

CHAPTER 5

REGISTRATION OF CHARGES

Background

- 5.1 The present law on the registration of charges is set out in Part III of the CO, sections 80 to 91. A company is obliged to send to the Registrar for registration particulars of every charge created by it that falls within the list of registrable charges set out in section 80(2).
- 5.2 The original instrument⁴⁴ (if any) by which the charge is created or evidenced must be delivered along with the prescribed particulars of the charge. The Registrar compares the charge document with the filed particulars and is required to issue a certificate of due registration if satisfied that the particulars are in order. Currently, it usually takes the CR nine working days to process an application for registration. If particulars are not submitted for registration within five weeks from the date of creation of the charge⁴⁵, then the company and its every officer in default is liable to a fine and, for continued contravention, a daily default fine. In practice, registration is done on the application of the charge holder whose economic incentive is stronger⁴⁶; failure to register means that the charge is void against the liquidator and any creditor of the company to the extent that it confers any security over the company's property or undertaking. There is a facility for registration out of time but this necessitates an application to the court.

General Considerations

- 5.3 There are a number of justifications that support the existence of statutory registration requirements in respect of charges created by companies. The main consideration is the provision of information for persons who wish to assess the financial position of the company, such as credit reference agencies, prospective charge holders, investors and financial analysts, who are able to ascertain from the register whether or not the

⁴⁴ In the case of a charge created out of Hong Kong comprising property situated outside Hong Kong, the delivery of a copy of the instrument creating the charge verified in the prescribed manner is sufficient for the purpose of registration.

⁴⁵ In the case of a charge created out of Hong Kong comprising property situated outside Hong Kong, the particulars and instrument creating the charge (or copy) should be delivered for registration within five weeks after the date on which the instrument (or copy) could, in due course of post, and if dispatched with due diligence, have been received in Hong Kong.

⁴⁶ The charge holder is also entitled to recover from the company the amount of any fees paid to the Registrar in connection with the registration.

assets of the company are encumbered. The registration requirement is also a key test for a receiver or liquidator in considering whether to acknowledge the validity of a charge.

- 5.4 The Hong Kong system for the registration of charges created by companies is largely based on the UK registration scheme. The UK-type registration is often compared with its US equivalent, a notice filing system which merely provides that a security interest may exist without definitively establishing its existence⁴⁷. Fully adopting the US system would require reform beyond the realm of company law. This would not be within the scope of this legislative exercise.
- 5.5 It appears that the existing regime has been working well and therefore, we do not recommend substantial changes or radical redesign. In this connection it should be noted that the CA 2006 has rearranged the present structure of the registration of charge provisions but no changes of substance have been made⁴⁸.
- 5.6 It may also be noted that the fundamentals of the UK system are also followed in other common law jurisdictions like Australia, Singapore and Ireland, though with some differences in detail. We have considered but rejected some of the changes considered or adopted in the UK or other jurisdictions as these changes are either unnecessary or inappropriate in the Hong Kong context. The proposed changes which we suggest **not to adopt** include:
- (a) comprehensively codifying the law on priorities where there is more than one charge over the same property created by a company;
 - (b) introducing an advance or provisional registration system;
 - (c) providing a legislative clarification of the kinds of retention of title clause that constitute a registrable charge;
 - (d) registering sale or absolute assignment of book debts (or receivables);
 - (e) registering pledges;

⁴⁷ The latter, which derives from Article 9 of the US UCC, provides a filing regime for all security interests regardless of whether the provider of the security is a company, some other form of business organisation or indeed an individual. The UK and Hong Kong registration schemes apply only where the security provider is a company. It should be noted however that New Zealand has moved over to a US-style registration system and a similar move is presently being considered in Australia though the outcome of the Australian review is far from certain. In England, the Law Commission proposed a form of notice filing system that would apply to traditional security interests as well as to sales of receivables (see the Law Commission Final Report (2005, Law Com No 296, Cm 6654)). The proposal met with a considerable amount of resistance from practitioners and has not been adopted.

⁴⁸ The Scottish system is somewhat different from the English system and the differences will increase with the implementation of the Scottish Bankruptcy and Diligence Act 2007.

- (f) registering trust receipts if they operate for more than a specified period of time;
 - (g) registering insurance policies; and
 - (h) registering fixed charges on shares (and other marketable securities).
- Our reasons are discussed briefly in **Appendix V**. On the other hand, we consider that a number of improvements may be made to the list of registrable charges and the registration procedure. These proposals are set out in paragraphs 5.7 to 5.35 below.

Question 6

- (a) Do you agree that the changes listed in Appendix V should not be adopted in Hong Kong?**
- (b) If not, please specify which of the changes you think should be introduced in Hong Kong and the reasons.**

Updating the List of Registrable Charges

5.7 The existing approach in the CO is to set out a list of registrable charges. We recommend the retention of this approach. We advise against adopting the alternative of an inclusionary or negative listing approach which would seek to make all charges registrable except those which would be specifically excluded. One of the major reasons is that it could create uncertainties as it might include a lot of complex financial transactions which are not registrable at the moment⁴⁹. Nevertheless, some updating to the list of registrable charges could be considered.

Item to be considered for inclusion

Aircrafts

5.8 While a charge on a ship or share in a ship is already registrable under section 80(2)(h), the list of registrable charges does not include aircrafts and interests in them and we recommend its extension in this fashion.

⁴⁹ Also the current system appears to be familiar to practitioners who do not seem to have encountered any major problems and the negative listing approach does not offer any effective solutions to the problems arising from the listing approach (for example, there would be definitional problems under both options and both options entail the need to regularly update the list of charges registrable or excluded).

Question 7

Do you agree that charges on aircrafts and interests in them should be made registrable?

Items to be considered for deletion

Charges Securing Issue of Debentures

- 5.9 We would like to invite views on whether section 80(2)(a) (along with sections 80(7) and (8)), which requires registration of charges securing the issue of debentures, should be deleted on the ground that it duplicates some other heads of registrable charges. Typically, issues of debentures are supported by a floating charge, or a fixed charge that is registrable by virtue of some other categories of registrable charges.
- 5.10 Moreover, section 80(2)(a) is not free of ambiguity since it is not altogether clear whether it catches the issue of a single debenture. This is because “debenture” is generally understood to refer to a document evidencing indebtedness and, whilst this section uses the term in the plural, the rules of interpretation provide that, unless the contrary intention appears, words in the plural include the singular. The effect of this could be to make almost every charge registrable, since a charge almost always exists to secure an indebtedness. However, that could not have been the legislative intent since it would render the other heads of registrable charges superfluous.
- 5.11 It is more likely that section 80(2)(a) is intended to refer to debt securities, hence the phrase “issue of debentures”. The definition of “debenture” in section 2 of the CO as including “debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not” does not statutorily change the position for Hong Kong as the definition is an inclusive one.
- 5.12 An alternative to deletion of the provision would be to clarify and redraft the statutory language along the lines recommended in the Diamond Report⁵⁰ in the UK. If one followed this approach, then the phrase used in section 80(2)(a) to describe an issue of debentures would follow the wording employed in section 80(7) which deals with the formalities of

⁵⁰ The full name of the Diamond Report is “A Review of Security Interests in Property” (HMSO, 1989). This is a report commissioned by the UK Department of Trade and Industry and which influenced the provisions of Part 4 of the UK Companies Act 1989 reforming the law relating to the registration of company charges. Part 4, however, was enacted but never implemented and has since been repealed by the CA 2006.

registration where a company creates “a series of debentures containing, or giving by reference to any other instrument, any charge to the benefit of which the debenture holders of that series are entitled *pari passu*”. As this in effect provides no further information other than merely clarifying the present practice, we do not recommend pursuing this line.

Question 8

Should section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures be deleted on the ground that it is redundant?

Bills of Sale

- 5.13 Section 80(2)(c) provides that a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale, is a registrable charge. It has been commented that the term “bill of sale” is antiquated and somewhat unclear in its coverage though essentially it means a charge over goods but subject to a long list of exceptions. Two approaches have been suggested to deal with this issue. One approach might be to update the provision along the lines of section 262(3) of the ACA⁵¹ which makes registrable a charge on personal chattels created or evidenced by instrument but with a list of exceptions that essentially mirrors the effects of the bill of sale legislation.
- 5.14 There is a view however that the provision is superfluous in the company context⁵² since charges on goods may not exist in isolation, being usually coupled with a floating charge over a company’s entire undertaking. Whatever is caught by the provision, after the exclusions are taken into account, may be largely irrelevant as a form of security in the Hong Kong context. The other approach therefore might be to delete section 80(2)(c) altogether as the reference to “bill of sale” is out of date and it is doubtful if there are any justifications for keeping it. The SCCLR is in favour of this approach although it should be noted that charges over goods continue to be registrable in other comparable jurisdictions like the UK⁵³, Australia and Singapore⁵⁴. We would like to hear the views of the public

⁵¹ Available at <http://www.comlaw.gov.au>

⁵² Bills of Sale under the Bills of Sale Ordinance (Chapter 20), which excludes companies (section 26), are themselves almost obsolete. To be effective against third parties, they should be registered in the High Court. The average number of registrations is about 10 per year.

⁵³ See section 860(7)(b) of CA 2006.

⁵⁴ See section 131(3)(d) of SCA.

before taking a final view.

Question 9

Would you prefer the reference to “bills of sale” in section 80(2)(c) of the CO to be:

- (a) retained as is;**
- (b) retained but clarified along the lines of section 262(3) of the ACA; or**
- (c) deleted?**

Item to be considered for clarification

Definition of Book Debts

- 5.15 We are of the view that the reference to “book debts” in section 80(2)(e) should be retained. However, we would like to invite views on whether a definition of “book debts” should be provided in the CO, and if so, whether it should be defined along the lines of section 262(4) of the ACA. The provision reads as follows: “The reference in...to a charge on a book debt is a reference to a charge on a debt due or to become due to the company at some future time on account of or in connection with a profession, trade or business carried on by the company whether entered in book or not, and includes a reference to a charge on a future debt of the same nature although not incurred or owing at the time of the creation of the charge but does not include a reference to a charge on a marketable security, on a negotiable instrument or on a debt owing in respect of a mortgage, charge or lease of land”.
- 5.16 The argument against defining “book debts” statutorily is that the term does not lend itself to a ready definition. Not defining it would also allow its meaning to evolve through future case law.
- 5.17 Regardless of whether the term “book debts” is to be defined in the CO, we recommend that it be clarified that a lien on subfreights is not within this head or indeed any other head of registrable charge. Essentially a lien on subfreights is a provision in the charterparty (lease) of a vessel stating that the shipowners shall have a claim upon all amounts due under sub-charterparties for payments in respect of the headcharter. The provision gives the shipowner the personal right to intercept sub-charter payments before they reach the charterer but the provision nevertheless seems to lack the proprietary characteristics of a charge⁵⁵. Registration

⁵⁵ Lord Millett in *Re Brumark Ltd: Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 at paragraph 41.

is also inconvenient from a commercial perspective since charterparties are usually negotiated by shipbrokers and not by lawyers and are normally of a relatively short duration.

- 5.18 We also suggest that cash deposits be expressly excluded from this head of registrable charge. “Cash deposits” could arguably be classified as a book debt. This type of charge should be excluded from registration as it is normally taken over credit balances with financial institutions, or charge-backs with another bank. Third party creditors would not be misled by the absence of registration since bank accounts are usually operated confidentially and it is reasonable to expect the depositary bank to have a superior claim to the credit balance. Moreover, charge-backs would ordinarily mirror the effect of a set-off which also does not require registration.

Question 10

- (a) Would you prefer the term “book debts” to be statutorily defined or left to the courts to define?**
- (b) If your preference is for a statutory definition, would you agree to a definition along the lines of section 262(4) of the ACA, or some other (please specify)?**
- (c) Do you agree that a lien on subfreights and cash deposits should be expressly excluded from the registration requirement?**

The Registration Procedure

Obligation to Register

- 5.19 Under the current law, the obligation to register particulars of a charge is imposed on the company creating the charge and not on the charge holder. It has been suggested that the law should be changed so as to make charge holders responsible for registering on the basis that such change actually reflected what is being done in practice. Nevertheless, it is considered that the obligation to register charges should remain with the company. This obligation should be treated in the same way as reporting changes in directors, secretary or other relevant information about the company where the onus is on the company. The company has a responsibility to maintain its records up-to-date. It is also appropriate to retain the criminal penalties on the company for failure to register charges.

Acceleration of the Payment Obligation

5.20 Under the current law, if particulars of the charge are not submitted for registration within the requisite period, the amount secured becomes immediately repayable. We note that automatic statutory acceleration of repayment as provided in section 80(1) of the CO may create problems for banks. Suggestions have been made that a discretion would be provided to the lender either to demand repayment or to waive statutory acceleration especially since the CO already contains provisions for late registration of charges. Accordingly, we recommend that the CO should be amended to provide that the lender has a right, but not a duty, to demand immediate repayment of the amount secured by the charge should a company fail to register a charge within the prescribed time.

Question 11

Do you agree that the automatic statutory acceleration of repayment in section 80(1) of the CO should be replaced with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time?

Registration of Instrument of Charge and the Issue of Incorrect Particulars

5.21 We believe that there is a strong case for reforming some of the mechanics of the registration process to streamline the whole process. The CO currently lays down an obligation to submit the instrument of charge along with prescribed particulars. The Registrar compares the particulars with the instrument of charge and, if satisfied that the particulars are correct, issues a certificate of due registration which is conclusive evidence that all the requirements as to registration have been complied with. The information appearing on the register that is open to public inspection is that gleaned from the particulars. Currently, the instrument of charge itself does not appear on the register and cannot be searched in this manner.

5.22 We suggest that there is considerable merit in registering the instrument of charge itself together with some simple particulars on a prescribed form⁵⁶. The implementation of this recommendation increases the amount of information that is available for public inspection as the whole instrument of charge will be made available for inspection. In this regard,

⁵⁶ Particulars that are required in the prescribed form may include basic information about the company, particulars of the chargee and date of creation of the charge.

companies or charge holders will have to exercise their own judgement in drafting the instrument if they do not want to include commercially sensitive information in the instrument. Currently, registration of the particulars of a charge merely gives constructive notice of the existence of the charge and does not give constructive notice of the contents of a charge instrument. If the charge instrument itself is registered, it may constitute constructive notice of all the terms in the charge instrument, including negative pledge clauses, to those who may reasonably be expected to search the register, such as banks, financiers and relevant professionals.

- 5.23 Moreover, with the implementation of an electronic filing system, the registration of the charge instrument and the prescribed particulars could be made easier and more efficient on an operational level. Registering the instrument would also assist in diminishing reliance on the particulars.
- 5.24 Conversely, if it is considered not desirable to file the instrument of charge, an alternative approach could be to follow the Singaporean approach where the filer is required simply to deliver the prescribed particulars. While the Singaporean registration office may require the instrument of charge to be produced for inspection, this is not done as a matter of course.
- 5.25 No matter which approach is adopted, the company and the charge holder are the ones most familiar with the charge details. It is their duty to record and verify the particulars entered into the prescribed form against the instrument of charge. The Registrar does not have any additional knowledge about the transaction, and the CR serves as the depository rather than the verifier of the details. We therefore consider it logical that the Registrar should no longer check or verify the particulars entered into the prescribed form and should only issue a receipt rather than a certificate of due registration. The receipt would certify that the particulars and the instrument (if required) have been submitted on a particular date. Such an approach would have the merit of shortening the whole registration process and reducing the ‘invisibility’ period so that other parties have access to the information sooner.

Question 12

- (a) Do you agree that both the instrument of charge and prescribed particulars should be registrable and open to public inspection?**
- (b) Do you agree that the Registrar should no longer issue a certificate of due registration, but a receipt showing the particulars submitted for registration, as well as the date on which the instrument of charge (if required) and the particulars are submitted for registration?**

5.26 As an additional measure to ensure accuracy in the particulars delivered for registration, it is for consideration if the charge holder should be precluded from relying on rights to security in excess of those referred to in the particulars. This proposal is modeled on a provision in the UK Companies Act 1989 but the provision is not retained in the CA 2006⁵⁷. It could be argued, however, that since the instrument of charge will appear on the register (subject to the acceptance of the proposal in Question 12(a)), searchers, typically banks and legal professionals etc., should themselves be able to verify the information in the particulars against the instrument of charge. Therefore, we are of the view that this additional step is unnecessary.

Question 13

If the charge instrument is not registrable as an answer to Question 12(a), should the charge holder be precluded from relying on rights to the security in excess of those referred to in the particulars submitted for registration?

Time Limits for Registration

5.27 There is an obligation to submit details of a charge for registration within five weeks from the date of the creation of the charge⁵⁸. The five-week period compares with 21 days in the UK. As we are proposing streamlining the registration procedure (see paragraphs 5.21 to 5.25 above), we are minded to recommend that the five-week period should be shortened to minimise the period where a charge is “invisible” to outside

⁵⁷ Part 4 of the UK Companies Act 1989 reforming the law relating to the registration of company charges was enacted but never implemented and has since been repealed by the CA 2006.

⁵⁸ See footnote 45 above.

parties. We therefore invite views on whether 21 days is the most appropriate period.

Question 14

- (a) Do you agree that the period to register a charge should be shortened?**
- (b) If so, do you think that 21 days is an appropriate period?**

Late Registration of Charges

- 5.28 If a charge has not been registered within the time required pursuant to section 80 of the CO, section 86 gives the court jurisdiction to make an order allowing late registration. The court may exercise the discretion to sanction late registration if the omission was accidental, or due to inadvertence or some other sufficient causes, or is not of a nature to prejudice the position of creditors or shareholders of the company, or on other grounds it is just and equitable to grant relief.
- 5.29 Where the court grants relief, it may do so upon such terms and conditions as seemed to be just and expedient. Although the court allows late registration applications in most cases without prejudice to the rights of intervening creditors, there are circumstances that applications are denied. Generally, where the company is in liquidation or in imminent liquidation, the court may refuse the order⁵⁹. The court would also serve as arbiter prior to registration if there are objections to the late registration by third parties such as liquidators or creditors.
- 5.30 There are about 10 late applications each month out of a total number of some 3,000 to 3,500 charges registered. Given that most late registration applications have been dealt with by the court on paper without a hearing, there has been a suggestion that the requirement of having to apply to the court for late registration should be abolished. Instead, it is suggested that applications for late registration could be submitted to and administered by the CR in lieu of the court. To prevent a substantial increase of cases of late registration as a result of introducing the new administrative mechanism, a higher late registration fee could be introduced.

⁵⁹ In the absence of exceptional circumstances, the court is unlikely to grant an order for extension of time for registration where the company whose property has been charged has commenced liquidation. Also, the imminence of liquidation of the company is a relevant factor to be considered by the court.

5.31 One possible option of an administrative mechanism is for late registration to be granted automatically but subject to two provisos:

- (1) late registration would be made without prejudice to parties with rights against the property of the company that forms the subject matter of the charge and who have acquired such rights before the charge is actually registered; and
- (2) late registration should be deemed to be ineffective (i.e. the charge is void against the liquidator and creditors of the company) if the company goes into insolvent liquidation within a certain period after the actual registration of the charge unless the charge holder relying on the late registration establishes that the company was solvent at the time that the charge was registered.

5.32 The first proviso mirrors the effect of the proviso normally attached to orders currently given by the court permitting the late registration of charges. Judicial interpretation of the proviso shows that only proprietary rights holders and hence secured, but not unsecured, creditors are protected. The second proviso tries to reflect what the court might order under normal circumstances. In particular, it would guard against the possibility of charge holders connected with the company (such as directors) not registering their charges and then making a late registration application when the company is about to go into liquidation. The specified period could be kept relatively short, say, 6 months or less, so as to minimize any possible uncertainty for the charge holder.

5.33 Nevertheless, there are two main concerns about such an administrative mechanism. Firstly, unlike the existing regime under which all charges which appear on the register are effective, there will be uncertainty over whether some of the charges as registered are effective until expiry of the specified period. The charge holder may be disadvantaged in certain situations as a result of such uncertainty. For example, under the current system, while the charge holder may be asked by the court to establish at the point of a late registration application that the company is not insolvent, the task would be less onerous than presenting retrospective evidence after a lapse of time. It may also be difficult for the charge holder to secure the necessary assistance or cooperation from the company to prove its solvency, especially at a time when the company in question has gone into insolvent liquidation. Secondly, the proviso in paragraph 5.31(2) could not fully replicate the current discretionary power exercised by the court. For example, the proviso excludes the possibility of a late registration being valid even if the company is insolvent at the

time of late registration when it would have been in the interests of the company and its unsecured creditors to do so⁶⁰.

- 5.34 A variant of the proposed administrative mechanism is to require an application for late registration to be supported by a statement in a specified form by the company's directors that no winding-up petition has been presented and that no meeting has been convened to pass a resolution for a creditors' voluntary winding-up petition⁶¹. Late registration would then be granted subject to the proviso in paragraph 5.31(1) only. It would remove the uncertainty for the charge holder mentioned in paragraph 5.33 above but would fail to address concerns about connected charge holders registering charges late when they realise that the company is on the verge of going into liquidation.
- 5.35 In view of the above complexities, we would like to hear views on the idea of replacing the court procedure for late registration by a purely administrative one before deciding whether to develop the proposal and incorporate it into the White Bill for further public consultation.

Question 15

- (a) What are your views on the viability and desirability of introducing an administrative mechanism for late registration of charges?**
- (b) If you think an administrative mechanism is desirable, what should be its essential features?**

⁶⁰ There is an overseas example where the court exercised such discretion – *Re Chantry House Developments plc* [1990] BCLC 813.

⁶¹ In the UK, the CLRSG suggested that late registration should be possible without application to the court provided that, at the time of registration, no winding-up petition had been presented and no meeting had been convened to pass a resolution for a creditors' voluntary winding-up petition. See *Modern Company Law for a Competitive Economy: Final Report* at paragraph 12.76. However, the recommendation has not been adopted in the CA 2006.