



The New Companies Ordinance

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Major Changes for Company Directors





Corporate directorship

- Corporate directors are not permitted for public and guarantee companies.
- Private companies must have at least one director who is a natural person. Existing companies have 6 months to comply with the requirement.

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Duty to prepare a more analytical business review

- The new CO requires a directors' report to include a business review which should cover the following information of a company
 - ◆ a fair review of its business
 - ◆ a description of its principal risks and uncertainties
 - ◆ particulars of any important events affecting it which have occurred since the end of the financial year
 - ◆ an indication of likely future development in its business

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Duty to prepare a more analytical business review (cont'd)

- ◆ a discussion on its environmental policies and performance, including compliance with the relevant laws and regulations that have a significant impact on the company
- ◆ an account of its key relationships with employees, customers, suppliers and others that have a significant impact on the company and on which its success depends
- The requirement for business review is in line with international trends to promote corporate social responsibility.

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Duty to prepare a more analytical business review (cont'd)

- The following companies are not required to prepare a business review -
 - ◆ companies falling with the reporting exemption
 - ◆ a private company that does not fall within the reporting exemption with 75% approval from members
 - ◆ a wholly owned subsidiary of a body corporate
- A director is not liable for untrue or misleading statement or omission unless he knew or was reckless as to whether it was untrue or misleading, or there was dishonest concealment of a material fact.

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Indemnification of officers against liability to company

- A provision that exempts a director from liability for negligence, default, breach of duty or breach of trust in relation to the company is void.
- The avoidance of a provision that indemnifies a director against liability is extended to include indemnity for a director of an associated company. The scope of permitted liability insurance is also extended to a director of an associated company.
- The new CO provides for permitted indemnity against liability incurred by a director to a third party. The indemnity must not cover liability to pay a fine in criminal proceedings, in defending criminal proceedings in which the director is convicted etc.
- Permitted indemnities must be disclosed in directors' report and copies must be kept and made available for inspection by members.

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Directors' duty of care, skill and diligence

- There is no provision in Cap 32 on the directors' duty of care, skill and diligence. The common law position in HK is not entirely clear.
- Under the new CO, a director must exercise reasonable care, skill and diligence, i.e. the care, skill and diligence that would be exercised by a reasonably diligent person with –
 - ◆ the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company ("objective test"); and
 - ◆ the general knowledge, skill and experience that the director has ("subjective test")
- The duty also applies to a shadow director.

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Ratification of conduct by directors by disinterested members' approval

- No specific provision in Cap 32 on ratification by members' approval.
- Ratification of conduct involving negligence, default, breach of duty or breach of trust is by resolution, disregarding the votes of a member who is a director in respect of whose conduct the ratification is sought, or who is an entity connected with that director or holder of any shares in the company in trust for that director or entity.
- Does not affect the validity of a decision taken by unanimous consent of the members or power of the directors to agree not to sue, or to settle or release a claim made on behalf of the company.

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Transactions with directors or their connected entities

- For public companies the prohibitions on loans and similar transactions are extended to cover a wider category of persons connected with a director. For example, adult children, cohabitants, parents.
 - ◆ Connected entity includes family members, person in cohabitation relationship, associated body corporate, specified categories of trustees and partner.
- Disinterested members' approval is required in the case of public companies.
 - ◆ Interested parties: the relevant directors, connected entities and any person who holds any shares in the company in trust for these persons/entities.
- Members' approval for directors' employment exceeding three years is required. For public companies, the votes of the director or the person holding shares in trust for him must be disregarded.

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Transactions with directors or their connected entities (cont'd)

- To facilitate business, new exemptions and exceptions are introduced
 - ◆ exemptions from prohibition on loans etc with prescribed approval of members
 - ◆ exception for small loans etc not exceeding 5% of net assets or called up capital
 - ◆ exception for expenditure on defending proceedings etc or in connection with investigation or regulatory action, subject to financial limit and requirements as to repayment
- The criminal sanction in Cap 32 is removed. Civil consequences only -
 - ◆ voidable at company's instance, with exceptions
 - ◆ directors and others liable to account to company
- The prohibitions on payments for loss of office are extended to cover payment to entity connected with director or former director and to payment to director of holding company.

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Transactions with directors or their connected entities (cont'd)

- The ambit of disclosure of material interest in contract of significance with the company is widened
 - ◆ covers "transaction" and "arrangement", instead of just "contract"
 - ◆ for a public company, the ambit of disclosure is widened to include disclosure of material interest of entities connected with director, except interest that the director is not aware of
 - ◆ disclose the "nature and extent" of interest, instead of just "nature"
 - ◆ also covers shadow directors
 - ◆ procedures for declaration of interest are set out

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Major Changes relating to Company Administration



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Introduction of a comprehensive set of rules for written resolution

- Cap 32 does not provide for the procedures for proposing and passing a written resolution.
- Anything that may be done by a resolution passed at a general meeting or class meeting, without any previous notice being required, may be done by a written resolution. Exception - a resolution removing auditor or director.
- A written resolution is passed when all members who are entitled to vote have signified their agreement.

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Introduction of a comprehensive set of rules for written resolution (cont'd)

- Procedure for proposing and passing a written resolution
 - ◆ The directors or members holding 5% of total voting rights may propose a written resolution.
 - ◆ A member who proposes a written resolution may request the company to circulate with the resolution a statement of not more than 1000 words on the resolution.
 - ◆ A company is not bound to circulate the statement if the Court is satisfied that the right is being abused or being used to secure needless publicity for defamatory matter.

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Introduction of a comprehensive set of rules for written resolution (cont'd)

- Written resolutions may be circulated by sending in hard copy or electronic form or by making them available on the website.
- The period for agreeing to the proposed written resolution is 28 days or such period as specified in articles.
- The statutory provisions do not override any rule of law e.g. the common law principle of unanimous shareholders' consent.
- Articles may provide its own procedures for passing a written resolution provided unanimous members' approval is required.

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Dispensation with the holding of AGM

- Circumstances in which company not required to hold AGM
 - ◆ If everything done by written resolution.
 - ◆ Single member company.
 - ◆ A dormant company.
 - ◆ Members' unanimous resolution to dispense with the holding of AGM in respect of a particular financial year or for subsequent financial years.

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Dispensation with the holding of AGM (cont'd)

- Where no AGM is held –
 - ◆ Directors (failing which members) may appoint the company's first auditor for the company's first financial year.
 - ◆ Copy of financial statements and reports to be sent to the members.
 - ◆ Current auditor deemed to be re-appointed unless he declines.
 - ◆ If reappointment declined, members replace retiring auditor at a general meeting.

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Dispensation with the holding of AGM (cont'd)

- AGM is required to be held after dispensation if -
 - ◆ a member requests the company to convene an AGM by giving notice to the company not later than 3 months before the end of the statutory period for holding an AGM.
 - ◆ the unanimous resolution for dispensing with holding an AGM is revoked by an ordinary resolution.

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Engagement of shareholders in decision making

- Under Cap 32 members may request the company to circulate at their expense a proposed resolution for an AGM or a statement relating to any proposed resolution or business to be dealt with at general meeting.
- The new CO provides that the expenses of circulation of the statement and the resolution in relation to an AGM are to be paid by the company if the request is received in time to enable the company to send a copy of the statement or resolution with the notice of meeting.
- Company not required to circulate the statement if the right is abused or is used to secure needless publicity for defamatory matter.

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Lowering the threshold for demanding a poll

- The threshold for members to demand a poll is reduced from 10% (in Cap 32) to 5% of the total voting rights.
- The other threshold of at least 5 members in Cap 32 is retained.

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Clarification of the rights of proxy

- Subject to the articles, 2 members present in person or by proxy form a quorum of a general meeting. Currently Cap 32 requires 2 members personally present to be a quorum.
- A proxy may exercise all or any of the member's rights to attend, speak and vote at a general meeting. Currently Cap 32 allows a proxy to vote on a poll only.
- Subject to the articles, a proxy may be elected as the chairperson of a general meeting. There is no express provision to that effect in Cap. 32.
- Where a proxy put forward by a company is appointed by a member to be his proxy, the new CO requires the proxy to vote in the way specified in the appointment of the proxy.
- The appointment of a proxy is regarded as revoked if the appointor attends and votes at the meeting.
- Multiple proxies are allowed in the case of a company having a share capital.

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Enhanced Protection of Shareholders' Interest



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Scheme of Arrangement - headcount test

- Headcount test in current CO
 - ◆ “majority in number” (“headcount test”) “representing three-fourths in value of the members...” (“share value test”). Court may sanction scheme which will be binding on all members, i.e. court still has discretion whether or not to sanction scheme even if both tests are satisfied.
 - ◆ Listed companies must also satisfy rule 2.10(b) of the Takeovers Code, i.e. number of votes cast against the scheme must not be more than 10% of the votes attaching to disinterested shares.
 - ◆ The headcount test is reviewed in the light of *Re PCCW Ltd* case where there is evidence of share splitting.

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Scheme of Arrangement - headcount test (cont'd)

- ◆ Headcount test inconsistent with “one share one vote” principle.
- ◆ Most shares in listed companies within the Central Clearing and Settlement Scheme (CCASS) are registered in the name of HKSCC Nominees Ltd. The headcount test does not serve the purpose it was originally designed to achieve.
- ◆ Australia amended the Corporations Act in 2007 to give the court a discretion to approve a members’ scheme even though majority in number is not obtained.

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Scheme of Arrangement - headcount test (cont'd)

- For members’ scheme of arrangement involving a general offer to buy back shares or a takeover offer, the headcount test is replaced by the requirement that the votes cast against the scheme do not exceed 10% of the total voting rights attached to all disinterested shares.
- The headcount test is retained for other members’ schemes but the Court is given a discretion to dispense with the test in special circumstances.
- Court may order costs against a member only if his opposition to the scheme is frivolous or vexatious.

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Remedies for unfair prejudice

- Extended to cover proposed acts and omissions.
- “with a view to bringing to an end the matter complained of” in Cap 32 replaced by any order “that it thinks fit for giving relief in respect of the matter” complained of.
- Currently the Winding Up Rules are applicable to unfair prejudice proceedings. Under the new CO, CJ is given express power to make rules to regulate such proceedings (see Companies (Unfair Prejudice Petitions) Proceedings Rules, Cap 622L).

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“multiple derivative action”

- Statutory derivative action introduced in 2004. Subsequently CFA held that a multiple derivative action was possible at common law.
- Amendments were made in 2010 to provide for multiple derivative action to enable a member of an associated company to bring proceedings in respect of misconduct committed against a company. Such provisions are restated in the new CO.

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