

## PART 4

### SHARE CAPITAL

#### Introduction

1. **Share capital** means the money paid into the company (or legally promised as being available on call) by members for shares in the company. The current rules relating to share capital require companies having a share capital to have a **par value (or a nominal value)** ascribed to their shares (the requirement for par value). The rules also require that the capital so raised must be kept in the company, and used for the purposes of its business only, and must not be returned to shareholders except in restricted circumstances (the **capital maintenance rules**).
2. The complex provisions on “share capital” and “debentures” are currently set out in Part II (sections 37 to 79) of the CO. To make the law more user-friendly and readable, the provisions will be reorganised into three smaller parts in the CB. The core concepts about “share capital”, its creation, transfer and alteration will be set out in Part 4. Those provisions relating to capital maintenance rules and debentures will be transferred to Part 5 and Part 7 respectively. The provisions on prospectuses in the CO (sections 37 to 44B, 48A in Part II and Part XII) will be dealt with in a separate review by the SFC and will be transferred to the SFO in due course.

- The significant changes to be introduced under this Part are highlighted below:
  - (a) **Adopting a mandatory system of no-par for all companies with a share capital, with a transition period of 24 months;**
  - (b) **Removing the power of companies to issue share warrants to bearer;**
  - (c) **Extending the requirement of shareholders’ consent for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares;**
  - (d) **Clarifying certain concepts relating to class rights;**

- (e) Extending the statutory provisions for variation of class rights to cover companies without a share capital; and**
- (f) Requiring a company to deliver to the Companies Registry a return or notification including a statement of capital whenever there is a change to its capital structure.**

## **Significant Changes**

- (a) Adopting a mandatory system of no-par for all companies with a share capital, with a transition period of not less than 24 months**

### *Background*

3. Par value (also known as nominal value) is the minimum price at which shares can generally be issued. Currently, companies incorporated in Hong Kong and having a share capital are required to have a par value ascribed to their shares<sup>1</sup>. There is no essential difference between a share of no par value and one having a par value. The par value does not serve the original purpose of protecting creditors and shareholders, and may, to some extent, even be misleading.
4. Retiring the concept of par would create an environment of greater clarity and simplicity, particularly in accounting treatment of share capital, that would be desirable for the business community generally. Jurisdictions that have adopted mandatory no-par shares include Australia, New Zealand and Singapore. During the public consultation conducted during June to September 2008, there was majority support for the proposal to adopt a mandatory system of no-par. We intend to give companies at least 24 months from the enactment of the CB to review their documents before the conversion is effected<sup>2</sup>.

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<sup>1</sup> Section 5(4) of the CO.

<sup>2</sup> FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (February 2009), paragraphs 5 to 10 (available at [http://www.fstb.gov.hk/fsb/co\\_rewrite](http://www.fstb.gov.hk/fsb/co_rewrite)).

## Proposal

5. **Clause 4.2** effectively abolishes the concept of nominal value. From the “appointed day” (see **Clause 4.71**), a company’s shares will have no nominal value. This will apply to all shares, including shares issued before the appointed day which is to be appointed by the FS by notice in the Gazette. The appointed day is intended to be at least 24 months after the enactment of the CB. This is to allow companies time to review and amend their documents where necessary.
6. **Clause 4.38** empowers a company, by resolution in general meeting, to alter its share capital in a number of ways set out in sub-clause (2). The clause is a modified version of existing section 53 of the CO. In addition to the alterations allowed under section 53, the new provision allows a company to capitalise its profits without issuing new shares and to allot and issue bonus shares without increasing share capital. This is one of the advantages of no-par shares.
7. Companies will continue to be able to effectively consolidate and subdivide shares. Whilst there is no nominal amount to be divided for no-par shares, a similar result to subdivision can be achieved by increasing the number of shares. The process of consolidating shares into a smaller number should be considerably simplified where there are no par values to contend with. The number of shares will just reduce with no visible effect on the share capital.
8. Without par, there will no longer be share premium and there will no longer be a need to distinguish between share capital and share premium, and consequently to account for them separately. **Clause 4.78** is a legislative deeming provision for the amalgamation of the existing share capital amount with the amount in the company’s share premium account (and also capital redemption reserve) immediately before the migration to no-par share capital.
9. To avoid hardship to companies existing before the appointed day which would lose the permitted uses of share premium that they enjoyed prior to the migration to no-par, a transitional provision **Clause 4.79** is introduced to preserve substantially the currently permitted uses of the share premium for the amount standing to the credit of the share premium account before the migration to no-par. As for the position after the migration to no-par,

**Clause 4.17** provides that on or after the appointed day, a company may apply its capital in writing off the preliminary expenses of the company, commission paid or any other expenses of any issue of shares.

10. **Subdivision 2 of Division 9 (Clauses 4.76 to 4.81)** contains transitional provisions relating to the move from nominal value shares to shares having no nominal value. The provisions are intended to provide legislative safeguards to ensure that contractual rights defined by reference to par value and related concepts will not be affected by the abolition of par. For example, **Clause 4.81** is a statutory deeming provision, which will save considerable work, expense and time for companies and reduce the possibility of disputes. Nonetheless, even with the transitional provisions, individual companies may still wish to review their particular situation to determine if they need to introduce more specific changes to their documents having regard to their own unique circumstances.
11. There will also be modifications to the provisions on merger and group reconstruction relief following the migration to a no-par regime as there will no longer be any share premium in a no-par environment<sup>3</sup>. **Clauses 4.62 to 4.66** modify sections 48C to 48E to apply the merger relief to any excess of the value of the equity shares acquired or cancelled over the subscribed capital of the acquired company attributable to the shares acquired or cancelled. Group reconstruction relief will apply to the excess of the value of the assets transferred over the net base value of the assets transferred<sup>4</sup>.
12. The proposal to legislate for no-par will not affect companies incorporated off-shore as they will continue to be governed by the law of their place of incorporation. Where there are Hong Kong legislation or rules that apply to these companies, such as the SFO and Listing Rules, these can be amended to accommodate both par and no-par value shares to address the fact that the shares of some of these off-shore incorporated companies could still have par value.

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<sup>3</sup> Sections 48C to 48E of the CO provide relief from a company's obligation to transfer amounts to the share premium account where:

- (i) shares are issued at a premium as consideration for the transfer or cancellation of another company's shares in the context of a merger; and
- (ii) shares are issued at a premium as consideration for the transfer of assets in the context of a group reconstruction.

In the case of mergers, the relief extends to the whole of the premium. However, in the case of group reconstructions, it is limited to any excess over the base value of the assets transferred.

<sup>4</sup> The proposal was supported by the majority of respondents in the public consultation conducted in June to September 2008. See the Consultation Conclusions mentioned in footnote 2, paragraphs 14 to 17.

13. The proposal to remove the requirement for authorised capital which is also related to the migration to no-par is discussed in the Explanatory Notes on Part 3. There are certain provisions that will apply only in the 24-month transition period between the enactment of the CB and the commencement of the no-par regime. These provisions will be the equivalent provisions of the CO that refer to or are based on the concepts of nominal value, share premium, capital redemption reserves and authorised capital. For example, sections 49A(1)(b), 49A(2), 49A(4), 49G(1), 49H, 49I(4) and (5), 49Q(2)(b), 49R(2) and (3), 58(1A) and (3). Since these provisions will only be relevant during the transition period, they are not currently included in the draft CB but they will be finalised and included in the CB, when it is introduced in the LegCo.

**(b) Removing the power of companies to issue share warrants to bearer**

*Background*

14. Under section 73 of the CO, a company limited by shares is allowed to issue “share warrants to bearer” – i.e. a warrant stating that the bearer of the warrant is entitled to the shares specified in it. It is possible for legal title to shares to pass merely on the delivery of the warrant. Share warrants are undesirable from the perspective of anti-money laundering because of the lack of transparency in the recording of their ownership and the manner by which they are transferred.

*Proposal*

15. **Clause 4.7** repeals a company’s power to issue “share warrants to bearer” but provides that such share warrants issued prior to the commencement of that clause would be grandfathered so that upon the surrender of such existing share warrants, the bearer’s name will be registered in the company’s register of members. The clause partially re-enacts section 97 of the CO, to provide for the surrender of share warrants. **Clause 4.72** provides that the records in the register of members in respect of existing share warrants would be preserved until the share warrants are surrendered.

- (c) **Extending the requirement of shareholders' consent for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares**

Background

16. The allotment of shares is generally carried out by directors, but under section 57B of the CO, they are only entitled to do that with the prior approval of the company in general meeting. There are only two exceptions to this rule, namely: (i) a rights issue; and (ii) an allotment to the founder members (sections 57B(1) and (7)). The requirement of shareholder approval (save in the two circumstances set out above) is mandatory and notwithstanding any provision in the company's articles to the contrary.
17. However, section 57B only requires shareholder approval for the allotment of shares. The grant of an option to subscribe for shares or a right to convert any security into shares would not be within the scope of section 57B, but the subsequent exercise of the option or the right of conversion which would result in an allotment would require shareholders' approval.
18. It would not be prudent for a company to issue an option for unissued shares or a security convertible into new shares without the prior approval of its shareholders for the subsequent allotment, but strictly the CO does not require shareholders to give such prior approval. To enhance the protection of minority shareholders against dilution, it is proposed that the requirement of shareholder approval for allotments of shares be extended to the grants of rights to subscribe for, or to convert securities into, shares. If approval is given for the grant of an option, there would not be a need to obtain further approval of the allotment of shares pursuant to that option.

Proposal

19. **Clause 4.8** provides that the power of the directors of a company to allot shares, as well as to grant rights to subscribe for, or convert any security, into shares cannot be exercised except in accordance with **Clause 4.9**. Apart from the two original exceptions (i.e. rights issue and allotment to founder members), there is an additional exception that applies to an allotment of shares, or grant of rights, on a bonus issue of shares. **Clause 4.9** provides for a company to give approval for its directors to allot shares,

or grant rights to subscribe for, or convert any security, into shares. This is done by resolution of the company in general meeting, in advance of the allotment or grant of rights. Similar to section 57B(3), the approval would expire at the conclusion of the next AGM. As all companies are now allowed to dispense with AGMs subject to meeting certain conditions, **Clause 4.9(3)(b)** has also provided for the time when an approval will expire in case a company is not required to hold an AGM.

**(d) Clarifying certain concepts relating to class rights**

*Background*

20. Sections 63A and 64 of the CO set out the requirements for a variation of class rights of shareholders. The CO does not presently define the concept of class rights. There may be an issue as to whether class rights: (1) are rights attached to shares only<sup>5</sup>; (2) include rights conferred on individuals in a capacity other than as a member or shareholder of the company<sup>6</sup>; or (3) include rights that are not attached to any particular shares but are conferred on the beneficiary in the capacity as member or shareholder of the company<sup>7</sup>.

*Proposal*

21. For companies with share capital, the provisions on class rights under **Subdivision 1 of Division 7** refer to “rights attached to shares in a class of shares” (e.g. **Clause 4.48**). **Clause 4.45** clarifies that references to the rights attached to a share in a class of shares are references to the rights of the holder of the share as a member of the company. The intention is that the second and third categories of rights referred to in the preceding paragraph are excluded from the concept of class rights under the CB. To provide further guidance on the meaning of a class of shares, **Clause 4.46** provides that shares are in a class if the rights attached to them are in all respects uniform. However, they are not regarded as different only because the shares do not carry the same rights to dividends in the first 12 months immediately after allotment.

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<sup>5</sup> These are rights attached to particular shares which are not enjoyed by others, for example, ‘dividends and rights to participate in surplus assets on a winding up’.

<sup>6</sup> *Eley v Positive Government Security Life Assurance Co Ltd* (1875) 1 Ex D 20, is an instance of this. There the articles stipulated that Eley shall be the company’s solicitor.

<sup>7</sup> An example of this would be pre-emptive rights conferred upon a shareholder where these rights are not attached to any particular shares but conferred on the shareholder by name.

22. For a company without a share capital, **Clause 4.54** clarifies that references in the CB to the rights of members of a company are references to the rights of the members in their capacity as members of the company. **Clause 4.55** establishes when members of a company are in a class. Members are in a class if the rights of the members are in all respects uniform.
- (e) **Extending the statutory provisions for variation of class rights to cover companies without a share capital**

### Background

23. Sections 63A, 64 and 64A of the CO only provide for variation of class rights for companies with a share capital. The CO is silent on how members' rights may be varied in the case of companies without a share capital. It would seem that this would largely depend on whether provision has been made in the articles of association<sup>8</sup> for their variation but this is clearly less than satisfactory.
24. The same problem existed in the UK Companies Act 1985 but this was remedied in the UKCA 2006 which extends the statutory provisions on variation of class rights of companies with a share capital to companies without a share capital (section 631). The CB will likewise provide for the variation of class rights for companies without a share capital.

### Proposal

25. **Subdivision 2 of Division 7 (Clauses 4.53 to 4.60)** provides for variation of class rights for companies without a share capital. The provisions mirror the corresponding provisions in **Subdivision 1 of Division 7 (Clauses 4.44 to 4.52)**, which applies to companies with a share capital. **Clause 4.56** sets out the procedural requirements for the variation of the rights of a class of members of a company that does not have a share capital. **Clause 4.57** requires a company that does not have a share capital to notify each class member if the rights of the class are varied (the corresponding provision for companies with a share capital (**Clause 4.49**) is a new requirement). **Clause 4.58** allows members amounting to at least 10% of members of the class to apply to the Court of First Instance to have a variation of the rights of the class disallowed. **Clause 4.60** requires a company that does not have

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<sup>8</sup> Provisions contained in the memorandum of association of existing companies are deemed to be contained in the articles of association on and after the commencement of the CB.



a share capital to notify the CR of a variation of the rights of a class of members within one month after the variation takes effect.

- (f) **Requiring a company to deliver to the CR a return or notification including a statement of capital whenever there is a change to its capital structure**

*Background*

26. A statement of capital is in essence a “snapshot” of a company’s total subscribed capital at a particular point in time. We will require a company to deliver to the Registrar such a statement to be contained in a return or notification, whenever there is a change to its capital. For instance, in the context of an allotment of shares or a permitted alteration of share capital under **Clause 4.38**, a statement of capital will show the company’s share capital information as at the time the company has so changed its share capital. This new requirement enhances the existing requirements for notification to the CR of changes of a company’s share capital. This will ensure that the public register contains up-to-date information on a company’s share capital structure. A similar requirement for a company to submit a “statement of capital” when there is a change to its capital structure has been introduced under the UKCA 2006.

*Proposal*

27. **Clause 4.69** sets out the information to be contained in a statement of capital. Other provisions in the Part (such as **Clauses 4.10, 4.39, 4.41, 4.43** and **4.52**) require a company to include a statement of capital in a return or notice delivered to the CR. A statement of capital must state the total number of issued shares in the company and the total amount paid and unpaid (if any) on them. Where the share capital is divided into classes, the statement must also contain particulars of the rights attached to shares of each class, the total number of issued shares of each class and the total amount paid and unpaid (if any) on issued shares of each class.

## Other Changes

### (a) **Providing expressly that a company may redenominate its share capital from one currency into another**

28. Whilst a company incorporated under the CO may issue foreign currency shares, it cannot easily convert its existing share capital into another currency. If a company wishes to redenominate its share capital into a different currency it is likely to find that an equivalent amount in the new currency would create shares expressed in awkward fractions of the new currency.
29. In order to create shares in the new denomination with whole numbers, the company would need to denominalise its shares as well, that is change the nominal value of each share. The process requires a cancellation of issued shares or buying back its existing shares (the shares it wants to redenominate) and an issue of new shares with a different denomination. These difficulties arise because there is no provision in the CO which deals specifically with the redenomination of issued share capital.
30. Under a no-par system, although there would not be a need to provide for the renominalisation of the shares, it would still be useful to have formal provisions in the CB on the denomination and redenomination of share capital.
31. **Clause 4.3** provides that a company's shares may be denominated in any currency. It further provides that shares of different classes in a company may be denominated in different currencies.
32. **Clause 4.40** empowers a company to convert its share capital, or any class of its share capital, from one currency to another currency. This power may be exercised on or after the appointed day for the introduction of shares having no nominal value. A redenomination does not affect any rights or obligations of members under the company's articles or any restrictions affecting members under the articles, and in particular does not affect any rights to dividends, voting rights or liability in respect of amounts unpaid on the shares.

**(b) Removing the power of companies to convert shares into stock**

33. “Stock” is a fund that has a nominal value equivalent to that of the total of the shares so that a member, instead of holding particular identified shares of 100 shares of \$10.00 each numbered 1 to 100, holds a \$1,000.00 stock. The expression of a holding in terms of dollars or cents seems inappropriate to no-par value shares which are, in substance, no more than fractions of the company’s net worth.
34. The use of “stock” is nowadays uncommon. Although, theoretically, there does not appear to be a reason why stocks cannot be redefined and expressed in number of shares or percentage of participation in a particular company or class of shares, there does not appear to be much practical purpose to this. It is therefore proposed that the concept of stock be abolished. A company which has previously converted shares into stock may reconvert the stock back into shares.
35. **Clause 4.6** repeals a company’s power to convert shares into stock. **Clause 4.42** empowers a company that has converted paid up shares into stock (before the repeal of the power to do so) to reconvert the stock into shares. **Clause 4.43** requires a company that has reconverted its stock into shares under **Clause 4.42** to deliver a notice to the Registrar within one month. The notice must include a statement of capital.

**(c) Clarifying requirements to register an allotment in the register of members**

36. Although in the case of an allotment of shares, section 45 of the CO requires a company to deliver a return of the allotment to the Registrar for registration, there is no express requirement for a company allotting its shares to enter the information on the allotment and the details of the allottees in the register of its members within a specified period.
37. **Clause 4.11** of the CB will require an entry to be made in the register of members within 2 months after the date of the allotment of shares.

**(d) Refusal of registration of shares transmitted by operation of law**

38. **Clause 4.26** provides for a new requirement for a company to send a notice of refusal of registration to a person to whom shares are transmitted to the

person by operation of law and whose registration as a member has been refused. **Clause 4.27** provides that such person may apply to the Court of First Instance for an order to compel registration. These provisions mirror the corresponding provisions for transfer of shares in **Clauses 4.19** and **4.20**.

(e) **Raising the threshold amount in replacement of lost share certificate and publicizing the notice in company’s website**

39. **Division 5** deals with the replacement of listed companies’ lost share certificates. The Division re-enacts the substance of section 71A with a number of improvements.

40. **Clause 4.32** imposes publication requirements on the company before it may issue a replacement share certificate. Notice of intention must be published in the manner required by the law. In certain cases, a copy of the notice must also be served on the registered holder of the shares. The clause re-enacts the substance of section 71A(3) to (5) of the CO, except that the publication requirements are simplified. For cases where the value of shares is below \$50,000 (instead of \$20,000 in the current CO), the notice will be published in the listed company’s website (in both Chinese and English) for one month (instead of in newspapers in the current CO). For cases where the value of shares is at or above \$50,000, the notice will be published in the listed company’s website (in both Chinese and English) for three months and once in the gazette within one month after the company has first published the notice on its own website (instead of publishing the notice in the gazette once in each of three consecutive months under the current CO).

41. The definition of “genuine purchaser”<sup>9</sup> in **Clause 4.30** clarifies that the person to whom the new certificate is issued is excluded from the term. The effect of the definition is to confirm that, under **Clause 4.35**, the Court may make an order under **Clause 12.99** (which gives the Court of First Instance power to make an order for rectification of the register of members) in favour of the original registered owner against the person to whom the new certificate was issued and against any person deriving title from him or her otherwise than as a genuine purchaser without notice.

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<sup>9</sup> The phrase “genuine purchaser” is used in place of “bona fide purchaser” in Division 5 of Part 4.