

CHAPTER 5

NOTICE OF REFUSAL TO REGISTER A TRANSFER OF SHARES

- 5.1 Section 69(1) of the CO requires a company which refuses to register a transfer of shares or debentures to send a notice of such refusal to the transferor and transferee within 2 months of the lodgement of the transfer with the company. There is no requirement for the notice to be accompanied by the reasons for refusal to register the transfer. The existing provision for shares is essentially restated in **Clause 4.19** of the CB. Nevertheless, we would like to hear public views on whether we should introduce a new requirement for a company to give reasons explaining its refusal to register a transfer of shares.

Background

- 5.2 At common law, directors of private companies need not give reasons for their decision whether to accept or reject a transfer,⁴⁰ and their failure to give their reasons, either in the resolution embodying their decision or in evidence at the trial, will not be construed against them⁴¹. A dissatisfied transferor or transferee can attack the directors' decision only if he or she can show that they exercised their discretion for an improper purpose or for a reason outside the grounds for rejecting transfers which are specified in the articles⁴². Unless reasons are voluntarily given by the directors, it may be difficult to challenge the directors' decision.
- 5.3 The position is similar under the CO. Although the right of the transferee to apply to the court to have a transfer of shares registered is provided under section 69(1B), the burden of proving that directors have wrongfully disapproved a transfer would be equally difficult as directors are not required to provide grounds for their refusal.
- 5.4 The position of a transferee of shares by operation of law is different. That person is entitled under section 69(1A) of the CO to call on the company to provide reasons for a refusal to register him or her as member. The company is required to register the transfer if it fails to furnish reasons within 28 days of the request.

⁴⁰ *Duke of Sutherland v British Dominion Land Settlement Corpn* [1926] Ch 746.

⁴¹ *Re Coalport China Co* [1895] 2 Ch 404; Robert R. Pennington, *Pennington's Company Law* (London: Butterworths, 7th edn, 1995), page 1002.

⁴² Robert R. Pennington, *Pennington's Company Law* (London: Butterworths, 7th edn, 1995), page 1002.

Position in the UK

- 5.5 The UKCA 2006 requires a company which refuses to register a transfer (whether of shares or debentures) to give the transferee notice of refusal *accompanied by reasons* as soon as practicable and in any event within two months of lodgement of the transfer (section 771(1)). The transferee has a right to request further information about the reasons for the refusal but such request has to be reasonable, and cannot include a request for copies of meetings of directors (section 771(2)).

Considerations

- 5.6 Where there is a discretion to refuse registration of a transfer of shares, it is for consideration whether directors who refuse to register a transfer should either be required to give reasons (in the manner of the UKCA 2006), or be required upon request to provide reasons (which is currently the position under the CO for transmissions by operation of law).

Pros and Cons

- 5.7 The company's constitution may give directors power in their absolute discretion, or in prescribed circumstances, to refuse to register a transfer of shares, but the discretion is a fiduciary one that must not be exercised fraudulently, capriciously or for a collateral purpose. It is however for the person alleging that the directors' decision is improper to prove it, and this is difficult to discharge if directors are not obligated and do not provide reasons for their refusal to register a transfer. The proposal to require directors to give reasons rectifies this problem, thereby providing for transparency. Giving the reasons may also be helpful to transferors and transferees, particularly when the reason was just because there were pre-emptive rights or the forms were not completed correctly.
- 5.8 However, there is a concern about the proposal in that it will impose a statutory obligation on directors to justify a refusal and would unduly restrict the directors' entrenched right to reject a transfer. This new requirement may encourage litigation, and directors may feel compelled to obtain legal advice before refusing a transfer on discretionary grounds thereby increasing costs. At the same time, it might open a floodgate to dissatisfied transferees, particularly in cases of family disputes. But weighed against this is the transferor's right to transfer the shares, and the transferee's right (as an incident of the transferee's property in the shares) against the company to be registered, which should only be restricted to the extent provided for in the company's constitution and by law, and not otherwise.

- 5.9 The requirement for directors to provide reasons does not mean that family companies can no longer control who can or cannot buy into the shares of the company. It will not interfere with a decision made legitimately, or substitute the court's decision for the directors', made in good faith, as to the interests of the company. The new requirement does not change the legal principles as to whether the directors' refusal to register a transfer is valid or not.
- 5.10 We would like to hear public views before deciding whether to introduce the requirement for a company to give reasons explaining its refusal to register a transfer of shares. In the case of debentures, ownership does not depend on registration and so the debt constituted or evidenced by the debenture is transferred in a manner similar to other choses in action⁴³. For a legal transfer, this will be governed by section 9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23), subject to any restrictions in the terms of the trust deed or agreement. Hence we believe that it is not necessary to introduce the requirement for debentures⁴⁴.

Question 5

- (a) Do you think the CB should make it obligatory for a company to give reasons explaining its refusal to register a transfer of shares?**
- (b) If your answer to (a) is in the affirmative, should the company be required to provide reasons with the refusal:**
- (i) in the manner of the UKCA 2006 (i.e. mandatory whenever there is a refusal); or**
 - (ii) upon request, as in the case of transmissions by operation of law under section 69(1A) of the CO?**

⁴³ Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (London: Sweet & Maxwell, 8th edn, 2008), page 1147.

⁴⁴ For comparison, under section 69(1A) of the CO, a person to whom shares have been transmitted by operation of law is entitled to call on the company to provide reasons for a refusal to register him or her as member. This requirement does not apply to debentures and this position is preserved in the CB.