

# 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 Group<sup>1</sup>. We have also commissioned an external legal consultant<sup>2</sup> 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 2009<sup>3</sup>. Details about the background and the guiding principles of the CO rewrite have already been set out in the first phase consultation paper<sup>4</sup>. The first phase consultation covered Parts 1 to 2, 10 to 12 and 14 to 18 of the CB.

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<sup>1</sup> 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](http://www.fstb.gov.hk/fsb/co_rewrite/eng/advisorygroup/advisorygroup.htm).

<sup>2</sup> 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.

<sup>3</sup> 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](http://www.fstb.gov.hk/fsb/co_rewrite)).

<sup>4</sup> 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**<sup>5</sup>. 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);

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<sup>5</sup> 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 2010<sup>6</sup> 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

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<sup>6</sup> 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) Ordinance<sup>7</sup>. 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.

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<sup>7</sup> 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 SFO<sup>8</sup>. 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 Kong<sup>9</sup>. 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.

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<sup>8</sup> 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](http://www.sfc.hk)).

<sup>9</sup> 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 Kong<sup>10</sup>. 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*).

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<sup>10</sup> 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.