The New Hong Kong Companies Ordinance

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Companies Ordinance Rewrite

- ***Background to the Hong Kong Companies Ordinance Rewrite***
  - Rewrite of the Companies Ordinance was endorsed by Legislative Council ("LegCo") and launched mid-2006
  - The new Companies Ordinance (Cap. 622) ("new CO") – deals with all provision in Cap. 32 relating to live companies
  - The winding-up and insolvency related provisions and provisions on prospectuses will remain in Cap. 32 which will become the Companies (Winding Up and Miscellaneous Provisions) Ordinance ("C(WUMPO")
  - C(WUMP)O will be amended in due course

Companies Ordinance Rewrite (2)

- The Companies Bill was introduced into LegCo in January 2011
- The Bills Committee conducted 44 meetings totalling over 120 hours and examined over 200 papers and submissions from the Administration and various deputations along with over 800 amendments
- The resumed second reading debate commenced in LegCo on 3rd July 2012 and after 8 days of intense deliberation, the new CO was passed by LegCo on 12 July 2012

The new CO

- 21 Parts, comprising 921 sections and 11 schedules
- 12 items of subsidiary legislation – final batch enacted by Legislative Council on 17 July 2013
- Commencement expected in the 1st quarter of 2014

Structure of the new CO

- Divided into 21 Parts, comprising 921 sections and 11 Schedules

Part 1 – Preliminary
Part 2 – Registrar of Companies and Companies Register
Part 3 – Company Formation and Related Matters, and Re-registration of Company
Part 4 – Share Capital
Part 5 – Transactions in relation to Share Capital
Part 6 – Distribution of Profits and Assets
Part 7 – Debentures
Part 8 – Registration of Charges
Part 9 – Accounts and Audit
Part 10 – Directors and Company Secretaries

Structure of the new CO (2)

Part 11 – Fair Dealing by Directors
Part 12 – Company Administration and Procedure
Part 13 – Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back
Part 14 – Remedies for Protection of Companies' or Members' Interests
Part 15 – Dissolution by Striking Off or Deregistration
Part 16 – Non-Hong Kong Companies
Part 17 – Companies not Formed, but Registrable, under this Ordinance
Part 18 – Communications to and by Companies
Part 19 – Investigations and Enquiries
Part 20 – Miscellaneous
Part 21 – Consequential Amendments, and Transitional and Saving Provisions

Four major objectives of the new CO

- Enhancing corporate governance
- Ensuring better regulation
- Facilitating business
- Modernising the law

Topics to be considered to-day

- ***Modernizing the Law***
  - Streamlining the types of companies that can be formed
  - Abolition of Memorandum of Association for **all** companies
  - Retiring the concept of par for shares of **all** companies
- ***Ensuring Better Regulation***
  - Lowering the threshold for contravention by officers through a new definition of “responsible person”
  - Improving the registration of charges regime
  - Empowering the Registrar to compound specified offences to encourage due compliance and optimize the use of judicial resources

Topics to be considered to-day (2)

- ***Facilitating Business***
  - Introducing a new alternative court free procedure for reducing capital based upon a solvency test
  - Allowing all types of companies (other than just private companies) to purchase their own shares out of capital, subject to a solvency test
  - Allowing all types of companies (whether listed / unlisted) to provide financial assistance to another party to acquire shares in the company or its holding company, subject to a solvency test

Streamlining types of companies

Under Cap. 32, 8 different types of company can be formed:

- Private company limited by shares
- Non-private company limited by shares
- Private company limited by guarantee without share capital
- Non-private company limited by guarantee without share capital
- Private unlimited company with share capital
- Non-private unlimited company with share capital
- Private unlimited company without share capital
- Non-private unlimited company without share capital

Streamlining types of companies (2)

Under the new CO:

- Unlimited companies without share capital are abolished (there are none registered and there are unlikely to be such registered in the future)
- Companies limited by guarantee, whether private or non-private are amalgamated and become companies limited by guarantee. A separate category of company generally treated in the same way as public companies, e.g. they will all be required to file accounts (see **section 9** for definition which applies to existing as well as companies formed under new CO)
- Non-private companies become "public companies", which mean companies other than private companies or guarantee companies (see **section 12**)

Streamlining types of companies (3)

Under the new CO, 5 types of companies may be formed:

- **section 66** of new CO:
  - a public company limited by shares
  - a private company limited by shares
  - a public unlimited company with share capital
  - a private unlimited company with share capital
  - a company limited by guarantee without a share capital
- Registrar will inform all existing private companies limited by guarantee of their new obligations under the new CO by issuing a letter to them

Abolition of the memorandum for all companies

Background

- Abolition of ultra vires rule, means the objects clause has become less significant with most companies having the capacity and right powers and privileges of a natural person (section 5A of Cap 32 and **section 115** of new CO)
- Most information is now contained in the incorporation form and articles of association and most provisions of the memorandum can be amended
- The need for the memorandum as a separate constitutional document has diminished
- Under new CO, the memorandum is abolished for all companies

Abolition of the memorandum for all companies (2)

- Pursuant to **section 67** of the new CO, any one or more persons may form a company by signing the articles of the company intended to be formed and delivering to the Registrar for registration: (i) an incorporation form; and (ii) a **copy** of the articles
- The agreement by the subscribers to take up shares in the company (previously set out in the memorandum) will now be in the articles, which will be signed by all of the subscribers
- The incorporation form must contain a statement confirming that the company's articles have been signed for the purposes of **section 67(1)(a)** by every person proposing to become a member of the company on formation and a statement that the articles delivered under **section 67(1)(b)(ii)** are the same as those signed by the founder members / subscribers (**section 68(1)(e**))

Abolition of the memorandum for all companies (3)

Mandatory Articles

- Every company is statutorily **required** to have articles on the following:
  - Company name **(section 81)**
  - If the company has a licence to dispense with the use of the word "limited" in its name – objects **(section 82(1))**
  - A statement that the liability of members is limited or unlimited, as the case may be **(section 83)**
  - Details of liabilities / contributions of members **(section 84)**
  - Capital and initial shareholding on formation **(section 85)**
- These mandatory articles comprise information previously set out in the memorandum

Optional Articles

- Any company other than one with a licence to dispense with the use of the word "limited" in its name **may** state objects **(section 82(2))**
- A company **may** state the maximum number of shares that a company may issue

Abolition of the memorandum for all companies (4)

Model Articles / Bespoke Articles

- For additional regulations, all companies may create bespoke articles or may adopt all or any of the Model Articles prescribed by the Financial Secretary for the type of company to which it belongs (**sections 78 and 79)**
- Companies (Model Articles) Notice (L.N. 77 of 2013) prescribes Model Articles for:
  (1) public company limited by shares (Schedule 1)
  (2) private company limited by shares (Schedule 2)
  (3) guarantee company (Schedule 3)
- These replace Table A and Table C in the First Schedule to Cap 32
- The Model Articles will apply by default if no additional articles are filed by the company or even if filed in so far as the registered articles do not exclude or modify the Model Articles **(section 80)**

Abolition of the memorandum for all companies (5)

Existing Companies

- **Section 98**:
  - A condition of the memorandum of an existing company immediately before commencement of the new CO is deemed to be regarded as a provision of that companies articles of association, except that any such condition setting out authorized share capital and the par value of shares are to be regarded as deleted for all purposes
  - All references in any other ordinances / documents etc to memorandum is a reference to articles of association

What Needs to be Done

- The deeming provisions ensure that existing companies need not take any steps as a result of the changes – the deeming provisions are sufficient to ensure compliance
- However companies may wish to take this opportunity to review their constitutional documents to see if there are any changes that they wish to make as a result of the new CO

Retiring the concept of par

Background

- Nominal value (also known as "par value") of shares is the minimum price at which shares can generally be issued
- It is generally accepted that par value does not serve its original purpose of protecting creditors and shareholders, and in fact may even be misleading because the par value does not necessarily give an indication of the real value of the shares
- The new CO adopts a mandatory system of no-par for all local companies having a share capital and retires the concept of par value for all shares

Retiring the concept of par (2)

- This is in line with international trends to provide companies with greater flexibility in structuring their share capital. In other comparable common law jurisdictions, there is also growing acceptance of no-par value shares. Jurisdictions that have adopted mandatory no-par value shares include Australia, New Zealand and Singapore
- There is no essential difference between a share of no par value and one having a par value. Both represent a share, being a fraction of the equity, but par value share has attached to it a fixed face value, and share without par value does not
- It is considered that retiring the concept of par creates an environment with greater clarity and simplicity and is more desirable for the business community generally

Retiring the concept of par (3)

Major changes

- Under Cap. 32 companies incorporated in Hong Kong and having a share capital are required to have a par value ascribed to their shares **(section 5(4)(a))**. This represents the minimum amount at which a share can be issued
- Companies must also declare in their Memorandum of Association the maximum amount of share capital that may be issued by the company (the requirement for "authorized share capital") **(section 5(4)(a))**
- The amount of the excess of the issue price of the share over its par value is designated as "share premium". Under Cap. 32, there are restrictions on how a company can deal with share premium and how it must be accounted for **(section 48B)**

Retiring the concept of par (4)

- Under the new CO, as a result of migration to mandatory no-par, relevant concepts such as par value, share premium, and requirement for authorised share capital are no longer necessary and are abolished

- **Authorised share capital**

- Upon commencement of the new CO, the provisions in the Memorandum of Association of an existing company (deemed to be provisions in the Articles of Association after commencement of the new CO) relating to authorised share capital and par value of the shares are for all purposes to be regarded as deleted (**section 98(4)**). The share capital of a company would be its issued share capital

Retiring the concept of par (5)

- **Share capital**

- The full proceeds of a share issue will be credited to share capital under the new regime and become the company's share capital. The notion of issued or paid capital will continue to be relevant even after the abolition of par value, and it will then include the amount previously credited to the share premium account. In other words, it will represent the total amount that the company actually receives from its shareholders as capital contribution.

- **Share premium account**

- With the abolition of par value, "share premium" will no longer exist. There is a deeming provision in the new CO to provide for the amalgamation of the existing share capital amount with the amount in the company's share premium account (**section 37 of Schedule 11**).

Retiring the concept of par (6)

- The currently permitted uses of share premium existing on the date of commencement of the new CO will be preserved, e.g., to pay up shares which are issued as bonus shares (**section 38 of Schedule 11**). For this purpose, the company should continue to maintain records of the balance of the former share premium account

- **Capital redemption reserve**

- On the commencement date of the new CO, any amount standing to the credit of the company's capital redemption reserve becomes part of the company's share capital (**section 37 of Schedule 11**)

Retiring the concept of par (7)

Alteration of share capital

- A company will have greater flexibility to alter its share capital in a no-par environment, e.g. a company will be able to capitalise its profits without issuing new shares and to allot and issue bonus shares without increasing its share capital (**section 170**)

- 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 (**section 170(2)(e)**)

Retiring the concept of par (8)

- Bonus shares can continue to be issued notwithstanding that there will no longer be a share premium account since in a no-par environment, shares can be issued without transferring an amount to the share capital account (**section 170(2)(d)**)

Retiring the concept of par (9)

Transitional arrangements

- It is expected that the new CO will commence operation in the first quarter of 2014. The abolition of par value for the shares of all Hong Kong companies will take effect immediately upon commencement of the new CO
- The new regime applies to all local companies regardless of whether the companies are formed before or after the commencement date of the new CO. All shares issued, before, on and after the commencement date of the new CO shall have no par value. The law will deem all shares issued before the abolition to have no par value (**section 135**). There is no conversion process required from the companies

Retiring the concept of par (10)

- The new CO contains transitional and deeming provisions relating to the move from par value shares to no-par value shares (**sections 35 to 41 of Schedule 11**). 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. The transitional and deeming provisions will save considerable work, expense and time for companies and reduce the possibility of disputes.

- For example, the statutory deeming provision in the new CO (**section 40 of Schedule 11**) provides that for the purpose of interpreting and applying (i) a resolution of a company made and (ii) a trust deed or other document executed before the commencement of the new CO, a reference to the par or nominal value of a share (whether made expressly or by implication) is a reference to the nominal value of the shares immediately before that commencement date

Retiring the concept of par (11)

- Nonetheless, individual companies may 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, e.g. the company's constitutional documents, contracts entered into by the company, trust deed involving the company and share certificates for use under the no-par regime by the company

- *The Companies Registry has issued an External Circular on this topic which can be accessed at:*

  <http://www.cr.gov.hk/en/publications/guidelines_01.htm>

Responsible Person

- Lowering the threshold for contravention by officers through a new definition of "responsible person":
  - The Companies Ordinance attributes criminal liability to an officer of a company who is in default if he knowingly and wilfully authorizes or permits the default. The evidential burden for the prosecution is very high because of the requirement to prove "wilfulness"
  - "Wilfulness" means requiring to prove that the conduct was deliberate
  - The offences involved are mostly regulatory in nature and the majority (over 90%) are summary offences punishable by fine
  - "Responsible person" is defined in the new CO as an officer of a company who authorizes or permits, or participates in, the contravention or failure **(section 3)**

Responsible Person (2)

- Reckless conduct will be prosecuted
- This will include turning a blind eye or "wilful blindness"
- Negligence is not being targeted with the new formulation
- The effect of the new formulation is to lower the prosecution threshold to remove the "wilful" element

Responsible Person (3)

- The original proposal for the new formulation in the Companies Bill was modelled upon section 1121 of the UK Companies Act 2006 and had an additional limb of "fails to take all reasonable steps to prevent the contravention"
- This caused concern during the legislative process that negligence was being criminalized
- After much lively debate, the administration agreed to amend the formulation recognizing that the amended formulation would still achieve the policy objective of ensuring better regulation
- Under the new formulation, to prosecute a responsible person it will be necessary for the prosecution to prove that he acted "knowingly or recklessly".

Changes in the Registration of Charges

- ***Improving the registration of charges regime***
  - Current regime is basically retained with some improvements
  - Updating the list of registrable charges **(section 334)**
    - It is expressly provided that a charge on an aircraft / share in an aircraft is registrable
    - A charge on instalments due but not paid on issue price of shares is registrable
    - Charge for the purposes of securing any issue debentures is removed (as usually registered as a floating charge)

Changes in the Registration of Charges (2)

- It is clarified that a shipowner's lien on subfreights is not regarded as a charge on book debts / floating charge and is not registrable
- A charge on cash deposits is not regarded as a charge on book debts

- Replacing the automatic acceleration of repayment obligation with a choice for the lender **(section 337(6))**
- Requiring a certified copy of the charge instrument to be registrable and available for public inspection **(sections 335, 336 and 338 to 340)**
- Shortening the period for delivery to the Registrar of a certified copy of the charge instrument and the prescribed particulars from five weeks to one month **(sections 335, 336 and 338 to 340)**

Changes in the Registration of Charges (3)

- Requiring a certified copy of written evidence of debt satisfaction or release of a charge to be registered and made available for public inspection **(section 345)**
- Clarifying the effect of an order made by the Court to extend the time for registration in respect of criminal liability already incurred **(section 346(4))**
- Empowering the Court to rectify the particulars in the registered charge instrument and evidence of discharge **(section 347)**
- More important than ever for lenders to make enquiries and search the register to ascertain what charges have already been registered by the company

Changes in the Registration of Charges (4)

- Most significant charge is registration of certified copy charge instrument
- Full details of charge available on public register e.g. negative pledge / automatic crystallisation
- Third parties will have deemed notice of all terms in the charge instrument
- Later chargees will be deemed to know terms of all previous charges; and this may affect priorities

Compounding

- **Section 899** empowers the Registrar, at her discretion, to compound specified offences so as to:
  - Encourage compliance with the provisions of the new CO, and
  - Optimize the use of judicial resources
- Specified offences are set out in **Schedule 7** of the new CO:
  - Failing to deliver director's written Consent to Act **(section 74(2))**
  - Failing to engrave name etc. on common seal **(section 124(3))**
  - Improper use of the common seal **(section 124(4))**
  - Failure to file annual returns (**sections 662(6)** and **section 788(3)** re registered non-Hong Kong companies)
  - Failure by a registered non-Hong Kong company to deliver accounts **(section 789(3))**

Compounding (2)

- Additional offences relating to the display of company names under **section 7** of the Companies (Display and Publication of Company Name and Liability Status) Regulation will be added
- Corresponding offences for registered non-Hong Kong companies re the display of names will also be added (**section 792(6)** of the new CO re breach of **section 792(1) and (2)**)

- The Registrar may, if she has reason to believe a prescribed offence has been committed, give the company notice in writing which:

  (i) States that the Registrar has reason to believe the company has committed the offence and setting out particulars of the offence; and

  (ii) Conditions upon which no prosecution action will be taken including:
  - Amount of the compounding fee to be paid;
  - The period within which conditions must be complied with; and
  - Any other information that the Registrar considers necessary

Compounding (3)

- Where the offence is a failure to do a particular act, the Notice will require the act to be done within a specified period (which can be extended)
- The compounding fee will be set as HK$600
- If the fee is paid and the act is done, no prosecution action will be taken
- If either the fee is not paid or the act is not done, the Registrar may proceed with prosecution action
- The payment of compounding fee is not an admission of liability
- The Notice may only be issued before proceedings for any contravention are commenced
- Offences will be confined to those offences that are straight forward minor regulatory offences committed by a company that are punishable by a fine only

Transactions in relation to Share Capital

- ***Court-free reduction of capital***

  - Cap. 32 only allows a reduction of share capital if it is approval by the shareholders via a special resolution and if the reduction is approved by the court (**sections 58 to 63**). Court approval is not required if the sole purpose of the reduction is to re-designate the nominal value of shares to a lower amount (**section 58(3)**)

  - The new CO introduces, as an alternative procedure, a general court-free procedure based on a solvency test which will be faster and cheaper and can be utilised by all companies

Transactions in relation to Share Capital (2)

- **Sections 215 to 225** provide for the said court-free procedure, subject to compliance with the solvency test**.** The key features of the procedure include –
- (a) all the directors need to sign the solvency statement;
- (b) members' approval by a special resolution;
- (c) notices in the Gazette and newspapers;
- (d) register the solvency statement with the CR;
- (e) any creditor or non-approving member of the company may, within five weeks after the special resolution is passed, apply to the court for cancellation of the resolution; and
- (f) register the relevant return with the CR after the expiry of objection period.

Transactions in relation to Share Capital (3)

- ***Shares buy-back out of capital***
  - Under Cap. 32, the general rule is that a company can only buy back its shares using distributable profits or using the proceeds of a fresh issue of shares (**sections 49A and 49B**). This rule is derived from the capital maintenance doctrine. There is an exception for private companies which may fund a buy-back by payment out of capital based on a solvency test (**sections 49I to 49N**)
  - Under the new CO, all companies are allowed to fund buy-backs out of capital, subject to a solvency requirement

Transactions in relation to Share Capital (4)

  - **Sections 258 to 266** retain most of the Cap. 32 requirements and procedures applicable to buy-backs by a private company out of capital, and extend them to all companies. The requirements and procedures are similar to the new court-free procedure for reduction of capital

- ***Financial assistance to acquire shares***
  - **Section 47A** of Cap. 32 prohibits a company and its subsidiaries from giving financial assistance for the purpose of acquiring shares in the company. The broad prohibition is subject to certain exceptions

Transactions in relation to Share Capital (5)

- The main change under the new CO is to allow all types of companies (listed or unlisted) to provide financial assistance, subject to satisfaction of the solvency test and one of the three procedures set out in **sections 283 to 289**
- The first procedure, set out in **section 283**, 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 shareholders' funds (paid up share capital and reserves of the company (as disclosed in the most recent audited financial statements of the company))
- The second procedure, set out in **section 284**, provides that a company may give financial assistance if it is approved by written resolution of **all** members of the company

Transactions in relation to Share Capital (6)

- The third procedure, set out in **sections 285 to 288**, provides that a company may give financial assistance if it is approved by an ordinary resolution. Shareholders holding at least 5% of the total voting rights or members representing at least 5% of the total members of the company may apply to the court to restrain the giving of the assistance
- **Section 47C(4)(b)** of Cap. 32 provides that the prohibition on financial assistance does not apply to employee share schemes, provided that the financial assistance is restricted to the provision of money for the purchase or subscription of fully paid shares. This is relaxed in the new CO. **Section 280** allows financial assistance for all types of employee share schemes 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

Transactions in relation to Share Capital (7)

- ***Uniform solvency test***
  - Under Part II of Cap. 32, a solvency test is provided for in respect of (a) buy-backs of its own shares out of capital by a private company (**section 49K(3), (4) and (5)**); and (b) financial assistance to acquire shares given by an unlisted company (**section 47F(1)(d) and (2)**)
  - Both solvency tests are based on cash flow alone, but there are minor differences between them, as follows –

    (a) for buy-backs, **under section 49K(5),** the solvency statement has to be accompanied by an auditors' report; and

    (b) for financial assistance, **section 47F(1)(d)(i)** has an additional requirement for the solvency statement which provides for the situation where the company intends to commence winding up within 12 months of the date of the proposed financial assistance

Transactions in relation to Share Capital (8)

- It is desirable to adopt a uniform solvency test for buy-backs and financial assistance, and extend its application to the court-free procedure for reduction of capital, for consistency in the law. The new CO adopts the approach for financial assistance set out in **section 47F(1)(d)**, as it can give clarity and certainty on how the solvency test may apply in different scenarios
- **Section 204** of the new CO provides that a uniform solvency test will be applicable to reduction of capital, buy-backs and financial assistance. **Section 205** sets out the content of the uniform solvency test, which in substance, re-enacts **section 47F(1)(d)** of Cap. 32.

Transactions in relation to Share Capital (9)

- A company satisfies a solvency test in relation to a transaction if:

  (a) immediately after the transaction there will be no ground on which the company could be found to be unable to pay its debts; and

  (b) either (i) if it is intended to commence winding up within 12 months, the company will be able to pay its debts in full within 12 months of the commencement of the winding up; or (ii) in any other case the company will be able to pay its debts as they become due during 12 months after transaction

- A solvency statement must be made and signed by all directors for buy-backs and reductions of capital, and made and signed by a majority of directors for financial assistance

Statement of capital

- Under Cap. 32, the capital structure of a company can only be ascertained by searching through a number of documents on the register, e.g. the annual return, any return of allotment filed since the annual return, any documents filed in relation to a permitted reduction of capital. It is therefore not easy to ascertain the capital structure at a specific moment in time without a thorough check of the register

- A statement of capital is in essence a “snapshot” of a company’s total subscribed capital at a particular point in time

Statement of capital (2)

- The new CO requires a company to deliver to the CR such a statement to be contained in a return or notification, whenever there is a change to its capital, e.g. where there is an allotment of shares (**section 142**) or a permitted alteration of share capital (**section 171**). A statement of capital will show the company's share capital information as at the time the company has so changed its share capital

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

Looking Forward

- ***The new CO can be accessed at:***
  < http://hklaw.ccgo.hksarg/eng/index.htm >

- ***The CR website has information on the new CO, please visit the website at:*** **< http:// www.cr.gov.hk >**

Thank you