applies to companies with a share capital. **Clause 4.56** sets out the procedural requirements for the variation of the rights of a class of members of a company that does not have a share capital. **Clause 4.57** requires a company that does not have a share capital to notify each class member if the rights of the class are varied (the corresponding provision for companies with a share capital (**Clause 4.49**) is a new requirement). **Clause 4.58** allows members amounting to at least 10% of members of the class to apply to the Court of First Instance to have a variation of the rights of the class disallowed. **Clause 4.60** requires a company that does not have

⁸ Provisions contained in the memorandum of association of existing companies are deemed to be contained in the articles of association on and after the commencement of the CB.

a share capital to notify the CR of a variation of the rights of a class of members within one month after the variation takes effect.

- (f) **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**

Background

26. A statement of capital is in essence a “snapshot” of a company’s total subscribed capital at a particular point in time. We will require a company to deliver to the Registrar such a statement to be contained in a return or notification, whenever there is a change to its capital. For instance, in the context of an allotment of shares or a permitted alteration of share capital under **Clause 4.38**, a statement of capital will show the company’s share capital information as at the time the company has so changed its share capital. This new requirement enhances the existing requirements 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. A similar requirement for a company to submit a “statement of capital” when there is a change to its capital structure has been introduced under the UKCA 2006.

Proposal

27. **Clause 4.69** sets out the information to be contained in a statement of capital. Other provisions in the Part (such as **Clauses 4.10, 4.39, 4.41, 4.43 and 4.52**) require a company to include a statement of capital in a return or notice delivered to the CR. A statement of capital must state the total number of issued shares in the company and the total amount paid and unpaid (if any) on them. Where the share capital is divided into classes, the statement must also contain particulars of the rights attached to shares of each class, the total number of issued shares of each class and the total amount paid and unpaid (if any) on issued shares of each class.

Other Changes

(a) **Providing expressly that a company may redenominate its share capital from one currency into another**

28. Whilst a company incorporated under the CO may issue foreign currency shares, it cannot easily convert its existing share capital into another currency. If a company wishes to redenominate its share capital into a different currency it is likely to find that an equivalent amount in the new currency would create shares expressed in awkward fractions of the new currency.
29. In order to create shares in the new denomination with whole numbers, the company would need to denominalise its shares as well, that is change the nominal value of each share. The process requires a cancellation of issued shares or buying back its existing shares (the shares it wants to redenominate) and an issue of new shares with a different denomination. These difficulties arise because there is no provision in the CO which deals specifically with the redenomination of issued share capital.
30. Under a no-par system, although there would not be a need to provide for the renominalisation of the shares, it would still be useful to have formal provisions in the CB on the denomination and redenomination of share capital.
31. **Clause 4.3** provides that a company's shares may be denominated in any currency. It further provides that shares of different classes in a company may be denominated in different currencies.
32. **Clause 4.40** empowers a company to convert its share capital, or any class of its share capital, from one currency to another currency. This power may be exercised on or after the appointed day for the introduction of shares having no nominal value. A redenomination does not affect any rights or obligations of members under the company's articles or any restrictions affecting members under the articles, and in particular does not affect any rights to dividends, voting rights or liability in respect of amounts unpaid on the shares.

(b) Removing the power of companies to convert shares into stock

33. “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 \$10.00 each numbered 1 to 100, holds a \$1,000.00 stock. The expression of a holding in terms of dollars or cents seems inappropriate to no-par value shares which are, in substance, no more than fractions of the company’s net worth.
34. The use of “stock” is nowadays uncommon. Although, theoretically, there does not appear to be a reason why stocks cannot be redefined and expressed in number of shares or percentage of participation in a particular company or class of shares, there does not appear to be much practical purpose to this. It is therefore proposed that the concept of stock be abolished. A company which has previously converted shares into stock may reconvert the stock back into shares.
35. **Clause 4.6** repeals a company’s power to convert shares into stock. **Clause 4.42** empowers a company that has converted paid up shares into stock (before the repeal of the power to do so) to reconvert the stock into shares. **Clause 4.43** requires a company that has reconverted its stock into shares under **Clause 4.42** to deliver a notice to the Registrar within one month. The notice must include a statement of capital.

(c) Clarifying requirements to register an allotment in the register of members

36. Although in the case of an allotment of shares, section 45 of the CO requires a company to deliver a return of the allotment to the Registrar for registration, there is no express requirement for a company allotting its shares to enter the information on the allotment and the details of the allottees in the register of its members within a specified period.
37. **Clause 4.11** of the CB will require an entry to be made in the register of members within 2 months after the date of the allotment of shares.

(d) Refusal of registration of shares transmitted by operation of law

38. **Clause 4.26** provides for a new requirement for a company to send a notice of refusal of registration to a person to whom shares are transmitted to the

person by operation of law and whose registration as a member has been refused. **Clause 4.27** provides that such person may apply to the Court of First Instance for an order to compel registration. These provisions mirror the corresponding provisions for transfer of shares in **Clauses 4.19** and **4.20**.

(e) **Raising the threshold amount in replacement of lost share certificate and publicizing the notice in company’s website**

39. **Division 5** deals with the replacement of listed companies’ lost share certificates. The Division re-enacts the substance of section 71A with a number of improvements.

40. **Clause 4.32** imposes publication requirements on the company before it may issue a replacement share certificate. Notice of intention must be published in the manner required by the law. In certain cases, a copy of the notice must also be served on the registered holder of the shares. The clause re-enacts the substance of section 71A(3) to (5) of the CO, except that the publication requirements are simplified. For cases where the value of shares is below \$50,000 (instead of \$20,000 in the current CO), the notice will be published in the listed company’s website (in both Chinese and English) for one month (instead of in newspapers in the current CO). For cases where the value of shares is at or above \$50,000, the notice will be published in the listed company’s website (in both Chinese and English) 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 the current CO).

41. The definition of “genuine purchaser”⁹ in **Clause 4.30** clarifies that the person to whom the new certificate is issued is excluded from the term. The effect of the definition is to confirm that, under **Clause 4.35**, the Court may make an order under **Clause 12.99** (which gives the Court of First Instance power to make an order for rectification of the register of members) in favour of the original registered owner against the person to whom the new certificate was issued and against any person deriving title from him or her otherwise than as a genuine purchaser without notice.

⁹ The phrase “genuine purchaser” is used in place of “bona fide purchaser” in Division 5 of Part 4.

PART 5

TRANSACTIONS IN RELATION TO SHARE CAPITAL

Introduction

1. Part 5 of the CB contains the provisions concerning “Capital Maintenance” (reduction of capital and purchase of own shares (“buy-backs”)) and related rules (financial assistance). The capital maintenance doctrine was first developed in the mid-19th century in the UK. The premise of the doctrine is that creditors provide credit on the basis of an express or implied representation by the company that consideration received for shares (the share capital) shall be applied only for the purposes of the business and that it shall not be returned to the shareholders except in a winding up after all creditors have been paid.
2. In the public consultation conducted during June to September 2008, we asked whether changes should be introduced to the current rules. Having regard to the comments received¹, the CB will introduce reforms to streamline and rationalize those rules which are commonly considered as unduly complex, ill-targeted for their intended purpose or somewhat overtaken by their exceptions.
3. In Chapter 2 of this Consultation Paper, we seek comments on the option of abolishing the prohibition on financial assistance for private companies, as an alternative to the rules on financial assistance proposed in Divisions 2 and 5 of this Part.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) **Adopting a uniform solvency test based on cash-flow for different types of transactions under this Part;**
 - (b) **Introducing an alternative court-free procedure for reduction of capital based on a solvency test;**

¹ FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (February 2009), paragraphs 30 to 51 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

(c) Allowing all companies to purchase their own shares out of capital, subject to a solvency test; and

(d) Allowing all types of companies (whether listed or unlisted) to provide financial assistance, subject to the satisfaction of the solvency test and certain specified procedures.

Significant Changes

(a) Adopting a uniform solvency test based on cash-flow for different types of transactions under this Part

Background

4. Under Part II of the CO a solvency test is provided for in respect of:

(i) buy-backs of its own shares out of capital by a private company; and

(ii) financial assistance by an unlisted company for the purpose of an acquisition of shares in the company or its holding company.

For (i), the solvency test has to be satisfied according to the requirements set out in section 49K(3), (4) and (5). For (ii), the solvency test has to be satisfied according to the requirements set out in section 47F(1)(d) and (2). Both of these solvency tests are based on cash flow alone. However, they are not exactly the same. The main differences are:

(i) the solvency test under section 47F(1)(d) seems to have an additional limb under section 47F(1)(d)(i) which provides for the situation where the company intends to commence winding up within 12 months of the date of the proposed financial assistance²; and

(ii) under section 49K(5), the solvency statement has to be accompanied by an auditor report³.

² It states that if it is intended to commence the winding up of the company within 12 months, that the company will be able to pay its debts in full within 12 months of the commencement of the winding up.

³ The auditor report should state that:

- the auditor has inquired into the company's state of affairs
- the auditor is not aware of anything to indicate that the opinion expressed by the directors in the statement is unreasonable in all the circumstances.

5. As the solvency test will be applied to transactions involving a reduction of capital, buy-back or financial assistance, we consider that a uniform solvency test would result in consistency of the law. A uniform adoption of the approach of section 47(F)(1)(d) can give clarity and certainty on how the solvency test may apply in different scenarios.
6. As to the auditor's report, we take the view that the issues that need to be considered in determining whether the company would satisfy the solvency test involve forward-looking business judgments and so auditors would not be in a better position than the directors in ascertaining the company's solvency. Directors would be expected to have reasonable grounds in forming their opinion as to the company's solvency, and should be left to decide in any given case whether professional assistance is needed. Requiring an auditor's report in every case would add expense and delay for relatively little gain. We therefore do not propose to retain the requirement of attaching an auditor's report to the solvency statement.

Proposal

7. **Clause 5.2** provides that a uniform solvency test will be applicable to all three categories of transactions - reduction of capital, buy-backs and financial assistance. **Clause 5.3** sets out the content of the uniform solvency test, which in substance, re-enacts section 47F(1)(d). **Clause 5.4** provides for the making of a solvency statement. A solvency statement in relation to a transaction is a statement that each of the directors making it has formed the opinion that the company satisfies the solvency test in relation to the transaction. In forming his opinion, a director must inquire into the company's state of affairs and prospects and take into account contingent and prospective liabilities of the company. The solvency statement must be in the specified form and be signed by each director making it.
- (b) Introducing an alternative court-free procedure for reduction of capital based on solvency test**

Background

8. 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 (sections 58 to 63 of the CO). Shareholders must agree by

special resolution. In determining whether to approve the reduction, the court will consider various factors, including whether the reduction is equitable between shareholders and whether creditors' interests are safeguarded.

9. We will introduce a court-free procedure based on the solvency test, as an alternative procedure to the current rules. The new procedure should be faster and cheaper and can be utilised by all companies.

Proposal

10. **Subdivision 2 of Division 3** provides for a court-free procedure for reduction of capital, subject to compliance with the solvency test. The key features of the process include:
 - (a) all the directors signing a solvency statement in support of the proposed reduction of capital (**Clause 5.12**);
 - (b) the company obtaining members' approval by a special resolution (**Clauses 5.11 and 5.13**);
 - (c) the company publishing notices with relevant information in the Gazette and newspapers⁴ and registering the solvency statement with the CR (**Clause 5.14**);
 - (d) any creditor or non-approving member of the company may, within 5 weeks of the date on which the resolution is passed, apply to the court for cancellation of the resolution (**Clauses 5.16 to 5.18**). During this 5-week period, the company must make available the special resolution and solvency statement for the members' and creditors' inspection (**Clause 5.15**); and
 - (e) the company must deliver after the 5-week period (but no later than 7 weeks) to the CR a return in specified form if there is no court application (**Clause 5.20**), or within 15 days⁵ after the court makes the order confirming the special resolution or the proceedings are ended without determination by the court (**Clause 5.21**). The reduction takes effect when the return is registered by the CR.

⁴ Instead of publishing notices in newspapers, the company may give written notice to that effect to each of its creditors.

⁵ Or such longer period as ordered by the court.

11. **Subdivision 2 of Division 3** is based on sections 49K to 49O, which set out the procedures for a private company to buy-back its own shares out of capital. There is a difference in that the CB provides that the reduction of capital will take effect when the return is registered by the CR under **Clause 5.20** or **5.21**.
- (c) **Allowing all companies to purchase their own shares out of capital, subject to a solvency test**

Background

12. 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 currently provided as an exception available to private companies only. We will streamline the rules and allow all companies to fund buy-backs out of capital, subject to a solvency requirement. This procedure is included in the CB as an alternative to the existing rules on buy-backs out of profits or the proceeds of a fresh issue of shares.

Proposal

13. **Clause 5.52** provides that a company may redeem or purchase its own shares out of distributable profits, out of the proceeds of a fresh issue of shares or out of capital. However, a listed company will not be allowed to make a payment out of capital in respect of a purchase of its own shares on the stock exchange because it would be impractical for the listed company to follow all the procedures for payment out of capital each time before it purchases its own share in the market.
14. **Clauses 5.53 to 5.61** retains much of the requirements and procedures applicable to the buy-backs by a private company out of capital, and extends it to all companies. Largely the same requirements and procedures will be adopted for the new court-free procedure for reduction of capital in **Subdivision 2 of Division 3**, which are discussed in paragraph 10 above. The main difference is that the company is not required to deliver to the CR a return in specified form after the 5-week period. This is because under **Clause 5.66**, the company will be required to deliver a similar return, which is applicable to all types of purchase/redemption of shares (not just those

financed out of capital) within 14 days after the date on which the redeemed/purchased shares are delivered to the company. The purchase or redemption must be made no earlier than 5 weeks and no later than 7 weeks after the date the special resolution is passed, unless otherwise ordered by the court.

- (d) **Allowing all types of companies (whether listed or unlisted) to provide financial assistance, subject to the satisfaction of the solvency test and certain specified procedures**

Background

15. Section 47A of the CO imposes broad prohibitions (subject to certain exceptions) on a company and its subsidiaries giving financial assistance for the purpose of acquiring shares in the company. In Chapter 2, we seek comments on the option of abolishing the prohibition on financial assistance for private companies.
16. Assuming that the prohibition on the giving of financial assistance for private companies are still considered necessary, we propose to streamline the financial assistance provisions in a manner similar to the NZCA.

Proposal

17. The CB retains the current definition of financial assistance in the CO (**Clause 5.70**). It also largely retains the current exceptions to the prohibition in section 47C of the CO (see also paragraph 21 below) and the special restrictions for listed companies in section 47D of the CO (**Clauses 5.73 to 5.78**). It then allows all types of company (whether listed or unlisted) to provide financial assistance, subject to the satisfaction of the solvency test⁶ and one of the three procedures set out in **Subdivision 4 of Division 5**.
18. The first which is in **Clause 5.79** provides that a company may give financial assistance if the assistance, and all other financial assistance previously given and not repaid, is in aggregate less than 5% of the

⁶ Unlike the solvency test for reduction of capital and redeem/purchase of own shares where all directors are required to make the solvency statement, the solvency statement for financial assistance is only required to be made by a majority of directors. This is the current position for the solvency test in financial assistance provisions in the CO and we believe having the majority of directors to make the statement should be sufficient as financial assistance is strictly not related to capital maintenance, and a lower threshold is justified.

shareholders' funds. The giving of the assistance must be supported by a solvency statement and a resolution of the directors in favour of giving the assistance. The assistance must be given not more than 12 months after the day on which the solvency statement is made. Within 15 days after giving the assistance, the company must notify its members the details of the assistance.

19. The second which is in **Clause 5.80** provides that a company may give financial assistance if it is approved by written resolution of all members of the company. The giving of the assistance must be supported by a solvency statement and a resolution of the directors in favour of giving the assistance. The assistance must be given not more than 12 months after the day on which the solvency statement is made.
20. The third which is in **Clause 5.81** provides that a company may give financial assistance if a notice is given to shareholders regarding the financial assistance. The giving of the assistance must be supported by a solvency statement and the board must resolve that giving the assistance is in the interests of the company. The company must send to each member a notice which contains all information necessary for the members to understand the nature of the assistance and the implications of giving it for the company. The assistance may only be given not less than 28 days after the day on which the notice is sent to the members and not more than 12 months after the day on which the solvency statement is made. **Clauses 5.82 to 5.84** provides that any member of the company or the company may, within the 28-day period, apply to the court to restrain the giving of the assistance.

Other Changes

- (a) **Making changes to the employee share scheme exception to giving financial assistance**
21. The existing section 47C(4)(b) of the CO provides that the prohibition on financial assistance does not apply to employee share schemes. However, the financial assistance is restricted to the provision of money for the purchase or subscription of fully paid shares. We note that section 682(2)(b) of the UKCA 2006 adopts a more flexible approach than the current CO. **Clause 5.76**, which is largely based on the relevant UKCA 2006 provisions, allows all forms of financial assistance if the assistance is

given in good faith in the interest of the company for the purposes of an employee share scheme or the giving of the assistance is for the purposes of enabling or facilitating transactions to acquire the beneficial ownership of shares for the employees. A number of definitions are also added for the purpose of clarity, e.g. “employee share scheme”.

(b) Standardising the definition of net assets in financial assistance

22. In section 47B(2) of the CO “net assets” is given “the same meaning as in section 157HA(15)”. The definition in section 157HA(15) includes the concept of “provisions”, which is itself defined in the Tenth Schedule of the CO. The Tenth Schedule will not be retained in the CB. There is another definition for “net assets” under section 47D(2) of the CO (which sets out a special restriction on financial assistance for listed companies). Since the two definitions are in substance the same, the definition set out in section 47D(2) is adopted in **Clause 5.70** for application in **Division 5 of Part 5**. The definition in section 47B(2) is not re-enacted.

PART 6

DISTRIBUTION OF PROFITS AND ASSETS

1. Part 6 deals with the distribution of profits and assets to members. The specific provisions on distributions are currently contained in sections 79A to 79P of Part IIA of the CO. Under the existing regime, “distribution” means every description of distribution of a company’s asset to its members whether in cash or otherwise, with a number of exceptions (e.g. a reduction of share capital and distribution in a winding up). The usual form of distribution is “dividend”.
2. If dividends can be paid despite the fact that the value of the net assets of the company is, or would become as a result of the payment, less than the value of the capital yardstick (i.e. the issued share capital plus share premium account and capital redemption reserve), then the purpose of the capital maintenance rules would be defeated. Part IIA lays down, for the protection of creditors, certain basic principles relating to the payment of dividends and the making of other distributions. The most important one is that a company may make a distribution only out of profits available for that purpose (section 79B(1)). A company’s profits available for distribution are its accumulated, realised profits (so far as not previously distributed or capitalised) less its accumulated, realised losses (so far as not previously written off in a reduction or reorganisation of capital) (section 79B((2)). Thus realised losses may not be offset against unrealised profits. Section 79C imposes a further restriction for listed companies.
3. Whether or not a distribution may be made within the terms of the CO is determined by reference to a company’s “relevant accounts”. Where it is proposed to make a distribution during the company’s first accounting reference period or before any accounts have been circulated, initial accounts must be prepared (section 79I). In all other cases, the relevant accounts are its last annual accounts that were circulated to members (section 79G) or interim accounts (section 79H), if the proposed distribution cannot be justified by reference to the last annual accounts.

4. The current rules on distribution have worked well and provide certainty. The CB does not propose any fundamental changes to the distribution provisions. This follows the consultation conclusions of the third topical consultation of not adopting a general solvency test in place of the capital maintenance doctrine¹.
5. Although the capital maintenance doctrine is largely retained, there are new exceptions based on a solvency test for reduction of capital, buy-backs and financial assistance. This wider use of the solvency test impacts on the current rules on distributions to a certain extent. For example, the exclusion of buy-backs out of capital from the definition of "distribution" (currently in CO s 79A(1)) would be wider under the CB (**Clause 6.1**) because of the wider circumstances where buy-backs can be made out of capital pursuant to the solvency test. Consequently, there could be more situations where "distributions" to shareholders under a buy-back are governed solely by the solvency test in Part 5 rather than the rules on distributions in Part 6.
6. There will also be technical amendments to change the terms used in Part 6 in accordance with the changes made in other Parts of the CB, e.g. the terms "profit and loss account" and "balance sheet" will be replaced by "financial statement" as in Part 9; the expression "purchase of a company's own shares" will be replaced by the term "buy-back" as in Part 5. References to "capital redemption reserve" and "share premium account" will be removed in parallel with the introduction of the no-par regime in Part 4. The existing section 79O of the CO would be removed as it is considered that there should not be exceptions for special classes of company (banking, insurance and shipping companies). The provisions will also be reorganised in a more logical and user-friendly way. Transitional provisions in this Part will be included in the finalised Bill.

¹ FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (February 2009), paragraphs 30 to 33.

PART 7

DEBENTURES

Introduction

1. The specific provisions on debentures are currently contained in sections 74A to 79 of the CO. They deal with a miscellany of matters, for example, the register of debenture holders, rights of inspection of the register and to copies of the register, trust deed and other documents, and meetings of debenture holders. A number of other provisions in the CO also apply to both debentures and shares (see paragraph 10 below).
2. To improve clarity, all substantive provisions on debentures are grouped into Part 7 of the CB. Adjustments are made mainly to align with the corresponding provisions for shares. We also introduce a new requirement for the allotment of debentures to be registered, in parallel with a similar new requirement for shares. Current sections 75A and 79 of the CO will not be re-enacted¹.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) **Aligning provisions for keeping of the register of debenture holders and branch register with the corresponding provisions for shares;**
 - (b) **Introducing new requirements applicable to the allotment of debentures to align with similar requirements for shares; and**
 - (c) **Allowing debenture holders to apply to the court to order a meeting to be held to give directions to the trustee for the protection of debenture holders.**

¹ Section 79 will be reviewed in Phase II of the Rewrite.

Significant Changes

(a) **Aligning provisions for keeping of the register of debenture holders and branch register with the corresponding provisions for shares**

Background

3. Section 74A of the CO sets out the requirement for keeping the register of debenture holders, similar to section 95 governing the register of members in relation to their holding of shares in a company. Although the provision is largely the same as that for shares, there is a difference in that the register of debenture holders is required to state the occupation of the debenture holders (or otherwise provide a description), whilst it is not so required for the register of members. Sections 103 and 104 of the CO provide for the keeping of a branch register of members. However, there is no provision for duplicate and branch register for debenture holders. Since it is as likely for debt securities to be issued outside the issuer's home jurisdiction these days as it is for shares, it would be useful to also provide for branch and duplicate registers of debenture holders.
4. In addition, there are provisions in the CO which govern the place where the register of members of a company is to be kept (section 95), and the right to inspect and request a copy of the register of members (section 98). These provisions are essentially restated in Part 12 of the CB². To ensure consistency, the provisions on registers of debenture holders and registers of members will be aligned.

Proposal

5. The clauses governing the register of debenture holders will generally mirror the corresponding clauses on the register of members. Such clauses include:
 - **Clause 7.2** on the keeping of the register of debenture holders;
 - **Clause 7.3** on the place where the register of debenture holders is kept;

² See FSTB, "Part 12: Company Administration and Procedure", *Companies Bill Consultation Draft (Parts 1, 2, 10-12 & 14-18)* (December 2009).

- **Clause 7.4** on the right to inspect and request a copy of the register of debenture holders³; and
- **Clauses 7.9 to 7.12** on the keeping of branch and duplicate registers of debenture holders.

(b) Introducing new requirements applicable to the allotment of debentures to align with similar requirements for shares

Background

6. Section 45 of the CO requires a company to deliver a return of the allotment of shares to the Registrar for registration. **Clause 4.11** of the CB will further require an entry to be made in the register of members within 2 months after the date of the allotment of shares⁴. Currently, there are no such requirements for the allotment of debentures. To help protect investors in debentures, requirements similar to those for the allotment of shares will be adopted.

Proposal

7. **Clause 7.13** provides that within one month after an allotment of debentures, a company must deliver to the Registrar for registration a return of the allotment. **Clause 7.14** provides that as soon as practicable and in any event within 2 months after an allotment of debentures, a company must register the allotment in the register of debenture holders.

(c) Allowing debenture holders to apply to the court to order a meeting to be held to give directions to the trustee for the protection of debenture holders

Background

8. Section 75A of the CO provides that certain provisions concerning meetings of debenture holders shall mirror those applicable to meetings of

³ The right to a copy of the trust deed will be restricted to debenture holders and trustees only, which is the same as the UK, Australia and Singapore.

⁴ See Explanatory Notes on Part 4 above.

shareholders⁵, but only if the debentures, the trust deed or other document securing the debentures or stock provide for such meetings and to the extent that they are not inconsistent with the debenture documents concerned. In practice, it is difficult to see when the provisions are likely to be invoked. If the debenture documents do not provide for meetings, the provision will be of no assistance. Where the debenture documents do so provide, these documents (if professionally prepared) are likely to have their own provisions which will negate the application of the statutory provisions. It is considered that conferring a power on the court to order a meeting to give directions to the trustee for the protection of debenture holders appears to be more helpful to debenture holders⁶.

Proposal

9. **Clause 7.28** provides for the right for debenture holders of a company who together hold 10% of the value of the debentures of the company to apply to the court to order a meeting and give directions to the trustee, subject to any provision in the trust deeds to exclude such right or require a higher percentage of debenture holders who may make the application to the court. The debentures to which this clause applies are limited to debentures forming part of a series issued by the company and ranking pari passu with the other debentures of that series and debenture stock.

Other Changes

Improving clarity by separating provisions applicable to debentures from those to shares

10. Currently, some of provisions applicable to both shares and debentures are scattered in different parts of the CO. Examples are:
 - production of instrument of transfer for transfer of shares and debentures to be registered (section 66);
 - notice of refusal to register transfer (section 69);

⁵ The section only applies to a series of debentures ranking pari passu with the other debentures of that series or debenture stock. The provisions concern a requisition to convene an extraordinary general meeting (section 113 of the CO); the power of the court to order a meeting (section 114B); the appointment of proxies (section 114C); the right of a proxy to demand or join in the demand for a poll (section 114D(2)); and voting on a poll (section 114E).

⁶ There are similar provisions in the ACA. See Part 2L.5 (section 283EC in particular) of the ACA.

- certification of transfers (section 69A);
 - duties of company with respect to the issue of certificates on allotment and transfer and the court's power to order such issue (section 70); and
 - a company's power to close register of members and register of debenture holders (section 99).
11. Such a layout is not user-friendly as a reader interested only in debentures has to comb through various provisions in different parts of the Ordinance to identify those provisions applicable to debentures. To improve clarity, all substantive requirements about debentures are now grouped under Part 7.

PART 8

REGISTRATION OF CHARGES

Introduction

1. Part 8 deals with registration of charges by both Hong Kong and registered non-Hong Kong companies. It sets out the types of charges which require registration and provides for the registration procedures involved and the consequences of non-compliance. It also contains provisions to regulate matters associated with registration, such as requiring companies to keep, and allow inspection of, copies of instruments of charges and registers of charges.
2. Part 8 basically retains the current registration regime under Part III of the CO (sections 80 to 91), with modifications made to improve the registration system, taking into account the comments received during the topical public consultation conducted in the second quarter of 2008 (“topical consultation”)¹.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) updating the list of registrable charges, such as expressly providing that a charge on an aircraft or any share in an aircraft is registrable and removing the requirement to register a charge for the purpose of securing any issue of debentures;**
 - (b) replacing the automatic acceleration of the repayment obligation with a choice given to the lender as to whether the secured amount is to become immediately payable where a charge is rendered void for non-compliance with the registration requirements;**
 - (c) in addition to the prescribed particulars of the charge, requiring the charge instrument to be registrable and available for public inspection;**

¹ The *Consultation Conclusions on “Company Names, Directors’ Duties, Corporate Directorship and Registration of Charges”* were issued in December 2008 and are available at www.fstb.gov.hk/fsb/co_rewrite.

- (d) shortening the period for delivery to the Registrar of the charge instrument and the prescribed particulars from 5 weeks to 21 days;
- (e) replacing the issue by the Registrar of a certificate of due registration with the issue of an acknowledgement of receipt; and
- (f) requiring written evidence of debt satisfaction/release of a charge to accompany a notification to the Registrar for registration of the debt satisfaction/release, thus rendering such documents to be available for public inspection.

Significant Changes

(a) Updating the list of registrable charges

Background

3. Under the current regime, only charges which fall within the categories as provided in section 80(2) of the CO are required to be registered. We suggest to make the following changes to the list:

(i) Charge on an aircraft or any share in an aircraft

The current list does not expressly include a charge on aircraft, though it may be argued that some charges on aircrafts are already made registrable as bills of sale under section 80(2)(c) of the CO. However, it is arguable that not all mortgages over aircrafts are necessarily registrable under section 80(2)(c)². We will expressly provide that a charge on an aircraft or any share in an aircraft is registrable.

(ii) Instalments due, but not paid, on the issue price of the shares

Section 80(2)(g) of the CO provides for the registration of a charge on calls made but not paid. It has been argued that the registrability should also cover a charge on instalments due, but not paid, on the issue price of the shares although these instalments are not calls in the

² Some such mortgages could fall within one or more of the exclusions from the definition of 'bill of sale' and are therefore not registrable under section 80(2)(c).

strict sense. We therefore propose that express provision should be made to clarify that a charge on such instalments is registrable.

(iii) Charge for the purpose of securing any issue of debentures

We consider that section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures duplicates some other heads of registrable charges and is therefore redundant. Typically, issues of debentures are usually supported by a floating charge or a fixed charge that is registrable by virtue of some other categories of registrable charges. Accordingly, section 80(2)(a) of the CO will not be retained in the CB.

(iv) Lien on subfreights

There is judicial authority to support the principle that a shipowner's contractual lien on subfreights is a charge on book debts³ or a floating charge⁴ which is registrable under section 80(2)(e) or section 80(2)(f) of the CO. On the other hand, it has also been said that a lien on subfreights is not a charge at all but merely a personal right to intercept freight before it is paid to the owner⁵. We take into account that since charterparties are usually negotiated by shipbrokers and not by lawyers and are normally of a relatively short duration, requiring a lien to be registered is inconvenient from a commercial perspective. We will clarify that a shipowner's lien on subfreights does not fall within the category of a charge on book debts nor a floating charge on the company's property.

(v) Cash deposits

Although a charge over cash deposits could arguably be registrable as a charge on book debts under section 80(2)(e) of the CO, we will exclude such charges from this registrable head, the reason being that such charges are normally taken over credit balances with financial institutions, i.e. in the form of charge-backs with banks. Third party creditors would not be misled by the absence of registration since bank accounts are usually operated confidentially and it is reasonable to expect the depository bank to have a superior claim to the credit

³ *In re Welsh Irish Ferries Ltd* [1986] Ch 471.

⁴ *The Annangel Glory* [1988] 1 Lloyd's Rep 45.

⁵ Lord Millett in *Re Brumark Ltd: Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, at paragraph 41.

balance. Moreover, being in the nature of a charge-back, such charges would ordinarily have the effect of a set-off which, of itself, also does not require registration.

Proposal

4. **Clause 8.3(1)(h)** provides expressly that a charge on an aircraft or any share in an aircraft is registrable.
 5. **Clause 8.3(1)(f)** expressly makes a charge on instalments due, but not paid, on the issue price of shares to be registrable.
 6. **Clause 8.3(1)**, which contains the list of charges to be registrable under the CB, no longer specifically provides for the registration of a charge for the purpose of securing any issue of debentures.
 7. **Clause 8.3(4)** states that a shipowner's lien on subfreights shall not be regarded as a charge on book debts or as a floating charge.
 8. **Clause 8.3(3)(b)** stipulates that if a company deposits money with another person, a charge given by the company over its right to enforce repayment of the money is not regarded as a charge on book debts of the company.
- (b) Replacing the automatic acceleration of repayment obligation**

Background

9. Section 80(1) of the current CO states that where a charge becomes void for not being registered with the Registrar within the specified time limit, the money secured by it automatically becomes immediately payable. We note that this statutory acceleration of repayment may create problems for banks, as the acceleration arises automatically. We therefore propose to replace the "automatic" acceleration provision with a "discretionary" acceleration provision in the CB. The proposal received general support in the topical consultation.

Proposal

10. **Clause 8.6(6)** provides that when a charge becomes void should it be not registered with the Registrar within the specified time limit, the money secured by the charge becomes immediately payable at the option of the lender.
- (c) **In addition to the prescribed particulars of the charge, requiring the charge instrument to be registrable and available for public inspection**

Background

11. The present law requires the charge instrument⁶ (if any) together with the prescribed particulars of the charge in the specified form⁷, to be submitted to the Registrar for registration. However, only the prescribed particulars are required to be registered and made available for public inspection⁸ by the Registrar. The charge instrument itself, which is delivered for the purpose of enabling the Registrar to verify the contents of the prescribed particulars, does not appear on the Register for public search.
12. We note that it is desirable to make available to those who search the Register more detailed information as to the charges. We will therefore make both the charge instrument (if any) and the prescribed particulars of the charge registrable and available for public inspection. If the charge instrument is required to be registered, we believe that registration will give rise to constructive notice of all the terms in the charge instrument, including negative pledge clauses, on the part of those who may reasonably be expected to search the Register, such as banks, financiers and relevant professionals.

Proposal

13. The particulars of a charge required for registration under the CB are to be contained in a “statement of the particulars of a charge” which will be in specified form. The statement contains less details as compared with the

⁶ “Charge instrument” means the instrument by which a charge is created or evidenced. In the case of a charge in a series of debentures where the debenture holders of that series are equally entitled to the benefit of the charge, the charge instrument means the debenture containing the charge or the instrument of charge to which the debenture refers.

⁷ The prescribed particulars are contained in Form M1.

⁸ Only those prescribed particulars as set out in section 83(1) of the CO are required to be entered in the Register and made available for public inspection.

prescribed particulars under the CO, since the charge instrument itself will be registered. **Clauses 8.4(1), 8.4(2), 8.5(1), 8.5(2), 8.7(2), 8.8(3), 8.9(2) and 8.9(3)** require Hong Kong companies and registered non-Hong Kong companies to deliver to the Registrar for registration the statement of the particulars of the charge and the charge instrument (if any) under the circumstances stated in those provisions (i.e. where the company creates a registrable charge or acquires property subject to a registrable charge). Failure to deliver the statement of the particulars of the charge and the charge instrument (if any) within the specified registration period is an offence (**Clauses 8.6(2), 8.7(5), 8.8(6) and 8.9(7)**). Where a registrable charge created by the company is not registered in time, the charge is void as against the liquidator and creditors, as is the case under CO section 80 (**Clause 8.6(4)**).

(d) Shortening the period for delivery to the Registrar of the charge instrument and the prescribed particulars from 5 weeks to 21 days

Background

14. The CO currently requires a company to submit particulars of a charge and the charge instrument (if any) for registration within a period of five weeks⁹. It may therefore be possible that the particulars of a charge will only be visible on the Register after the expiration of the five-week period. We take the view that the period for the particulars of a charge to be invisible to outside parties should be minimized. As set out in the topical consultation conclusions, we will shorten the period for registration of the particulars of charge to 21 days, the same as in the UK.

Proposal

15. **Clauses 8.4(5), 8.5(6), 8.7(3), 8.8(4) and 8.9(5)** require the statement of the particulars of a charge and the charge instrument (if any) to be lodged for registration within 21 days. In the case of an issue of debentures in a series, a statement of particulars of each issue of the debentures must be submitted for registration within 21 days **Clause 8.10(4)**, and where the charge or the debentures involves the payment of commission, allowance or discount, a statement of the particulars of the commission, allowance or discount must also be delivered for registration within 21 days (**Clause 8.11(6)**).

⁹ For registration of a charge created by a company, the period of five weeks commences from the day after the day on which the charge is created. For registration of a charge existing on property acquired by a company, the period of five weeks commences from the day after the day on which the acquisition is completed.

(e) **Replacing the issue of a certificate of due registration with the issue of an acknowledgement of receipt**

Background

16. We consider that the procedure undertaken by the Registrar to verify the delivered particulars in the specified form against the charge instrument (if any) inevitably slows down the registration process. It should be the duty of the company, rather than the Registrar, to verify the particulars entered in the specified form. We recommend that the Registrar should be relieved from performing such a checking function in order to expedite the registration process. As a corollary to such a change, the Registrar should no longer be required to issue a certificate of due registration. A simple acknowledgement of receipt¹⁰ of the documents submitted for registration will instead be issued. It is not to be treated as conclusive evidence that all the registration requirements have been complied with.

Proposal

17. **Clause 8.13(2)** stipulates that the Registrar must issue a receipt acknowledging the receipt of the filed document(s) by the Registrar on the date of receipt for registration.

(f) **Requiring written evidence of debt satisfaction/release of a charge to accompany a notification to the Registrar for registration of the debt satisfaction/release**

Background

18. The current law provides a means whereby a charge that is released or discharged can be shown as discharged on the Register. If the debt secured by a registered charge has been satisfied, an application in the specified form¹¹ may be made to the Registrar for entering on the Register a memorandum of satisfaction. A similar application may also be made where the property or undertaking subject to a registered charge has been released from the charge or has ceased to form part of the company's property or undertaking. The Registrar will, in such event, enter on the

¹⁰ This document will not be called a "certificate", because at the time of issuing the document, the process that will have been undergone by the Registrar so far will in substance be an acknowledgement of receipt by the Registrar of the submitted document(s) for the purpose of registration on the date of receipt.

¹¹ Form M2.

Register a memorandum of release or cessation. Such applications should be accompanied by such evidence of discharge as the Registrar may require, which is usually the deed of release/discharge of a charge.

19. Presently, only the memoranda of satisfaction/release are open for public inspection. The evidence of discharge is neither registered nor available for public inspection. As we will make the charge instrument (if any) registrable, for consistency, we will also make the evidence of discharge registrable and open to public inspection as set out in the topical consultation conclusions.

Proposal

20. **Clause 8.14(4)** provides for the registration of the notification and the accompanying evidence of discharge¹².

Other Changes

- (a) **A certified copy of the charge instrument and written evidence of debt satisfaction/release of a charge to be delivered for registration**

21. At present, the original of the charge instrument has to be delivered to the Registrar except where the charge is created by the company out of Hong Kong comprising property situate outside Hong Kong¹³ or the charge is existing on property acquired by the company¹⁴ in which case a copy would suffice.
22. Under the CB, only a certified copy of the charge instrument is required to be submitted to the Registrar for registration (**Clauses 8.4(1), 8.4(2), 8.5(1), 8.5(2), 8.7(2), 8.8(3), 8.9(2) and 8.9(3)**). For the written evidence of debt satisfaction/release of a charge, **Clause 8.14(3)(c)** also only requires a certified copy to be lodged.

¹² Under the current practice, the Registrar will only request for the production of the evidence of discharge if the application is made and signed by the company. Such practice will not be continued under the CB regime as the evidence of discharge should be registered and open for public inspection no matter who signs the application form.

¹³ Section 80(3) of the CO.

¹⁴ Section 82(1) of the CO.

(b) Extension of time for registration by the Court of First Instance (the “Court”)

23. Under the current law, if the Court grants relief to extend the time for registration of a charge, section 86(2) of the CO provides that the grant of such relief will, if the Court so directs, not have the effect of relieving the company or its officer of criminal liabilities already incurred under section 81 of the CO.
24. The effect of section 86(2) of the CO, in its current wording, is unclear as to whether a grant of such relief by the court will, in the absence of any court direction, automatically relieve the company and the officers from criminal liability.
25. In order to remove this uncertainty, **Clause 8.15(5)** states that unless the Court directs otherwise, any liability already incurred for an offence under **Clauses 8.6(2), 8.7(5), 8.8(6), 8.9(7), 8.10(8) or 8.12(1)** in relation to the registration of the charge or debenture is extinguished.

(c) Rectification of particulars in the registered charge instrument and evidence of discharge

26. Currently, section 86(1) of the CO allows the Court to rectify an omission or mis-statement of the registered particulars of a charge or in the memoranda of satisfaction/release. As the CB will make the charge instrument (if any) and evidence of discharge registrable and open to public inspection, the Court will also be empowered under the CB to rectify an omission or mis-statement of the particulars in the registered charge instrument and evidence of discharge (**Clauses 8.15(1)(b)(i) and 8.15(1)(b)(iii)**). Such powers of rectification, however, will be subject to the common law rules and equitable principles as applied in relation to rectification of documents by the Court **Clause 8.15(4)**¹⁵.

¹⁵ Under the general law, the court may rectify a document in particular circumstances where the document failed to record the intention of the parties accurately. The remedy of rectification is available, not for the purpose of altering the terms of the agreement, but for that of correcting a document which does not reflect accurately the true agreement of the parties: *Agip SpA v Navigazione Alta Halia SpA* [1984] Lloyd’s Rep 353 at 359.

(d) Drafting of provisions concerning registered non-Hong Kong companies

27. The current CO only has one provision (section 91) which applies the rest of Part III to registered non-Hong Kong companies. The drafting approach under the CB is different where there are now express provisions dealing with registered non-Hong Kong companies for the purpose of clarity. The change of drafting approach does not itself alter the substance of the charge registration and other requirements imposed on registered non-Hong Kong companies, other than those changes highlighted above.

(e) Transitional provisions

28. Upon implementation of the CB, certain types of charges which are currently not registrable under the CO will become registrable, and vice versa. A revised registration mechanism, concerning matters such as the documents required to be lodged for registration and the time allowed for registration of charges, will also come into play. Transitional provisions are not currently included in the draft CB but they will be finalised and included in the CB that will be introduced in LegCo.

PART 9

ACCOUNTS AND AUDIT

Introduction

1. Part 9 contains the accounting and auditing provisions in relation to the keeping of accounting records, the preparation and circulation of annual financial statements, directors' and auditor's reports and the appointment and rights of auditors. Apart from amending the existing accounting and auditing provisions in sections 121 to 141E of the CO, there are new provisions to lessen the compliance burden on private companies and small guarantee companies through reporting exemptions. The financial reports and disclosure requirements under Part 9 will be complemented by other standards and rules governing the contents of accounts and reports i.e. the financial reporting standards issued by the HKICPA and, in the case of listed companies, Listing Rules of HKEx.
2. Part 9 operates prospectively so that it applies in relation to a financial year, whether of an existing company or a company incorporated under the new Ordinance, that begins on or after the commencement of Part 9. A financial year of a company that begins before or straddles the commencement date of Part 9 will continue to be governed by the existing CO. We will provide for transitional and saving provisions for Part 9 after consideration of the public's views.

- The significant changes¹ to be introduced under this Part are highlighted below:
 - (a) **Clarifying the financial year of a company by providing for an accounting reference period and an accounting reference date, with reference to which financial statements and reports are to be prepared and laid before the company in general meeting or circulated to members of the company;**
 - (b) **Relaxing the qualifying criteria for private companies to prepare simplified financial and directors' reports and allowing small guarantee companies and groups of private or guarantee**

¹ Directors' remuneration reports provided in Subdivision 5 of Division 4 is not covered here in view of the proposal not to pursue this recommendation, see Chapter 3 of the Consultation Paper.

companies to take advantage of the simplified accounting and reporting requirements;

- (c) Aligning the statutory accounting requirements with accounting standards and streamlining disclosure requirements that overlap with the accounting standards;**
- (d) Requiring companies to prepare a more comprehensive directors' report which includes an analytical and forward-looking business review whilst allowing companies qualified for simplified accounting to prepare a simplified directors' report;**
- (e) Enhancing auditor's right to information and strengthening enforcement by imposing criminal sanctions for breaches in relation to the provision of information to auditors;**
- (f) Improving transparency with regard to circumstances of cessation of office of auditor;**
- (g) Providing for the appointment and the deemed re-appointment of auditors and the term of office of an auditor; and**
- (h) Revamping the summary financial report provisions and extending their application to companies in general.**

Significant Changes

- (a) Clarifying the financial year of a company by providing for an accounting reference period and an accounting reference date, with reference to which financial statements and reports are to be prepared and laid before the company in general meeting or circulated to members of the company**

Background

3. At present, the CO does not provide for a company's financial year and accounting reference period. Section 122 of the CO requires accounts to be made out every year and to be laid before the company at its AGM, and those accounts shall be made up to a date falling not more than a specified

number of months before the date of the AGM. Section 111 of the CO requires that not more than 15 months shall elapse between the date of one AGM and the next. It therefore indirectly requires accounts to be made up for a period of not more than 15 months, but there are no rules on shorter accounting periods. In addition, there is currently no provision to regulate the first accounting period, except that the first AGM has to be held within 18 months of incorporation.

Proposal

4. ***For a company incorporated on or after the commencement of the new Ordinance, Clauses 9.12(2), 9.13(4) and (5)*** provide that the first accounting reference period is a period of not more than 18 months from the date of the company's incorporation and ending with its "primary accounting reference date" as appointed by directors, or the last day of the month in which the anniversary of its incorporation falls².
5. ***For an existing company, Clauses 9.12(1), 9.13(1) and (3)*** state that the first accounting reference period begins on the date immediately following the "primary accounting reference date" which is any one of the following dates and ends on the first anniversary of that date:
 - (a) for a company that, immediately before the commencement of Part 9, was required to hold an AGM under section 111(1) of the CO, either the date up to which the most recent accounts were made (in case the accounts have been laid before its AGM after the commencement of this Part and, in the case of a public or guarantee company, before a certain date to be appointed) or the last day of the month in which the first anniversary of its incorporation occurs; or
 - (b) for a company that was not required to hold an AGM in accordance with section 111(1) of the CO, it is the date up to which the last accounts provided to a member under section 111(6)(b) of CO were made.
6. **Clause 9.12(3)** stipulates that the subsequent accounting reference periods of a company are successive periods of 12 months beginning immediately after the end of the previous accounting reference period and ending with

² For example, if a company is incorporated on 1 January 2013 and has not appointed any date as its accounting reference date, its first accounting reference period should start from 1 January 2013 and end on 31 January 2014 (i.e. the last day of the month within which the anniversary of its incorporation falls).

the company's accounting reference date unless the accounting reference period is shortened or extended.

7. **Clause 9.15** defines a company's accounting reference date to be the anniversary of its primary accounting reference date and **Clause 9.16** provides that it may be altered by a directors' resolution, subject to a number of conditions and exceptions.
 8. **Clause 9.11** determines a company's financial year following section 390 of the UK CA 2006. In gist, a company's first financial year is the same as its first accounting reference period, except that the directors may alter the last day of the financial year by plus or minus seven days, so as to allow for some flexibility in fixing the financial year.
- (b) Relaxing the qualifying criteria for private companies to prepare simplified financial and directors' reports and allowing small guarantee companies and groups of private or guarantee companies to take advantage of the simplified accounting and reporting requirements**

Background

9. Section 141D of the CO provides that a private company (other than a company which is a member of a corporate group, a banking/ 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 and simplified directors' reports in respect of one financial year at a time. According to the SME Financial Reporting Framework (SME-FRF) issued by the HKICPA, a company incorporated under the CO qualifies for reporting under the SME-FRF if it satisfies the requirement under section 141D.

Proposal

10. We propose to relax the restrictive qualifying criteria to enable more private companies and small guarantee companies to prepare simplified financial and directors' reports³ to save business and compliance costs⁴. We note the implementation of the Hong Kong Financial Reporting Standard for

³ Further adjustments to the provisions may be required pending discussion with HKICPA on the applicable accounting and reporting standards.

⁴ Companies qualified to prepare simplified financial reports are also exempted from the preparation of business review and certain disclosure requirements (see para. 28, 31 and footnote 8).

Private Entities as a reporting option for eligible private entities on 30 April 2010. We would welcome views of the accounting profession on the implications of the following proposals.

Private Companies

11. **Clauses 9.2(1)(a), 9.4(1) and (2)** provide that a private company (except for a banking/deposit-taking company, an insurance company, or a stock-broking company)⁵, will automatically be qualified for simplified accounting, if it is a “small private company” that satisfies any two of the following conditions specified in **Clause 9.8(1)**:
 - Total annual revenue of not more than HK\$ 50 million.
 - Total assets of not more than HK\$ 50 million.
 - No more than 50 employees.
12. **Clause 9.4(3) and (4)** further provide that if a company is not qualified under paragraph 11 and subsequently becomes qualified it will be able to prepare simplified reports if it has been qualified for two consecutive reporting periods⁶. Similarly, a company previously qualified for simplified reporting will be disqualified after it is no longer qualified for two consecutive reporting periods.
13. Private companies that do not qualify as a “small company” can also enjoy the benefit of simplified financial and directors’ reports if members holding at least 75 % of the voting rights so resolves and no other member objects (**Clauses 9.2(1)(b) and 9.3(1)**). The resolution will remain in force until it is objected to by any member.
14. By **Clauses 9.2(3) and 9.6(1)**, a group of companies is qualified as a “small group” in a year if each company in the group is a small private company and the group satisfies any two out of the following conditions under **Clauses 9.8(6)**:

⁵ 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.

⁶ An existing company that qualifies as an SME in its first financial year following the commencement of Part 9 or in the preceding financial year or a company incorporated under the new Ordinance that qualifies as an SME in its first financial year would qualify for reporting under the SME-FRF. There is no need to satisfy the two years’ rule.

- Aggregate total annual revenue of not more than HK\$50 million net.
 - Aggregate total assets of not more than HK\$50 million net.
 - No more than 50 employees.
15. Under **Clauses 9.2(3), 9.3(2) and (3)**, if the above conditions cannot be met, an election for simplified reporting can still be made with the approval of members holding at least 75% of the voting rights (with no member objecting) in the holding company or in the non-small private companies, depending on the circumstances.

Companies Limited by Guarantee

16. Guarantee companies are often set up for non-profit making purposes, such as educational, charitable, religious or community-related purposes and are subject to certain tighter requirements than private companies, such as the requirement to file annual accounts with the Registrar. However, guarantee companies vary in size and it would be inappropriate to require those small guarantee companies to be subject to the Hong Kong Financial Reporting Standards (HKFRSs) that are primarily used for reporting by large or public companies.
17. 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 the small ones. We suggest using a total annual revenue of not more than HK\$25 million as a bright line rule for guarantee companies. Under **Clauses 9.2(2), 9.5 and 9.8(3)**, a small guarantee company with a total annual revenue of HK\$25 million or less, or under **Clauses 9.2(4), 9.7 and 9.8(8)** a holding company of a group of such companies with a total aggregate annual revenue of HK\$25 million net or less, can take advantage of the simplified accounting and reporting requirements.
18. To sum up, the 7 types of companies that will be allowed to prepare simplified financial and directors' reports are:
- (a) a small private company;

- (b) other private company with the requisite members' approval;
 - (c) a small private company which is a holding company of a group of small companies;
 - (d) a private company which is a holding company of a group of one or more non-small private companies with the requisite members' approval;
 - (e) a small private company which is a holding company of a group of small companies with the requisite members' approval;
 - (f) a small guarantee company; and
 - (g) a guarantee company which is the holding company of a group of small guarantee companies.
- (c) **Aligning the statutory accounting requirements with accounting standards and streamlining disclosure requirements that overlap with the accounting standards**

Background

19. At present, there are certain inconsistencies between the accounting requirements under the CO and the accounting standards, particularly in respect of the simplified accounting requirements in section 141D. Compared to the requirements under section 141D, the SME Financial Reporting Standard (SME-FRS) requires a more complete set of accounts and more disclosures. For example, pursuant to section 141D(1)(e), the auditor's report of a company which applies section 141D covers only the balance sheet but not the profit and loss account.
20. Another incongruity is that there is no obligation on a company applying section 141D to prepare accounts showing a "true and fair view". Yet section 141D(1)(e)(ii) requires the auditor's report of a company applying section 141D to state "whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view

of the state of the company's affairs...". The phrase "true and correct" may be inappropriate in certain circumstances⁷.

21. The CO also provides for certain disclosure requirements as to the contents of the financial statements in the Tenth and Eleventh Schedules. These requirements essentially overlap with the disclosure requirements in HKFRSs and SME-FRS respectively. As accounting standards are constantly evolving, it is very difficult to keep the statutory requirements in the CO up-to-date. This can give rise to possible conflicts between the two.

Proposal

22. To align with the terminology used in the HKFRSs, the requirements under the CO to prepare annual "accounts" for companies and "group accounts" for holding companies will respectively be changed to the requirement to prepare a "financial statement" and "consolidated financial statement". The terms "balance sheet" and "profit and loss account" used in the CO will respectively be replaced by "statement of financial position" and "statement of comprehensive income".
23. To avoid any potential conflicts between the Tenth Schedule and HKFRSs and between the Eleventh Schedule and SME-FRS, the Tenth and Eleventh Schedules will be repealed, with only a small number of public interest disclosure requirements not covered by the HKFRSs or SME-FRS being retained in the form of a **Schedule**⁸.
24. To align with the SME-FRS, companies that are qualified to prepare simplified financial and directors' reports will be required to prepare a full set of financial statements dealing with the financial position and financial performance of the company. Holding companies of a corporate group that prepares simplified financial and directors' reports are similarly required to prepare consolidated financial statements dealing with the financial position and financial performance of the company and its subsidiary undertakings as a whole. The auditor's report will be expanded to cover the financial statements and consolidated financial statements of such companies.

⁷ For example, as the amount of depreciation shown in the accounts is an estimate, the use of the word "correct" to describe the amount is inappropriate.

⁸ Such disclosures include auditor's remuneration (which applies to companies other than those that fall within the reporting exemption), 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.

25. Under **Clause 9.25**, the requirement for financial statements to show the “true and fair view” will also apply to companies that are qualified to prepare simplified financial reports so that there will be a common requirement for all companies incorporated in Hong Kong to prepare financial statements that give a true and fair view of the financial position and financial performance of the company, or of the company and its subsidiary undertakings as a whole.
26. The HKFRSs and SME-FRS will be given indirect statutory recognition as **Clause 9.25(4)** requires a financial statement to comply with the applicable accounting standards which are issued by a body to be prescribed by regulation (i.e. HKICPA). **Paragraph 4 of the Schedule** further requires a statement to be made in the financial statement as to whether it has been prepared in accordance with the applicable accounting standards, and to give the particulars of, and the reasons for, any material departure from those standards.
- (d) **Requiring companies to prepare a more comprehensive directors’ report which includes an analytical and forward-looking business review while allowing companies qualified for simplified accounting to prepare a simplified directors’ report**

Background

27. Section 129D of the CO sets out the detailed information required in a directors’ report. A copy of the report must be sent to every member and debenture holder of the company together with a copy of the accounts and the auditor’s report. To enhance transparency, we propose that all public companies and “large” private and guarantee companies (i.e. other than those qualified to apply the simplified accounting and reporting requirements, see paragraph 18 above) should be required to prepare more analytical and forward-looking information.

Proposal

28. **Clauses 9.29 and 9.31** provide that companies (except for those qualified to apply the simplified accounting and reporting requirements) are required to prepare, as part of the directors’ report, a business review which is more analytical and forward-looking than the information currently required. The proposed business review is similar to the business review which all

companies (except small companies) in the UK have to include in their directors' reports under section 417 in the UKCA 2006. Specifically, the business review should include:

- (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 development 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, including:
 - (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.
29. The requirement to include in the business review information relating to environmental and employee matters is in line with international trends to promote corporate social responsibility⁹.
30. **Clause 9.29(1)** requires the disclosure of other matters prescribed in regulations to be made by the FS. We envisage that the information will include:

⁹ Reference can also be made to paragraph 52(vi) and (viii) of Appendix 16 to the Listing Rules (Main Board) which sets out the recommended additional disclosures to be made in the management discussion and analysis prepared by listed companies.

- (a) the directors' interests in the company, its subsidiary undertakings, its holding company or a subsidiary undertaking of the company's holding company,
 - (b) directors' permitted indemnity provisions
 - (c) donations by the company and its subsidiary undertakings,
 - (d) the shares issued and equity-linked agreements entered into by the company,
 - (e) the management contracts entered into by the company,
 - (f) the amount (if any) that the directors recommend should be paid by way of dividend, and
 - (g) if any director has resigned or given notice declining to stand for re-election during the financial year on the ground of his disagreement with the management of the company, a summary of his reasons for disagreement with the management of the company, if he has given such reasons to the company.
31. Companies which are qualified to apply the simplified accounting and reporting requirements will be exempted from disclosure of information about company donations, recommended dividends and the resigning director's reasons for disagreement with the management of the company.
32. The requirement to prepare a business review will not impose a significant burden on private companies as only a small number of "large" private companies where the members have not opted for the simplified accounts and simplified directors' report would be subject to that requirement.

(e) **Enhancing auditor’s right to information and strengthening enforcement by imposing criminal sanctions for breaches in relation to the provision of information to auditors**

Background

33. To ensure that an auditor will be in a position to perform his oversight functions in an effective manner, it is important for him to have access to the relevant information regarding the state of affairs of the company. The auditors’ current rights to information as set out in sections 133(1) and 141(5) of the CO are considered to be too restrictive¹⁰. A new provision should be drafted along the lines of sections 499 and 500 in the UKCA 2006. It should allow auditors to require a wider range of persons to provide them with information, explanations or assistance as they think necessary for the performance of their duties as auditors.
34. To ensure effective and continuous oversight, there should be proper transitional arrangements in the event of any changes in the auditor of a company. In practice, sudden or frequent changes in auditors often lead to market speculation. Thus, while noting that there are legitimate reasons for changes in auditors, such as disagreement on fees, the existing provisions regarding the rights as well as the duties of the outgoing and incoming auditors should be enhanced. At present, an outgoing auditor needs to seek the company’s permission to discuss the affairs of the company with the incoming auditor because of the principle of confidentiality. The lack of consent may prevent the dissemination of relevant “work-related information” to the incoming auditor.

Proposal

35. **Clause 9.56** provides that auditors will be empowered to require a wider range of persons, including the employees of the company and the officers and employees of its Hong Kong subsidiary undertakings, and any person holding or accountable for any of the company’s or the subsidiary undertakings’ accounting records, to provide them with information, explanations or assistance as they think necessary for the performance of their duties as auditors. The range of persons also covers the officers,

¹⁰ 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” (namely, directors, managers and secretary) of the company, but not company employees, to provide information.

employees or auditor of a subsidiary undertaking which is not a company incorporated in Hong Kong.

36. To tighten enforcement, **Clause 9.57** provides for offences caused by a failure to comply with the obligations under **Clause 9.56** by the company or the responsible person of the company concerned.
37. **Clause 9.58** provides that an outgoing auditor does not contravene any duty just because he gives “work-related information” to an incoming auditor. “Work-related information” means information of which the person became aware in the capacity as such auditor. (**Clause 9.58(3)**)

(f) Improving transparency with regard to circumstances of cessation of office of auditor

Background

38. Under sections 132(3) and 140B of the CO, an auditor who is proposed to be removed or not to be re-appointed and a resigning auditor has the respective right to make written representations or a statement (collectively “cessation statement”) to the company with regard to his cessation of office and request for circulation of such written representations or statement to members of the company. The auditor is entitled to attend, to be heard and to receive all notices of the relevant meetings of the company in respect of his cessation of office. The written representations and statement need not be sent to members of the company if the court is satisfied, on the application of the company or a person who claims to be aggrieved, that the outgoing auditor’s rights are being used to secure needless publicity for defamatory matter.
39. Under section 140A(1) and (2) of the CO, a resigning auditor is required to make a statement in the notice of resignation as to whether there are any circumstances in relation to his resignation that he considers should be brought to the notice of the members or creditors of the company, and if so, a statement of any such circumstance (“statement of circumstances”). Auditors who have ceased office owing to other reasons, e.g. removal or not being re-appointed as auditor after expiration of his term of office, are not required to make such a statement.

Proposal

40. To improve transparency and corporate governance, an outgoing auditor's right to make and request for circulation of a cessation statement and the mandatory requirement to make a statement of circumstances will be expanded.

Cessation statement

- (a) The right to make a cessation statement will apply where an auditor resigns or where a resolution removing an auditor from office or having the effect of appointing another person as auditor instead of the retiring auditor is proposed to be passed (**Clauses 9.66 and 9.67**).

Statement of circumstances

- (b) Under **Clauses 9.68 and 9.69**, the mandatory requirement to make and circulate the statement of circumstances will cover not only resigning auditors but will also be extended to an auditor who has been removed and a retiring auditor who has not been re-appointed so that such auditors are also required to provide a statement of circumstances, or if there are no such circumstances, a statement to that effect.

In either case, the company will be required to circulate the statement to members of the company unless the company, or a person who claims to be aggrieved, applies to the court for an order not to publicize the statement.

41. Under **Clause 9.54**, auditors will be provided with qualified privilege for statements made in the course of their duties as auditors. A cessation statement and a statement of circumstances made by an auditor in respect of his ceasing to hold office as auditor will be covered by such privilege. Accordingly, an auditor will not, in the absence of malice on his part, be liable to any action for defamation in respect of any statement made by him in the course of his duties as auditor and in respect of his ceasing to hold office as auditor.

(g) Providing for the appointment and the deemed re-appointment of auditors and the term of office of an auditor

Background

42. One aspect affected by the dispensation of the AGM is the appointment and term of office of an auditor. Section 131(1) of the CO provides that every company shall at each AGM appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the next AGM. We need to provide for these matters where the AGM is dispensed with under **Clause 12.75(2)**¹¹.

Proposal

43. We propose to follow the approach in sections 485, 487 and 488 of the UKCA 2006 to make provisions for an “appointment period” and the deemed re-appointment of auditors. It will also be made clear that an auditor deemed to be appointed does not take office until the retiring auditor ceases to hold office.

Appointment of another person as auditor in place of the retiring auditor

44. If a company is not required to hold an AGM:
- (a) **Clause 9.40(4)** provides that an auditor must be appointed before the end of the “appointment period” which is defined in **Clause 9.36** as the period of 28 days beginning with:
- the last date on which copies of the company’s financial statements and reports for the previous financial year must be sent to its members under **Clause 9.74(3)** or **12.75(1)(b)** as the case may be, or
 - if earlier, the date on which copies of such financial statements and reports are sent out under such clauses.
- (b) The retiring auditor ceases to hold office at the end of that period unless re-appointed or deemed to be re-appointed and the new auditor

¹¹ See Part 12 in FSTB, *Companies Bill Consultation Draft – Parts 1, 2, 10 - 12 & 14 – 18* (December 2009).

will not take office until the retiring auditor ceases to hold office (**Clause 9.46**).

- (c) **Clauses 9.40, 9.44 and 9.45** set out the procedure for appointing an auditor in place of the retiring auditor.

Deemed re-appointment of current auditor where no appointment of auditor has been made

45. If no auditor is appointed by the end of the appointment period, **Clause 9.47** provides that the current auditor is deemed to be re-appointed on the same terms at that time. However, the deemed re-appointment can be prevented by any of the circumstances mentioned in **Clause 9.47(2)**, including where the auditor gives written notice to the company to decline the re-appointment.
- (h) **Revamping the summary financial report provisions and extending their application to companies in general**

Background

46. Under sections 141CA to 141CH of the CO, a listed company may send a summary financial report to its members and debenture holders in place of the accounts, together with directors' and auditor's reports required to be sent under section 129G of the CO ("the reporting documents") provided that it has obtained the agreement of those persons.
47. Sections 141CA to 141CH, and the Companies (Summary Financial Reports of Listed Companies) Regulation came into effect on 4 January 2002 but very few listed companies have offered the alternative of providing summary financial reports to members partly due to cost considerations and partly because the company has to obtain the members' consent by complying with complex rules for sending notification to and receiving a response from the members. Currently, there is no exemption for listed companies incorporated in Hong Kong not to send out the reporting documents or summary financial reports. However, in some jurisdictions those documents need not be sent if the members so request¹².

¹² See section 316(1)(a) of the ACA 2001 and section 203A(3) of the SCA and regulation 3(1)(f)(iii) of the Singaporean Companies (Summary Financial Statement) Regulations.

Proposal

48. Against this background, we will make the summary financial reports provisions more user-friendly so as to encourage the publication of summary financial reports and help save operating costs. The key proposals are summarised as follows:
- (a) Under **Clause 9.86**, companies (except for those that prepare simplified accounts) are given a choice of sending a copy of the summary financial report instead of a copy of the reporting documents to their members. This will avoid the complex rules which require a company to ask its members in advance before it can send them a copy of the summary financial report. Members receiving summary financial reports may, under **Clause 9.90**, request a copy of the reporting documents from the company.
 - (b) Under **Clause 9.87**, the company can at any time ascertain the wishes of its members through a “notification” which allows the members to elect to receive a copy of the reporting documents, or a copy of the summary financial report in hard copy form, or electronic form, or by making it available on a website; or not to receive any copies of the documents.
 - (c) The technical requirements as to the form and contents of summary financial reports will be prescribed in regulations to be made by the FS.

Other Changes

- (a) **Requiring directors to make a declaration whether in their opinion the financial statements give a true and fair view of the financial position and financial performance of the company**
49. Section 129B of the CO requires every balance sheet of a company to be approved and signed on behalf of the board of directors. With reference to similar provisions in Australia and Singapore¹³, we propose to repeal section 129B and replace it by a directors’ declaration in respect of the financial statements of the company so as to remind the directors of their

¹³ See section 201(15) of the SCA and section 295(4) and (5) of the ACA 2001.

obligation to prepare financial statements that give a true and fair view of the financial position and financial performance of the company.

50. **Clause 9.28** provides that a financial statement laid before a company in general meeting, or otherwise sent to a member, circulated, published or issued, must be accompanied by a declaration that states whether, in the directors' opinion, the financial statement or consolidated financial statement, gives a true and fair view of the company or the group's financial position and financial performance as required by **Clause 9.25**.

(b) Providing new offences relating to contents of auditor's report

51. At present, there is no offence in the CO relating to intentional or reckless omissions in the auditor's statement concerning problems in the accounts or audit. Some comparable jurisdictions such as the UK have introduced new offences relating to such omissions¹⁴. We propose that similar provisions should also be introduced to enhance the integrity of auditor's reports.

52. **Clause 9.52(1)**, modelled on section 507(2)(a) and (b) of the UKCA 2006, provides the offence where an auditor knowingly or recklessly causes an auditor's report to omit a statement required by:

- (a) **Clause 9.51(2)(b)** (statement that the company's financial statement does not agree with accounting records), or
- (b) **Clause 9.51(3)** (statement that necessary information and explanation not obtained).

53. **Clause 9.52(2)** defines the persons liable to be caught by **Clause 9.52(1)** as:

- (a) the auditor, if he is an individual, and his employees and agents;
- (b) the members, employees and agents of an audit firm; and
- (c) the officers, members, employees or agents of an auditor which is a body corporate.

¹⁴ See section 507 of the UKCA 2006. The section also provides for an offence of "commission", where a person knowingly or recklessly causes an auditor's report to include anything that is misleading, false or deceptive. This will be taken care of by widening the scope of the offence of false statements in Clause 20.1. See Explanatory Notes on Part 20, paragraphs 2 to 6.

PART 13

ARRANGEMENTS, AMALGAMATION, AND COMPULSORY SHARE ACQUISITION IN TAKEOVER AND SHARE BUY-BACK

Introduction

1. Part 13 basically restates the provisions with some proposed amendments concerning schemes of arrangement with creditors or members, reorganisations of share capital of a company, and reconstructions or amalgamations of a company with other companies. The relevant provisions are currently found in sections 166, 166A, 167, 168, 168B and the Ninth and Thirteenth Schedules¹ of the CO.
2. Based on the recommendation of the SCCLR and the feedback from the public consultation conducted in June to September 2008, we will introduce a court free statutory amalgamation procedure whereby wholly-owned intra-group companies would be allowed to amalgamate and continue as one of the amalgamating companies without the need for any court sanction.
3. On the review of the “headcount” test under section 166(2) of the CO which was included in the First Phase Consultation Paper issued in December 2009, we are studying the feedback obtained during the consultation and will amend the relevant provisions in the CB, if necessary.

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

Schemes of Arrangements, Takeovers and Share Buy-backs

- (a) **Extending the application of the provisions for facilitating reconstructions and amalgamations of companies currently under section 167 of the CO to cover companies liable to be wound up under the CO, which would include both Hong Kong and non-Hong Kong companies;**

¹ The Ninth Schedule deals with provisions relating to acquisition of minority shares after successful takeover offer. The Thirteenth Schedule covers provisions relating to acquisition of minority shares after successful buy out under a share buy-back.

- (b) Revising the definitions of “property” and “liabilities” currently under section 167(4) of the CO to include rights and duties respectively of a personal character or incapable under the general law of being assigned or performed vicariously;
- (c) Clarifying the meaning of a “takeover offer”, “shares already held by the offeror” and “shares to which the offer relates”;
- (d) Introducing new provisions to allow an offeror in a takeover offer or share buy-back offer who is unable to achieve the necessary squeeze out threshold because of untraceable shareholders related to the offer, to apply to court for an authorization to give squeeze out notices;
- (e) Introducing new provisions to allow a revised offer to be treated as the original offer so long as certain specified conditions are met;

Court-free Statutory Amalgamation Procedure

- (f) Introducing a new court-free statutory amalgamation procedure for wholly-owned intra-group companies.

Significant Changes

Schemes of Arrangements, Takeovers and Share Buy-backs

- (a) **Extending the scope of section 167 of the CO to cover companies liable to be wound up under the CO**

Background

4. Section 167 of the CO, which provides for the sanctioning of a scheme of compromise or arrangement by the court initiated under section 166, does not apply to a company other than one formed and registered under the CO or the preceding Companies Ordinances. This is contrary to the provision of section 166(5) and 166A where the expression “company” means any company liable to be wound up under the CO which in effect includes a non-Hong Kong company.

Proposal

5. **Clauses 13.3 to 13.10** restate the provisions under sections 166, 166A and 167 of the CO. **Clause 13.3(1)** defines a company for the purpose of these clauses as a company liable to be wound up under the Companies (Winding-up Provisions) Ordinance (Cap 32)² thereby removing the difference in the categories of companies currently covered under section 166, 166A and 167 of the CO.
- (b) **Revising the definition of “property” and “liabilities” currently under section 167(4) of the CO**

Background

6. The expression “property” is defined in section 167(4) of the CO as including “property, rights and powers of every description”, and the expression “liabilities” as including “duties”. Based on the court’s views in decided cases, a transfer order made under section 167 to facilitate reconstructions and amalgamations of companies is unable to operate to transfer a contract of personal service. As a result, contracts of employment are not transferable under the section.
7. We propose to follow the ACA where “property” and “liabilities” are defined to include rights and duties respectively of a personal character or incapable under the general law of being assigned or performed vicariously (i.e. in substitution for another person). This will enable personal rights and duties, which could not have been transferred or assigned unless with the consent of the parties concerned, to be transferred or assigned once a transfer order is made.

Proposal

8. **Clause 13.9** restates section 167 of the CO. **Clause 13.9(8)** redefines “property” as including:
 - (a) rights and powers of a personal character and incapable of being assigned or performed vicariously under the law; and

² Provisional title of Cap 32 after it is consequently amended by the new Companies Ordinance. It is subject to change.

(b) rights and powers of any other description.

and “liabilities” as including:

(a) duties of a personal character and incapable of being assigned or performed vicariously under the law; and

(b) duties of any other description.

(c) **Clarifying the meaning of “takeover offer”, “shares already held by the offeror” and “shares to which the offer relates” in a takeover**

Background

9. Section 168 of the CO, together with the Ninth Schedule, deal with the compulsory acquisition of shares following a takeover. Section 168 applies, inter alia, where a company makes an offer to acquire all the shares not already held by it in another company on terms which are the same in relation to all the shares to which the offer relates. There are no clear definitions of what would constitute “shares already held by an offeror” and “shares to which the offer relates”. For the sake of clarity, we consider that these terms should be clearly defined.

Proposal

10. **Clause 13.22(1)** defines what constitutes a takeover offer. First, it must be an offer to acquire all the shares (or shares of any class) in the company except those that, at the date of the offer, are held by the offeror. Secondly, in relation to all the shares to which the offer relates (or all the shares of the class to which the offer relates), the terms of the offer must be the same.

11. **Clause 13.22(3)** defines “shares that are held by an offeror” as including shares that the offeror has contracted, unconditionally or conditionally to acquire, but excluding shares that are subject to a contract which is:

(a) intended to secure that the holder of the shares will accept the offer when it is made; and

(b) entered into for no consideration by deed, for consideration of negligible value, or for consideration consisting of a promise by the offeror to make the offer.

12. **Clauses 13.22** and **13.24** clarify that shares to which a takeover offer relates may include:
- (a) shares that are allotted after the date of the offer but before a date specified in the offer (**Clause 13.22(6)**);
 - (b) shares which the offeror acquires or contracted to acquire other than by virtue of acceptances of the offer during the offer period unless the acquisition consideration exceeds the consideration specified in the terms of the offer (**Clause 13.24(2)**); and
 - (c) shares which a nominee or an associate of the offeror has contracted to acquire after a takeover offer is made but before the end of the offer period, unless the acquisition consideration exceeds the consideration specified in the offer (**Clause 13.24(4)**).
13. **Clauses 13.40(1), 13.40(3) and 13.42** contain similar provisions in relation to compulsory acquisition powers following a share buy-back offer.
- (d) **Introducing new provisions to allow an offeror in a takeover offer or share buy-back offer who was unable to achieve the necessary squeeze out threshold because of untraceable shareholders related to the offer to apply to court for an authorisation to give squeeze out notices**

Background

14. Under the CO, there is no mechanism for an offeror to apply for a court order authorising the giving of squeeze out notices for those takeover or buy-back offers which failed to achieve the applicable threshold for giving of such notices because of untraceable shareholders related to the offer. Such a mechanism has been included in the UK Companies Act since 1987 and is considered practical and useful.

Proposal

15. **Clauses 13.26(3) to (7)** introduce the mechanism mentioned in paragraph 14 above which will apply if the offeror has been unable to trace the relevant shareholders after reasonable enquiry. The consideration offered must be fair and reasonable and the court may not make an order unless it considers that it is just and equitable to do so having regard, in particular, to the

number of shareholders who have been traced but have not accepted the offer.

16. **Clauses 13.45(4) to (8)** provide a similar mechanism in the case of a share buy-back offer.
- (e) **Introducing new provisions to allow a revised offer to be treated as the original offer so long as certain specified conditions are met**

Background

17. At present, the CO does not have any provision on revised offers to provide for unexpected changes of circumstances after the making of an offer. As a result, an offeror who wishes to revise his offer will have to make a new takeover or share buy-back offer and address the acceptances received under the old offer. Both the UKCA 2006 and the SCA have provisions for a revised offer to be treated as the original offer as long as certain specified conditions are met. The ACA has specific provisions for variation of offers.

Proposal

18. **Clause 13.25** provides that a revision of the terms of a takeover offer is not regarded as the making of a fresh offer if:
 - (a) the terms of the offer provide for the revision and the acceptances on the previous terms to be regarded as acceptances on the revised terms;
and
 - (b) the revision is made in accordance with that provision.
19. **Clause 13.43** contains a similar provision in the case of a share buy-back offer.

Court-free Statutory Amalgamation Procedure

(f) **Introducing a new court-free statutory amalgamation procedure for wholly-owned companies which are within the same group**

Background

20. At present, companies intending to amalgamate have to resort to the procedures under sections 166 to 167 of the CO which require court sanction. In practice, sections 166 to 167 of the CO are rarely used. Apart from the complex procedure involved and high compliance costs, the court's restrictive approach in applying the provisions may also be a disincentive. Other comparable jurisdictions such as Singapore and New Zealand have provided a court-free regime in their company law.
21. In June 2008, we consulted the public whether a court-free amalgamation process along the lines of the Singaporean model with minor modifications should be introduced in Hong Kong³. While a majority of the respondents supported the introduction of a court-free procedure, some respondents raised a pertinent concern regarding the protection of the interests of minority shareholders and creditors. To minimise the risk that the new procedure may be abused, we consider it prudent to confine it only to amalgamations of wholly-owned intra-group companies where minority shareholders' interests would normally not be an issue⁴. The proposed procedure is modelled on the "short form amalgamation" procedure under sections 215D to 215J of the SCA and sections 222 to 226 of the NZCA.

Proposal

22. **Clauses 13.11 to 13.19** provide for a court-free statutory amalgamation procedure for wholly-owned intra-group companies limited by shares to amalgamate and continue as one of the amalgamating companies. The amalgamation may either be vertical (i.e. between the holding company and one or more of its wholly-owned subsidiaries) or horizontal (i.e. between two or more subsidiaries of the same holding company) (**Clauses 13.13(1) and 13.14(1)**).

³ See FSTB, *Consultation Paper on Share Capital, the Capital Maintenance Require, Statutory Amalgamation Procedure*, Chapter 4 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

⁴ See FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Require, Statutory Amalgamation Procedure* (February 2009), paragraphs 55 to 56 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

23. The details of the procedure are:

- **Amalgamation Proposal**

Clauses 13.13(2) and 13.14(2) set out the terms and conditions of the amalgamation. No formal amalgamation proposal is required.

- **Directors' approval and solvency statements**

Clauses 13.13(2) and 13.14(2) provide that the board of each amalgamating company must make a statement to confirm that the assets of the amalgamating company is not subject to any charge of a floating nature⁵ and to verify the solvency of the amalgamating company as well as the amalgamated company. Details of the solvency statement are set out in **Clause 13.12**.

Clause 13.16(1) — every director who votes in favor of the making of the solvency statement must sign a certificate confirming that in his opinion, the amalgamating company and/or the amalgamated company satisfy the required solvency conditions.

- **Shareholders' approval**

Clauses 13.13(1), (3) and (4) and 13.14(1), (3) require that the amalgamation proposal be approved by the shareholders of each amalgamating company by special resolution.

- **Notice of amalgamation**

Clause 13.15(2) stipulates that the directors of each amalgamating company must give written notice of the proposed amalgamation to every secured creditor of the amalgamating company and to publish a newspaper notice of the proposal.

- **Registration of amalgamation**

Clause 13.17 requires that the amalgamation proposal, the directors' solvency statement, the certificate regarding the solvency statement, etc must be registered with the Registrar. As soon as practicable after the registration of the required documents, the Registrar shall issue a certificate of amalgamation.

⁵ Please see the last bullet point below.

- **Effect of amalgamation**

Clauses 13.18(1) and (2) state that the amalgamation shall take effect on the date shown in the certificate of amalgamation. Upon the amalgamation taking effect, each amalgamating company ceases to exist as an entity separate from the amalgamated company (**Clause 13.18(3)**). The amalgamated company succeeds to all the property rights and privileges and all the liabilities and obligations of each amalgamating company.

Clause 13.18(4) further sets out that on or after the effective date of an amalgamation, any proceedings pending by or against an amalgamating company may be continued by or against the amalgamated company. Any conviction, ruling, order or judgment in favour of or against an amalgamating company may be enforced by or against the amalgamated company.

- **Creditors' and shareholders' right to seek court relief**

Clause 13.19 provides that before the effective date of the amalgamation proposal, on application by a member or creditor of an amalgamating company, the court may disallow or modify the amalgamation proposal or give any directions, if it is satisfied that giving effect to the amalgamation proposal would unfairly prejudice a member or a creditor of an amalgamating company or a person to whom an amalgamating company is under an obligation. This is to protect the interests of the minority shareholders and creditors in the course of the amalgamation process.

- **Exclusion of companies with floating charges**

As the effect of amalgamation is that the amalgamated company takes the benefits and is subject to the liabilities of the amalgamating companies, this poses a problem when 2 or more of the amalgamating companies have floating charges subsisting over their respective assets in favour of different security holders. There will be a question of priorities between the competing security holders over the assets of the amalgamated company, which may result in unfairness between the security holders.

The problem will not be solved by providing that any floating charges will be deemed crystallized immediately before the coming into effect of the amalgamation proposal, as the question of the order of priority between crystallized former floating charges over the same assets still persists. Further, upon crystallization, the company will no longer be able to deal with the assets in the ordinary course of business without the consent of the chargee and this may have the effect of paralyzing the business of the company.

As the purpose of the proposal is to introduce a simple and less costly procedure for amalgamation, we therefore propose to exclude companies with floating charges from the proposal in order to keep the procedure simple and easy to implement.

PART 19

INVESTIGATIONS AND ENQUIRIES

Introduction

1. Part 19 deals with investigations and enquiries into a company's affairs. Currently, the CO provides the following:
 - (a) investigation of a company's affairs: the FS may appoint an inspector with extensive powers to conduct an investigation into the affairs of a company (sections 142 to 151); and
 - (b) inspection of books and papers: the FS or a person authorised by him may, in specified circumstances, require a company and any person who appears to be in possession of the company's books and papers to produce those documents and to provide explanation of them (sections 152A to 152F).

The CO also provides that a company may appoint an inspector to investigate its own affairs (section 152).
2. Part 19 reorganises, with some modifications, the existing provisions in sections 142 to 152F of the CO. The relevant provisions are clarified or modernised, making reference to the more updated provisions on investigations in the SFO and the FRCO. The power to inspect books and papers is rephrased as power to "enquire into company's affairs" to better described the nature of the power. The Part also provides a new power for the Registrar to obtain documents, records and information for the purposes of ascertaining whether any conduct that would constitute an offence under **Clause 15.7(7)** (concerning giving false or misleading information in connection with an application for deregistration of a company¹) or **20.1(1)** (concerning making a statement that is misleading, false or deceptive in any material particular²) has taken place.
3. Background information on the needs for the powers is provided in Chapter 4 of the consultation paper.

¹ The equivalent of section 291AA(14) in the CO.

² The equivalent of 349 in the CO.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) **Enhancing the investigatory powers of an inspector, for example, requiring a person under investigation to preserve records or documents and to verify statements by statutory declaration;**
 - (b) **Extending the categories of companies that may be subject to investigation;**
 - (c) **Providing better safeguards for confidentiality of information and protection of informers; and**
 - (d) **Providing for a new power for the Registrar to obtain documents or information for ascertaining whether any conduct that would constitute certain offences under the CB has taken place.**

Significant Changes

(a) Enhancing the investigatory powers of an inspector

Background

4. The provisions in sections 142 to 151 of the CO deal with investigations of a company's affairs by independent inspectors appointed by the FS. The FS may appoint an inspector on application by members (section 142) or a company by special resolution, upon an order made by the Court³ or on his own initiative where there is fraud or mismanagement involved (section 143). Inspectors appointed under these sections are vested with extensive investigative powers, including the power to:
 - (a) require production of books or documents;
 - (b) require attendance and examination of persons on oath;
 - (c) require reasonable assistance to be given;

³ The appointment must be made under this scenario.

- (d) apply to the Court to punish a person who failed to comply with a requirement made by an inspector as if the person had been guilty of contempt of the Court; and
- (e) apply for a search warrant.

At the end of the investigation, an inspector is required to make a final report to the FS.

- 5. The SFO and the FRCO both contain provisions which empower the SFC and the FRC respectively to carry out investigations. We have made reference to these two pieces of legislation in the enhancement of the powers of an inspector.

Proposal

- 6. **Clause 19.9(1)(b)** gives the inspector a new power to require a person to preserve records or documents before production to the inspector.
- 7. **Clause 19.11(2)** gives the inspector a new power to require a person to verify by statutory declaration any answer or explanation given to the inspector. **Clause 19.11(3)** provides another new power in that if a person does not give any answer for the reason that the information is not within the person's knowledge or possession, the inspector may require the person to verify that reason and fact by statutory declaration.
- 8. **Clause 19.26** introduces criminal sanctions for non-compliance with a request made by an inspector. Under the CO, criminal sanctions are imposed for non-compliance with a request made by the FS or an authorised person for the inspection of books and papers, but there is no such sanction for non-compliance with a request made by an inspector. This clause therefore addresses the anomaly.
- 9. **Clause 19.27** introduces express provisions allowing the Court to not only punish a person who failed to comply with an inspector's requirement as if he had been guilty of contempt of the Court but also to order the person to comply with the requirement made by the inspector.

(b) Extending the categories of companies that may be subject to investigation

Background

10. Currently under the CO, companies which may be subject to investigations by an inspector are:
- (a) companies formed and registered in Hong Kong;
 - (b) companies which have, or had a place of business in Hong Kong even though the company is incorporated elsewhere⁴. This provision does not apply to those investigations on the application of a company's members (section 142); and
 - (c) bodies corporate which are related to the company being investigated (e.g. its subsidiary or holding company or body corporate substantially under the control of the same person as the company being investigated).
11. Inspection of books and papers under section 152A may cover both companies formed and registered in Hong Kong and companies incorporated elsewhere which are carrying on or have carried on business in Hong Kong.
12. Nowadays, companies incorporated elsewhere may conduct business activities in Hong Kong (for example over the Internet) although they are not registered or have a place of business here. For investigations in general, a broader scope covering all companies incorporated elsewhere that are doing business in Hong Kong is therefore preferred. As regards the appointment of inspectors on the application of members, there is also room to extend the right to members of registered non-Hong Kong companies, i.e. those registered under Part 16 of the CB.

Proposal

13. **Clause 19.2** provides for the definition of "company". In relation to appointment of inspectors on the application of members of a company

⁴ The investigatory powers are subject to such adaptations and modifications as may be specified by Regulations to be made by the FS under section 146A. So far, no regulations have been made.

under **Clause 19.3(2)**, an application may be made by members of registered non-Hong Kong companies, in addition to companies incorporated in Hong Kong. Appointment of inspectors under other scenarios in **Clause 19.4** may cover companies incorporated outside Hong Kong but doing business in Hong Kong (whether or not having a place of business in Hong Kong or registered in Hong Kong) and any other companies within a group comprising such companies, wherever incorporated.

(c) **Providing better safeguards for confidentiality of information and protection of informers**

Background

14. Currently, section 152C of the CO provides for security of information or documents relating to a company which have been obtained by section 152A (inspection of books and papers) or section 152B (documents seized by search warrant). There is however no confidentiality or statutory “gateway” provision concerning the information obtained by an inspector.
15. There is also no provision dealing with the protection of an informer’s identity in the CO. Such provisions (such as section 52 of the FRCO) would encourage persons to volunteer information to facilitate investigations.

Proposal

16. **Clauses 19.43, 19.44 and 19.45** enhances the confidentiality of matters or information obtained pursuant to an investigation of a company’s affairs or enquiry into company’s affairs. It defines expressly how such information may be disclosed to other regulatory authorities, through the introduction of a statutory regime along the lines of section 378 of the SFO, section 51 of the FRCO and section 120 of the Banking Ordinance.
17. **Clause 19.47** introduces provisions to give protection (by granting immunity from liability for disclosure) to persons who volunteered information to facilitate an investigation of a company’s affairs or enquiry into company’s affairs. **Clause 19.48** gives additional protection by keeping the identity of an informer anonymous in civil, criminal or tribunal

proceedings. These clauses are also applicable to the new power for the Registrar to obtain documents, records and information.

- (d) **Providing for a new power for the Registrar to obtain documents or information for ascertaining whether any conduct that would constitute certain offences under the CB has taken place.**

Background

18. Currently, investigation of a company's affairs and inspection of books and papers are initiated by the FS and not by the Registrar. We will provide for a new but limited power for the Registrar to obtain documents, records and information for the purposes of ascertaining whether any conduct that would constitute an offence under **Clause 15.7(7)** or **20.1(1)** has taken place.
19. These offences, which relate to the provision of false information in documents delivered to the CR, help to safeguard the integrity of the Companies Register and the quality of information disclosed to the public. The proposed power would help CR's enforcement efforts and facilitate the handling of public complaints by improving the quality of the evidence needed for successful prosecution against breaches of the relevant obligations under the CB.

Proposal

20. **Clause 19.36** gives the Registrar the new power to require production of records or documents, to make copies of the records or documents and to require information or explanations in respect of the records or documents. The clause also sets out safeguards in exercising the power. **Clause 19.37** states that the Registrar may delegate to any public officer the power.
21. **Clause 19.38** provides for the criminal sanctions for non-compliance with the Registrar's requirement.

Other Changes

Minor improvements of the law

22. **Clause 19.1** updates the definitions of "books", "document", "information" and "record" to cover electronic or other types of records (this definition is

also applicable to the new power for the Registrar to obtain documents, records and information).

23. **Clauses 19.3(4) and 19.4(3)** provide expressly that the FS would be guided by the public interest in appointing an inspector to investigate a company's affairs. This reflects the existing position where the FS will only appoint an inspector if significant or great public interest is involved.
24. **Clause 19.4(2)** restates the existing section 143(1)(c) of the CO on the circumstances where the FS may appoint an inspector, except that section 143(1)(c)(iii) (i.e. a company's members have not been given all the information with respect to its affairs that they might reasonably expect) is not restated as there are other provisions, such as **Clause 19.3** (appointment of inspectors by application of members) and **Clause 14.22** (court may order inspection of records), which are concerned with this type of situation.
25. **Clauses 19.6 to 19.8** provide expressly that the FS may give direction to an inspector, define the terms of the appointment of an inspector, limit or expand the scope of an investigation, suspend an investigation at his discretion, or terminate an investigation.
26. **Clauses 19.14 to 19.17** introduce express provisions on the resignation of an inspector, the revocation of an inspector's appointment by the FS, the replacement of an inspector and the handing over of documents and information that an inspector has obtained or generated during the course of an investigation.
27. **Clauses 19.22 and 19.23** gives the FS greater discretion to prevent premature access to a copy of the report filed with the Court and to decide whether to provide a copy of the report to the company or its shareholders.
28. **Clause 19.25** provides that the findings of fact by an inspector stated in his/her report should be regarded as evidence of that fact in civil proceedings (as compared with "evidence of the opinion" under the CO⁵).
29. **Clauses 19.28 and 19.35** provide for an express obligation for an inspector or the FS or a person authorised by him (for enquiry into company's affairs) to inform or remind a person required to provide answers or explanations (to

⁵ Except for disqualification order under section 168J of the CO where the findings are already currently regarded as evidence of fact.

the inspector) or information or explanations (to the FS or a person authorised by him) in respect of the record or document obtained of the limitations concerning the use in criminal proceedings against the person of self-incriminating evidence. **Clause 19.39** provides for the equivalent obligation in exercising the new Registrar's power to obtain information or explanation in respect of the record or document obtained.

30. **Clause 19.29** clarifies the provisions relating to the recovery of expenses of an investigation from other parties. Specifically, **Clause 19.29(8)** provides that expenses recoverable should include general staff costs and overhead expenses of the Government and the cost of insurance for the inspector.
31. **Clause 19.40** improves the existing provisions in the CO regarding search warrants by incorporating relevant features of the SFO and the FRCO, including: a search warrant application may be made to the Magistrate before or after a formal request for the document has been made; the duration of a search warrant is shortened from 1 month to 7 days; receipt should be issued for any record or document removed; and a search warrant could be issued to a specified person or a police officer (i.e. not just to a police officer).

PART 20
MISCELLANEOUS

Introduction

1. Part 20 contains a number of miscellaneous provisions which may be classified into the following three categories generally:
 - (a) miscellaneous offences, namely the offences for false statements and for improper use of the words “Limited”, “Corporation” or “Incorporated”, based on sections 349 and 350 of the CO respectively;
 - (b) miscellaneous provisions relating to investigation or enforcement measures, including provisions based on sections 306, 351A, 351B and 352 of the CO, and a new power for the Registrar to compound certain offences under the CB; and
 - (c) other miscellaneous provisions which are based on sections 354, 355, 357, 358 and 359A of the CO.

- The significant changes to be introduced under this Part are highlighted below:
 - (a) **Widening the scope of the offence for false statements;**
 - (b) **Empowering the Registrar to compound certain offences; and**
 - (c) **Widening the categories of companies that the court may require security for costs in actions.**

Significant Changes

- (a) **Widening the scope of the offence for false statement**

Background

2. Section 349 of the CO creates a criminal offence of wilfully making a statement to the Registrar which is false in any material particular and

which the offender knows to be false. The offence arises in the context of false statements made in any return, certificate, balance sheet or other document which is required by, or for the purposes of, any provision of the CO. The requisite mental element of the offence requires proof of knowledge and wilful intent.

3. We consider that the ambit of the offence in section 349 could be too narrow as it might not cover, for example, the making of a misleading statement. In addition, the requirement to prove a “wilful” intent would leave out cases where false statements are delivered to the Registrar recklessly.
4. In other comparable common law jurisdictions, there are similar offences but their scope is much wider. In Australia and Singapore, it is an offence to make a false statement or to make a misleading statement. It is also an offence to authorise the making of a statement that is false or misleading, or to omit or authorise the omission of any matter or thing without which the document would be misleading¹. In the UK, the offence covers any statement that is misleading, false, or deceptive in a material particular².
5. Moreover, the requisite mental element is different in Australia and the UK. The proof of “wilful” intent is not required in Australia in prosecuting the offence. In the UK, the offence covers acts committed “knowingly or recklessly”.

Proposal

6. **Clause 20.1** now provides for the matters currently covered by section 349 of the CO subject to the modifications that the offence is extended to cover “a statement that is misleading, false or deceptive in any material particular” and that the mental element covers acts committed “knowingly or recklessly”.

(b) Empowering the Registrar to compound certain offences

Background

7. Other than prosecution for non-compliance, the CR has implemented a range of administrative measures to encourage due compliance with the

¹ Section 1308 of the ACA; section 401 of the SCA.

² Section 1112 of the UKCA 2006.

filing obligations under the CO. These include the publication of various information pamphlets, posters and external circulars to provide general guidelines on compliance. While information pamphlets are distributed to company promoters on incorporating or registration of companies, posters on compliance are placed in the public areas of the Registry. In addition, companies may also subscribe to an Annual Return e-Alert Service to receive email notifications on the filing of annual returns.

8. To further expand the repertoire of measures to encourage due compliance with the CO filing obligations and to optimise the use of scarce judicial resources, we propose to give the Registrar a new power to compound, at her discretion, certain offences under the CB³.

Proposal

9. **Clause 20.5(1)** provides that the Registrar may, if she has reason to believe that a person has committed an offence specified in a schedule to be created in the CB, give the person a notice that contains the following:
 - (1) the allegation that the person has committed the offence and the particulars of the offence;
 - (2) the conditions upon which no proceedings will be instituted against the person in respect of the offence, including the amount of compounding fee to be paid and the period within which the conditions have to be complied with; and
 - (3) any other information that the Registrar thinks fit.
10. **Clause 20.5(2)** provides that the notice may be given only before the proceedings on the offence commences.
11. **Clause 20.5(3)** empowers the Registrar, by a further written notice, to extend the period within which the conditions as specified in the notice issued have to be complied with. It also specifies that such power of extension may be exercisable during, or after the end of, that period.

³ If a regulator is empowered to compound an offence, he may offer a person in default by giving a notice to him an opportunity to rectify the default by paying an amount to the regulator as a compounding fee and, where appropriate, remedying the breach constituting the offence within a specified period. If that person accepts and complies with the terms of the notice, no prosecution will be initiated against him for that offence.

12. **Clause 20.5(4)** provides that the notice may not be withdrawn during the period specified in the notice or the extended period.
13. The proposal distinguishes between an offence constituted by a failure to do an act and an offence not constituted by a failure to do an act.
14. For the former category, **Clause 20.5(5)** provides that if, within the period specified in the notice or within the extended period, the person pays the Registrar the compounding fee specified in the notice and rectifies the act in default, no proceedings will be instituted against the person in respect of that offence. However, if within the period specified in the notice or within the extended period, the person has not paid the Registrar the compounding fee specified in the notice or has not rectified the act in default, proceedings may be instituted against the person in respect of that offence.
15. For the latter category, **Clause 20.5(6)** provides that if, within the period specified in the notice or within the extended period, the person pays the Registrar the compounding fee specified in the notice, no proceedings will be instituted against the person in respect of that offence. However, if within the period specified in the notice or within the extended period, the person has not paid the Registrar the compounding fee specified in the notice, proceedings may be instituted against the person in respect of that offence.
16. **Clause 20.5(7)** makes it clear that the payment of the compounding fee specified in the notice is not to be taken as an admission by the person of any liability for the offence alleged in the notice to have been committed by that person.
17. This proposal is targeted generally at offences which are (a) related to non-compliance with filing obligations and with obligations for affixing or publishing a company's name; (b) punishable only by a fine; and (c) triable summarily only. The compoundable offences will be set out in a Schedule to the CB⁴ which may be amended by the FS by notice published in the Gazette, subject to negative vetting by the LegCo.

⁴ The Schedules of the CB are not included in the Consultation Draft.

(c) Widening the categories of companies that the court may require security for costs in actions

Background

18. Section 357 of the CO only applies to a limited company which is formed and registered under the CO or an existing limited company, i.e. one formed and registered under an earlier CO. Therefore, a plaintiff which is an unlimited company or a company incorporated outside Hong Kong would not be caught by the section.
19. In a number of Hong Kong cases involving applications for security for costs against companies incorporated outside Hong Kong⁵, the court recommended the amendment of section 357 of the CO to remove the anomaly that a company incorporated outside Hong Kong but having its central management and control in Hong Kong is immune from any security for costs as it is neither ordinarily resident out of the jurisdiction under Order 23 rule 1(1)(a) of the Rules of the High Court nor a company caught by section 357 of the CO. We agree that it is appropriate to widen the categories of companies that the court may require security for costs in actions.

Proposal

20. We consider that section 357 of the CO should be extended to all types of companies incorporated outside Hong Kong, irrespective of whether the company is a limited or unlimited company. It is reasonable and just to order a foreign plaintiff to give security for costs in view of the difficulties that a defendant may encounter in enforcing a judgment against a foreign party. This also covers the loophole under Order 23 rule 1(1)(a) in the situation where the plaintiff is a company incorporated outside Hong Kong but having its central management and control in Hong Kong.
21. However, we have reservations on the extension of section 357 to unlimited companies incorporated in Hong Kong. It is an established common law principle that the insolvency or poverty of a plaintiff is no ground for requiring him to give security for costs. The only exception is in the case of a limited company under section 357 of the CO. It may be argued that

⁵ *Insurance Co of the State of Pennsylvania v Grand Union Insurance Co Ltd* [1988] 2 HKLR 541; *Charter View Holdings (BVI) Ltd v Corona Investments Ltd & Another* [1988] 1 HKLRD 469; *Akai Holdings Ltd v Ernst & Young* [2008] 5 HKLRD 133.

the policy behind section 357 of the CO is to impose a price for the privilege of limited liability and therefore the provisions were not extended to unlimited companies. As the liability of the shareholders of an unlimited company is without limitation, a costs order against an unlimited company may ultimately require payment from the shareholders.

22. **Clause 20.9** provides for the matters currently in section 357 of the CO subject to the modifications that any court having jurisdiction in the matter may require a plaintiff to give security for costs if the plaintiff is (a) a limited company incorporated in Hong Kong; or (b) a company incorporated outside Hong Kong.

Other Changes

(a) **Clarifying the power of the Registrar to require a defaulting company or officer to make good the default**

23. Currently section 306 of the CO provides that where a company having made default in complying with any requirement of the CO, the Registrar may issue a compliance notice to the company or the officer concerned to comply with that requirement. If the company or the officer concerned fails to make good the default within 14 days after the service of notice, the Registrar or any member or creditor of the company may apply to the Court of First Instance for an order to compel a company or its officers to make good the default within the time specified by the court. Where a company or its officers fail to comply with the court order, the defaulting company or officer may be punished for contempt of court.
24. Section 306 is intended to facilitate enforcement of filing of information with the Registrar. However, the phrase “default in complying with any requirement of this Ordinance” used in that section may be perceived literally as covering all requirements in the CO.
25. **Clause 20.4** clarifies that the default being referred to is a default in complying with any requirement under the Ordinance to (a) deliver a document to the Registrar or (b) give notice to the Registrar of any matter.

- (b) **Clarifying that the time limitation provision under section 351A of the CO only applies to summary offences and to prosecution made at the level of Magistrates' Courts**
- 26. **Clause 20.6** provides for the matters currently under section 351A of the CO with clarifications that:
 - (a) the time limitation as provided therein does not apply to an indictable offence and an offence triable either on indictment or summarily; and
 - (b) the limitation only applies to prosecution made in the Magistrates' Courts.
- (c) **Extending the power given under section 352 of the CO to the District Court to direct the application of any fine imposed**
- 27. **Clause 20.7** provides for the matters currently under section 352 of the CO. Modification has been made to extend the power to the District Court to direct any fine imposed under the CB for paying the costs of proceedings or rewarding the informant etc.
- (d) **Empowering the FS to make regulations**
- 28. As the FS is empowered to prescribe certain matters in the CB, **Clause 20.14** provides that the FS is empowered to make regulations in respect of any matter required or permitted to be prescribed by him under the CB.