STANDING COMMITTEE ON COMPANY LAW REFORM

SECOND REPORT TO HIS EXCELLENCY THE GOVERNOR IN COUNCIL

Subjects considered by the Standing Committee during 1985

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(Note: The Standing Committee also considered the question of legislation on disclosure of beneficial ownership of shareholdings and has submitted a separate report on the subject.)

1. Section 38D(2)(c) of the Companies Ordinance

Illustrations in prospectuses

1.1 Section 38D(2)(c) provides to the effect that no prospectus issued by or on behalf of a company incorporated in Hong Kong under the Companies Ordinance shall contain any photographs or illustrations of a pictorial or graphic nature. Oddly enough, however, Part XII of the Companies Ordinance which deals with prospectuses circulating in Hong Kong which offer shares or debentures in foreign companies, does not contain such a provision nor is there any corresponding provision in the British legislation on prospectuses.

1.2 Research shows that the provision was not specifically recommended by the First Report (June 1971) of the Companies Law Revision Committee when they made their recommendations on prospectuses issued by companies incorporated in Hong Kong. (The Report did, however, recommend such a provision for the then-proposed separate legislation for prospectuses issued by mutual funds companies; this separate legislation was never proceeded with).

1.3 The Standing Committee received detailed representations from both the Law Society of Hong Kong and a number of underwriting institutions requesting that the provision be deleted. Members were sympathetic to the request, feeling that in the case of certain types of companies, particularly those involved in advanced technology, the inclusion of graphs and other illustrations is often necessary to make a prospectus comprehensible. The Committee also noted that, apart from the provision in Section 38D(2)(c), the Registrar General as Registrar of Companies has a general power under Section 38D(5) to refuse to register a prospectus if, inter alia, it contains any information likely to mislead or misleading in the form

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and context in which it is included. They were satisfied that, provided it was made clear that this general power extended to cover misleading photographs and illustrations, it would provide sufficient protection to investors against abuse of the right to include photographs and illustrations.

1.4 The Committee therefore recommend that:

(a) Section 38D(2)(c) be deleted, and

(b) Section 38D(5) be amended by deleting "information" and substituting "material" to make it clear that the Registrar of Companies' power of refusal to register extends to misleading photographs and illustrations.

2. (1) Section 48 of the Companies Ordinance (Prohibition of provision of financial assistance by a company for the purchase of its own shares)

(2) Purchase by a company of its own shares

(3) Distributable profits

2.1 Section 48 prohibits the giving by a company, whether directly or indirectly, of financial assistance for the purpose of, or in connection with, a purchase by any person of shares in the company, except where a company:

(a) lends money for the purpose, in the ordinary course of its business, part of which is the lending of money;

(b) provides money, under a scheme, for the purchase by trustees of fully paid shares to be held by or for employees, or

(c) lends money to bona fide employees, other than directors, with a view to enabling them to purchase fully paid shares.

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In the event of contravention, the company and every officer in default is liable to a fine of $2,000.

2.2 Section 48 was copied from Section 45 of the Companies Act 1929.

2.3 The section was considered by the Companies Law Revision Committee in its Second Report (April 1973). The Committee noted that Section 45 of the Companies Act 1929 had been repealed and replaced by Section 54 of the Companies Act 1948, which had remedied two of the more obvious deficiencies in the 1929 provisions i.e. it had extended the provisions to cover subscriptions for shares in the company and also, where it was a subsidiary company, purchase of, or subscription for, shares in its holding company. The Second Report also pointed out, however, that the Jenkins Committee had received many criticisms of Section 54 of the 1948 Act and had recommended that it be substantially redrafted to deal with problems arising in relation to assistance given to enable someone to acquire control of a company. Very briefly, the Jenkins Committee proposed to allow any company to give financial assistance for the purchase of its shares subject to the directors of the company giving a statutory declaration of solvency in respect of the company and to the giving of the assistance being approved by a special resolution of the company; a dissentient minority (10%) would have the right to apply to the court to prohibit the proposed giving of assistance. The Second Report recommended:

(a) that, as an interim measure, Section 48 of Cap. 32 should be amended to bring into line with the then-current Section 54 of the 1948 Act, and

(b) that when the amendments to Section 54 of the 1948 Act recommended by the Jenkins Committee had been enacted in Britain, Hong Kong should adopt the new provisions.

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2.4 When drafting of a new Companies (Amendment) Bill began here in 1979, there was still no sign of an amended version of Section 54 of the Companies Act 1948 being introduced in Britain. Government therefore decided to take the initiative and proceeded with its own new version of Section 48 of Cap. 32 which incorporated both the amendments which had been introduced in Section 54 of the 1948 Act and those recommended by the Jenkins Committee. This proposed new version of Section 48 was included in clause 24 of the draft Companies (Amendment) Bill which was published as a White Paper in 1980.

2.5 The proposed new version of Section 48 attracted criticism from the Law Society of Hong Kong and the Hong Kong General Chamber of Commerce. The Law Society felt that the proposed new version gave rise to so many problems that the law should be left as it was, or a new Section 48 in the same terms as Section 54 of the Companies Act 1948 should be substituted. The General Chamber of Commerce also felt that Section 48 should be redrafted in the same form as Section 54 of the 1948 Act.

2.6 By the time an ad-hoc working group of UMELCO members came to consider the Law Society's and the General Chamber of Commerce's comments in detail, the anticipated new British legislation on the subject had arrived in the shape of Sections 42, 43 and 44 of the Companies Act 1981 (now Sections 151 - 158 of the Companies Act 1985). However, this new legislation was not a straightforward implementation of the Jenkins Committee recommendations. Not only did it contain a complete prohibition, subject to certain technical exemptions, of provision of financial assistance by a public company, but the provisions allowing a private company to provide financial assistance were much more complicated and strict than those recommended by the Jenkins Committee. The prohibition of provision of financial assistance by a public company was necessitated

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by Article 23 of the Second EEC Directive on Company Law. The new legislation did, however, define what constituted provision of financial assistance more clearly and in a more realistic way.

2.7 At the same time, Sections 45 - 62 of the Companies Act 1981 (now Sections 159 - 181 of the Companies Act 1985) introduced provisions which allowed companies to purchase their own shares in certain circumstances, something which had previously been illegal and regarded by most authorities as reprehensible in principle, although allowed in the U.S.A. Some members of the public urged Government to introduce similar legislation here.

2.8 In these circumstances, the UMELCO ad-hoc working group decided that the proposed new version of Section 48 contained in the 1980 White Paper should be deleted and that the subject, together with that of the question of allowing companies in Hong Kong to purchase their own shares, should be referred to the Standing Committee for consideration.

2.9 On studying the situation regarding Section 48, the Committee thought that there were two aspects of the situation which had not been specifically referred to by the Companies Law Revision Committee in its Second Report viz:

(1) As already mentioned, the penalty for breach of Section 48 is only a fine of $2,000. The Committee feel that there may be members of the business community who have been misled by this small statutory penalty into thinking that a breach of the provisionsof Section 48 is not really a serious matter. In fact, as explained in (2) below, the civil penalties can be very severe indeed.

(2) Directors of a company in breach of Section 48 can be called upon to compensate the company and the range of actions which are in breach of the section is wider than was

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previously thought. A good illustration can be found in Belmont Finance Ltd. v Williams Furniture Ltd. (No. 2) [1980] 1 AER 393 where the directors used a procedure which previously had been generally considered legal, only to find it held to be in breach of the provisions of Section 54 of the 1948 Act.

2.10 With regard to the new provisions in the 1981 Act, it seems to the Committee that, very briefly, their net effect is:

(1) they introduce clearer and more sensible criteria as to what constitutes the provision by a company of financial assistance for the purchase of its own shares;

(2) subject to certain exemptions of a technical nature, they prohibit a public company and its subsidiaries from giving anyone financial assistance, direct or indirect, for the purpose of acquiring shares in that company; but

(3) they do, however, allow a private company to give financial assistance for acquisition of shares in the company or its holding company (unless the holding company is itself a public company or there is an intermediary holding company which is a public company) provided:

(a) it has net assets which are not reduced by the giving of the assistance, or

(b) to the extent that those net assets are reduced, the financial assistance is given out of distributable profits;

(c) the giving of the financial assistance must be approved by a special resolution of the company in general meeting;

(d) where the financial assistance is for the acquisition of shares in the company's holding company, that holding

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company and any intermediary holding company must also give approval by special resolution in general meeting;

(e) before the general meeting to approve a special resolution for the giving of assistance, the directors of the company giving the financial assistance (and if the shares to be acquired are shares in the holding company, the directors of the holding company and of any intermediary holding company) must make a statutory declaration of solvency in respect of the company. The statutory declaration must have annexed to it a report by the auditors of the company that they have inquired into the state of affairs of the company and are not aware of anything to indicate that the opinions expressed by the directors in the statutory declaration are unreasonable.

2.11 We noted the following points about the new provisions:

(1) as already mentioned, the prohibition of a public company giving financial assistance goes against the recommendations of the Jenkins Committee;

(2) the provisions allowing the provision of financial assistance by private companies are developments of those recommended by the Jenkins Committee with additions; the most important additions are those referred to in (3)(a) and (b) above;

(3) the detailed procedures for provision of financial assistance by a private company are so complicated and strict that it is unlikely that many private companies will in fact be able to use them in practice; and

(4) the concept of "distributable profits" forms a very important part of the provisions and there are detailed

statutory provisions on what constitutes distributable profits in Part III of the Companies Act 1980, as amended (now Part VIII of the Companies Act 1985); however there are no provisions on the subject in the Companies Ordinance.

2.12 The Committee also considered the new British provisions allowing a company to purchase its own shares (Sections 45 - 62 of the Companies Act 1981; now Sections 159 - 181 of the Companies Act 1985).

2.13 The provisions allow both private and public companies to purchase their own shares. Rather oddly, in our opinion, the procedure for purchase by a public company of its own shares is the simpler of the two.

2.14 The provisions are, as one would expect, fairly complicated but basically they allow both private and public companies to buy their own shares out of distributable profits or the proceeds of a fresh issue of shares made for the purpose, subject to prior approval by a special resolution in the case of a private company and by an ordinary resolution in the case of a public company buying its listed shares. In addition, a private company can purchase its own shares out of capital if there are insufficient distributable profits and if there are insufficient proceeds from any fresh issue of shares (although there is no compulsion to make such an issue).

2.15 As the Committee continued their detailed consideration of the subjects of Section 48 and the purchase by a company of its own shares, it became clear to us how important the concept of distributable profits was to the British legislation on both subjects. As already mentioned, there is no provision in the Companies Ordinance on the subject. It was considered by the Companies Law Revision Committee in their Second Report (pages 193 - 196). At that time, there were no provisions on the subject

in the British companies legislation either but the Jenkins Committee had made a number of important recommendations which were awaiting implementation. The Second Report recommended that if and when the Jenkins Committee recommendations were adopted in Britain, they should, subject to a minor amendment detailed in the Report, be adopted here also. As already mentioned, the Companies Act 1980, Part III implemented most of the Jenkins Committee recommendations. (We understand that, here again, the driving force behind the introduction of these provisions, was the need to respond to the EEC directives on company law harmonization.)

2.16 We decided that before we reached any decisions on the subjects of Section 48 and purchase by a company of its own shares, we would have to have a decision on whether the Companies Ordinance should contain detailed provisions on distributable profits. The subject is a particularly technical one and it has to be remembered that the British legislation was drafted very much with the British tax system in mind. The Committee therefore appointed a Sub-Committee consisting of Mr. Connolly as Chairman, two co-opted members of the Law Society of Hong Kong and two co-opted members of the Hong Kong Society of Accountants to consider and report on it. The Sub-Committee has met on a number of occasions and we understand that they expect to be able to submit their recommendations in the first quarter of 1986. Once these are to hand, we shall resume our consideration of both Section 48 and the question of the purchase by a company of its own shares.

3. Section 57B of the Companies Ordinance (Approval of company required for allotment of shares by directors)

3.1 Section 57B(1) of the Companies Ordinance and the proviso thereto read as follows:

"57B(1) Notwithstanding anything in a company's memorandum or articles, the directors shall not without the prior approval of the company in general meeting exercise any power of the company to allot shares: Provided that no such prior approval shall be required in relation to the allotment of shares in the company under an offer made pro rata by the company to the members of the company, excluding for that purpose any member whose address is in a place where such offer is not permitted under the law of that place."

The basic purpose of the proviso is, of course, to allow the directors of a company to make a rights issue without having to get the prior approval of a general meeting.

3.2 The Law Society of Hong Kong has proposed three amendments:

"(a) at present a rights issue by a company excluding an offer to members resident in the U.S.A. would require the consent of the members of the company. An offer is permitted in the U.S.A. but cannot be made without a local registration. The present wording does not cover that situation and the exclusion should therefore be broad enough to exclude members in places where the offer is not permitted without a separate registration in that place of the offer documents;

(b) fractional entitlements. An exemption from the pro rata requirements is appropriate to allow the allotment of shares in a proportion "as nearly as practicable" equal to the existing holding of shares. (see Section 17 U.K. Companies Act 1980); and

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(c) a rights issue of shares involving two classes of shareholders. We refer here to the definition of "relevant shares" in Section 17(11) U.K. Companies Act 1980 as a simple method of broadening the existing proviso."

3.3 The Committee are agreeable to suggested amendments (b) and (c) but have asked for further information about the scale of the problem which has led to suggestion (a), in order to consider the matter further.

4. Section 79 of the Companies Ordinance (Payment of certain debts out of assets subject to floating charge in priority to claims under the charge) and Section 265 of the Companies Ordinance (Preferential payments)

4.1 Section 265 of the Companies Ordinance sets out in detail the debts which have priority in the winding up of a company i.e. certain amounts of wages and salaries of staff, severance payments, statutory debts due to the Crown which became due and payable within the 12 months preceding the date of the winding up etc.

4.2 Section 79 gives the same priority where a receiver is appointed under a debenture secured by a floating charge and the company is not in course of being wound up.

4.3 The Registrar General in his capacity as Official Receiver had drawn to the attention of the Standing Committee statements in various authorities which suggest that, where a floating charge has crystallised

automatically, it becomes a fixed charge. Section 79 then does not apply to it and a receiver who is appointed after the automatic crystallisation is therefore not bound to give priority to the preferential debts detailed in Section 265. He has also pointed out the recent English case of Re Woodroffes (Musical Instruments) Ltd. (in liquidation) [1985] 2 All ER 905 which lays down that cessation of a company's business automatically crystallises a floating charge. Assuming that this case is followed in Hong Kong, it will almost certainly lead to an increase in the incidence of automatic crystallisation of floating charges because it is generally thought that there is a greater tendency here for companies to cease carrying on business before a receiver is appointed.

4.4 The Registrar General is concerned about the situation which would arise if the authorities previously referred to were followed in Hong Kong and there was a large number of cases where receivers were not liable to give priority to wages and salaries etc. He pointed out that the Australian equivalent of Section 79 had been amended to make it clear that the section continues to apply if the floating charge has crystallised automatically before the appointment of the receiver.

4.5 When the Standing Committee started considering the matter, however, our attention was drawn to the fact that a leading new textbook disagrees with the view that the British equivalent of Section 79 does not apply in a case where the floating charge has crystallised automatically before the appointment of the receiver.

4.6 Nevertheless, the Committee are concerned about the possibility and our preliminary view is that the prudent course would be to follow the Australian precedent and put the point beyond doubt by amending Section 79 in the same way as has been due in Australia. However, before reaching any final decision, we would like to have the views

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of various professional and business organisations and have written to them accordingly.

5. Section 145 of the Companies Ordinance (Production of documents, and evidence, on investigation)

5.1 The effect of Section 145 is:-

(a) to impose a duty on all officers and agents of a company under investigation by an inspector appointed by the Financial Secretary, to produce the company's books and documents to the inspector (subsection (1));

(b) to give the inspector power to examine on oath the officers, agents and employees of the company under investigation (subsection (2)); and

(c) to give the inspector power to apply to the court for examination on oath of any other person where he thinks it is necessary for the purpose of the investigation (subsection (4)).

5.2 The corresponding section in the British legislation is Section 167 of the Companies Act 1948, as amended, (now Sections 434 - 436 of the Companies Act 1985). This has gone beyond our Section 145 and has given an inspector power:

(i) to require anyone whom he considers is, or may be, in possession of any information concerning the company's affairs to produces any books or documents of the company in his possession (subsection (1A));

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(ii) to require directors (but not the banks concerned) to give information about certain bank accounts (subsection (1B)); and

(iii) to examine on oath anyone whom the inspector considers is, or may be, in possession of any information concerning the company's affairs (subsection (2)).

5.3 An inspector appointed by the Financial Secretary under the Companies Ordinance wrote to Government recommending that Section 145 of the Companies Ordinance be extended to give inspectors the powers referred to in (i) and (iii) above. He had found during the inspection proceedings that documentation relating to the company was widely dispersed between various parties, including third parties who were not officers, agents or employees of the company. If these latter third parties were unco-operative, he had had to go through the time-consuming process of applying to the court under the existing subsection 145(4) to examine them. The Committee noted that, even then, it appeared that the subsection did not specifically authorise the court to order the third party to hand any books or documents to the inspector for retention for detailed examination.

5.4 The Committee agreed that it was reasonable that Section 145 be extended as requested by the inspector and also decided that the provision in Section 167(1B) of the 1948 Act, as amended, regarding certain bank accounts be adopted here. The Committee consulted the Hong Kong Association of Banks regarding the latter amendment and the Association confirmed that it had no objections.

5.5 The Committee therefore recommend that Section 145 of the Companies Ordinance be amended by:

(a) introducing an equivalent of subsection 167(1A) of the Companies Act 1948, as amended,

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(b) amending subsection 145(2) of the Companies Ordinance to bring it into line with subsection 167(2) of the 1948 Act,

(c) introducing an equivalent of subsection 167(1B) of the 1948 Act,

(d) making the following minor consequential amendments:

(i) delete the reference to "any employee" in Section 145(2) because employees would be covered by the proposed amendment to the subsection,

(ii) delete Section 145(4) because this also would be superseded by the proposed amendment to subsection 145(2),

(iii) in our equivalent to subsection 167(1B) of the Companies Act 1948, amend the cross-references as follows:

	British legislation referred to	Suggested HK reference
Sec 167(1B)(a)	Sec 6 of 1967 Act	Sec 161 of Cap 32
" " (b)(i)	Sec 54 of 1980 Act	Secs 129D(3)(j) & (k) & 162A of Cap 32
" " " (ii)	Sec 56(4) & (4A) of the 1980 Act	Sec 161B of Cap 32
" " " (iii)	Sec 57 of the 1980 Act	Sec 161B of Cap 32

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6. Section 155A of the Companies Ordinance (Approval of company required for disposal by directors of company's fixed assets)

6.1 This section applies only to listed companies and companies which are members of a group which contains a listed company. It prohibits the directors from making any disposal of fixed assets without the consent of a general meeting, if such a disposal would mean that the value of the fixed assets to be disposed of, plus the value of any fixed assets disposed of in the preceding 4 months, would exceed 33% of the company's total fixed assets as shown in the company's latest balance sheet laid before the company in general meeting.

6.2 The Law Society of Hong Kong has proposed that:

(a) intra-group transfers should be exempted from the section, and

(b) there should be a statutory definition of "fixed assets".

6.3 With regard to suggestion (a), the Committee are sympathetic to the view that the section should be amended to exempt intra-group transfers between a holding company and a wholly-owned subsidiary, or between two wholly-owned subsidiaries, but feel that the question of exempting transfers to subsidiaries which are not wholly-owned needs further consideration and have asked the Law Society for more detailed comment.

6.4 With regard to suggestion (b), the Committee noted that, since 1974, para. 4(2) of the Tenth Schedule to the Companies Ordinance has required that fixed assets, current assets and assets that are neither fixed nor current, shall be separately identified in a company's balance sheet and that there has been no evidence of widespread complaint that this is impracticable. The Committee have therefore asked the Law Society for examples of specific problems which have arisen and for suggestions for a suitable definition of the term "fixed assets".

6.5 The Hong Kong Society of Accountants has also been asked for its views on the matter and these are already to hand.

7. Section 161B of the Companies Ordinance (Particulars in accounts of loans to officers, etc.)

7.1 Section 157H of the Companies Ordinance (Prohibition of loans to directors, etc.) contains restrictions on the loans which companies can make to their directors and other companies in which their directors hold controlling interests. It also restricts the guarantees or security which companies can provide to third parties in respect of loans made to such directors, etc. In the case of a listed company, or a company which is a member of a group which contains a listed company, the restrictions apply to loans to, or guarantees or security on behalf of, a spouse, child or step-child of a director and to certain trustees and partners. There are, however, many exceptions to the restrictions and, in particular, a private company which is not a member of a group of companies which contains a listed company can make any loans which are approved by the shareholders in general meeting. All companies can make loans to their directors for the purchase of homes.

7.2 Licensed banks are exempted from the provisions of Section 157H. The Committee understand that the reason for this is that licensed banks are subject to the separate restrictions on loans to directors contained in the Banking Ordinance, Cap. 155.

7.3 Since there are so many exceptions to the prohibition of loans to directors one would expect to see a requirement for disclosure of loans which are made, or guarantees or security which are given, by

virtue of these exceptions and, indeed, such a requirement is found in Section 161B of the Companies Ordinance. Section 161B requires the following information in respect of every loan made to a director or other officer of a company or to any company in which such a director has a controlling interest, to be included in the company's annual accounts:

(a) the name of the borrower,

(b) the terms of the loan, including the rate of interest and the security therefor,

(c) the amount outstanding on the loan, principal and interest, at the beginning and at the end of the company's financial year and the maximum amount so outstanding during that financial year, and

(d) the amount of any interest which, having fallen due, has not been paid and the amount of any provision made in respect of any failure or anticipated failure by the borrower to repay the whole or part of the loan or interest.

Detailed information is also required about guarantees or security provided by the company in respect of any loan to an officer by a third party.

7.4 This requirement applies to all companies, including licensed banks.

7.5 The Hong Kong Association of Banks wrote to Government requesting that Section 161B be amended along the following lines:

(1) Licensed banks should be exempted from the requirement to give the detailed information required by Section 161B in their annual accounts and they should only be required to give an aggregate figure for the total amount of all such loans etc. outstanding as at the end of the financial year, as in Britain; the banks would also give aggregate figures

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for the maximum amounts of loans outstanding to officers etc. during the year.

(2) Licensed banks should be required to keep a register setting out the detailed information required by Section 161B and this should be available for inspection by the Commissioner of Banking only pursuant to the new Banking legislation intended for the protection of depositors.

(3) If disclosure of the register to the Commissioner of Banking only is not acceptable such disclosure should be made to the registered shareholders only as in the UK, where the legislation has stood the test of time and the UK Government is evidently satisfied that the register, like other statutory registers should not be inspected otherwise than by the registered shareholders.

7.6 The Association's principal reasons for their request appear to be as follows:

(a) The disclosure of information about loans made by a bank is a breach of the confidentiality which is observed strictly in the banker/client relationship. Local banks are anxious to have leading figures from Hong Kong's industrial, commercial and professional sectors act on their boards of directors in order to get the benefit of their extensive knowledge and experience but businessmen may be reluctant to act as such directors when they know that it will mean the publication of details of all loans made to them or to companies controlled by them (and, if the bank is a listed company or is a member of a group which contains a listed company, loans to their spouse and children, trustees and partners); such information can, in certain circumstances, be of use to competitors.

(b) The requirement to give all the statutory information in the annual accounts can mean the inclusion of substantial amounts of detail which takes up an unreasonable amount of space and which, in any case, is of very little practical use to anyone; for example, the bald statement that a loan is secured by a mortgage on land is not informative enough to be of any real use.

(c) The trend in supervision of banks everywhere is for more detailed information to be supplied to the regulatory authorities to assist them in the carrying out of their prudential supervisory duties, rather than for such information to be published.

(d) Foreign banks operating here are not subject to the requirements of Section 161B and this gives them an unfair advantage over banks incorporated in Hong Kong under the Companies Ordinance.

7.7 After careful consideration, the Committee formed the following views on the Association's arguments:

(a) Members agreed that the preservation of confidentiality is highly desirable and that disclosure should only be required where the public interest demands it. However, they thought that experience both in Hong Kong and overseas during the past few years had amply demonstrated that details of loans by banks to their directors and companies connected with or controlled by their directors could be of considerable importance in reaching an informed view of the financial condition of individual banks. They felt that a reasonable amount of such detail should be made

available publicly in Hong Kong, where the rule of caveat emptor still applies to depositors as well as other creditors.

(b) & (c) Members sympathised with the view that the annual accounts of banks are not really the appropriate place for detailed information on individual loans to directors etc. They agreed that it would be sufficient if the accounts contained only aggregate figures. However, they were firmly of the view that the suggested register containing details of individual loans etc. should be made available for inspection by all members of the public for a reasonable time around the time of the annual general meeting of a bank. They noted that the equivalent register is only open for inspection by shareholders in Britain but considered that this was hardly logical. In the first place, it meant that a shareholder with only, say, 10 shares in a bank, could get information on details of loans to directors while a non-shareholder with a £10 million deposit in the bank could not. In the second place, if the bank was a listed company, any representative of the media could simply buy a board lot of shares to get the information on loans to directors and publish it. Members also noted that it could be argued that there is rather less need for disclosure of information about banks in Britain in that there is a limited form of deposit insurance.

(d) Members noted that Section 36 of the Banking Ordinance provides to the effect that all licensed banks, including foreign banks, require to comply with the auditing

requirements of the Companies Ordinance, which, presumably, necessitates compliance with Section 161B. However, they were informed that the exemption provisions in Section 37(4) of the Banking Ordinance are usually applied to foreign banks and that these exempted foreign banks therefore do not need to comply with any of the auditing requirements of the Companies Ordinance. It is therefore correct that in many, perhaps most, cases of foreign banks operating in Hong Kong, there is no public disclosure of loans made to directors etc; equally, however, in some cases, the requirements in the home countries of these banks may be just as strict as those in Hong Kong and an interested party can obtain information on loans to directors in the bank's home country. In any event, Members took the view with the absence or otherwise of disclosure requirements for foreign banks was not of itself a good reason for not applying such requirements to banks incorporated in Hong Kong under the Companies Ordinance.

7.8 The Committee therefore recommend that Section 161B be amended to provide:

(a) that the annual accounts of a licensed bank shall contain an aggregate figure for all loans to directors etc. outstanding at the end of the financial year concerned and aggregate figures for the highest amount of loans to directors during the financial year, and

(b) that every licensed bank shall keep a register showing the detailed information required under Section 161B and this

shall be open for inspection by all members of the public for a period of 14 days prior to the annual general meeting and 7 days thereafter.

8. Section 269 of the Companies Ordinance (Restriction of rights of creditor as to execution or attachment in case of company being wound up)

8.1 Under Section 269, where a creditor has issued execution against the goods or lands of a company or has attached any debt due to the company, and the company is subsequently wound up, he shall not be entitled to retain the benefit of the execution or attachment against the liquidator unless he has completed the execution or attachment before the commencement of the winding up.

8.2 Section 269 also provides that an execution against goods shall be taken to be completed by seizure and sale. Messrs. Wilkinson & Grist, Solicitors, wrote to the Committee pointing out that this provision puts a creditor in Hong Kong who has obtained a charging order absolute over shares held by company A in company B in an unsatisfactory situation, particularly when compared with his equivalent in Britain.

8.3 In Britain, the creditor is protected as soon as he obtains his charging order nisi. In Hong Kong, however, since shares are "goods" for the purposes of Section 269 and a charging order on them is an "execution" for the purposes of the section, the creditor has to complete the seizure and sale, i.e. actually receive the proceeds of the sale of the shares, before he is protected. Under the Rules of the Supreme Court, no steps can be taken to enforce a charging order until 6 months have

elapsed from the Notice to Show Cause and, from start to finish, the process of execution can easily take 12 months. If the company is wound up in the meantime, the creditor losses his priority rights over the proceeds of the eventual sale. We understand that it is not unknown for company A to threaten the creditor with putting itself into voluntary liquidation solely to prevent him getting the proceeds of the sale of the shares in company B.

8.4 The Committee agree that the situation is unsatisfactory and recommend that Section 269 be amended to bring it into line with the corresponding legislation in Britain i.e. to provide that an execution against goods shall be taken to be completed by seizure and sale or by the making of a charging order absolute.

(Note: Shortly after making this decision, the Committee were informed that a Committee appointed to consider the need for any amendments to the Supreme Court Ordinance and headed by The Honourable Mr. Justice Kempster had also recommended amendments to Section 269 of the Companies Ordinance to the same effect).

9. General fiduciary duty of directors

9.1 This section was considered in the Second Report of the Companies Law Revision Committee (para. 7.11). They noted that some witnesses appearing before the Jenkins Committee in Britain had suggested that the existing legal duties and responsibilities of directors should be codified in legislation; others had suggested that these should be set out as simply as possible, together with such other guidance to appropriate behaviour as might seem useful, in a Directors' Code. As regard codification

of the law, the Jenkins Committee had agreed with the General Council of the Bar that "any attempt to define the duties of directors more clearly would involve the risk that, since it would be impossible to define such duties exhaustively, there would be inevitable lacunae which might well make it more difficult to determine in any particular set of circumstances what these duties were". However, the Jenkins Committee had thought that a general statement of the basic principles underlying the fiduciary relationship of directors towards their companies might well be useful to directors and other concerned with company management. They had therefore recommended that such a statement of principles be included in the Companies Acts. The Companies Law Revision Committee noted that there was already a provision to the same general effect in the Australian Companies Acts and recommended that provisions should be included in the Companies Ordinance on the lines of those recommended by the Jenkins Committee.

9.2 Accordingly, when the draft Companies (Amendment) Bill was published as a White Paper in 1980, it included a proposed new Section 155B in the following terms:

"155B(1) A director of a company shall observe the utmost good faith towards the company in any transaction with it or on its behalf and shall act honestly in the exercise of the powers and the discharge of the duties of his office.

(2) A director of a company shall not make use of any money or other property of the company, or of any information acquired by him by virtue of his position as a director or other officer of the company, to gain directly or indirectly an

improper advantage for himself at the expense of the company.

(3) A director of a company who, by any breach of subsection (1) or (2), makes a profit or inflicts any damage on the company shall be liable to account to the company for the profit or to compensate it for the damage.

(4) This section is without prejudice to any other provision of this Ordinance and to any rule of law with respect to the duties or liabilities of directors."

9.3 The proposed section was objected to by the Law Society of Hong Kong and the Hong Kong Society of Accountants. The former adopted the objections made by the Law Society of England and Wales to a similar proposal in Britain in 1978 i.e. "It is considered that any attempt at codification would inevitably produce more evils than it would cure because no code could cover every set of circumstances". The ad-hoc working group of UMELCO members who considered the objections decided to delete the clause from the Bill and referred the subject to this Committee for further consideration.

9.4 The Committee noted with interest the attempt by the then Labour Government to implement the Jenkins Committee recommendations in Britain in the abortive Companies (Amendment) Bill 1978. The Bill failed because of the intervening general election, which Labour lost, and the incoming Conservative Government dropped the relevant clause from its 1979 Companies Bill, merely saying that the proposed section was not satisfactory.

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9.5 There are at present two opposing schools of thought among the Members of the Committee on this subject. The first group agree with the Jenkins Committee and the Companies Law Revision Committee that it is desirable that there should be a codification of the basic principles of the law on fiduciary duties of directors which will be readily available for reference by all directors and especially by those who are new to their posts and are perhaps not familiar with these basic principles. At present, the principles can only be studied by referring to legal textbooks and decided cases. The second group agree with the objections expressed by the Law Society of Hong Kong and the Hong Kong Society of Accountants to the proposed codification contained in the draft Bill published as a White Paper in 1980. They consider that the law on the subject is, by its nature, very detailed and complicated and that any attempt to codify its basic principles would be bound to be seriously incomplete and would be a trap for laymen directors who would easily be misled by its apparent simplicity. They feel that the attempted codification would give rise to more problems than it would solve and that it would be best to continue with the present system where, if a director feels that there may be a question involving his fiduciary duties to his company, he should consult his professional advisers. Both sides agree that before any decisions are reached on any recommendations, the up-to-date views of the professional bodies concerned will require to be obtained. We have also written to the United Kingdom to see if we can obtain further information as to why the 1978 proposals were abandoned.

9.6 Investigation and consideration of the subject are still proceeding.

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10. Further Matters Under Consideration

10.1 During the course of the year, consideration has been given to amendment in respect of the Sections listed below. In each case a decision has been deferred pending further information or comment from interested organisations:-

Sec 48B	- Application of premiums received on issue of shares (with reference to Secs 36 - 41 of the Companies Act 1981).
Sec 114C	- Proxies.
Sec 157A	- Appointment of directors to be voted on individually.
Sec 228A	- Circumstances in which a company may be wound up voluntarily.
Proposed Sec 155D	- Directors' duties regarding information to shareholders.

10.2 The final report and recommendations of the Sub-Committee referred to in para. 1.27 of our previous report are expected in the near future.

Appendix 1

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 Economic Services to the Governor 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 Commission in its role of administering those Ordinances.

Appendix 2

Membership of the Standing Committee as at 31st December 1985

Chairman:

The Hon. Mr. Justice Cons

Members:

Mr. Peter Brockman,

Dr. Andrew Chuang Siu-leung, JP,

Mr. D.E. Connolly, JP,

Mr. Kenneth Fang Hung,

Mr. Robert Fell, CB, CBE,

Mr. Andrew Li Kwok-nang,

Mr. Eric K.C. Lo,

Mr. P.J. Pearson,

Mr. Charles H. Wilken,

Professor P.G. Willoughby, JP,

Mr. C.H. Wong, JP,

The Hon. Peter C. Wong, OBE, JP,

Mr. Charles Wrangham

Ex-officio Members:

Mr. P. Jacobs, OBE, JP, Secretary for Economic Services,

Mr. Noel M. Gleeson, JP, Registrar General, and

Mr. Ray Astin, JP, Commissioner for Securities

Co-opted Members of Sub-Committee:

Sub-Committee on Sec 80(2)(c) & (e) of the Companies Ordinance

Mr. Malcolm Barnett, and

Miss Vanessa Stott

Sub-Committee on Distributable Profits

Mr. Richard Hall,

Mr. K.G. Morrison,

Mr. David J. Shaw, and

Mr. J.B. Wilkinson

Former member: Mr. T.G. Freshwater

Secretary:

Mr. P. Murphy, Registrar General's Department

Appendix 3

Meetings held during 1985

Seventh	Meeting	- 5th January	Thirteenth	Meeting	- 17th August
Eighth	"	- 2nd February	Fourteenth	"	- 7th September
Ninth	"	- 13th April	Fifteenth	"	- 5th October
Tenth	"	- 4th May	Sixteenth	"	- 2nd November
Eleventh	"	- 1st June	Seventeenth	"	- 7th December
Twelfth	"	- 6th July			