Standing Committee on Company Law Reform (SCCLR)

The Eighteenth Annual Report

2001/2002

Standing Committee on Company Law Reform (SCCLR)

Eighteenth Report to the Chief Executive in Council

Subjects considered by the

Standing Committee during 2001/2002

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PREFACE

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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 and the Treasury 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 2001/2002

Chairman : The Hon Mr Justice Rogers, V-P, JP

Members : Mr Roger T Best, JP
Mr Henry Fan Hung-ling, SBS, JP
Ms Betty Ho May-foon
Mrs Angelina P L Lee, JP
Mr Winston Poon, SC
Mr Richard Thornhill
Mr Alvin Wong Tak-wai

Mr Ian Perkin
Mr Randolph Sullivan
Mr Peter S H Wong
Mr Michael W Scales
Mr William Tam Sai-ming

Ex-Officio Members : Mrs Alexa Lam, Chief Counsel (up to 31.10.2001)
The Securities & Futures Commission

Mr Ashley Alder, (from 1.11.2001)
Executive Director (Corporate Finance)
The Securities & Futures Commission

Mr Lawrence Fok, Chief Executive
The Stock Exchange of Hong Kong Limited

Mr Charles Barr
Department of Justice

Mr E.T. O'Connell
The Official Receiver

Mr Gordon W E Jones, JP
The Registrar of Companies

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

Miss Susie HO Shuk-yee
Deputy Secretary for Financial Services[1]

Secretary : Mr J S Bush

[1] "Called "Deputy Secretary for Financial Services and the Treasury" since 1 July 2002"

(iii)

Meetings held during 2001/2002

One Hundred and Fifty Fifth Meeting	-	16th June 2001 and 23rd June 2001
One Hundred and Fifty Sixth Meeting		13th October 2001
One Hundred and Fifty Seventh Meeting	-	10th November 2001
One Hundred and Fifty Eighth Meeting	-	8th December 2001
One Hundred and Fifty Ninth Meeting	-	26th January 2002
One Hundred and Sixtieth Meeting	-	16th March 2002

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 and the Treasury, to the Chief Executive in Council on amendments that are under consideration.

From 1st April 2001 to 31st March 2002, the SCCLR held six meetings. In addition to their work on the matters discussed at the meetings covered in this report, members continued their review of Corporate Governance in Hong Kong. On the 20th July, a consultation paper on the proposals made in Phase I of the Corporate Governance Review was released for public comment. After a three-month consultation period, 53 submissions had been received from interested persons and institutions which, after analysis, enabled members to confirm almost all the proposals put forward in the consultation paper. However, they decided not to proceed with the proposal to require private companies to file their financial statements with the Companies Registry. In addition, members also decided to delay a final decision on certain aspects of their proposals on connected party transactions in order to coordinate these with similar proposals by the Stock Exchange of Hong Kong then under consultation and to review certain aspects of their proposals concerning transactions between directors or connected parties and associated companies. As part of the Corporate Governance Review, a Joint Government and Hong Kong Society of Accountants Working Group was set up to review comprehensively the accounting and auditing provisions of the Companies

Ordinance.

During the reporting period, the SCCLR considered a paper entitled "Corporate Regulation – Enforcement of the Companies Ordinance" produced by the Financial Services Bureau[2] and a Consultation Paper entitled "Proposed Amendments to the Conveyancing and Property Ordinance (Cap 219) Execution of Conveyancing Documents by Corporations" prepared by the Department of Justice. It also considered a Discussion Paper on Netting by Deposit/Insurance Scheme prepared by the Hong Kong Monetary Authority and a Discussion Paper entitled "The HAMS Proposal" prepared by Mr David M Webb.

The SCCLR also endorsed proposals :-

(a) to amend Part XI of the Companies Ordinance to clarify and simplify the registration requirements and filing procedures for companies incorporated elsewhere which establish a place of business in Hong Kong;

(b) to amend section 155C of the Companies Ordinance to exclude its application to listed companies;

(c) to amend the Companies (Forms) Regulations regarding the certification and translation of documents delivered to the

[2] "Called "Financial Services and the Treasury Bureau" since 1 July 2002"

Companies Registry on behalf of oversea companies;

(d) to amend the Companies Ordinance in respect of the delegation of authority to amend the schedules to the Companies Ordinance;

(e) to amend the Companies Ordinance to further facilitate electronic incorporation; and

(f) to amend the Companies Ordinance and the Limited Partnerships Ordinance to remove the restriction on numbers of partners.

A brief summary of the 12 chapters of this Annual Report is set out in the following table :-

Chapter	**Subject Matter**	**Recommendations/Remarks**
1	Corporate Governance Review	The proposals made on Directors, Shareholders and Corporate Reporting by the SCCLR in its Consultation Paper on Phase I of its Corporate Governance Review and the public responses to these proposals.
2	A Review of Part XI of the Companies Ordinance on the Registration of Companies Incorporated Outside Hong Kong	Members agreed to amendments to Part XI of the Companies Ordinance.

3	Corporate Regulation - Enforcement of the Companies Ordinance	Members endorsed proposals to explore the need and options for enhanced corporate regulation in Hong Kong.
4	Netting by Deposit Insurance Scheme	Members endorsed a system for full netting under the proposed Deposit Insurance Scheme.
5	"The HAMS Proposal"	Members were not prepared to endorse the HAMS proposal.
6	Section 207 of the Companies Ordinance Change of Title of "Committee of Inspection" to "Liquidation Committee"	Members were not prepared to endorse the proposal at this stage.
7	Section 155C of the Companies Ordinance Directors' Duty to Shareholders regarding Prospectus or Statement in Lieu	Members agreed that section 155C of the Companies Ordinance should be amended to exclude its application to listed companies.
8	Proposed Amendments to Certification and Translation Requirements in the Companies (Forms) Regulations	Members endorsed proposals to amend Regulations 3, 6(a) and 6(f) of the Companies (Forms) Regulations.
9	Delegation of Authority to Amend Schedules to the Companies Ordinance	Members endorsed a proposal to amend the authority in sections 30(2C) and 43(7) to amend the Second and Fourth Schedules of the Companies Ordinance.
10	Proposed Amendments to the Companies Ordinance to Facilitate Electronic	Members endorsed further proposals to amend various sections of the Companies Ordinance to facilitate

	Incorporation	electronic incorporation.
11	Proposed Amendments to the Conveyancing and Property Ordinance (Cap 219) Execution of Conveyancing Documents by Corporations	Members were not prepared to endorse either of the two proposals set out in the Consultation Paper.
12	Removal of the Restriction on Numbers of Partners	Members endorsed proposals to remove the restriction on numbers of partners in section 345 of the Companies Ordinance and section 3 of the Limited Partnerships Ordinance.

Chapter 1

Corporate Governance Review

Background

1.1 Members continued their review of corporate governance in Hong Kong through the Directors, Shareholders and Corporate Reporting Sub-committees. The sub-committees held a total of 11 meetings culminating in a draft paper for consideration by the full SCCLR which set out the first phase of a set of proposals to improve the standard of corporate governance in Hong Kong. Each sub-committee is awaiting the results of the four research and survey projects commissioned by the Financial Services Bureau[3] (FSB) to assist members of the sub-committees in their work on the review. At the 155th meeting, members considered a draft of the SCCLR's Consultation Paper on the proposals made in Phase I of its Corporate Governance Review. The draft Paper explained the inception of the review, its structure, scope, direction, policy considerations, the review programme, its future work and its request for submissions on the proposals. The Paper set out the issues considered by the three sub-committees and their proposals on each of these issues which are summarized below.

[3]"Called "Financial Services and the Treasury Bureau" since 1 July 2002"

Directors

Directors' duties

1.2 In the absence of any great uncertainties in the law with regard to the duties of directors, the SCCLR did not see the need to enact these duties into statute. However, it was agreed that it would be useful to draft a non-statutory code and action has been taken to do this.

Voting by directors in relation to directors' self-dealing

1.3 The law should set out the general position which is that an interested director should not vote at a board meeting on a matter in which he has an interest. The extent to which the articles of a company should be permitted to allow a director to be exempted from his duty to abstain from voting should be statutorily amended. Disclosure of interests should be on an ad hoc as well as a general basis.

Shareholder approval for connected transactions of significance involving directors

1.4 The law should be amended to obtain the approval of disinterested shareholders in relation to transactions or arrangements of a requisite value involving directors or persons connected with directors.

Transactions between directors or connected parties with an associated company

1.5 The listing rules relating to connected party transactions should be extended to an "associated company" and not limited to "subsidiaries". An "associated company" for these purposes, should be defined as one in which the listed company controls the exercise of 20% or more of the voting rights of the equity share capital.

1.6 The Companies Ordinance should require the approval of disinterested shareholders in relation to transactions involving directors or connected persons and an associated company.

Nomination and election of directors

1.7 Subject to the results of the further studies and consultations :-

(a) Statutory requirements are needed to ensure the effective circulation of notices relating to a nominee proposed by shareholders in time for the date fixed for election.

(b) There should be a requirement that the biographical details of a candidate for a directorship be given to shareholders in a timely fashion.

(c) Cumulative voting on election of directors should be encouraged.

Role of the independent director

1.8 The role of the non-executive director, independent or otherwise, should not be set out in statute but in codes of best practice.

Shareholders

Self-dealing by controlling shareholders

1.9 Subject to de minimis and other exceptions, connected transactions must be disclosed and subject to a disinterested shareholders' vote, with interested shareholders abstaining from voting to ensure procedural fairness. Voting must take place by poll.

Derivative action

1.10 A statutory derivative action should be introduced to make it clear that shareholders may commence a derivative action on behalf of a company on the grounds of fraud, negligence, default and breach of duty without leave of the court.

Unfair prejudice

1.11 Section 168A should be expanded to enable the court to award damages,

interest thereon and costs by way of remedies to shareholders or former shareholders at the time the cause of action arose in circumstances of unfair prejudice. The court's existing powers, particularly that to order a buy-out of a minority interest, should be retained and the section should apply to Part XI companies.

Personal rights

1.12 The law should be clarified so that an individual member can enforce all rights in the memorandum and articles of association as personal rights. The recommendations are contained in the Companies (Amendment) Bill 2002.

Orders for inspection

1.13 A statutory method, on application to the court, by which shareholders can obtain access to company records should be provided, subject to the prescribed safeguards.

Other powers of the court

1.14 Injunctions for breaches of the Companies Ordinance and of fiduciary duties should be provided. The court should have a general power, on application by an affected person or, a relevant authority, to grant an injunction against any contravention of the Companies Ordinance.

1.15 The court should have a general power to order costs in statutory derivative actions as well as unfair prejudice actions.

1.16 These powers should be applicable in cases involving oversea companies registered under Part XI.

The role of regulators

1.17 The Securities and Futures Commission (SFC) should, without court approval, be empowered to bring derivative actions on behalf of listed companies including overseas companies listed in Hong Kong in the interests of both the public and the company.

Corporate Reporting

Filing of financial statements

1.18 Private companies with limited liability should file their financial statements with the Companies Registry (CR) for public inspection. This would enable parties, such as suppliers and creditors of private companies to have better access to financial information on private companies and have a better assessment of the risks inherent in their dealings with these companies.

Management discussion and analysis (MD & A)

1.19 The Listing Rules on MD&A should be amended to include more qualitative and forward looking disclosure.

Inconsistencies between the audited financial statements and other financial information contained in the directors' report and other sections of the annual report

1.20 The Companies Ordinance should be amended to enable auditors to report on any inconsistencies between the audited financial statements and financial information contained in the directors' reports.

Accounting reference date

1.21 The Companies Ordinance should be amended to provide for an accounting reference date, an accounting reference period and a financial year.

Standards setting process

1.22 The membership of the Financial Accounting Standards Committee and Accounting Standards Committee of the Hong Kong Society of Accountants (HKSA) should be widened to include more lay people in order to increase the credibility of the standards set by these committees.

Body to investigate financial statements

1.23 A body similar to the Financial Reporting Review Panel in the United Kingdom should be set up as a means of strengthening the regulatory framework for financial reporting.

Quality of audit practice and monitoring of audit practice

1.24 Public comment was sought on possible improvements to the HKSA's Practice Review and in particular the standard and frequency adopted.

Revision of audited financial statements and related matters

1.25 Where it comes to the directors' attention that there are material misstatements in the financial statements, which have been laid before a company in general meeting and filed with CR, a warning document should be filed with the CR to prevent further reliance on these statements. If directors refuse to do so, the law should allow the auditors to file such a document.

Present Position

1.26 At the 159th meeting, members examined 53 submissions from institutions, academics, lawyers, accountants, bankers and other interested members of

the community on the proposals made in the Consultation Paper in Phase I of the Corporate Governance Review.

1.27 Members noted that a large majority of opinion considered that private companies were mainly in single ownership and care ought be taken to avoid requiring such companies to be governed in the same way as "public/listed" companies even though such companies may be wholly-owned subsidiaries of "public" companies. It was noted that certain large undertakings were run by private companies with more diversified ownership, in particular, second or third generation family owned companies. It was felt that it was necessary to maintain the balance between the good governance of private companies and over restrictive governance which may have an adverse effect on the conduct of business in Hong Kong.

1.28 Members agreed that proposals for the thresholds relating to shareholders' approval for connected transactions of significance involving directors and self-dealing by connected shareholders be coordinated with similar proposals being made by the Stock Exchange of Hong Kong (SEHK) at that time. The Directors Sub-committee should review the proposals concerning transactions between directors or connected parties and associated companies. The proposal that private companies filed financial statements should not be pursued.

1.29 Arising from the Corporate Governance Review, a Joint Government and

HKSA Working Group was set up to undertake a comprehensive review of the accounting and auditing provisions of the Companies Ordinance. It held its first meeting on 19 March 2002.

Chapter 2

A Review of Part XI of the Companies Ordinance on the Registration of Companies Incorporated Outside Hong Kong

2.1 At the 155th meeting, members considered a report of a sub-committee set up by the SCCLR to examine Part XI of the Companies Ordinance to review the registration of companies incorporated outside Hong Kong. The report was approved with minor amendments suggested by members.

Background

2.2 At the 148th meeting, members asked the Registrar of Companies to form a sub-committee to examine Part XI of the Companies Ordinance and to report thereon to the SCCLR within one year. The principal recommendations of the working group are summarized as follows :-

- First, to confirm that the test for registration under Part XI of the Companies Ordinance was to be the "establishment of a place of business" rather than the test of "carrying on business" in Hong Kong.

- Secondly, section 333 should be substantially restructured to

make it clearer and more user friendly.

- Thirdly, all oversea companies should be required to file full annual returns every year together. The filing fees should be on a sliding scale to discourage the filing of late returns.

- Fourthly, oversea companies which are required to file audited accounts in their home jurisdictions would be required to do so in Hong Kong.

- Fifthly, the definition of "place of business" in section 341 should be removed and replaced with a definition which states that a place of business does not include institutions or bodies specified by the Registrar of Companies in a new schedule to the Companies Ordinance. The first category of such bodies would be the representative offices of banks authorised, under the Banking Ordinance, by the Monetary Authority.

- Sixthly, the requirement to register charges will apply only to charges given by companies registered under Part XI.

2.3 Whilst members agreed with most of the recommendations, they did not consider it appropriate to delete section 333C from the Ordinance.

They also felt that the Registrar of Companies should further consider the need for annual returns filed by oversea companies to set out full details of an oversea company as this would act as a check and balance on the conduct and the affairs of an oversea company. Members did not agree with the recommendation to delete section 337B (6) because this section authorised an oversea company to apply to the court to review the CR's decision under that section.

Chapter 3

Corporate Regulation

Enforcement of the Companies Ordinance

3.1 At the 156th meeting, members considered a discussion paper prepared by the FSB[4] to explore the need and options for enhanced corporate regulation in Hong Kong. It was agreed that :-

(a) A more pro-active approach should be taken to enhance public education of the rights of the shareholders, their entitlements under the existing regime, including the bodies to which complaints could be lodged;

(b) The inspection provisions in the Companies Ordinance should be closely examined;

(c) Consideration should be given as to whether and, if so, how arrangements should be made available in-house to prepare for possible requests for preliminary investigations under section 152A of the Companies Ordinance;

[4] "Called "Financial Services and the Treasury Bureau" since 1 July 2002"

(d) In the light of the low number of complaints received by the Companies Registry and bearing in mind the objective to reduce the size of the civil service, it would be difficult to justify setting up another agency to pro-actively detect breaches of the Companies Ordinance;

(e) The offences and punishments in the Companies Ordinance should be reviewed.

Background

3.2 The FSB's paper outlined the requirements for companies incorporated in Hong Kong and those incorporated outside Hong Kong which established a place of business here and fell under the category of oversea companies under Part XI of the Companies Ordinance. It did not address any issues relating to the regulation of listed companies under the SEHK Listing Rules or the Takeover Code or otherwise outside the Companies Ordinance. It itemized the various offences under the Companies Ordinance which were categorized into filing and non-filing offences, considered how these are dealt with by the CR and the Commercial Crime Bureau, and the extent to which the CR is able to monitor the filing of documents, which have to be filed according to a specific statutory time-table, and handles complaints made to the CR. The paper also considered sections 142 to 149 of the Companies Ordinance which deal with the investigation of the company affairs by independent inspectors appointed by the Financial Secretary,

sections 152A to 152F of the Companies Ordinance which give the Financial Secretary the power to require a company to produce books and papers to a person appointed by the Financial Secretary, and sections 29A and 37A of the Securities and Futures Commission Ordinance which deal with the commission's powers to require production of records and documents and make applications to court in cases of unfair prejudice. A comparison of the corporate regulation regimes in the United Kingdom, Australia and Singapore was also given.

3.3 The paper noted that the enforcement of the provisions in the Companies Ordinance is mainly complaint driven and, to a large extent, relies on shareholders' and creditors' awareness of their rights and their willingness to take action. Although a number of company inspections have been initiated in the past, they may not be the most effective or efficient procedures to seek redress. Furthermore, the avenue of preliminary investigations under section 152A had never been invoked while the effectiveness of investigations by liquidators may also be limited in the sense that, in most cases, it only provided a limited remedy (disqualification orders) for the aggrieved parties, usually a long time after the event.

3.4 Members discussed the issues raised in the paper and agreed that the FSB should proceed with the way forward as recommended in the paper.

Chapter 4

Netting by Deposit Insurance Scheme

4.1 At the 156th meeting, members approved a system for full netting under the proposed Deposit Insurance Scheme (DIS).

Background

4.2 Members considered a Discussion Paper on Netting by Deposit Insurance Scheme prepared by the Hong Kong Monetary Authority (HKMA). The paper explained that it was proposed that a DIS should be introduced into Hong Kong to cover bank failures where depositors were also bank borrowers. It was important for the HKMA to be advised on whether the scheme should adopt a system of partial or full netting of liabilities due by the depositor to the bank against his claims on the bank in respect of insured deposits. Partial netting means that "past due" items and contractually due items are netted off against deposits and the balance of the insurance monies are paid to the depositor to the amount insured, with any amounts, not yet due, being disregarded. Under full netting, one sets off all liabilities due by the depositor and pays him the net amount up to the amount insured. Canada and the USA have adopted partial netting whereas the United Kingdom and certain regional schemes adopt full netting.

4.3 The main argument for partial netting is that the future obligations of a

depositor will not be accelerated by the failure of the bank. This will help a customer's cash flow and hence the effectiveness of the DIS in preventing rumour driven bank runs. If the DIS paid the depositors, it would be able to subrogate itself up to the amount paid to the depositor in the liquidation. However, the DIS may not be able to claim the full amount it has paid to the depositor since full netting would be applied by the liquidator. This may result in higher costs for the DIS. Although this problem could be addressed by amending the insolvency legislation, changes to the insolvency legislation in favour of the DIS may mean that the interests of other creditors (including uninsured depositors) might be affected since the amount of assets of a failed bank available for appropriation to creditors is a fixed sum.

4.4 Members considered that bank customers would benefit more by a full netting scheme where their deposits amounted to more than the loans made to them because the netting off would extinguish the liquidator's claim against the depositor although the depositor would be able to make a claim against DIS or the liquidator in respect of the remaining net amount due under the deposit. It was felt that the full netting scheme would be more in line with current insolvency laws and fairer to depositors.

Chapter 5

"The HAMS Proposal"

5.1 At the 157th meeting, members considered a discussion paper entitled "The HAMS Proposal" but were not prepared to endorse the proposals.

Background

5.2 Mr David M Webb introduced a paper entitled "The HAMS Proposals" which proposed the creation of a body called the Hong Kong Association of Minority Shareholders (HAMS). This emphasized the imbalance in the market place of corporate governance in Hong Kong. This was not unusual in other markets which were dominated by family or government controlled public companies. In the USA or the United Kingdom, major corporations generally have a dispersed ownership of institutional and retail investors rather than controlling shareholders comprising an individual or a single family. In such a market place, conflicts of interest disappear and the close alignment of the interests of the shareholders and the directors enables the shareholders to reflect their views to the board in a forceful manner so that the board can conduct the affairs of the company to maximize the value of the equity. Directors have an incentive to maximise the value of the publicly held equity to deter predators from attempting a takeover. Their share options, which are often a significant part of the directors' personal net worth, also provide incentives them to maximise shareholder value. These factors ensure a close

alignment of the interests of directors and public shareholders (with the notable exception of boardroom pay), and a free flow of information to shareholders well above the regulatory minimum.

5.3 Mr Webb said that he was not suggesting a drastic change in the ownership structure but instead urged that a system be found which brought public shareholders into the governance system on a level footing with the issuers and controlling shareholders. There were many factors affecting the non-activity of minority shareholders in the governance process. For example, little is achieved by the "bottom-up" action of attending a general meeting and being outvoted continually by a controlling shareholder, so a "top-down" approach to legal and regulatory reform is needed to enhance the standards of Corporate Governance; asset managers affiliated with commercial banks or investment banks having conflicts of interest, as criticism of corporate clients is not good business; the analysis of proposed new securities and companies laws and changes to regulations such as the Listing Rules, Accounting Standards and Takeover Code is not a simple exercise and needs expert advice; and the prohibition of class actions in Hong Kong other than by way of a derivative action which require up front funding with only partial refunding of costs if successful, and in such actions the award goes to the company which may still be controlled by the offending party.

Outline of the HAMS Proposal

5.4 The HAMS proposal envisaged the setting up of a body that would be funded

by a levy on all stock market transactions that would be called the Good Governance Levy. The membership of the body would be open to all investors at a comparatively small fee. The HAMS body would be under the direction of a board elected by the membership. The HAMS body was to have 3 functions. There would be a policy division whose task it would be to promote and lobby for better laws and regulations. There would a corporate governance rating division that would assess each and every company on a continuous basis in relation to corporate governance issues. Finally there would be an enforcement division that would comprise skilled lawyers and other professionals who would be expected to take legal proceedings against those companies and individuals. The aim would be to deter bad corporate governance by well-funded litigation.

5.5 As it was not be possible to fund HAMS sufficiently from private means, it was necessary to seek approval from Government to impose a "Good Governance Levy" of 0.005% on every stock market transaction which would have to be prescribed by legislation. This would amount to approximately $20 per year for every investor with investments of $200,000 if they turned it over once per year. Global and local asset mangers, by publicly endorsing the HAMS Proposal, had indicated their support for this measure as the payback from better governance will be far greater than the levy.

5.6 Members had a lengthy discussion with Mr Webb on various aspects of the HAMS proposal. Their principal areas of concern were the proposed levy to

be charged by HAMS on every stock market transaction, the lack of safeguards available against the abuse of the powers which would have to be given to HAMS, the monitoring of HAMS by its members and the possible duplication of the roles of HAMS and the regulatory functions of the Securities and Futures Commission. These areas of concern are discussed further in the following paragraphs.

Accountability and Governance

5.7 A crucial part of the HAMS proposal is public funding through a statutory levy on all stock exchange transactions i.e. a tax. While the proposed levy might be low in percentage terms, the amount that is proposed should be raised and allocated by HAMS is substantial (HK$200 million or more). However, the proposed governance structure of HAMS envisages a board of directors elected by members but quite independent of Government, despite the fact that it is to be funded by a significant amount of public monies. In other words, it would be a privately-owned and controlled but publicly-funded body. Members of the committee considered that this would be highly undesirable and not something which they could recommend. Members considered that if such a body were to be publicly funded, it would have to be publicly accountable. If the HAMS body were to be publicly-accountable, it would need to be established as a statutory body with consequential Government involvement in the constitution of the board and statutorily defined lines of accountability and responsibility. As a result of the discussion, it was clear that the HAMS proposal of an

independent body was incompatible with the requirement of public accountability for the use of public funds.

Membership

5.8 The levy would have to be paid by all investors irrespective of whether or not they subsequently joined HAMS. However, the board of governors would be elected only by those investors who decided to become members i.e. HAMS would not be representative of all members of the investing public. There would also be uncertainty as to whether the membership would, in practice, monitor the performance of HAMS, particularly given the lethargy of retail investors in monitoring the companies in which they had shares.

Levy

5.9 Hong Kong's transaction costs are some of the most expensive in the world and a further levy would only increase these at a time when ways of reducing these costs were being examined. In addition, HAMS's alleged independence may be compromised each year by having to persuade the Government to continue the levy.

Duplication of the SFC's role and resources

5.10 The SFC is already funded by a levy on stock market transactions. It has statutory powers to intervene as and when appropriate on behalf of minority shareholders which will be enhanced under proposals made in the context of

the Corporate Government Review. Consequently, the proposed enforcement role of HAMS would duplicate work which is already the SFC's responsibility. Furthermore, if the object of HAMS is to improve corporate governance, the emphasis should be on 'prevention' rather than 'cure' as, by the time that a case needs to be taken to court, it is too late to take any effective action against the abuse in question without substantial expenditure on court costs with no certain result.

Alternatives

5.11 Notwithstanding the problems inherent in the HAMS model, members were supportive of shareholder activism as an important catalyst to improve corporate governance in Hong Kong. However, they considered that, if HAMS were to be set up, it should take the form of a privately funded organization which would monitor corporate governance standards in Hong Kong and lobby, where appropriate, for improvement. Possible models for such an organization exist in the shareholder activist groups in Australia, Malaysia and New Zealand which are funded by lump sum grants from institutional investors and members' subscriptions.

Chapter 6

Section 207 of the Companies Ordinance

Change of Title of "Committee of Inspection"

to "Liquidation Committee"

6.1 At the 158th meeting, members agreed that this matter ought to be postponed and reconsidered when the SCCLR examined the role and functions of a Committee of Inspection in more detail.

Background

6.2 The Official Receiver introduced a paper on this subject which proposed that the title of a "Committee of Inspection" be changed to a "Liquidation Committee" as recommended by the Law Reform Commission in its Report on the Winding-up provisions of the Companies Ordinance published in July 1999.

6.3 Members considered the matter to be more complicated than a mere change of name and that it ought to be discussed more thoroughly. It involved the awkward relationship between the members of such a committee and a liquidator. The role of a Committee of Inspection should be a supervisory role as indicated by its current name. It was felt that the name of the committee should be discussed as part of a full consideration of the

structure, role and functions of a Committee of Inspection.

Chapter 7

Section 155C of the Companies Ordinance

Directors' Duty to Shareholders regarding

Prospectus or Statement in Lieu

7.1 At the 158th meeting, members agreed that section 155C should be amended to exclude listed companies from the obligation to send a copy of the prospectus or statement in lieu, delivered to the Registrar of Companies, to each person who is a member of the company.

Background

7.2 Members considered a paper prepared by the Mass Transit Railway Corporation concerning section 155C of the Companies Ordinance. This section imposed a duty on all Hong Kong incorporated companies to send a printed copy of any prospectus or statement in lieu it issued to each of their existing shareholders. This obligation placed a very expensive burden on Hong Kong companies with a large shareholder base whereas other jurisdictions only require the prospectus to be made available at a "viewing facility" e.g. on both the internet or in printed form at the SEHK or the company's registered office. As the section only applies to companies incorporated in Hong Kong, it is more difficult and more expensive for them, compared with companies incorporated elsewhere, to raise finance. In order

to avoid the expense and difficulties associated with section 155C and the need to comply with the prospectus contents requirement, it has become standard practice in Hong Kong for Hong Kong incorporated companies to incorporate offshore subsidiaries to issue debt securities to professional investors.

7.3 It was also pointed out that section 155C came into operation before the inception of the CCASS system. In view of this, it is now very unlikely that prospectuses or statements in lieu will come to the attention of the majority of a listed company's shareholders.

7.4 Members noted that as a listed company was obliged under the Listing Rules to disclose material information in any event, the repeal of section 155C would not have any effect upon this. However, as unlisted companies would not be covered by the Listing Rules, it was considered more appropriate to exclude listed companies from section 155C rather than repealing the section so that unlisted companies would remain bound by it.

Chapter 8

Proposed Amendments to Certification and Translation Requirements in the Companies (Forms) Regulations

8.1 At the 158th meeting, members agreed with proposals to amend Regulations 3, 6(a) and (f) of the Companies (Forms) Regulations.

Background

8.2 The Registrar of Companies introduced a paper which set out proposals to amend the Companies (Forms) Regulations to expand the category of persons who can carry out the certification of documents and translations delivered for registration at the CR on behalf of oversea companies. Representations had been received by the CR from presenters of documents delivered for registration on the difficulties of complying with certification requirements under the Regulations.

8.3 The proposed amendments to the Regulations were as follows :-

(a) Regulation 3 - to expand the category of persons who can carry out the certification process, whether that certification process is carried out in or outside Hong Kong.

(b) Regulation 6(a) - to expand the category of persons who can carry out the certification of the competency of persons making translations of the specified documents, where the translation is made outside Hong Kong.

(c) Regulation 6(f) - to expand category of persons who can carry out the certification of the competency of persons making translations of the specified documents where the translation is made in Hong Kong.

8.4 After discussion, members agreed with the proposed amendments.

Chapter 9

Delegation of Authority to Amend Schedules to the Companies Ordinance

9.1 At the 158th meeting, members agreed with revised proposals on the appropriate level of authority to whom the amendment of the schedules of the Companies Ordinance ought to be delegated. In view of this, sections 30(2C) and 43(7) of the Companies Ordinance should be amended so that the authority to amend the Second and Fourth Schedules respectively be delegated from the Chief Executive in Council to the Financial Secretary.

Background

9.2 At the 153rd meeting held on the 9th December 2000, members considered a review undertaken by the Registrar of Companies of the statutory delegation of authority to amend the schedules of the Companies Ordinance but were unable to agree on the appropriate level of delegation at this meeting.

9.3 After further discussion, it was agreed that, with the exceptions of the Second and Fourth Schedules, the level of delegation to amend the Schedules should remain unchanged.

Chapter 10

Proposed Amendments to the Companies Ordinance to Facilitate Electronic Incorporation

10.1 At the 160th meeting, members accepted further proposals by the Registrar of Companies to amend various sections of the Companies Ordinance to facilitate electronic incorporation.

Background

10.2 At the 149th meeting held on 20 May 2000, members agreed that the specified form to incorporate a company could be signed digitally by any two founder members named in the form or, in the case of a one member company, by that founder member, using digital certificates issued by a recognized certification authority, such as the Hong Kong Post.

10.3 A discussion paper had been prepared by the Registrar of Companies proposing to include various items in the new specified form to be used for the incorporation of a company when the CR was able to accept applications electronically. It proposed that the term "subscribers" be replaced with the term "founder members" whenever it appears in the Companies Ordinance. It was also proposed that sections 6 and 12 of the Companies Ordinance be amended to dispense with the need to witness the

signatures of the founder members in both the Memorandum and Articles of Association wherever the specified form and the Memorandum and Articles of Association are submitted electronically and have been authenticated by each founder member in such manner as is directed by the Registrar of Companies.

10.4 The paper also proposed that the address of the company's intended first registered office be set out in the application form instead of, as is presently required, within 14 days of incorporation. It was also proposed that the names and particulars of the first directors and secretary should be stipulated in the form in order to give a more complete picture of the new company's "make-up" and again obviate the need to file a return of the first directors and secretary and a statement of their consent to act as is currently provided in Form D3. If such a proposal was accepted, a separate provision in the Companies Ordinance would be required in relation to the deeming of the appointment of the first directors and secretary from the date of incorporation. An amendment was required to section 16 of the Companies Ordinance to cover any possible conflict between the incorporation form and the appointment of directors or secretary contained in the Articles of the Association of the company.

Chapter 11

Proposed Amendments to the Conveyancing and Property Ordinance (Cap 219) Execution of Conveyancing Documents by Corporations

11.1 At the 160th meeting, members were not prepared to endorse either of the two proposals set out in the discussion paper to deal with problems of proof of title concerning the execution of conveyancing documents by corporations.

Background

11.2 The discussion paper stated that many conveyancing documents executed in the past on behalf of corporations were attested by a single director in such a manner that it may not in future be possible to prove or presume due executions. As a result, many vendors were unable to prove good title to their property. The Law Society proposed that the Conveyancing and Property Ordinance be amended by the addition of a further presumption under a new section 23A whereby a deed or other instrument (whenever executed) relating to conveyancing purporting to be executed by or on behalf of a corporation aggregate shall be presumed, until the contrary is proved, to be duly executed.

11.3 The Department of Justice put forward a possible alternative approach. It

considered that the essential question appeared to be, whether, in any particular circumstances, a good or secure title could be passed despite formal defect in execution (including a lack of appearance of due execution) in the chain of title. The problem, if dealt with by legislation, might be more appropriately dealt with by way of a provision (to be retrospective) which dealt specifically with the matter of good title in all the circumstances rather than solely with due execution. Under such a provision, where there was no appearance of due execution on the face of the assignment (so that the existing presumption under section 23 of the Conveyancing and Property Ordinance was unavailable), it would nevertheless be presumed, until the contrary is proved, that good title was conveyed under an assignment notwithstanding a formal defect in its execution where, in the circumstances, it appeared beyond reasonable doubt that the vendor intended to vest title in the purchaser and that there was no real risk that the assignment would be set aside in future proceedings.

11.4 Members considered that the proposed amendments were more likely to benefit solicitors who had failed to check title properly than their vendor or purchaser clients. They also did not think it useful to single out conveyancing documents for this purpose.

11.5 Members agreed that the execution of company documents should be the same for all types of transaction without exceptions being made in respect of conveyancing documents. They also agreed that the matter could be

rectified by the adoption of a system of registered title and title insurance.

Chapter 12

Removal of the Restriction on Numbers of Partners

12.1 At the 160th meeting, members agreed that the restriction of the 20 partner limit contained in section 345 of the Companies Ordinance and section 3 of the Limited Partnerships Ordinance should be abolished.

Background

12.2 Section 345 of the Companies Ordinance and section 3 of the Limited Partnerships Ordinance limit the size of a partnership to 20 persons. Section 345 of the Companies Ordinance contains an exception for partnerships carrying on the professions of solicitors, accountants, stock brokers and those specified in regulations made by the Chief Executive in Council which are allowed an unlimited number of partners.

12.3 In this regard, Hong Kong had followed the provisions of English Company Law imposed in the 19th century because, at that time, all members of a partnership had to be joined in an action which, as the partnerships grew larger, caused many problems for those suing such partnerships. This has now been remedied, in Hong Kong, by Order 81 of the Rules of the High Court.

12.4 Members took into account various factors, in particular the reasons for the

restriction were outdated and unnecessary; the restriction placed an unnecessary burden on business by preventing the expansion of business by the introduction of new partners; and the restriction stifled flexibility and its removal would provide greater flexibility for investors in the private equity sectors. Members were unable to find any specific reason for retaining the limit on the number of persons in a partnership.