Standing Committee on Company Law Reform (SCCLR)

The Fourteenth Annual Report

1997/98

Standing Committee on Company Law Reform (SCCLR)

Fourteenth Report to the Chief Executive in Council

Subjects considered by the

Standing Committee during 1997/98

	Table of Contents	Page No.
Preface		
	(i) Terms of Reference of the Standing Committee on Company Law Reform	1
	(ii) Membership of the Standing Committee for 1997/98	1 - 2
	(iii) Meetings held during 1997/98	2 - 3
Executive Summary		4 - 6
Chapter 1	Review of the Hong Kong Companies Ordinance - Consultancy Report	7 - 10
Chapter 2	Requirement of a complete printed set of Articles of Association to be registered - Section 13 of the Companies Ordinance (CO)	11 - 13
Chapter 3	Definition of the term "place of business" - Oversea Companies Section 341 of the Companies Ordinance and Recommendations 11.03 and 11.04 of the Review of the Hong Kong Companies Ordinance - Consultancy Report	14 - 16
Chapter 4	The Nationality of every Director and Secretary - Sections 158 and 333 of the Companies Ordinance	17 - 18

	Table of Contents	Page No.
Chapter 5	Extension of "Professionals Exemption" under section 343(2) of the Companies Ordinance to companies incorporated in Hong Kong	19 - 21
Chapter 6	Guide for Directors of Listed Companies and Handbook on Disciplinary Proceedings	22 - 23
Chapter 7	Miscellaneous items: (a) The United Kingdom Law Commission Report on Shareholder Remedies (b) Draft Model Law on Cross-Border Insolvency of United Nations Commission on International Trade Law (UNCITRAL)	24 - 25
Chapter 8	Prosecution of Directors for failing to file annual returns	26 - 29
Chapter 9	Official Receiver's Annual Departmental Report 1995/96	30 - 32
	Official Receiver's Annual Departmental Report 1996/97	
	Companies Registry Annual Report 1996/97	
Appendix 1	Terms of Reference of the Review of the Hong Kong Companies Ordinance	33
Appendix 2	Summary of Recommendations extracted from the Consultancy Report	34 - 44
Appendix 3	List of Public Submissions Received on the Consultancy Report on the Review of The Hong Kong Companies Ordinance	45 - 47

	Table of Contents	Page No.
Appendix 4	Terms of Reference and Executive Summary of the UK Law Commission Report on Shareholder Remedies	48 - 51
Appendix 5	The statistics showing the number of cases where receiving orders and winding-up orders were made covering a period from 1986 to 1996	52
Appendix 6	Analysis of Disqualifications of Directors for 1996-97	53
Appendix 7	Workload Statistics of the Companies Registry	54 - 55

PREFACE

(i)

Terms of Reference of the Standing Committee on Company Law Reform

(1) To advise the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary.

(2) To report annually through the Secretary for Financial Services to the Chief Executive in Council on those amendments to the Companies Ordinance that are under consideration from time to time by the Standing Committee.

(3) To advise the Financial Secretary on amendments required to the Securities Ordinance and the Protection of Investors Ordinance with the objective of providing support to the Securities and Futures Commission in its role of administering those Ordinances.

(ii)

Membership of the Standing Committee for 1997/98

Chairman	:	The Hon Justice Rogers, JA	
Members	:	Mr Richard E T Bennett	(up to 31 January 1998)
		Mr Roger T Best	
		Mr John R Brewer	
		Mr Moses Cheng Mo-chi, JP	
		Mr Henry Fan Hung-ling	
		Ms Betty Ho May-foon	
		Mr Gerald Hopkinson	(from 1 May 1997)
		Mr Robert G Kotewall, JP, SC	
		Mrs Angelina P L Lee, JP	
		Mr Winston Poon, SC	(from 1 May 1997)
		Mr David Shaw	
		Mr Alan Smith, JP	(up to 31 January 1998)
		Mr Alvin Wong Tak-wai	(from 1 February 1998)

Ex-Officio Members	:	Mr Raymond Tang, Chief Counsel Securities & Futures Commission
		Mr Alec Tsui Yiu-wa, Chief Executive The Stock Exchange of Hong Kong Limited
		Mr Charles Barr Department of Justice
		Mr A R Hearder, JP The Official Receiver
		Mr Gordon W E Jones, JP The Registrar of Companies
		Mr David T R Carse, JP Deputy Chief Executive (Banking)
		Mrs Rebecca Lai, JP Deputy Secretary for Financial Services
Secretary	:	Mr D O Kitchell, JP

(iii)

Meetings held during 1997/98

One Hundredth and Nineteenth Meeting	-	8 March 1997
One Hundredth and Twentieth Meeting	-	3 May 1997
One Hundredth and Twenty First Meeting	-	31 May 1997
One Hundredth and Twenty Second Meeting	-	21 June 1997
One Hundredth and Twenty Third Meeting	-	13 September 1997

One Hundredth and Twenty Fourth Meeting	-	18 October 1997
One Hundredth and Twenty Fifth Meeting	-	15 November 1997
One Hundredth and Twenty Sixth Meeting	-	13 December 1997
One Hundredth and Twenty Seventh Meeting	-	17 January 1998
One Hundredth and Twenty Eighth Meeting	-	14 February 1998
One Hundredth and Twenty Ninth Meeting	-	21 March 1998

EXECUTIVE SUMMARY

The Standing Committee on Company Law Reform (SCCLR) was formed in 1984 to advise the Financial Secretary on amendments to the Companies Ordinance and other related ordinances. The SCCLR reports annually, through the Secretary for Financial Services, to the Chief Executive in Council on amendments that are under consideration.

From March 1997 to March 1998, the SCCLR held a total of 11 meetings and the major item of discussion was the Consultancy Report on the Review of the Companies Ordinance. The Consultant, after a two-year review, recommended that a modern new Business Corporations Ordinance based largely on the North American model should be introduced to replace the existing Companies Ordinance in accordance with the overall objective of simplification, rationalisation and modernisation of Hong Kong's company law. Under the "core-company law" approach adopted in the North American model, matters relating to securities regulation, financial services regulation, insolvency, charges and not-for-profit companies should be removed and re-enacted in separate legislation.

The Consultancy Report comprises a total of 12 chapters and the SCCLR has commenced a detailed chapter-by-chapter review of the Report. Up to the end of March 1998, it has examined five chapters which cover matters relating to incorporation, capital structure, management and administration, directors and executive officers, and shareholders' rights and remedies. The SCCLR took note of the operation of the existing provisions of the Companies Ordinance in the present context and has reached some preliminary views on a number of recommendations of the Consultant. However, as many of these recommendations are inter-related to issues discussed in other chapters and would have impact on the wider context of the overall direction of the development of company law in Hong Kong, the SCCLR intends to re-visit these recommendations at a later stage. It is therefore considered pre-mature to set out in detail the SCCLR's views on the Consultant's recommendations in this Annual Report.

Simultaneously with the SCCLR's examination, the Consultancy Report was released for public consultation on 1 May 1997. During the public consultation period, a total of 28 public submissions had been received including many substantive ones from the professional bodies. An initial analysis of the submissions revealed that views are generally diverse on individual/detailed recommendations. While many respondents agreed that there is a need for simplifying and rationalising the company law, some also

queried whether it is practical and appropriate to import the North American model into Hong Kong. The SCCLR will take into account these public submissions before submitting its final views on the Consultancy Report to the Government.

Apart from the Consultancy Report, the SCCLR considered a number of legislative proposals aimed at updating the relevant provisions of the Companies Ordinance to meet operational needs. During the reporting period, the following two proposals have been endorsed by the SCCLR : to require all companies to file a complete set of amended Articles of Association after alterations have been made which would have the benefit of facilitating search of updated company information (Chapter 2); and to remove the requirements for company directors and secretaries to report their nationality which is considered to be excessive and irrelevant (Chapter 4). These two proposals have been passed to the Administration for preparing the legislative amendments.

A brief summary of the 9 chapters of this Annual Report is set out in the following table :-

Chapter	Subject Matter	Recommendations/Remarks
1	Review of the Hong Kong Companies Ordinance - Consultancy Report	Members agreed to discuss the recommendations first and later to consider the public comments received before finalising their views.
2	Requirement of a complete printed set of Articles of Association to be registered - Section 13 of the Companies Ordinance	Members endorsed the proposal to require the filing of a complete printed set of amended Articles of Association after alterations had been made.
3	Definition of the term "place of business" - Section 341 of the Companies Ordinance. Recommendations 11.03 and 11.04 of the Review of the Hong Kong Companies Ordinance - Consultancy Report	Members did not come to a conclusion on this matter. It was agreed to consider again this matter together with the whole of Part XI of the Companies Ordinance.

Chapter	Subject Matter	Recommendations/Remarks
4	The Nationality of every Director and Secretary - Sections 158 and 333 of the Companies Ordinance	Members endorsed a proposal to delete the requirement to record and report the nationality of every director and secretary.
5	Extension of "Professionals Exemption" under section 343(2) of the Companies Ordinance to companies incorporated in Hong Kong	It was agreed that this matter be looked at again in the context of the Review of Hong Kong Companies Ordinance.
6	Guide for Directors of Listed Companies and Handbook on Disciplinary Proceedings	The Guide and Handbook were tabled for discussion.
7	(a) UK Law Commission Report on Shareholder Remedies (b) Draft Model Law on Cross-Border Insolvency of United Nations Commission on International Trade Law (UNCITRAL)	The UK Law Commission Report and the Draft Model Law were tabled for information.
8	Prosecution of Directors for failing to file annual returns	The Registrar of Companies briefed members on the policy.
9	Official Receiver's Annual Departmental Report 1995/96 Official Receiver's Annual Departmental Report 1996/97 Companies Registry Annual Report 1996/97	These Annual Reports were tabled for discussion.

Chapter 1

Review of the Hong Kong Companies Ordinance

Consultancy Report

Introduction

1.1 In his budget speech for 1994, the Financial Secretary announced :

> " We have tried in the past to respond to developments in the corporate world through piecemeal amendment of the Companies Ordinance. I believe we have reached a stage when a thorough review has become essential. We now need an ordinance for the 21st century. I have therefore asked the Secretary for Financial Services to take this forward. "

1.2 In support of its proposal to undertake an overall review of the companies legislation, the Administration pointed out that a number of significant changes and developments have taken place since the inception of the Standing Committee. These included :

(a) the setting up of the Securities & Futures Commission;

(b) the more prominent role played by the Stock Exchange as a regulator in the Securities sector;

(c) the dramatic increase in the numbers of private companies and the

consequential difficulties of enforcing the companies legislation against them in the event of a breach;

(d) the large numbers of listed companies which had redomiciled;

(e) the development of Hong Kong as an international financial centre;

(f) the growing numbers of Chinese enterprises seeking a listing on the Stock Exchange;

(g) the growth in trade between Hong Kong and the Mainland; and

(h) the requirement for the United Kingdom to harmonise its laws, including company law (which had hitherto been the model for the Hong Kong legislation), with other European Communities countries.

All these factors had persuaded the Administration that an overall review was necessary. Mr. Pascutto and Professor Cally Jordan were appointed to undertake such a review.

1.3 The terms of reference of the review of the Hong Kong Companies Ordinance are set out at Appendix 1. A summary of the recommendations extracted from Consultancy Report (the Report) is at Appendix 2. The major task of the SCCLR during this year has been to consider the recommendations made in the Report.

Public Consultation

1.4 The Report was launched for public consultation at a press conference on 1 May 1997. The period of public consultation was extended to 31 March 1998. Comments and views from members of public have been collected and summarized.

At present, the Report is being considered by the SCCLR. At a later stage, the SCCLR will also consider the comments from the public. It will probably take 12 to 18 months to complete the consideration of the Report and the public comments. As on 5 August 1998 a total number of 28 submissions from the public had been received. The list of public submissions received is at Appendix 3.

Discussion

1.5 At the 119th meeting, Mr. Pascutto and Professor Cally Jordan introduced the major recommendations of the draft Final Report to members. They proposed the enactment of a new company law for Hong Kong by 2001 which members considered to be very optimistic.

1.6 At the 120th meeting, members discussed the general approach and methodology of the review. Most members thought that the review should have started off by looking at the existing Companies Ordinance to identify current problems and defects and recommending solutions. Furthermore, little thought appeared to have been given to the position in connection with the Mainland. The Report seemed to have started off on the basis that we should commence with a clean sheet so that a completely new company regime could be applied to Hong Kong.

1.7 Members asked whether Government was prepared to tackle the matter from a law drafting point of view by employing a law draftsman to go through the Companies Ordinance in order to identify weaknesses, drafting defects and related problems. At the 121st meeting, the Chairman reported that the Secretary for Financial

Services had confirmed that it was not possible for Government to employ a law draftsman for the task. In view of this, the SCCLR would proceed by considering the Report and the public response to the Report.

1.8 At the 122nd to 129th meetings the SCCLR had considered those recommendations in :-

- Chapter 3.00 : Incorporation; Capacity and Powers;
- Chapter 4.00 : Capital Structure;
- Chapter 5.00 : Management and Administration;
- Chapter 6.00 : Directors and Executive Officers ; and
- Chapter 7.00 : Shareholders' Rights and Remedies.

However, without considering the public submissions, the SCCLR's views on those recommendations could not be crystallised.

The Way Forward

1.9 The public submissions on the recommendations in the Report will be considered by the SCCLR after completing an examination of the Report. The SCCLR's views on the recommendations in the Report will be finalised after considering the comments from the public.

Chapter 2

Requirement of a complete printed set of Articles of Association to be registered - Section 13 of the Companies Ordinance (CO)

Summary of Recommendations

2.1 At the 122nd meeting, members endorsed the proposal to require the filing of a complete print of amended Articles of Association after alterations had been made.

Background

2.2 At the 121st meeting, a proposal put forward by the Hong Kong Institute of Company Secretaries (HKICS) was tabled for members' consideration and discussion. The HKICS had asked the SCCLR to consider requiring any alteration of the Articles of Association to be completed by registration of the amended Articles of Association in the Companies Registry (CR) in the same way as is required in the case of any alteration of the Memorandum of Association. In support of its proposal, the HKICS stated:

> "The task of reviewing the articles of a private company which adopts some but not all of Table "A" and then proceeds in later years to alter those articles is not straightforward. Many more offices (and homes)

today possess word processing capability as opposed to typewriting and we feel that it would not be unreasonable to expect (a) the articles that a company first registers to be complete (as opposed to a statement of those provisions of Table "A" do not apply and listing substitute regulations), and (b) later alterations to be registered by way of reprinted articles. Any search of the Registrar's files would then show the up-to-date version in a manner which was readily recognizable."

2.3 The proposal has the advantage of making it easier to ascertain the up-to-date Articles of Association by looking at the latest filed copy of the Articles. This would simplify searching and would not require the examination of filed special resolutions to determine the latest version of the Articles of Association of a company.

2.4 During the course of discussion, some members agreed that the proposal was highly desirable. It saved time and businessmen needed such information as quickly as possible. It was convenient to have the up-to-date Articles of Association in one single document.

2.5 One member remarked that, if every minor amendment required a complete amended version of Articles of Association to be filed, that might have cost implications for small companies. A company would also have to print numerous copies for all its shareholders.

2.6 Another member suggested that a printed copy of the latest Articles of Association incorporating all up to date amendments could be required to be filed together with the Annual Return. As such, it would have to be done once a year instead of each time when the Articles of Association were amended.

2.7 It was realised that the proposal meant that every small amendment in the Articles of Association would result in the registration of a printed copy of the Articles. As a result, the CR could be inundated with numerous booklets of Articles of Association. Following detailed consideration from an operational angle, the Registrar of Companies confirmed at the 122nd meeting that there would be no problem if the proposal was to be implemented. It was pointed out that, in 1996, the number of amendments of Articles of Association amounted to only about 3,700. In comparison with the total number of registered companies, the number of amendments of Articles of Association was relatively small.

Chapter 3

Definition of the term "place of business" - Oversea Companies Section 341 of the Companies Ordinance and Recommendations 11.03 and 11.04 of the Review of the Hong Kong Companies Ordinance - Consultancy Report

Problem and Recommendations

3.1 At present, the Companies Ordinance requires any oversea company which establishes "a place of business in Hong Kong" to register in the Companies Registry. The problem with that requirement is the uncertainty of what would constitute "establishing a place of business in Hong Kong". An alternative proposal might be to require registration when a company is "carrying on business" in Hong Kong. At the 121st meeting it was realised that the exact wording might depend on the type of oversea companies that government wish to monitor. Members decided to discuss this problem again together with the consideration of the whole of Part XI of the Companies Ordinance.

Background

3.2 The Hong Kong Bar Association had asked the SCCLR to consider the unsatisfactory definition of 'place of business' set out in Section 341 of the

Companies Ordinance. This is defined as :

> " Place of business includes a share transfer or share registration office and any place used for the manufacture or warehousing of any goods but does not include a place not used by the company to transact any business which creates legal obligations. "

That definition was considered to be not clear enough. Members responded by suggesting that the matter be examined further by the consultant in the Review of the Companies Ordinance.

3.3 The consultant dealt with this matter in recommendations 11.03 and 11.04 of Chapter 11.00 of the Consultancy Report which suggested the replacement of the existing "establishment of a place of business in Hong Kong" test by the "carrying on business in Hong Kong" test for determining whether a foreign company has to be registered in Hong Kong.

3.4 It was argued that the policy should depend on the types of foreign companies that Government wished to monitor and the objectives of Government. If the purpose of requiring registration was to facilitate the service of process on overseas companies, many overseas companies would probably not mind being registered. The objectives of requiring registration were not clear from the Consultancy Report, which provided merely a comparative study of how various jurisdictions dealt with various issues in their companies legislation.

3.5 It is possible for a company to "carry on business in Hong Kong" without actually having a 'place of business' established in Hong Kong, and some members suggested that a foreign company "carrying on business in Hong Kong" should be required to register an address for service. Other members considered that an address for service of process should be dealt with in the Supreme Court Ordinance or Rules rather than being covered in the Companies Ordinance. One member also opined that registration under Part XI meant more than just providing an address for service of documents. When a person considered dealing with a foreign incorporated company, it would be useful if more information about it could be found in the Companies Registry. There was also a view that any foreign company which either had a place of business in Hong Kong or carried on business here had to be registered.

3.6 As members did not come to a final conclusion on the recommendations of the Consultant, they agreed to consider this issue again in the context of considering the whole of Part XI of the Companies Ordinance.

Chapter 4

The Nationality of every Director and Secretary - Sections 158 and 333 of the Companies Ordinance

Summary of Recommendations

4.1 At the 127th meeting, members agreed with the recommendation to delete the requirement to record and report the nationality of every director and secretary of a Hong Kong company under section 158 of the Companies Ordinance and a similar requirement in respect of an overseas company registered under section 333.

Background

4.2 A submission was made to the SCCLR recommending the deletion of the requirement to record and report the nationality of every director and secretary. In support of the submission it was stated :

> " We understand that the requirement to report and disclose directors' and secretaries' nationalities and their changes to the respective companies and Companies Registry may cause unnecessary additional costs to the directors and secretaries concerned, the companies themselves and Companies Registry staff since all parties have to ensure that the information is complete and correct. From our experience, we do not think that the disclosure of the nationality of all company directors and secretaries

(whether or not they reside in Hong Kong) to the public is an additional benefit to any searcher in Hong Kong requiring information concerning the directors and/or secretaries. We are, therefore, of the opinion that this requirement is irrelevant and excessive. "

4.3 It was noted that nationality laws might not be conclusive in international law.

4.4 In the course of discussion, one member pointed out that the reason for requiring nationality to be specified was historical in nature and probably related to the nineteenth century concerns with possible claims on enemy assets.

4.5 Members were advised that a similar recommendation had been made in the February 1997 Consultative Document on Disclosure of Directors' and Company Secretaries' Particulars issued by the Department of Trade and Industry of the United Kingdom which stated that:

" The requirement to disclose nationality is a potentially sensitive matter because it could indicate the director's racial or ethnic origin. "

4.6 Members agreed with this recommendation. It was noted that a simple deletion of the words "his nationality" in sections 158(2)(a), 158(2A)(d), 158(3)(a), 333(2)(a)(i), 333(2)(aa)(iv) and 333 (2)(b)(i) of the Companies Ordinance would be sufficient.

Chapter 5

Extension of "Professionals Exemption" under section 343(2) of the Companies Ordinance to companies incorporated in Hong Kong

Summary of Recommendations

5.1 This matter was considered at the 129th and 130th Meetings. At the 130th meeting, it was agreed that this matter should be looked at again in the context of the Review of the Hong Kong Companies Ordinance.

Background

5.2 Under section 343(2) of the Companies Ordinance, if a company incorporated outside Hong Kong offers shares or debentures for subscription or sale to any person whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, it shall not be deemed to be making an offer to the public. Consequently, under the "professionals exemption" in section 343(2) there is no requirement for a company incorporated outside Hong Kong to register a prospectus for any offering or sale of securities within Hong Kong if the offers or sales are made to what are usually termed "market professionals".

5.3 However, the "professionals exemption" in section 343(2) does not apply to Hong

Kong incorporated companies. If a Hong Kong company offers or sells securities by means of a written document to more than a limited number of investors it is making an "offer to the public" under section 41 of the Companies Ordinance and therefore must :-

- comply with the disclosure requirements of section 38 of the Companies Ordinance and
- file a prospectus with the Registrar of Companies. Prior to registration, the issuer must have the prospectus approved by the Securities and Futures Commission (SFC).

5.4 A submission was made to the SFC recommending, inter alia, that the existing legislation be amended so that, where offers or sales of shares or debentures are being made to the public in Hong Kong by means of any written document, issuers should be permitted to avoid the registration of a prospectus with the Registrar of Companies on the basis of "professionals exemption", whether or not the issuer is a company incorporated in Hong Kong or outside Hong Kong. This recommendation was referred to the SCCLR for consideration.

5.5 The representative from the SFC said that the anomaly in the Companies Ordinance in respect of "professionals exemption" from registration of prospectuses applicable to Hong Kong and overseas companies was recognised and the Commission was generally in favour of the proposal to remedy the situation. However, the question was when would be the appropriate time to make the amendment and how it should

be done. In this respect, it could either be introduced as a piecemeal amendment with a similar exemption in Part II to deal with Hong Kong companies or as part of a wider exercise to review and relocate provisions regarding this examination and approval of prospectuses from the Companies Ordinance to the securities legislation. If the decision was that these provisions should be transferred to the securities legislation, it would be appropriate to structure the amendment to correspond with provisions in the securities legislation which treats the "professionals exemption" somewhat differently. It was decided that this matter be looked at again in the context of the Review of the Hong Kong Companies Ordinance.

Chapter 6

Guide for Directors of Listed Companies and Handbook on Disciplinary Proceedings

6.1 At the 119th meeting, the following booklets issued by the Stock Exchange of Hong Kong Limited (the "Exchange") were tabled for information and discussion :-

(a) Guide for Directors of Listed Companies (the "Guide"); and

(b) Handbook on Disciplinary Proceedings (the "Handbook")

6.2 Members were informed that the first edition of the Guide had been published in 1995. This edition updated the first edition and was one of the initiatives undertaken by the Exchange to improve the standards of corporate governance in Hong Kong. The purpose of the Guide is to acquaint directors of listed companies with their responsibilities under the Listing Rules. Members considered that the Guide was very useful and more user-friendly than the first edition, which was too long, complex and full of legalistic jargon.

6.3 The Handbook was a new publication issued by the Exchange as a step towards acquainting listed issuers and professional advisers with the consequences of a breach of the Exchange Listing Rules. The Handbook is divided into two parts : Part A explains the various courses of action that may be taken by the Exchange following a breach of the Exchange Listing Rules and Part B sets out the procedures

to be followed in disciplinary proceedings. One member thought that it would be useful to have included a guide to the time scale involved when disciplinary proceedings were initiated. A question was raised as to whether the Secretary to the Listing Committee's involvement in Disciplinary Proceedings might place him in a conflict of interest position, since he is an employee of the Exchange and would take the side of the Exchange. In other words, he cannot be relied upon to be impartial. It was stressed that if the Listing Committee had only delegated administrative powers to the Secretary in Disciplinary Proceedings, then the possibility of conflict of interest would be minimal. At the 120th meeting, members were advised that the Listing Committee of the Exchange had considered the matter and confirmed that the powers delegated to the Secretary were only administrative in nature and there would be no conflict of interest problem for the Secretary.

Chapter 7

Miscellaneous items:

(a) UK Law Commission Report on Shareholder Remedies

(b) Draft Model Law on Cross-Border Insolvency of United Nations Commission On International Trade Law (UNCITRAL)

7.1 At the 125th meeting, the following documents were tabled for examination :-

(a) The United Kingdom Law Commission Report on Shareholder Remedies; and

(b) Draft Model Law on Cross-Border Insolvency of United Nations Commission on International Trade Law (UNCITRAL)

The UK Law Commission Report on Shareholder Remedies

7.2 The UK Law Commission Report on Shareholder Remedies was considered to be very useful in the discussion on the recommendations in Part 7.00 "Shareholders Rights and Remedies" of the Consultancy Report. The terms of reference and the executive summary of this UK Law Commission Report are at Appendix 4.

UNCITRAL

7.3 The purpose of this Model Law, as set out in the preamble, is "to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

(a) cooperation between the courts and other competent authorities of different countries involved in cases of cross-border insolvency;

(b) greater legal certainty for trade and investment;

(c) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

(d) protection and maximization of the value of the debtor's assets; and

(e) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment."

7.4 It was agreed that the Draft Model Law on Cross-Border Insolvency of United Nations Commission on International Trade Law be considered when cross-border insolvency is considered by the SCCLR.

Chapter 8

Prosecution of Directors for failing to file Annual Returns

8.1 At the 129th meeting, the Registrar of Companies briefed members on the CR's policy to prosecute directors who failed to file annual returns in accordance with the statutory provisions of the Companies Ordinance with effect from 1 April 1998.

Background

8.2 The filing of annual returns is a fundamental obligation for all local Hong Kong companies incorporated and registered under the Companies Ordinance. In return for the significant privilege of limited liability, all such companies are required to disclose certain basic information about themselves such as their registered address, directors and share capital structure. Any enterprise is free to decide whether or not to form a limited liability company in order to undertake its business but, once having formed such an entity, the company is subject to the statutory disclosure regime enshrined in the Companies Ordinance.

8.3 Under section 107 of the Companies Ordinance, all companies are obliged to prepare and file with the CR annual returns containing the information required in section 107(2). If no changes to the information filed have taken place between the time when the last annual return was filed and the time that the current annual return is due, under the provisions of section 107(5), a company may file a very

simple certificate of no change to the information previously filed.

8.4 The statutory time limits specified in sections 109(1) and 109(1A) for filing this information are as follows:

- in the case of public companies, within 42 days of the date of the last AGM
- in the case of private companies, within 42 days of the date of the last anniversary of the incorporation of the company

Section 109(4) provides that, if a company fails to comply with section 107, the company and every officer who is in default shall be liable to a fine and, for continued default, to a daily default fine.

8.5 At present, the compliance rate in Hong Kong for companies filing annual returns is about 70% which is relatively poor when compared with a compliance rate of 91% for filing annual returns in the United Kingdom in 1996/97. It is important to improve the compliance rate in Hong Kong as enforcement of the Companies Ordinance's disclosure requirements ensures the transparency of company affairs which is a very important element in the territory's continued status as a leading international and financial business centre. In addition, enforcement to ensure improved compliance will encourage directors to observe their statutory duties and promote corporate governance.

8.6 In view of these considerations, the Companies Registry is determined to ensure that companies and their directors comply with their statutory duties to file annual returns. Furthermore, the computerization of the CR's data base has enabled the department to considerably enhance its enforcement role. Consequently, with effect from 1 April 1998, the directors of companies which fail to file their annual returns within the statutory time limits are liable to face prosecution under section 109(4). In connection with the implementation of the new prosecution policy, the CR has arranged a very extensive publicity programme.

8.7 Some members were in favour of the tightening up to improve the compliance rate. However, they suggested replacing the current "criminal offence" of not filing an annual return with a "statutory penalty" which would be a sensible way of enforcing compliance with filing requirements. The CR should prosecute only if a company failed to pay the "statutory penalty".

8.8 One member suggested that the discretion to prosecute or not should be exercised generously. If the whole board of directors including executive and non-executive directors were to be prosecuted, this would create a grave sense of grievance. Another member thought that there should be a distinction between the roles of executive directors and non-executive directors. It was suggested that it would be more reasonable to prosecute a company secretary rather than all the directors, since compliance was the main duty of a company secretary.

8.9 In response to the concerns of members, the Registrar of Companies explained that the procedure had been arranged so that there would be adequate warnings and would be regarded as fair to directors.

Chapter 9

Official Receiver's Annual Departmental Report 1995/96

9.1 At the 119th meeting, the Official Receiver's Annual Departmental Report 1995/96 was tabled for discussion. Members discussed the increase in insolvency cases. The statistics showing the number of cases where receiving orders and winding-up orders were made covering a period from 1986 to 1996 are set out in Appendix 5.

9.2 Members were advised that the Bankruptcy (Amendment) Bill 1996, which sought to implement the recommendations in the Law Reform Commission's Report on Bankruptcy, had been passed by the Legislative Council in December 1996. The bankruptcy rules and forms were being drafted and, once ready, would be tabled in the Legislative Council as subordinate legislation.

9.3 Members were also informed that, up to September 1996, a 97% dividend had been paid to creditors in the liquidation of the Bank of Credit and Commerce (Hong Kong) Limited.

Official Receiver's Annual Departmental Report 1996/97

9.4 At the 126th meeting, the Official Receiver's Annual Departmental Report 1996/97 was tabled for discussion.

9.5 Members were advised that the directors' disqualification procedure is a civil procedure. The disqualification is ordered in open court and such disqualification may be published in the press. The court would notify the Registrar of Companies of any disqualification which would be kept in a register and would be available to the public. In addition, a disqualified director who acted as a director would be subject to severe criminal sanctions including sentences of imprisonment in serious cases. An analysis of disqualification of directors proceedings for 1996-97 is at Appendix 6.

Companies Registry Annual Report 1996/97

9.6 At the 125th meeting, the Companies Registry Annual Report for 1996/97 was tabled for discussion. The workload statistics disclosed that, compared to the previous financial year, there had been increases of 8.9% and 73.3% in the numbers of incorporations of public and private companies respectively whilst the numbers of oversea companies registering under Part XI of the Companies Ordinance had also increased by 12.3%. Details of these statistics are at Appendix 7.

9.7 The CR officially launched its Vision and Mission Statement and a Home Page on the Internet on 1 May 1997 and in July 1997 respectively. In addition, the Registry is considering the introduction of an Interactive Voice Response System in order to provide an efficient and convenient means of serving the increasing number of telephone enquiries.

9.8 A small-scale on-line search service on the company names and document indices has been tested and launched through the Internet in July 1997. The database expansion project to include key data of over 480,000 registered companies was well underway. In connection with the introduction of the expanded company database which is scheduled for use within 1998, a feasibility study on the Companies Registry On-line Public Search System (CROPS) has also been commissioned so that customers will be able to obtain information from the Registry through their own computers at their own premises.

Appendix 1

REVIEW OF THE HONG KONG COMPANIES ORDINANCE

TERMS OF REFERENCE

Having regard to:-

(a) The Government's policy of minimum interference in the market;
(b) the economic and legal systems in Hong Kong;
(c) Hong Kong's status as an international financial and business centre;
(d) the particular and unique aspects of the corporate culture in Hong Kong;
(e) recent developments in companies law and regulation in other comparable jurisdictions; and
(f) the existing framework of securities-related law and regulation in Hong Kong.

consider and make recommendations on the following matters:-

A. (a) The proper aims and objectives of the Companies Ordinance

(b) Whether private and public (and, in particular, listed) companies should continue to be subject to the same regulatory regime, under the Ordinance, in relation for example to requirements for accounts, or whether they should be the subject of distinct and separate regulation in the light of, inter alia,

(i) developments in the role and responsibilities of the Securities and Futures Commission since its establishment in 1989; and

(ii) the fact that 50% or more of the companies listed on the Hong Kong Stock Exchange are incorporated overseas,

and if the latter course of action is proposed, to make recommendations as to the nature of the respective regulatory regimes for private and public/listed companies.

B. The scope for and desirability of -

(a) rationalising and simplifying the Ordinance, including a greater use of subsidiary legislation and/or administrative arrangements;
(b) streamlining and simplifying the procedures prescribed under the Ordinance, including in relation to the incorporation of a company and the submission of returns;
(c) codifying duties and responsibilities and stipulating minimum qualifications and capacities for company directors;
(d) including more specific statutory assistance for minority shareholders, and other persons who deal with companies, who wish to forestall, or to seek redress against, misconduct or abuses by a company and/or its directors (including through easier access to the judicial process);
(e) extending financial and other disclosure requirements, having regard also to existing non-statutory rules in respect of listed companies;
(f) rationalising and making more effective the enforcement provisions and sanctions under the Ordinance;
(g) extending regulatory powers in relation to the investigation and inspection of a company's affairs; and
(h) providing alternative forms for the constitution of a company.

C. Whether Part XI of the Ordinance is sufficient to regulate the activities of companies incorporated overseas with a place of business in Hong Kong.

D. The relevance with respect to Hong Kong of the development of international business companies.

E. Such other related matters as the Secretary for Financial Services may from time to time specify.

November 23, 1994
Hong Kong

SUMMARY OF RECOMMENDATIONS

1.00 GENERAL RECOMMENDATIONS FOR A NEW BUSINESS CORPORATIONS ORDINANCE

1.01 **Aims and Objectives.** The proper aims and objectives of companies law in Hong Kong should be:

- to provide a simple, efficient and cost effective method of incorporation and ongoing corporate maintenance;
- to be enabling and permissive rather than regulating and prohibitive;
- to the extent possible, to be self-enforcing so as to avoid intervention of public authorities and to limit the necessity of recourse to the judicial system;
- to be written in clear, concise language so as to be accessible to business people as well as lawyers and accountants;
- to focus on "core company law", the birth, life and death of the enterprise;
- to strike a balance between the interests of management or majority shareholders on the one hand and shareholders or minority shareholders on the other hand, in keeping with modern commercial practices;
- to promote continuity, stability and certainty in commercial dealing;
- to refrain from being a vehicle for implementation of industrial relations, tax, social or monetary policy;
- to take account of and to meet international expectations with respect to the incorporation, operation and administration of modern companies.

1.02 **Business Corporations Ordinance.** Hong Kong should implement a modern, streamlined Business Corporations Ordinance drawing on the most appropriate aspects of existing North American and Commonwealth models. Continued primary reliance on the U.K. model of companies law is not advised.

1.03 **Single Regime.** With respect to core company law matters, the same regime should be applicable to both public and private companies. In addition, the new Ordinance should provide a basic optional regime for private companies that would facilitate their operation in an informal and consensual manner.

1.04 **Securities Regulation.** The new Ordinance should not regulate the capital markets activities of companies nor the protection, in the largest sense, of public investors; this should be left to the SFC and the SEHK. With the removal from companies legislation of securities regulation, the SFC should consider the need to re-enact existing, updated or comprehensive new provisions in securities legislation. In the process of extracting the securities law aspects from companies legislation, careful consideration needs to be given to the dangers of creating regulatory gaps as well as the need to address any inadequacies in existing statutory regulation.

1.05 **Insolvency.** The new Ordinance should not apply to insolvent winding up; matters pertaining to insolvency should be left to a comprehensive Insolvency Ordinance.

1.06 **Charges.** A study should be undertaken with a view to introducing a separate, comprehensive regime governing security interests in personal property (such as recommended by the U.K. Diamond Report).

It would permit the elimination of Part III of the Ordinance, Charges. Until such time, Part III would continue in effect in conjunction with the new Ordinance.

1.07 **Financial Institutions.** The new Ordinance would continue to serve as the basic legislation governing the "core company law" aspects of regulated financial institutions in Hong Kong, essentially incorporation and its incidents; the regulatory aspects would be determined by the Hong Kong Monetary Authority and the Insurance Authority, as appropriate, and would preferably appear in their related legislation.

1.08 **Not-for-profit Enterprises.** The new Ordinance would not be applicable to not-for-profit enterprises, currently formed as companies limited by guarantee; the current Ordinance would continue to apply to such entities until such time as consideration is given to their separate treatment.

1.09 **A new Not-for-profit Corporations Ordinance.** Serious consideration should be given to implementation of an Ordinance governing incorporated not-for-profit organisations.

1.10 **Structure of a New Ordinance.** The following structure is proposed for the organisation of a new Ordinance:

OUTLINE FOR A BUSINESS CORPORATIONS ORDINANCE

Part 1:	Interpretation
Part 2:	Administration of the Ordinance
Part 3:	Incorporation; Capacity and Powers
Part 4:	Capital Structure
Part 5:	Management and Administration
Part 6:	Directors and Executive Officers
Part 7:	Shareholders' Rights and Remedies
Part 8:	Fundamental Changes
Part 9:	Solvent Dissolution and Liquidation
Part 10:	Private Companies/Closely Held Corporations
Part 11:	Foreign Corporations/Oversea Companies
Part 12:	Transitional Provisions
Part 13:	General

2.00 ADMINISTRATION OF THE ORDINANCE

2.01 **Consolidation and Updating Part VII.** The provisions of Part VII of the existing Ordinance, General Provisions as to Registration, should be consolidated, and if necessary, updated in this Part. In particular, provision for the electronic keeping and filing of notices and other documents should be made.

2.02 **Role of Registrar.** The role of the Registrar should continue to be primarily an administrative and policy advisory one.

2.03 **Charges.** Pending reconsideration of the legislative treatment of "Charges", the Companies Registry would continue its administration of Part III of the current Ordinance.

2.04 **Subsidiary legislation.** Subsidiary legislation and standard forms should be used extensively to deal with technical filing requirements, fees, etc. in order to facilitate timely updating and amendment.

2.05 **Offences.** With respect to offences, the Twelfth Schedule should be eliminated; such offences which are to be retained or created should be regrouped in more generic categories in this Part of the Ordinance and accorded appropriate sanctions.

2.06 **Enforcement.** To the extent possible, companies legislation should be self-enforcing and self-executing; investigation and inspection by a government body should essentially be a residual remedy, available in the event that private civil recourses are inadequate or ineffective. Powers comparable to the existing investigation and inspection powers would be maintained.

2.07 **Role of the Financial Secretary.** The Financial Secretary should continue to have residual discretion to act in the public interest in certain circumstances (such as investigation).

3.00 INCORPORATION; CAPACITY AND POWERS

3.01 **One-step incorporation.** The new Ordinance would provide one-step incorporation by filing a simple application for incorporation.

3.02 **One person companies.** The new Ordinance would permit one person/one director incorporation.

3.03 **Numbered companies.** Provision should be made for numbered companies, and use of the company name.

3.04 **Pre-incorporation contracts.** Provisions for the adoption by the company of pre-incorporation contracts should be simplified.

3.05 **Capacity, powers and privileges of natural person.** A corporation should be given the capacity, powers and privileges of a natural person. Restrictions may be placed on the activities of a corporation in its constitution but the rights of third parties should be preserved in the event that a corporation acts in contravention of its articles or the Ordinance.

3.06 **Constructive notice.** The constructive notice doctrine should be eliminated except, temporarily, with respect to charges.

3.07 **Indoor Management rule.** A statutory formulation should be given to the indoor management rule (the so-called rule in Turquand's case).

4.00 CAPITAL STRUCTURE

4.01 **Modern capital structure.** A new Business Corporations Ordinance should provide for a modern, flexible capital structure.

4.02 **No par value shares.** Par value shares should be prohibited.

4.03 **Classes and rights of shares.** The corporate constitution should prescribe the classes of shares (if

more than one) and the number of shares of each class that the company is authorised to issue if there is a limit (which there need not be). If there is only one class of shares, that class must have three fundamental rights of share ownership: the right to vote, the right to receive dividends when declared and the right to receive the net assets of the company upon dissolution. Where there is more than one class of shares, the rights, preferences, etc. should be stated in the corporate constitution; the three fundamental rights of share ownership should be attached to at least one class of shares although not all rights need be attached to any one class. For statutory purposes, the traditional distinction between common or ordinary shares and preference shares should be eliminated.

4.04 **Series.** Statutory provisions with respect to the use of series within classes of shares are unnecessary.

4.05 **Partly paid shares.** Partly paid shares should be prohibited.

4.06 **Optional pre-emptive rights.** Pre-emptive rights for existing shareholders should be optional; they may be provided for in the corporate constitution.

4.07 **Solvency test.** The concept of impairment of capital should be replaced by a solvency test to be used to determine the ability of the company to engage in a variety of activities: repurchase of its own shares (by way of redemptive provisions in the corporate constitution or otherwise), payment of dividends and other activities in the nature of a transfer of corporate assets to the possible detriment of creditors.

No "distribution" (widely defined) of company assets should be permitted if, after giving effect to it:

(1) the company would not be able to pay its debts as they become due in the usual course of business; or

(2) the company's total assets would be less than the sum of its total liabilities plus (unless the constitution provides otherwise) the amount that would be needed, if the company were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

4.08 **Financial assistance.** Provisions with respect to "financial assistance" for the purchase of company shares should be eliminated.

5.00 MANAGEMENT AND ADMINISTRATION

5.01 **Companies' accounts.** Companies should be required to prepare accounts that give a true and fair view of the state of affairs of the company. Details as to the form and content of accounts, to the extent required to be specified, should appear in subsidiary legislation; the Tenth Schedule of the Companies Ordinance (Accounts) should be eliminated.

5.02 **Generally accepted accounting principles.** Rather than detailing line item by line item the information to be contained in accounts, reference should be made to preparation of accounts in accordance with generally accepted accounting principles (GAAP). GAAP would be embodied in standards set by an independent accounting standards body or by a Hong Kong Society of Accountants process that would involve a wider representation of interested parties.

5.03 **Waiver of generally accepted accounting principles.** All companies should prepare their accounts in accordance with generally accepted accounting standards; consideration should be given as to whether private companies should be able to dispense with this requirement by means of unanimous shareholder agreement (unless required for other purposes).

5.04 **Minimum financial information.** As an aid to small companies in particular, the minimum financial information to be delivered to shareholders, unless they agree otherwise, should be stipulated in the legislation, or subsidiary legislation.

5.05 **Filing of accounts.** Unless required by other legislation (as should be the case for public and listed companies), companies would not be required to file accounts.

5.06 **No mandatory audit.** Company accounts should continue to be audited but shareholders should be able to dispense with an audit by unanimous agreement.

5.07 **Formalities associated with directors' meetings.** The formalities associated with routine directors' meetings such as notice, quorum, attendance, dissent, etc. should be set out in Part V, Management and Administration of the new Ordinance.

5.08 **Formalities associated with shareholders' meetings.** The formalities associated with routine shareholders' meetings such as notice, quorum, attendance, proxies, record date, etc. should be set out in Part V, Management and Administration of the new Ordinance.

5.09 **Negotiable instruments.** Securities certificates should be statutorily recognized as negotiable instruments.

5.10 **Modernised security certificates system.** Provisions with respect to security certificates, their form, consent, registration and transfer should be modernised to provide for the optional use of "scripless" (book entry or "uncertificated") securities and, to the extent not dealt with under other legislation, the mechanics of their transfer (including the use of clearing agencies).

5.11 **Part III retained.** Pending consideration of the creation of a separate regime for the granting of security interests in personal property, Part III of the current Ordinance, Registration of Charges would continue to apply.

5.12 **Modern record keeping.** Provision should be made for modern record keeping, including electronic data processing. An obligation should be imposed to ensure the accurate preservation of data and its accessibility in written form to those entitled to it within a reasonable period of time.

5.13 **Company records.** The new Ordinance should contain a clear and concise statement of the records which must be kept by the company, their location and who has access to them (and in what circumstances and to what purposes.)

5.14 **Corporate seal.** Use of a corporate seal should be voluntary and no agreement should be invalid merely because a corporate seal is not affixed to it.

6.00 DIRECTORS AND EXECUTIVE OFFICERS

6.01 **Unitary board structure retained.** The traditional unitary board structure should be retained.

6.02 **Board of directors.** In private companies/closely-held corporations, a single decision making body should be an option; the responsibilities of the directors would be assumed by the shareholders.

6.03 **Statutory power of directors.** The board of directors should be given a direct grant of statutory power to manage, or supervise the management of, the company. This power should be made subject to any unanimous shareholder agreement.

6.04 **Delegation of powers.** The board of directors should be permitted to delegate all those powers which it is not required to exercise itself.

6.05 **Functions not subject to delegation.** Certain functions of the board of directors should not be subject to delegation, for example:

- submission to shareholders of any question requiring their approval
- filling an interim vacancy among directors, in the office of auditor, appointing or removing the chief executive officers
- in most circumstances, issuing securities
- declaring dividends
- purchasing, redeeming or otherwise acquiring shares issued by the company
- approving financial statements
- adopting, amending, repealing any constitutional documents

6.06 **Directors' minimum qualifications.** Directors should meet certain minimum qualifications:

- age of majority
- mental capacity (i.e. not found legally incapable)
- only individuals (no corporate directors)
- no one who has the status of an undischarged bankrupt unless permitted by court order
- no one who has been disqualified from acting as a director

6.07 **One director.** Private companies should be permitted to have a minimum of one director.

6.08 **Shadow and alternate directors.** The troublesome concepts of shadow and alternate directors should be eliminated.

6.09 **Company officers.** There should be no requirement for the appointment of any particular company officer such as a company secretary.

6.10 **Removal of directors by shareholders.** Shareholders should be able to remove directors by ordinary resolution, subject to class voting rights and the company constitution.

6.11 **Meetings of directors.** Meetings of directors should be permitted by means of electronic communications, unless otherwise specified in the company constitution.

6.12 **Unanimous action.** Directors should be able to act unanimously by written resolution without a meeting.

6.13 **Statutory statement of directors' duties.** There should be a statutory statement of directors' duties to act honestly and in the best interests of the company and to exercise the care, diligence and skill that a reasonably prudent person would. These duties should also be made applicable to those corporate officers appointed by the board.

6.14 **Reliance on reports.** Directors and officers should be able to rely in good faith on financial statements and other reports prepared by officers and employees as well as the professional advice of lawyers, accountants, etc.

6.15 **Business judgment rule.** There should be no need of a statutory formulation of the 'business judgment rule'.

6.16 **Indemnifying directors.** Companies should be permitted to indemnify directors and officers in specific circumstances; companies should be required to indemnify directors and officers in specific circumstances.

6.17 **Insuring directors.** Companies should be permitted to insure directors and officers except for a failure to act honestly and in good faith with a view to the best interests of the company.

6.18 **Disqualification of directors.** Disqualification of directors provisions should be eliminated for company law purposes. Those existing provisions relating to securities, insolvency or criminal activity should be reenacted in appropriate legislation.

6.19 **Conflicts of interest.** Consideration should be given to placing directors and executive officers (i.e. those appointed directly by the board) under a duty of fair dealing with respect to transactions they enter into with the company.

6.20 **Qualification of interested transactions.** Interested transactions should be upheld if (i) directors disclose to the board their material interest in the transaction; (ii) do not vote as a director on any resolution to approve the transaction; and (iii) the transaction was reasonable and fair to the corporation at the time it was approved. In the alternative, such transactions could also be approved by unanimous shareholder consent.

6.21 **Shareholder approval of interested transactions.** Shareholders should be able to vote to uphold a transaction by special resolution in certain circumstances.

6.22 **Loans to directors.** Transactions involving loans to directors should continue to be prohibited subject to certain exceptions.

6.23 **Use of Corporate Information and Opportunity.** Directors and officers should not disclose or use for their benefit a corporate opportunity or information that they obtain by reason of their position or employment except (i) with consent of disinterested board members, (ii) where disclosure is required by law or otherwise or (iii) where it is reasonable to assume that the disclosure or use of the information or opportunity will not be likely to prejudice the corporation.

7.00 SHAREHOLDERS' RIGHTS AND REMEDIES

7.01 **Shareholders' rights and remedies.** A separate part of the new Ordinance should be dedicated to matters dealing with shareholders, their rights and remedies.

7.02 **Proposal at annual meeting.** Any shareholder entitled to vote at an annual meeting should be able to submit a proposal to the company to be raised at the annual meeting and circulated prior to the meeting. The board of directors could refuse to circulate proposals in certain circumstances such as proposals designed to redress personal grievances or espousing political or other causes. In addition, or in the alternative, a proposal put forward by a minimum number or percentage of shareholders (e.g. the lesser of 25 shareholders or those holding 2½% of the voting shares) could not be refused by the board of directors.

7.03 **Requisition to call meeting.** Shareholders holding 5% of the voting shares should be able to requisition the directors to call a meeting of shareholders or, if the directors fail to act, a shareholder should be able to call a meeting itself. The time delay in which the directors may act should be fairly short, 21 days for example. The requisitioners should be reimbursed their expenses unless the meeting otherwise resolves.

7.04 **Shareholders' rights to dispense with meeting.** A resolution in writing signed by all shareholders entitled to vote should be sufficient to preclude the necessity of a meeting. A meeting should be required, however, in the event of the resignation or removal of a director or auditor who wishes to explain or contest the action. Shareholders should be able to dispense with the requirement for an annual general meeting (or other meetings) by unanimous shareholder agreement.

7.05 **One share entitled to one vote.** Unless otherwise provided by the company constitution, one share should be entitled to one vote. "Circular holdings" should be prohibited from voting.

7.06 **Unanimous shareholder agreement.** All companies should be able to make use of unanimous shareholder agreements to regulate (1) the exercise of corporate powers and management and (2) the relationship among shareholders.

7.07 **Statutory remedies.** There should be made available to shareholders a variety of statutory remedies designed to induce accountability of management and achieve the desired balance between flexibility in management powers and protection of shareholders, especially minority shareholders' interests. These statutory remedies should include the following:

- Statutory Derivative Action
- Oppression or Unfairly Prejudicial Action
- Buy-Out or Appraisal Remedy
- Compliance and Restraining Orders
- Just and Equitable Winding-up

7.08 **Statutory derivative action.** There should be a statutory derivative action in the new Ordinance.

7.09 **Unfairly prejudicial remedy.** The current unfairly prejudicial or oppression remedy should be broadened. The remedy should be available to a broader class of persons, to include

- any registered holder or beneficial owner, and any former registered holder or beneficial owner, of a security of the company or any of its affiliates;
- any director or officer or former director or officer; and
- the Financial Secretary.

The scope of the conduct that may be complained of would also be broadened to include conduct that is oppressive, unfairly prejudicial to or that unfairly disregards the interests of any security holder, director or officer.

7.10 **Statutory compliance and restraining order.** A shareholder or director should have the standing to apply to court for a statutory compliance and restraining order.

7.11 **Just and equitable winding-up.** The traditional "just and equitable" winding-up remedy should be retained, but the court should be given the option of making any other order it sees fit. The remedy should be dissociated from the more undesirable consequences of winding-up procedures in insolvency (such as the freezing of bank accounts).

7.12 **Appraisal or "buy-out" remedy.** A form of appraisal or "buy-out" remedy which does not necessitate judicial intervention should be adopted; the statutory buy-out remedy gives shareholders the right to have the company buy their shares upon the occurrence of a limited number of fundamental changes while permitting the company to proceed unimpeded with its proposed action. In the alternative, consideration should be given to introducing such a procedure but excluding its application to listed companies.

8.00 FUNDAMENTAL CHANGES

8.01 **Amendments by special resolution.** There should be regrouped in one section, all amendments to the company constitution that may be effected by special resolution of the shareholders. A special resolution should require a "super-majority" vote, i.e. 75%.

8.02 **Dissenting shareholder entitled to be "bought-out".** Where an amendment to the constitution would (1) affect substantially the nature of a shareholder's investment (e.g. remove or change any restriction on the nature of the business of the company or change the characteristics of its shares) or (2) where the company proposes a fundamental change such as an amalgamation, continuance in

another jurisdiction (see recommendation with respect to continuance), or sale of substantially all of its property, a dissenting shareholder should be entitled to be bought out of the company at a "fair" price.

8.03 **Class vote.** In certain circumstances, a class vote should be held where a proposed amendment to the constitution would affect, directly or indirectly, the rights of that class of shares.

8.04 **Corporate restructuring procedures.** Simple procedures should be made available to provide for corporate restructuring such as by way of amalgamation without the necessity for court intervention or liquidation.

8.05 **Restructuring of related companies.** Restructuring of related companies and wholly-owned subsidiaries should be facilitated.

8.06 **"Import" and "export" of companies.** "Import" and "export" of companies into and out of Hong Kong should be permitted. Foreign companies should be able to re-incorporate in Hong Kong under the new Ordinance without the necessity of liquidation and the resulting disruption and interruption of corporate existence; Hong Kong incorporated companies should be able to continue under the laws of incorporation of another jurisdiction in the same manner.

8.07 **Court ordered arrangements.** Provision should be made for court ordered arrangements for solvent companies where it is impracticable to restructure under other provisions of the legislation.

9.00 SOLVENT DISSOLUTION AND LIQUIDATION

9.01 **Solvent dissolution and liquidation.** Only solvent dissolution and liquidation should be dealt with in the new Ordinance.

9.02 **Voluntary dissolution by simple filing.** Voluntary dissolution should be effected by a simple filing (depending on the nature of the dissolution sought) and should take effect upon filing; the corporate existence would then be continued only for the purpose of winding up and liquidating the business and affairs of the entity.

9.03 **Circumstances for simple filing.** Voluntary dissolution by way of simple filing should be available in two instances; (1) before the company has commenced business and (2) where initiated by directors and shareholders.

9.04 **Revocation of dissolution.** Within a limited period of time a company should be able to revoke dissolution essentially in the same manner as it has been initiated.

9.05 **Claims of creditors.** Provision should be made for the claims of known and unknown creditors.

9.06 **Administrative dissolution.** The Registrar should be able to commence an administrative dissolution in limited circumstances, primarily where a company has failed to comply with its filing obligations under the new Ordinance.

9.07 **Dissolution by the court.** A court should be given broad discretion, both in terms of the grounds and the procedures adopted, to dissolve a company upon the application of the Financial Secretary or a delegated authority, a shareholder or a creditor.

10.00 PRIVATE COMPANIES/CLOSELY HELD CORPORATIONS

10.01 **No separate ordinance.** There should not be a separate specialised ordinance pertaining only to

private companies/closely held corporations.

10.02 **Purpose of legislative provisions.** The purpose of legislative provisions specifically applicable to private companies/closely-held corporations should be to facilitate the creation of incorporated entities that, for internal purposes, function like partnerships or sole proprietorships.

10.03 **Statutory definition.** There should be a statutory definition of or conditions to be met for private companies/closely held corporations.

10.04 **Definition of "private company".** The traditional definition of "private company" should be retained. A private company has restricted the right to transfer its shares, has limited the number of shareholders to 50 and prohibits any invitation to the public to subscribe for its securities. In addition, a company which by means of a unanimous shareholder agreement abolishes the distinction between ownership and management, irrespective of number of shareholders, should also fall within the definition.

10.05 **Optional regime.** A separate part of the new Ordinance should contain an optional regime applicable to private companies/closely held corporations. The regime could be varied in the corporate constitution or by unanimous shareholder agreement. It should contain the following provisions:

- Standard share transfer restrictions and exceptions (e.g. transfer to trustee in bankruptcy, by operation of law);
- Preservation of limited liability despite failure to observe corporate formalities;
- No mandatory audit;
- Standard form buy-sell and buy back provisions to permit shareholders to leave;
- Recourse to mediation or arbitration to resolve shareholder disputes;
- Possibility of applying to court for the appointment of a rehabilitative receiver in the event of deadlock, etc.

10.06 **Possibility of Eliminating Corporate Formalities.** Private companies/closely held corporations should be able, by unanimous shareholders agreement or in their constitution, to eliminate certain corporate formalities and otherwise derogate from standard statutory provisions:

- no need to have an annual meeting of shareholders unless requested by a shareholder;
- no need to have separate bylaws/articles of association if constitution and statute sufficient;
- ability to choose limited corporate life if desired;
- possibility of dissolution at the request of a shareholder (or certain % of shareholders) or upon the occurrence of a specified event;
- elimination of board of directors;
- restriction of discretion or powers of the board or weighted voting rights;
- operation of enterprise as if a partnership among shareholders;
- creation of relationship among shareholders that would otherwise be only appropriate among partners.

11.00 FOREIGN CORPORATIONS/OVERSEA COMPANIES

11.01 **Conflict of laws rule.** For purposes of the new Ordinance, the traditional common law conflict of laws rule applicable to companies, i.e. that their creation, internal affairs, and termination are governed by the law of their place of incorporation, should be respected.

11.02 **No extraterritorial effect.** As a general principle, the new Ordinance should not contain provisions having an extraterritorial effect.

11.03 Threshold of registration. Registration of foreign incorporated companies should be required in Hong Kong but the threshold test should be changed.

11.04 Threshold test. The threshold test of carrying on business in the jurisdiction, including both an inclusionary and exclusionary list of what is or is not considered carrying on business, should be adopted for purposes of the new Ordinance.

11.05 Filing requirements simplified. The filing requirements for registration as a foreign company should be simplified. It should not be necessary to file the company constitution or accounts.

11.06 Service of process. An agent for service of process within Hong Kong should be required; alternative methods of service of process should be stipulated in default of an agent.

11.07 Disclosure of foreign status retained. Current requirements with respect to the obligation to disclose the foreign status of the company (on letterhead, at the place of business, etc.) should be retained.

11.08 Filing requirements. The filing requirements applicable to foreign companies under the new Ordinance should be coordinated with those of the Business Registration Ordinance; registration under the new Ordinance should be deemed to satisfy requirements of the Business Registration Ordinance.

11.09 International business companies. There appears to be no need to address the use of international business companies in a new Ordinance or otherwise.

12.00 TRANSITIONAL PROVISIONS

12.01 Mandatory continuance for companies. A new Ordinance should include a requirement of mandatory continuance for companies created under the old legislation over a transitional period of three to five years.

12.02 Simple reregistration procedure. Continuation under the new Ordinance should be effected through a simple reregistration procedure which should involve only minimally more effort and expense than the current annual filing and audit requirements.

List of Public Submissions Received on the Consultancy Report on the Review Of The Hong Kong Companies Ordinance

From	Date of Submission
(1) Munich Reinsurance Company (Hong Kong Branch)	10.9.97
(2) Mr W.H. Lam	11.9.97
(3) Consumer Council (CC)	30.9.97
(4) The Association of International Accountants (AIA)	29.10.97
(5) Mr C.K. Low of The Chinese University of Hong Kong	12.11.97
(6) The Hong Kong Association of Banks (HKAB)	28.11.97
(7) The Hong Kong Institute of Directors Ltd. (HKIOD)	3.12.97
(8) Ho, Wong & Wong Solicitors & Notaries (HWW)	16.12.97
(9) The Chinese Executives Club (CEC)	9.2.98
(10) The Chinese General Chamber of Commerce (CGCC)	13.3.98

From	Date of Submission
(11) Baker & McKenzie (B&M)	24.3.98
(12) Stephenson Harwood & Lo	25.3.98
(13) The Law Society of Hong Kong (HKLS)	25.3.98
(14) The Hong Kong General Chamber of Commerce (HKGCC)	30.3.98
(15) Hong Kong Securities Clearing Company Limited (HKSCC)	30.3.98
(16) Deloitte Touche Tohmatsu (DTT)	31.3.98
(17) HongKong Managers & Secretaries Limited	31.3.98
(18) The Society of Chinese Accountants & Auditors (SCAA)	31.3.98
(19) The Hong Kong Federation of Insurers (HKFI)	31.3.98
(20) Hong Kong Kwun Tong Industries and Commerce Association Ltd. (KTICA)	31.3.98
(21) Commissioner of Inland Revenue (IRD)	31.3.98
(22) Hong Kong Society of Accountants (HKSA)	31.3.98
(23) Pillsbury Madison & Sutro, LLP	7.4.98
(24) The Hong Kong Institute of Company Secretaries (HKICS)	8.4.98
(25) The Securities & Futures Commission (SFC)	30.4.98

From	Date of Submission
(26) Adriana N. Ching	9.6.98
(27) Anselmo Reyes	9.6.98
(28) Stanley So & Co.	5.8.98

PART 1
INTRODUCTION

Terms of reference

1.1 In February 1995, the Lord Chancellor and the President of the Board of Trade requested us, in consultation with the Scottish Law Commission:

> ... to carry out a review of shareholder remedies with particular reference to:- the rule in *Foss v Harbottle* (1843) 2 Hare 461 and its exceptions; sections 459 to 461 of the Companies Act 1985; and the enforcement of the rights of shareholders under the articles of association; and to make recommendations.[1]

1.2 The focus of the project was on the *remedies* available to a minority shareholder[2] who is dissatisfied with the manner in which the company of which he is a member is run. This may be because there has been a breach of duty by the directors; or it may be because of the way in which the majority shareholders have used their voting power to cause the company to act in a manner which unfairly prejudices the interests of the minority shareholder; or it may simply be that the requirements of the company's constitution have not been properly complied with. We were not able, in the context of our limited terms of reference, to undertake a wider review of company law as a number of commentators have suggested would be desirable.[3]

1.3 So far as directors' duties are concerned, we explained in the consultation paper[4] that the project is concerned only with the machinery by which the duties owed in

[1] The original terms of reference continued: "The review is to be conducted under the present law and under proposals to be made by the Department of Trade and Industry as to the reform of the law relating to duties of the directors of companies and as to Part X of the Companies Act". The Department of Trade and Industry's ("DTI") work on directors' duties was, however, delayed and our review was conducted only under the present law.

[2] Ie one or more members not holding the majority of voting rights capable of being cast at general meetings. A shareholder who holds a majority of the voting rights will not usually need to resort to the remedies under consideration in this project, although he may be able to claim to have been unfairly prejudiced; see the comments of Knox J in *Re Baltic Real Estate Ltd (No 1)* [1993] BCLC 498, 501, and in *Re Baltic Real Estate Ltd (No 2)* [1993] BCLC 503, 506-507.

[3] See Rees, "Shareholder Remedies" [1997] 5 ICCLR 155. See also John Lowry, "Restructuring Shareholder Actions: A response to the Law Commission's Consultation Paper: Shareholder Remedies"; C A Riley, "The Law Commission Consultation Paper on Shareholder Remedies: Problems, Principles and Evidence"; and David Sugarman, "Enhancing Access to Justice, or Rouge on the Unacceptable Face of Capitalism". All three papers were delivered to a joint workshop on Consultation Paper No 142, under the joint auspices of the SPTL Company Law Section and the Institute of Advanced Legal Studies Centre for Corporate Law and Practice, 13 December 1996.

[4] See Consultation Paper No 142, para 1.5

law can be enforced. The content of those duties is outside the scope of the project, as is the accountability of directors to shareholders in listed companies.[1]

Problems identified in the consultation paper

1.4 In the consultation paper we identified two main problems. The first is the obscurity and complexity of the law relating to the ability of a shareholder to bring proceedings on behalf of his company. He may wish to do so to enforce liability for a breach by one of the directors of his duties to the company.[2] Generally it is for the company itself, acting in accordance with the will of the majority of its members, to bring any such proceedings. This is as a result of principles commonly known as the rule in *Foss v Harbottle*. However, if the wrongdoing director(s) control the majority of votes they may prevent legal proceedings being brought. There are therefore exceptions to the rule which enable a minority shareholder to bring an action to enforce the company's rights. But our provisional view was that the law relating to these exceptions is rigid, old fashioned and unclear.[3] We pointed out that it is inaccessible save to lawyers specialising in this field because, to obtain a proper understanding of it, it is necessary to examine numerous reported cases decided over a period of 150 years. We also explained that the procedure is lengthy and costly, involving a preliminary stage which in one case took 18 days of court time to resolve.[4]

1.5 The second main problem which we identified in the consultation paper relates to the efficiency and cost of the remedy which is most widely used by minority shareholders to obtain some personal remedy in the event of unsatisfactory conduct of a company's business. This is the remedy for unfairly prejudicial conduct contained in sections 459-461 of the Companies Act 1985. Although the remedy can be used in companies of any size and for unfairly prejudicial conduct of any kind,[5] we pointed out[6] that it is often used where there is a breakdown in relations between the owner-managers of small private companies and one of them is prevented from taking part in management. The dissatisfied shareholder can obtain a variety of types of relief but the most popular is a court order requiring the majority shareholder(s) to purchase his shares. As at 3 August 1997, there were some 1,080,671 private companies in Great Britain.[7] Our statistical

[1] In this connection, the Hampel Committee is carrying forward the work of the Cadbury Committee on the Financial Aspects of Corporate Governance and the Greenbury Committee on Director's Remuneration. The Hampel Committee published an interim report on 5 August (*Committee on Corporate Governance, Preliminary Report* (August 1997)) and intends to publish a final report in December 1997.

[2] These duties include fiduciary duties of loyalty and good faith, which mean that directors are obliged to act honestly and in good faith in the interests of the company, to exercise their powers for a proper purpose and not to place themselves in a position where their interests conflict with their duties to the company. They also include duties of skill and care in relation to the management of the company's business.

[3] See Consultation Paper No 142, paras 1.6 and 14.1-14.4.

[4] *Smith v Croft (No 2)* [1988] Ch 114.

[5] Including breaches of directors' duties.

[6] See Consultation Paper No 142, para 1.7.

[7] Unaudited figure supplied by Companies House.

EXECUTIVE SUMMARY

WHY SHAREHOLDER REMEDIES?

1. This report recommends law reform designed to make shareholder remedies more affordable and more appropriate in modern conditions.

2. There are three main shareholder remedies:

   - the "unfair prejudice" remedy, in which a member seeks redress for action by the company which injures his interest as a member
   - the derivative action, in which a member seeks to enforce a claim belonging to his company
   - action to enforce the company's constitution.

3. The unfair prejudice remedy and the derivative action are specialist remedies, and the former is far more common than the latter.

4. The unfair prejudice remedy is most commonly used by private companies of which, as at 3 August 1997, there were some 1,080,671[1] in Great Britain. We recommend statutory and other changes to simplify the remedy, and help reduce its high cost to litigant[2] and taxpayer alike.[3]

5. The derivative action is not common but it is an important mechanism of shareholder control of corporate wrongs. The current law is archaic. Our principal recommendation is for a new rule of court which would set out in a modern and accessible form the circumstances in which the courts will permit the derivative action to be brought. The underlying policy, which is restrictive of the circumstances in which a derivative action may be brought, is not affected.[4]

6. Prevention is better than cure. Litigation is time-consuming and costly. In order to minimise reliance on shareholder remedies, we recommend that a new article is added to Table A, which is the statutory model form of a company's articles of association. This contains a basic dispute resolution mechanism, and will encourage shareholders in future to have pre-agreed routes to resolve disputes without litigation.

THE WAY AHEAD

7. It is for the Government, Parliament and the new Civil Procedure Rule Committee to decide whether to implement our recommendations.

[1] Unaudited figure supplied by Companies House.

[2] See para 1.6.

[3] See para 1.6.

[4] The Scottish Law Commission's discussion and recommendations relating to the position under Scots law as respects the shareholder's action - the equivalent to the derivative action under English law - is contained in Appendix D to this report.

8. **By our principal recommendations we seek**

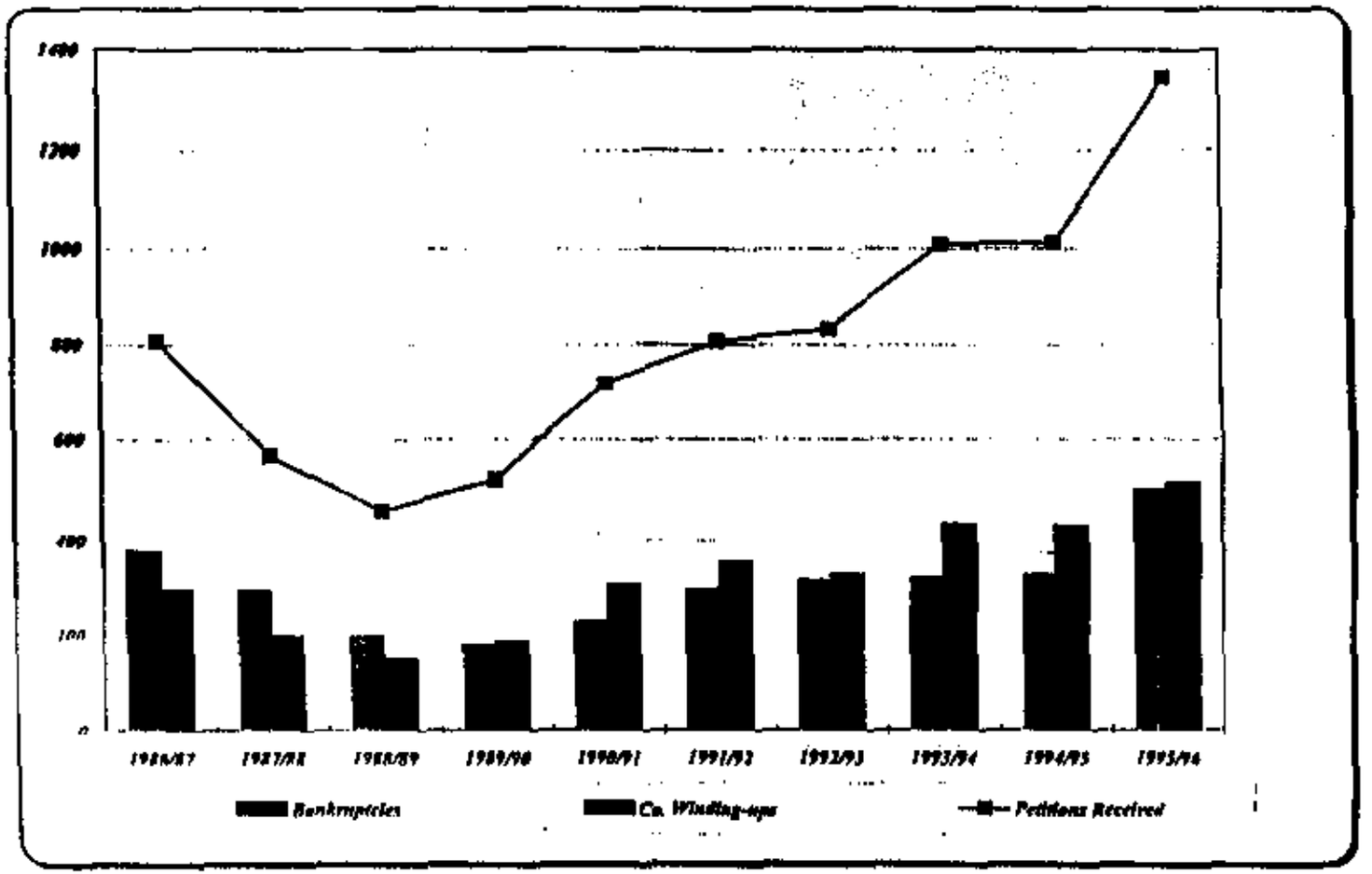
- in relation to unfair prejudice, new primary legislation
- in relation to the derivative action, new primary legislation[1] and a new rule of court
- in relation to Table A, the insertion of a new regulation by statutory instrument.

9. Implementation of the new rule of court for the derivative action and the new regulation in Table A does not depend on Parliamentary time.

[1] For Scotland, primary and subordinate legislation would be required

Number of Cases Where Receiving Orders/Winding-up Orders Were Made

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Bankruptcies	378	292	194	178	226	294	313	318	325	499
Co. Winding-ups	295	196	151	187	306	355	327	433	429	514
Total	673	488	345	365	532	649	640	751	754	1013
Petitions Received	807	567	459	521	717	819	832	1008	1011	1344



52

Analysis of Disqualifications of Directors for 1996-97

Suspected Conduct under Cap.32	b/f	Notices Sent	Reports Filed	Orders Made	Dismissed/ Withdrawn
S.190	9	12	13	11	1
S.121/S.274	5	26	22	14	2
S.182 & S.266	1	1	2	2	0
S.275	0	2	0	0	0
Total:	12	41	37	27	3

Length of Disqualification Period for Orders Made in 1996-97

Cap.32	Period of Disqualification:					Total:
	1 year	1 ½ years	2 years	2 ½ years	5 years	
S.190	3	0	7	1	0	11
S.121/274	1	1	11	1	0	14
S.182	0	0	1	0	0	1
S.266	0	0	0	0	1	1
Total:	4	1	19	2	1	27

Reports and Returns on the Conduct of Directors Received from Outside Liquidators and Receivers in 1996-97

Reports/ Returns Filed	Wound-up by Court	Creditors' Voluntary Liquidation ("V/L") under S.241	Creditors' V/L under S.228A	Members' V/L	Receivership	Total:
D1 Reports	2	0	5	0	1	8
D2 Returns	11	84	39	13	1	148
Total:	13	84	44	13	2	156

Companies Ordinance (Cap.32)

Section 190 : Failure of directors/officers to submit statement of affairs of company in time

Section 121/274 : Failure of directors/officers to keep and preserve proper books of account

Section 182 : Avoidance of dispositions of property after commencement of winding-up

Section 266 : Fraudulent preference

Section 275 : Fraudulent trading

Section 241 : Creditors' voluntary winding-up commenced by passing of a members' resolution

Section 228A : Creditors' voluntary winding-up commenced by delivery of a statutory declaration made by the directors to the Registrar of Companies that the company cannot by reason of its liabilities continue its business

Form D1 Report :

Report by a receiver/outside liquidator to the Official Receiver on misconduct of directors of a company

Form D2 Return:

Return by a receiver/outside liquidator to the Official Receiver within 6 months of the relevant date where a D1 Report has not been filed

APPENDIX 附錄 A

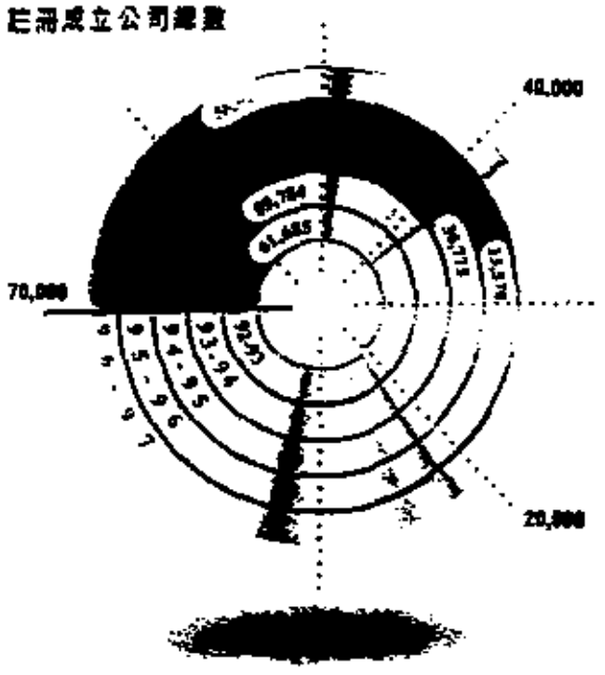
WORKLOAD STATISTICS 工作量統計數字

Year to 31 March 截至3月31日止年度

		1997	1996	% Change 增/減百分比 %
New Companies	**新公司**			
Incorporations	*註冊成立*			
- public	- 公眾公司	305	280	8.9
- private	- 私人公司	57,706	33,290	73.3
Oversea companies registered	登記的海外公司	655	583	12.3
General Registration of Documents	**公司文件登記**			
Charges registered	登記的押記			
- number	- 數目	37,881	28,938	30.9
- amount secured ($m)	- 所保證的款額（以百萬元計）	103,383	73,989	39.7
Documents received	所收到的文件	1,659,625	1,291,232	28.5
Change of name applications	更改名稱申請書	9,566	10,163	(5.7)
Voluntary liquidation notices	自願清盤通知書	3,143	3,578	(12.2)
Search Facilities	**查冊設施**			
Searches made	查冊檔案	1,925,906	1,851,177	4.0
Prosecution	*檢控*			
Summonses issued	發出傳票	173	298	(41.9)
Conviction rate	定罪率	97%	95%	2.1
Striking Off Action	**剔除行動**			
Action commenced	已展開行動	35,614	27,308	30.4
Companies struck off	被剔除的公司	34,749	7,795	345.8

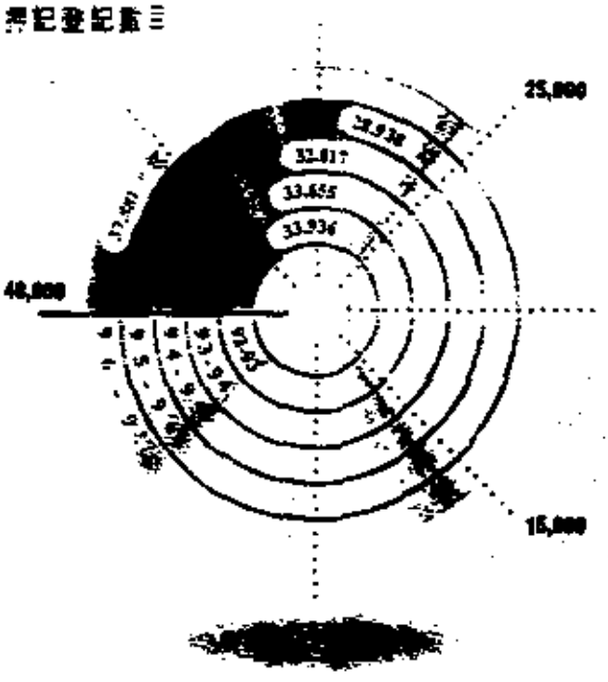
NUMBER OF COMPANIES INCORPORATED

已註冊成立公司總數



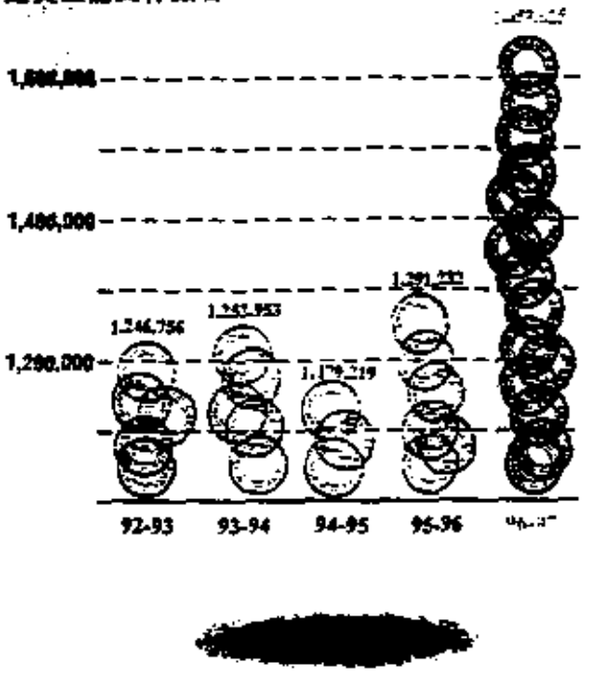
NUMBER OF CHARGES REGISTERED

已登記抵押書數目



DOCUMENTS RECEIVED FOR FILING

已遞交登記文件數目



NUMBER OF SEARCHES MADE

已進行查冊數目