

# CHAPTER 1

## INTRODUCTION

### Background

- 1.1 The CO provides the legal framework which enables the business community to form and operate companies. It also sets out the parameters within which companies must operate, so as to safeguard the interests of those parties who have dealings with them, such as shareholders and creditors. As at 31 October 2009, the register of companies had 760 412 companies which were formed and registered in Hong Kong, comprising 750 294 private companies<sup>1</sup> and 10 118 non-private companies<sup>2</sup>. Meanwhile, 7 842 non-Hong Kong companies that had established a place of business in Hong Kong were also on the register.
- 1.2 The CO is one of the longest and most complex pieces of legislation in Hong Kong, with over 600 sections and 20 schedules. It was last substantially reviewed and amended in 1984, and is broadly in line with the UK Companies Act 1948 and some subsequent reforms, such as those contained in the UK Companies Act 1976. The SCCLR<sup>3</sup> was formed in 1984 to advise the Government on necessary amendments to the CO.
- 1.3 Over the past decade, the SCCLR and the Government have conducted several major reviews with a view to modernising the company law and upgrading its corporate governance regime, resulting in recommendations to amend various sections of the CO. In the past few years, we have implemented some of those recommendations by means of several amendment bills.<sup>4</sup>
- 1.4 The piecemeal approach to amending the CO, however, has its limitations. A comprehensive rewrite of the CO is needed to modernise our company law to further enhance Hong Kong's status as a major international business

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<sup>1</sup> A private company is defined under section 29(1) of the CO to mean a company which by its articles:

- (a) restricts the right to transfer its shares;
- (b) limits the number of its members to 50; and
- (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

<sup>2</sup> Any company other than a private company is a non-private company. They are also commonly referred to as public companies. Public companies are subject to tighter regulation, such as the requirement to submit annual accounts to the Registrar.

<sup>3</sup> Members of the SCCLR include representatives of the SFC, the Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as individuals from relevant sectors or professions such as accountancy, legal and company secretarial. Please see <http://www.cr.gov.hk> for further information.

<sup>4</sup> A brief summary of the recent reviews and legislative amendments can be found in FSTB, "Appendix I: Summary of Recent Reviews of Company Law and Amendments to the Companies Ordinance", *Consultation Paper on Companies Ordinance Accounting and Auditing Provisions* (March 2007) (available at [http://www.fstb.gov.hk/fsb/co\\_rewrite/eng/pub-press/doc/cocap32\\_e.pdf](http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cocap32_e.pdf)).

and financial centre. With the support of the LegCo, the FSTB launched a comprehensive rewrite of the CO in mid-2006.

## **The Guiding Principles and Benefits of the Rewrite**

1.5 The rewrite exercise is guided by the following key principles:

- **Catering for SMEs - “think small first”**

The provisions of the CO should be reframed and aligned with special regard to the needs of private companies, particularly SMEs. We aim to reduce the compliance costs of companies, particularly private companies and SMEs.

- **Enhancing corporate governance**

The rewrite aims to strengthen corporate governance, taking into account the interests of stakeholders, such as members, directors, creditors and auditors. Various provisions, including those regarding directors’ conflicts of interest and members’ rights, will be reformed. In general, public companies should be subject to enhanced regulation, where appropriate.

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

The rewrite will benchmark Hong Kong against other comparable jurisdictions such as the UK, Australia and Singapore in general while taking into account Hong Kong’s unique business environment and our close economic relationship with the Mainland.

- **Encouraging the use of information technology**

We aim to promote the use of information technology, particularly in facilitating communications between companies and their shareholders as well as members of the public, and in encouraging environmentally friendly practices.

1.6 The rewrite will improve the structure of the parts and sections and enhance the clarity of the provisions so as to make the law more accessible to users.<sup>5</sup> It will also help modernise the CO and take forward reforms in respect of those areas which have not been reviewed previously, such as the capital

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<sup>5</sup> An information paper on the drafting of legislation was prepared by the Law Drafting Division, Department of Justice for a meeting of the Panel on Administration of Justice and Legal Services of the LegCo held on 15 December 2009. The paper is available on the LegCo’s website at <http://www.legco.gov.hk>.

maintenance provisions. Antiquated concepts, such as the concept of “par value” and the underlying assumption of paper-based communications between a company and its members, will be changed, updated or simplified. We believe that the reform will lead to enhanced market confidence in incorporating and registering companies to undertake business in Hong Kong.

## **Progress Made**

- 1.7 In view of the extensive nature of the rewrite exercise, we have adopted a phased approach by tackling the core company provisions which affect the daily operation of live companies in Hong Kong in the first phase. The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver’s Office, will be reviewed in the Phase Two of the rewrite. Those parts of the CO concerning prospectuses will be dealt with in a separate review by the SFC and will be transferred from the CO to the SFO in due course.
- 1.8 We consider it important to gauge the views of stakeholders and the general public in the process of the rewrite. In this connection, we have benefited from the advice of the SCCLR, as well as that of four dedicated AGs and the Joint Government/HKICPA Working Group to review the accounting and auditing provisions of the CO.<sup>6</sup> We have also commissioned an external legal consultant<sup>7</sup> to study and formulate proposals on certain complex areas of the CO, including share capital and debentures, distribution of profits and assets and registration of charges.
- 1.9 We conducted three public consultations in 2007 and 2008 to gauge views on more complex subjects, including:
  - (a) accounting and auditing provisions;
  - (b) company names, directors’ duties, corporate directorship and registration of charges; and
  - (c) share capital, capital maintenance regime and court-free merger procedure.
- 1.10 The consultation papers and consultation conclusions are available on the

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<sup>6</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>7</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.

CO rewrite website.<sup>8</sup> The final proposals have been incorporated into the draft clauses of the CB which we now issue for further public consultation.

## Future Work

- 1.11 Given that the draft CB is lengthy, we are conducting the public consultation on the draft clauses in two phases. The first phase covers Parts 1 to 2, 10 to 12 and 14 to 18. The second phase covers Parts 3 to 9, 13 and 19 to 20. The framework of the draft CB indicating the Parts to be covered in each phase is at **Appendix 1**. The second phase consultation paper and draft clauses will be issued in early 2010 for a three-month consultation. We will revise the draft CB, taking into account the comments received during the consultations. Our aim is to introduce the CB into the LegCo by the end of 2010.
- 1.12 Meanwhile, in order to tie in with the launch of CR's services for electronic incorporation of companies and filing of documents in late 2010/early 2011, we will introduce a Bill to amend the CO in early 2010. We will also make use of the opportunity to introduce a number of technical amendments to the CO ahead of the rewrite.<sup>9</sup>

## Outline of Consultation Paper

- 1.13 This consultation paper should be read together with the Consultation Draft of Parts 1 to 2, 10 to 12 and 14 to 18 of the CB being published in parallel. It comprises the following:
- **Chapters 2 to 5** outline how the key legislative changes proposed in the CB will contribute to the following objectives:
    - (a) enhancing corporate governance (*Chapter 2*);
    - (b) ensuring better regulation (*Chapter 3*);
    - (c) business facilitation (*Chapter 4*); and
    - (d) modernising the law (*Chapter 5*).
  
  - **Chapters 6 to 9** highlight specific issues for consultation. They are:

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<sup>8</sup> [http://www.fstb.gov.hk/fsb/co\\_rewrite](http://www.fstb.gov.hk/fsb/co_rewrite).

<sup>9</sup> The proposed amendments are summarised in the LegCo Panel on Financial Services paper CB(1)1829/08-09(01) available at <http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa0611cb1-1829-1-e.pdf>.

- (a) the “headcount test” for approving a scheme of compromise or arrangement (*Chapter 6*);
  - (b) disclosure of directors’ residential addresses and identification numbers of directors and company secretaries (*Chapter 7*);
  - (c) treatment of private companies associated with a listed or public company for the purposes of the provisions on fair dealings by directors (*Chapter 8*);
  - (d) whether the common law derivative action should be abolished (*Chapter 9*).
- A **list of all the questions** for consultation will be set out after Chapter 9.
  - **Explanatory notes** on the draft clauses of Parts 1 to 2, 10 to 12 and 14 to 18.

## Seeking Comments

1.14 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 in Chapters 6 to 9, 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.