

**Standing Committee on Company Law Reform
(SCCLR)**

The Sixteenth Annual Report

1999/2000

Standing Committee on Company Law Reform (SCCLR)

Sixteenth Report to the Chief Executive in Council

Subjects considered by the

Standing Committee during 1999/2000

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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 1999/2000

<u>Chairman</u>	:	The Hon Justice Rogers, JA	
<u>Members</u>	:	Mr Roger T Best, JP	
		Mr Moses Cheng Mo-chi, JP	(up to 31st January 2000)
		Mr Henry Fan Hung-ling, JP	
		Ms Betty Ho May-foon	
		Mr Gerald Hopkinson	
		Mr Edwin Ing	
		Mr Robert G Kotewall, JP, SC	(up to 31st January 2000)
		Mrs Angelina P L Lee, JP	
		Mr Winston Poon, SC	
		Mr Richard Thornhill	
		Mr Alvin Wong Tak-wai	
		Mr Ian Perkin	(from 1st February 2000)

Mr Randolph Sullivan (from 1st February 2000)

Mr Peter S H Wong (from 1st February 2000)

Ex-Officio Members : Mr Raymond Tang, Chief Counsel (up to 31st July 1999)
The Securities & Futures Commission

Mrs Alex Lam, Chief Counsel (from 1st August 1999)
The Securities & Futures Commission

Mr Alec Tsui Yiu-wa, Chief Executive
The Stock Exchange of Hong Kong Limited

Mr Charles Barr
Department of Justice

Mr T.E. Berry, JP (up to 31st August 1999)
The Official Receiver

Mr E.T. O'Connell (from 1st September 1999)
The Official Receiver

Mr Gordon W E Jones, JP
The Registrar of Companies

Mr David T R Carse, JP
Deputy Chief Executive
The Hong Kong Monetary Authority

Miss AU King-chi, JP (up to 4th July 1999)
Deputy Secretary for Financial Services

Miss Susie HO Shuk-yee
Deputy Secretary for Financial Services (from 5th July
1999)

Secretary : Mr J S Bush

(iii)

Meetings held during 1999/2000

One Hundred and Thirty Eighth Meeting	-	24th April 1999
One Hundred and Thirty Ninth Meeting	-	15th May 1999
One Hundred and Fortieth Meeting	-	12th June 1999
One Hundred and Forty First Meeting	-	17th July 1999
One Hundred and Forty Second Meeting	-	11th September 1999
One Hundred and Forty Third Meeting	-	16th October 1999
One Hundred and Forty Fourth Meeting	-	27th November 1999
One Hundred and Forty Fifth Meeting	-	14th December 1999
One Hundred and Forty Sixth Meeting	-	15th January 2000
One Hundred and Forty Seventh Meeting	-	19th February 2000

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 1st April 1999 to 31st March 2000, the SCCLR held 10 meetings. On completion of its examination of the Consultant's Review of the Companies Ordinance, the Committee spent the majority of the year preparing its report on the Review. Small task force groups of members were set up to discuss papers prepared by a member of the Standing Committee on the various recommendations made in the Consultancy Report, the views of members and the public comments thereon and other aspects of the Companies Ordinance. Each of these papers was critically appraised by the task force groups and before being submitted to the Standing Committee for further consideration. When finally approved, these papers formed the chapters and recommendations of the Report published by the Committee on the 23rd February 2000 entitled "The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance."

During this reporting period, the SCCLR also considered a consultation paper entitled "Legislative Reform for the Securities and Futures Markets" produced by the Financial Services Bureau and a consultative paper from the Stock Exchange of Hong

Kong on Electronic Share Applications. The SCCLR also endorsed proposals :-

- (a) to repeal Section 228A of the Companies Ordinance;
- (b) to repeal various sections of the Companies Ordinance no longer considered necessary following a review of filing practices and procedures;
- (c) to amend Section 333 1(i) & (ii) and 345 (2)(b) as a result of amendments to the Professional Accountants Ordinance;
- (d) to undertake a study of Corporate Governance in Hong Kong.

A brief summary of the 11 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	The Report of the SCCLR on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance was published on the 23rd February 2000
2	Special Procedure for Voluntary Winding-up in case of inability to continue its business - Section 228A Companies Ordinance	Members proposed that the section be repealed.
Chapter	Subject Matter	Recommendations/Remarks
3	The Pooling of Assets of Insolvent	Members were not in favour of this

	Related Companies	proposal without substantial evidence of improper use of related companies by other group companies and that creditors were suffering from such abuse.
4	Review of Filing Practices and Procedures and Other Amendments	Members endorsed proposals to repeal various subsections of the Companies Ordinance which were no longer necessary following a review of practices and procedures together with two other amendments resulting from changes to the Professional Accountants Ordinance.
5	A Consultation Paper Entitled “Legislative Reform For The Securities And Futures Market”	Members were invited to submit individual comments on the consultation paper to the Financial Services Bureau. Concern was expressed concerning the independence of the Market Misconduct Tribunal and some of the proposed market “wrongdoings.”
6	A Consultative Paper On Electronic Share Applications	Members were invited to submit individual written opinions to the Stock Exchange of Hong Kong (SEHK).
Chapter	Subject Matter	Recommendations/Remarks

7	The Official Receiver's Annual Departmental Report 1998/99	The Official Receiver briefed members on this Report.
8	The Companies Registry's Annual Report 1998/99	The Registrar of Companies briefed members on this Report.
9	Corporate Rescue	On consideration of the draft legislation, members made proposals on the fees of the provisional supervisor, the extension of the moratorium and restrictions on the appointment of the provisional supervisor as liquidator to avoid conflict of interest.
10	The Filing of Particulars of Members of Companies having a Share Capital	Members did not consider these proposals acceptable at this stage. Such records useful for historical and investigative purposes.
11	The Study of Corporate Governance in Hong Kong	Members agreed to undertake this study. The subject had obvious company law and regulatory dimensions particularly those matters recommended for further study in the SCCLR's Report published on the 23rd February 2000.

Chapter 1

Review Of The Hong Kong Companies Ordinance

Consultancy Report

- 1.1 With the exception of the 145th meeting, the major part of each other meeting held during this year was taken up with the preparation of the Committee's Report on the Consultant's Review of the Hong Kong Companies Ordinance.

- 1.2 Having accepted a member's offer to research the existing law and collate the recommendations of the consultants, the initial views of members and those submitted during the public consultation exercise, small task forces of other members discussed critically papers submitted by Ms Betty Ho. The approved papers formed the chapters and recommendations of a Report published by the Committee on the 23rd February 2000 and entitled "The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance."

- 1.3 The Consultants' Report had been a catalyst which had caused the Committee to focus attention on the overall structure and content of the Companies Ordinance. The process of examining the Consultants' recommendations afforded members an opportunity to examine some of the fundamental principles underpinning Hong Kong Company Law. In addition, this exercise enabled the Committee to

identify more areas where reform is required than would be possible if analysis had proceeded on an incremental and piecemeal basis. The Report contains 168 recommendations covering the 112 recommendations in the Consultants' Report. Having had the benefit of the views of the 28 written submissions, the Committee accepted 35 of the Consultants' recommendations. In the opinion of the Committee, many of the recommendations accepted could be taken forward quickly through amendment bills to the Companies Ordinance and the Committee accordingly recommended to the Administration. Other recommendations involving further study or consultation and more structural changes to the Companies Ordinance will require more time. The Committee urged the Administration to accord priority to these in order to ensure that Hong Kong's company law continues to provide the Special Administrative Region with the commercial legal infrastructure commensurate with its status as a major international financial and commercial centre in the 21st century.

Chapter 2

Special Procedure For Voluntary Winding-up In Case Of Inability To Continue Its Business - Section 228A Companies Ordinance

Summary of Recommendation

- 2.1 At the 138th meeting, members agreed that the section ought to be repealed.

Background

- 2.2 Section 228A provides an alternative procedure for the directors of a company to appoint a provisional liquidator if they have formed an opinion that the company cannot by reason of its liabilities continue its business and they consider it necessary that the company be wound-up and that there are good and sufficient reasons for the winding-up to be commenced under Section 228A.
- 2.3 Members noted that there had been an increasing trend in the use of Section 228A and found it difficult to accept that there had been an emergency in each case which necessitated its use. It was felt that the use of the section was being abused to save time and expense and that shareholders and creditors were being faced with a “fait accompli” if directors used the section and appointed a provisional liquidator in circumstances other than an emergency. In the usual case of emergency, a petition for compulsory winding-up can be filed followed by

an application for a provisional liquidator over whom the court is able to exercise a degree of control and supervision. This does not happen in the case of an appointment under Section 228A.

Chapter 3

The Pooling Of Assets Of Insolvent Related Companies

Summary of Recommendation

- 3.1 At the 138th meeting, members were not prepared to accept a proposal that the assets of insolvent related companies be pooled for the benefit of all creditors of the companies involved without substantial evidence of improper use of related companies by other group companies and that creditors were suffering from such abuse.

Background

- 3.2 This matter was referred to the SCCLR by the Law Reform Commission's Subcommittee on Insolvency to whom it had been referred by the Hong Kong Society of Accountants. It was pointed out that transactions within a group are sometimes not carried out on a commercial basis and one company in the group may be sacrificed for the good of the group and creditors of that company may be left without adequate assets to meet their claims.
- 3.3 Members considered that this subject raised arguments about the fundamental concept of "lifting the veil of incorporation". Members considered it to be wrong, from a creditor's point of view, to allow assets of one group company to be mixed with those of another company in the same group in order to repay

creditors. If creditors were looking to assets of a related company when dealing with another company in the group, the normal business practice would be to obtain a guarantee from the related company. Unless there was evidence of substantial abuse, members were not prepared to accept the proposal for pooling of assets of related companies. Creditors must continue to take normal contractual precautions.

Chapter 4

Review of Filing Practices and Procedures and Other Amendments

4.1 At the 140th Meeting, members accepted proposals submitted by the Registrar of Companies to delete various statutory filing requirements now considered unnecessary following a review of filing practices and procedures. The Registrar had identified the following :-

<u>Name of Document</u>	<u>Relevant Sections</u>	<u>Proposed action</u>
(1) Notice of the resolution relating to the proposed alterations to the Memorandum and Articles of Association of a S.21 company which have already obtained consent from the R of C	S.21(6)(a)	To be deleted because the relevant resolution was required to be filed under S.117 of the Companies Ordinance.
(2) Copies of resolutions giving approval to the directors to allot shares	S.57(B)	It was felt that these resolutions could be kept by the company and need not be placed on public record.

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| (3) Return in respect of the classification of any unissued shares or conversion of shares | S.64(b) and (c) | To be deleted because filing of the resolution or a document under S.64A(a) was considered sufficient. |
| (4) Statement signed by director that he has accepted the position of director and has attained the age of 18 years | S.158D(5) | Forms D1 and D2 reporting the appointment were to be amended to include this information. |
| (5) Copies of the resignation notice of directors or secretaries | S.157D(3)(b) | These are internal records of the companies. Notification of the resignations is filed by companies on Form D2 and by the relevant person on Form D4. |
| (6) Memorandum of Appointment or Power of Attorney for Appointment of authorized representative | S.333(1)(d) and S.335(1) | To be deleted because filing of the Form F3 was considered sufficient. |
| (7) Original or certified copy of the charter, statutes or memorandum and articles or other similar instrument and the latest | S.333(1)(a) and (f) | To be deleted because a certified translation of the same was considered sufficient. |

accounts written in a language other than English or Chinese submitted for new registration

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| (8) Original or certified copy of the accounts written in a language other than English or Chinese submitted for annual filing | S.336(5) | To be deleted because a certified translation of the same was considered sufficient. |
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4.2 At the 141st Meeting, members accepted proposals submitted by the Hong Kong Society of Accountants (HKSA) to :-

- (1) Amend Section 333(1)(i) &(ii) to the effect that a body corporate which is a corporate practice as defined by the Professional Accountants Ordinance (Cap 50) should be able to accept service of process or notices on behalf of an oversea company.

- (2) Amend Section 345(2)(b) to provide an exemption in respect of partnerships of more than twenty persons to apply to partnerships formed for the purpose of carrying on practice as a firm of certified or public accountants and registered under the Professional Accountants Ordinance instead of applying to “professional accountants holding practising certificates”.

Chapter 5

A Consultation Paper Entitled

“Legislative Reform For The Securities And Futures Market”

- 5.1 At its 141st meeting, members considered a consultation paper by the Financial Services Bureau entitled “Legislative Reform for the Securities and Futures market”. This paper outlined the major proposals to be enacted in the Composite Securities and Futures Bill which had been earmarked for introduction into the Legislative Council by the end of 1999. The purpose of the composite legislation was to provide optimal market regulation and afford sufficient protection to investors, while at the same time encouraging healthy competition and market innovations. The Legislative Reform was to be based on the existing relevant securities legislation together with (inter alia) more effective supervisory and investigative powers being given to the Securities and Futures Commission (SFC), the introduction of an independent Market Misconduct Tribunal, new regulation on internet trading and a streamlined licensing regime for market intermediaries.
- 5.2 It was, however, felt that a right of audience ought to be given to an independent prosecuting counsel at a Market Misconduct Tribunal and that “Market Offences” or the wrongdoing aspects of market conduct ought to be properly defined as they attracted very heavy civil penalties.

5.3 Members were also concerned about the proposals for statutory immunity for auditors of listed companies. Members queried whether a similar immunity could be given to directors and lawyers and bankers of such companies. It was also pointed out that members' concerns in this areas had been expressed at its 114th meeting held on the 13th July 1996.

5.4 It was agreed that, as there was insufficient time to cover the whole paper, members, who wished to, could submit their individual written comments to the Financial Services Bureau before the 6th August 1999.

Chapter 6

A Consultative Paper On Electronic Share Applications

- 6.1 At the 143rd meeting, members considered this consultative paper produced by the Stock Exchange of Hong Kong (SEHK).
- 6.2 The paper explained that the SEHK preferred to introduce a multi mode system for the electronic application for shares. Large investors would continue to use application forms but payments would follow the Hong Kong Monetary Authority's proposal. Regular investors may become Hong Kong Clearing I.P.s and apply for new shares electronically through the Central Clearing and Settlement System, its Investor Service Centre, or through CCASS Participants who would apply on their behalf. Small investors, who normally lodge a significant percentage of applications, may use Electronic Payment Instructions, such as ATM cards, to apply for shares.
- 6.3 It was explained that the exercise to convert to a scripless market would take between one and two years. Many of Hong Kong's listed companies were incorporated in Bermuda. However, Bermuda had legislation in place enabling regulations to be passed quickly so that Bermudan companies listed on the SEHK could issue scripless securities.

- 6.4 Amendments to the Companies Ordinance would have to be made to enable a system of electronic share applications to be operated.
- 6.5 In this regard, members were concerned that the prospectus provisions of the ordinance applied to all companies and, if scripless securities were to be introduced for listed companies only, complex amendments would be necessary. It was also pointed out that the Companies Registry would not be in a position to handle the electronic registration of prospectuses until the recommendations of the Registry's Strategic Change Plan had been implemented which would not take place until 2005.
- 6.6 Due to the priority of members' time being allocated to the preparation of the SCCLR's report on the Consultant's Review of the Hong Kong Companies Ordinance, members were invited to give their individual written opinions on the Consultative paper to the SEHK. The Paper could also be discussed again at a later meeting in the light of other relevant reports.

Chapter 7

Official Receiver's Annual Departmental Report 1998/99

7.1 At the 144th meeting, the Official Receiver's Annual Departmental Report was tabled for discussion and summarised by the Official Receiver. Members were advised by the Official Receiver that in the year under review :-

- The number of new bankruptcies had increased from 643 in 1997/98 to 1179 in 1998/99, mainly as a result of the enormous increase in self petitions from 37 in the previous year to 569 in the current year.
- The number of compulsory liquidations increased from 459 in the year 1997/98 to 763 in the current year.
- The increase in workload had given impetus contracting out summary cases (i.e. those with assets less than HK\$200,000) to Panel B insolvency petitions. The number of firms on the Panel B had increased to 17.

Chapter 8

Companies Registry Annual Report 1998/99

- 8.1 At the 144th meeting, the Companies Registry Annual Report was tabled for discussion. The workload statistics disclosed that, compared with the previous financial year, there had been a decrease of 7.6% and 21.4% in the number of incorporations of public and private companies respectively. The number of oversea companies registering under Part XI of the Companies Ordinance had decreased by 17.6%.
- 8.2 A very important service enhancement which was formulated in the course of 1998-99 was the statutory procedure to deregister defunct solvent private companies contained in the Companies (Amendment) Ordinance 1999 which was enacted on 30 June 1999. For the first time ever, the owners of such companies would have a simple, fast and inexpensive means of deregistering these companies without having recourse to the very expensive option of a members' voluntary winding-up on the one hand or abusing the striking-off provisions under section 291 of the Companies Ordinance on the other. The same ordinance also contained a number of other major improvements which will make company law more business and user-friendly such as the introduction of merger relief and the abolition of a number of the more onerous reporting requirements for directors, particularly the directors of listed companies.

Chapter 9

Corporate Rescue

Summary of Recommendation

- 9.1 At the 145th meeting of the SCCLR, members considered the draft Companies (Amendment) (No. 2) Bill 1999 so far as it related to Corporate Rescue and Insolvent Trading and agreed that it was preferable that the fees to be charged by a provisional supervisor should be agreed with the directors prior to his appointment and specified in the appointment document. Members also agreed that the draft legislation needed amendment to ensure that it was only the Court which could extend the moratorium on actions against a company during the first six months of a provisional supervision. Members were also concerned about the possible conflict of interest that could arise where a provisional supervision is terminated and the creditors put the company into voluntary liquidation and appointed the provisional supervisor as its liquidator.

Background

- 9.2 The purpose of the meeting was to discuss certain aspects of the 21st draft of the Companies (Amendment) (No. 2) Bill 1999 so far as it related to Corporate Rescue and Insolvent Trading. The Committee had discussed a consultation paper on the subject submitted by the Law Reform Commission's Sub-Committee

at its 109th Meeting on 18 November 1995. However, the Chairman had reservation about certain aspects of the draft legislation and had set out these concerns in a paper which had been circulated to members prior to the meeting. In particular, he considered there to be a lack of court or creditor control over the powers of the provisional supervisor or over the amount of costs that the provisional supervisor may incur. It was pointed out that a provisional supervisor's task was to prepare proposals for the rescue of the company within 30 days of his appointment or seek extension of the moratorium from the Court in the first 6 months and thereafter the creditors. In this way, control could be exercised over him. However, the draft legislation did not reflect members' view in respect of the costs of the provisional supervisor, the extension of the moratorium and a possible conflict of interest if the provisional supervisor became the liquidator and the Administration was asked to reconsider the draft legislation in the light of these considerations.

Chapter 10

The Filing Of Particulars Of Members Of Companies Having A Share Capital

Summary of Recommendation

- 10.1 Members did not agree to the proposed amendments.

Background

- 10.2 At the 146th meeting, members considered a paper prepared by the Registrar of Companies requesting members to amend Section 45(1)(a) of the Companies Ordinance to delete the requirement to give particulars of allottees and, if agreed, to reduce the time limit for delivery from 8 weeks to one month. In the case of listed companies the list of allottees was very lengthy and resulted in extra storage space being needed for bulky paper lists of shareholders. These returns were usually out of date by the time they were filed in the Registry. It was also pointed out that in many cases where the CCASS system was used, investors are not registered as members of the company. Members were, however, concerned with the preservation of historical records for investigative purposes where possible and did not consider the proposal acceptable at this stage. They also pointed out that the problems concerning storage could be solved by increasing the charges for this purpose.

Chapter 11

The Study Of Corporate Governance In Hong Kong

Summary of Recommendation

- 11.1 Members agreed to undertake this study because, although not confined to them, the subject had obvious company law and regulatory dimensions and certain aspects of the subject had been recommended for further study by the SCCLR in its Report published on the 23rd February 2000.

Background

- 11.2 At the 147th meeting, members considered a paper prepared by the Financial Services Bureau entitled “An Overall Review of Corporate Governance in Hong Kong.” Good Corporate Governance was something which institutional investors considered high on their list of priorities when deciding on their portfolios. At the moment, Asia was, in general terms, considered as being behind various western countries in this regard. Hong Kong needed to do something about Corporate Governance to overcome this perception and keep pace with global standards. Much work had already been done on the subject by other bodies such as the HKSA, the Hong Kong Institute of Chartered Secretaries, the SEHK, the SFC and the Hong Kong Institute of Directors. It was felt that the SCCLR could stock take to assess the current situation and future direction.

11.3 Although not all aspects of Corporate Governance involved company law, members agreed that, as there was an obvious company law dimension to the subject, much time could be saved if the SCCLR undertook the study. It was recognised that the membership of the SCCLR already covered the major government departments regulators and professional bodies involved in Corporate Governance.

11.4 Members considered that much thought would have to be given to how the subject should be studied. They did not think it appropriate to appoint a consultant at this stage. It may be possible to seek the assistance of the universities to research and study certain aspects of the subject. It was felt that the subject should be studied as part of the SCCLR's normal work and in particular certain of the subjects earmarked for further study in the Committee's recent Report ought to be studied on a timely basis.