

Standing Committee on Company Law Reform

The Twenty-Fourth Annual Report

2007/2008

**Standing Committee on Company Law Reform (SCCLR)
Twenty-Fourth Report
Subjects considered by the
Standing Committee during 2007/2008**

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PREFACE

(i)

Terms of Reference of the Standing Committee on Company Law Reform

- (1) To advise the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary.
- (2) To report annually through the Secretary for Financial Services 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 Ordinance¹ 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 2007/2008

Chairman : Mr Benjamin YU, S.C., J.P.

Members Mr Michael W SCALES (up to 31.1.2008)
Mr John POON Cho-ming
Mr David P R STANNARD
Ms Teresa KO Yuk-yin, J.P.
Mr Godfrey LAM Wan-ho, S.C.
Ms Vanessa STOTT
Mr Carlson TONG, J.P.
Mr Paul F WINKELMANN
Mr Patrick WONG Chi-kwong

¹ These two Ordinances were consolidated into the Securities and Futures Ordinance which commenced on 1 April 2003.

Mr Stephen HUI Chiu-chung, J.P.
Mrs Anne CARVER
Mr Felix CHAN Kwok-wai, M.H.
Ms Paddy LUI Wai-yu, J.P. (up to 31.1.2008)
Ms Edith SHIH
Mr Peter W GREENWOOD (from 1.2.2008)
Mr Vincent FAN Chor-wah (from 1.2.2008)

Ex-Officio

Members :

Mr Andrew YOUNG
Chief Counsel, Legal Services Division
The Securities & Futures Commission

Mr Paul CHOW
Chief Executive
Hong Kong Exchanges and Clearing Limited

Mr Charles BARR (up to 9.4.2007)
Department of Justice

Professor Edward L G TYLER (from 10.4.2007)
Department of Justice

Mr E T O'CONNELL
The Official Receiver

Mr Gordon W E JONES, J.P. (up to 26.8.2007)
The Registrar of Companies

Ms Ada CHUNG (from 27.8.2007)
The Registrar of Companies

Mr William RYBACK (up to 31.8.2007)
Deputy Chief Executive
The Hong Kong Monetary Authority

Mr Y K CHOI, J.P. (from 1.9.2007
to 7.12.2007)
Deputy Chief Executive
The Hong Kong Monetary Authority

Mr Stefan GANNON, J.P. (from 8.12.2007)
General Counsel/Executive Director
The Hong Kong Monetary Authority

Mr John LEUNG
Deputy Secretary for Financial Services and the Treasury

Secretary : Mr Edward LAU

(iii)

Meetings held during 2007/2008

Two Hundredth Meeting	-	14 May 2007
Two Hundred and First Meeting	-	16 June 2007
Two Hundred and Second Meeting	-	28 July 2007
Two Hundred and Third Meeting	-	22 September 2007
Two Hundred and Fourth Meeting	-	27 October 2007
Two Hundred and Fifth Meeting	-	8 December 2007
Two Hundred and Sixth Meeting	-	19 January 2008
Two Hundred and Seventh Meeting	-	8 March 2008

EXECUTIVE SUMMARY

The Standing Committee on Company Law Reform (“SCCLR”) was formed in 1984 to advise the Financial Secretary (“FS”) on amendments to the Companies Ordinance (“CO”) and other related ordinances. The SCCLR reported annually to the Chief Executive in Council through the Secretary for Financial Services and the Treasury on amendments that are under consideration.

As in the last year, the main focus of the SCCLR was still on the CO Rewrite exercise commenced formally in mid-2006. From 1 April 2007 to 31 March 2008, the SCCLR held eight meetings and considered altogether 24 papers, including 8 by way of circulation, covering over 400 proposals made by the four Advisory Groups set up to advise on specific topics in the rewrite exercise. Some of the major recommendations endorsed by the SCCLR included the following :-

(I) Seven Guiding Principles for the Rewrite (Chapter 1)

- Cater for the small and medium enterprises (“SMEs”)
- Enhance corporate governance
- Complement Hong Kong’s role as international business centre
- Encourage the use of information technology
- Attempting statutory statements, where appropriate
- Plain drafting and improved layout
- Provide flexibility for future updating

(II) Incorporation of Companies (Chapter 2)

- Abolition of Memorandum of Association
- Empowering the Registrar of Companies (“Registrar”) to act on court orders to direct a “shadow company” to change its infringing name and to substitute that name with its registration number on non-compliance.

(III) Share Capital and Debentures (Chapter 3)

- Abolition of par value
- Removal of requirement for authorized capital
- Introduction of registration requirement for allotment of debentures

(IV) Directors and Officers (Chapter 4)

- Members’² approval for four specific types of transactions, namely –
 - substantial property transactions
 - directors’ long-term service contracts
 - loans, quasi-loans to directors and credit transactions involving directors
 - compensation to directors for loss of office
- Disinterested members’ approval for the above transactions, if the company is a non-private company
- A new definition for “connected persons”
- Prohibition of indemnification by a company or a related company in respect of a director’s liability subject to qualifying third party indemnity provision
- Restricting the appointment of corporate directors for private companies
- Tightened procedure on public availability of residential addresses of directors³

(V) Company Administration and Procedures (Chapter 5)

- Dispensation with annual general meetings (“AGMs”) by unanimous members’ consent
- Introduction of provisions to facilitate electronic communications between companies and members
- Imposition of time limit for passing written resolution
- Lowering of the threshold for the right to demand a poll to five percent of the voting rights
- Defining appointment of proxy as a right for all members of a company
- Imposition of prior appointment requirement for inspection of a company’s record

(VI) Charges (Chapter 6)

- Updating the list of registrable charges
- Introduction of a new charge registration system which requires

² The terms “Members” and “Shareholders” are used interchangeably in this Report. They carry the same meaning.

³ See Footnote 23 below.

registration of the instrument of charge itself together with some simple particulars on a prescribed form

- Replacement of the current certificate of due registration by a receipt showing the date and particulars submitted for registration
- Shortening of the time limit for registration of a charge to 21 days
- Consulting the public on the idea of replacing the current court approval system for late registration of charges by an administrative mechanism

(VII) Arrangement, Reconstructions and Takeovers (Chapter 7)

- Introduction of a court-free statutory amalgamation regime

(VIII) Inspection and Investigation (Chapter 8)

- Clear provision to the effect that the exercise by the FS of his power to appoint inspector should be guided by public interest
- Strengthening of the powers of inspectors and investigators and expansion of the scope of target companies
- Introduction of clear provisions on self-incrimination and informer protection
- Empowerment of the FS to apply to court for wider restraining orders

(IX) Functions of the Registrar of Companies (Chapter 9)

- Clarifying or defining the powers of the Registrar to determine fees, specify requirements on delivery, refuse registration and rectify the register
- Introduction of provisions to facilitate inspection of the register through electronic means
- Clarifying or defining the powers of the Registrar to require a person to update his information on the register
- Streamlining the striking-off procedure for defunct companies
- Extension of the de-registration procedure to all companies, except for certain “public interest” companies
- Introduction of a new administrative restoration procedure for struck-off companies
- Combination of the three routes currently available for restoration of dissolved companies through court application into one

(X) **Offences and Punishment (Chapter 10)**

- Regulatory offences under the CO penalizing officers not to be made strict liability offences
- Introduction of compounding as a new administrative measure for securing compliance of company law obligations
- Introduction of the Registrar's certificate as prima facie evidence of fact as to whether a document has or has not been delivered to the Companies Registry on a particular date for registration

Apart from CO rewrite matters, the SCCLR had also considered a proposal submitted by the Securities and Futures Commission ("SFC") with regard to a withdrawal mechanism in the context of an initial public offer ("IPO") of shares to be listed on the Stock Exchange of Hong Kong Limited ("SEHK"). The SCCLR advised against that proposal on practical grounds and suggested that the focus should be on other more fundamental issues relating to the current IPO system instead of a withdrawal mechanism (Chapter 11).

CHAPTER 1

Guiding Principles for The Rewrite of the Companies Ordinance

Background

- 1.1 The Rewrite of the CO was formally commenced in mid-2006 following the setting up of the Companies Bill Team. The main objective of the exercise was to modernize company law in Hong Kong in order to enhance Hong Kong's competitiveness and attractiveness as a major international financial and business centre.
- 1.2 In order to provide focus and vision to the rewrite as well as to give practical guidance for the formulation of reform proposals, the SCCLR considered and approved a number of guiding principles for the rewrite.

(I) Cater for the SMEs

- The provisions of the CO should be reframed and re-aligned with special regard to the needs of private companies, particularly SMEs, with a view to reduce compliance costs and make it easier for them to comply with legislative requirements.

(II) Enhancing corporate governance

- The rewrite should aim at strengthening corporate governance⁴, taking into account the interests of stakeholders such as members and creditors, and considering other relevant factors, such as corporate social responsibility ("CSR")⁵ initiatives in the company law of comparable jurisdictions. Public companies should be subject to enhanced regulation, where appropriate.

⁴ Building upon the recommendations of the SCCLR in the Corporate Governance Review conducted from 2000 to 2003.

⁵ CSR has been the subject of attention in a number of developed economies over recent years. An example of such an initiative is extending corporate reporting to cover issues on corporate responsibility to environmental and employee matters.

- For listed companies, the new CO should complement the regulatory regime contained in the Securities and Futures Ordinance (“SFO”) (Cap. 571) and the Listing Rules. Any additional requirements for listed companies should generally be provided in the SFO and the Listing Rules in view of the fact that over 80% of listed companies are incorporated outside Hong Kong.

(III) Complement Hong Kong’s role as international business centre

- The rewrite should benchmark Hong Kong against other comparable jurisdictions such as the United Kingdom (“UK”), Australia and Singapore in general while taking into account Hong Kong’s unique business environment and its close economic relationship with the Mainland.

(IV) Encourage the use of information technology

- The new CO should promote the use of information technology, particularly in facilitating communications between companies and their shareholders, members of the public and the regulators⁶, and in encouraging environmentally friendly practices.

(V) Attempting statutory statements

- In appropriate situations, where general principles of law have been clearly established by decided cases, consideration should be given to expressing such principles in the CO by way of statutory statements, bearing in mind the need to allow common law rules to evolve and develop.

(VI) Plain drafting and improved layout

- The language and structure of the new CO should be rationalized, simplified and modernized to make it more readable and understandable without any loss of certainty and precision.

⁶ Regarding communications between the companies and the Companies Registry (“CR”), the CR has started developing the Integrated Companies Registry Information System Phase II, which will include the implementation of electronic filing of applications for incorporation and document registration. It is hoped that Phase II can be implemented in 2010/2011.

(VII) Provide flexibility for future updating

- Schedules, subsidiary legislation or non-statutory codes should be used, where appropriate, to contain detailed requirements to facilitate the regular updating of the law in the future.

CHAPTER 2

Incorporation of Companies

Background

2.1 The SCCLR considered the recommendations made by CO Rewrite Advisory Group 2 (“AG2”) with regard to

- Company formation, registration and re-registration
- Company names

2.2 The key recommendations endorsed by the SCCLR regarding company formation, registration and re-registration included the following :-

(I) Company formation and registration

- The Memorandum of Association of a company should be abolished upon the introduction of electronic incorporation of companies by the Companies Registry (“CR”)⁷.
- There should be provisions in the CO to deal with the authority of directors to bind the company in order to increase the security of third parties dealing with a company, similar to sections 40 and 41 of the UK Companies Act 2006 (“CA 2006”)⁸.
- Entrenchment provisions and related filing requirements which might prohibit the articles of association of a company to be amended over time are unjustified and should not be provided in

⁷ Please see Footnote 6. For additional information, members of the Advisory Group 2 noted that, with the abolition of the ultra vires rule, there was no longer a need to have two separate constitutional documents i.e. the Memorandum and the Articles of Association.

⁸ Section 40 of the CA 2006 is intended to protect third parties dealing with the company in good faith from any internal restrictions contained in, usually, the articles of association which limited the power of the board to act on the company’s behalf. Section 41 operates where a company enters into a transaction to which section 40 applies and the other party to the transaction is a director of the company or its holding company or a person connected with such a director. In such circumstances, the transaction, which might otherwise be enforceable under section 40, is voidable at the instance of the company, subject to certain exceptions as provided.

the CO.

- A court order amending the articles of association or members' resolutions of a company should be required to be filed with the CR.
- The keeping and use of a common seal by a company should be made optional. Where the seal was not used, a company might execute a document as a deed if the document was expressed to be executed as a deed and was executed by two directors of the company; or a director and a company secretary of the company.
- In respect of the power of a company to have an official seal for use abroad, the requirements currently under section 35 of the CO that (i) the objects of the company must require or comprise the transaction of business outside Hong Kong and that (ii) its articles of association had authorised the company to have an official seal, should be abolished.

(II) Re-registration

- A private company should be able to re-register as a non-private company by making application to the Registrar together with supporting documents, including its last audited accounts but not valuation report.
- In the case of a private company re-registering as a non-private company, the requirement to file a prospectus or a statement in lieu of prospectus currently under section 30 of the CO should be removed.
- Non-private companies should be able to re-register as private companies if supported by a special resolution and approved by the Registrar.

2.3 As regards company names, there were two main areas of concern, namely –

- (i) the problems posed by “shadow companies” whose names were very similar to existing well known or registered trademarks or trade names

of other companies so that the companies could easily pose themselves as representatives of the owners of such trademarks or trade names when contracting with Mainland manufacturers to produce counterfeit products bearing such trademarks or trade names, and

- (ii) hybrid company names in the combined form of Chinese characters and English alphabets or words.

2.4 Even though members, when the above issues were considered by the SCCLR in 2005⁹, were mostly of the view that hybrid names should, as a matter of policy, be allowed and that protection of intellectual property rights should not be a factor to be taken into consideration in determining the registrability of a company name, they reached no conclusion at that stage. As a result, they suggested that the matter should be further considered in the context of the CO rewrite.

2.5 Taking into account the administrative measures taken by the Government since 2005 to alleviate the shadow company and hybrid name problems¹⁰, AG2 and SCCLR revisited the two areas of concern and came up with a comprehensive set of recommendations as outlined below.

(I) Company names incorporating trademarks of names registered by other companies (shadow companies)

- The current law and practice in company name registration at the incorporation stage should generally be maintained.
- The Registrar should be empowered to direct a company to change its name when the Registrar was presented with a court order restraining the company from adopting a name that infringed the registered trademark or goodwill of the legitimate

⁹ See Chapter 2, SCCLR's *Annual Report 2005/2006*.

¹⁰ The Government has adopted a number of administrative measures to alleviate the problem, including :-

- (1) enhanced publicity efforts by the Intellectual Property Department and the CR in the Mainland and Hong Kong to promote awareness of the differences between Hong Kong's company registration and trademark registration systems;
- (2) information posted on the CR's website listing those companies which have failed to comply with the Registrar's directions to change name; and
- (3) placement of a warning statement in Certificates of Incorporation and Certificates of Change of Name highlighting the fact that registration of a company name does not confer any trademark or any other intellectual property rights as regards the name on the companies.

owner. If the company did not comply with the Registrar's direction to change its name within a specified period, the Registrar might substitute its infringing name with its registration number.

- The Registrar's consent should be obtained for the registration of a company name which was the same as a company name which he had directed to change and was the subject matter of a court order.
- The time within which the Registrar might direct a company to change its name on the basis that the company name was the same as or too like the name of another company currently under section 22 of the CO should be allowed for a period of 3 months if the objection was lodged within 12 months of the registration date¹¹.
- The Administration should study the possibility of introducing a two-stage mechanism¹² to expedite the company name approval procedure and shorten the incorporation time.

(II) Hybrid names

- Companies should not be absolutely prohibited from registering hybrid names. However, a hybrid name should only be allowed if it could be shown to the satisfaction of the Registrar that there were genuine business needs or commercial reasons for the proposed hybrid name. The Registrar might impose any conditions from time to time for the use of such hybrid names.

¹¹ Issues concerning company names had been included in the topical public consultation exercise launched in April 2008. While putting forward most of the SCCLR's recommendations in this respect to the public for consideration, this recommendation was not pursued further because the Administration considered that the present name changing mechanism under section 22 of the CO was working well and did not see the need to have it changed.

¹² Under the two-stage mechanism, a company name would be accepted for incorporation if it satisfies certain basic requirements, for example, that it is not identical to another name already on the register and does not contain words or expressions on a specified list. The Registrar would thereafter be given the power to direct a company to change its name within a specified period, in case where, upon further checking by the CR, its name is found to be offensive, likely to give the impression of a government connection or contrary to the public interest. The Administration has accepted the idea in principle.

CHAPTER 3

Share Capital and Debentures

Background

3.1 The SCCLR considered and endorsed all the recommendations put forward by CO Rewrite Advisory Group 1 (“AG1”) with regard to

- Par value, authorized capital and partly paid shares
- Debentures

3.2 The key ones are as follows :-

(I) Par value shares

- Par value shares should be abolished. The conversion to the no par value share regime should be automatic for all companies subject to a one year review period.
- There should not be any legislative control over the setting of the issue price of the no par value shares. The control should be left to the exercise of the directors’ general fiduciary duty in setting the appropriate issue price for the shares.

(II) Authorised capital

- The concept of “authorised capital” should be replaced by the maximum number of shares a company could have issued.
- A company should be allowed to change the amount of capital by reference to the number of shares or abolish it by way of an ordinary resolution.

(III) Partly paid shares

- The ability of companies to issue partly paid shares should be retained after the conversion to a no par value share regime. The

amount unpaid would be the difference between the issue price and the amount paid.

(IV) Debentures

- The definition of “debenture” currently in the CO¹³ should be slightly amended so that the scope of which would cover debentures issued by overseas companies, and any other debt securities but not structured products.
- An allotment of debentures by a company should be required to be registered with the CR.
- There should be no restriction on the right of access to the register of debentures holders.
- Meetings of debenture holders should not be statutorily provided for. However, they should be given the right, subject to a certain threshold and exclusion by contractual provision, to apply to the court for a direction to hold a meeting.
- Trustees for debenture holders should be statutorily excluded from liability for anything done (or not done) where they acted in accordance with the directions of a meeting of debenture holders.

¹³ The CO does not actually define a debenture, but the term is provided under 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.”

CHAPTER 4

Directors and Officers

Background

4.1 The SCCLR considered the recommendations made by CO Rewrite Advisory Group 3 (“AG3”) on the following subjects relating to directors and other officers, namely:

- Directors’ conflicts of interest
- Directors’ and auditors’ liabilities, indemnity and insurance
- Public availability of the residential address and number of identification document of directors and secretaries
- Shadow directors
- Appointment of directors and secretaries
- Miscellaneous provisions in the CO relating to directors and secretaries

(I) Directors’ Conflicts of Interest

4.2 The SCCLR made a number of recommendations relating to directors’ conflicts of interest in its Corporate Governance Review¹⁴ carried out during 2000 to 2004. The proposals cover two areas where the conflicts may be particularly acute, namely, directors’ self-dealing and connected transactions involving directors. The SCCLR also recommended that sections 157I of the CO concerning civil remedies for contravention of prohibited loans or similar transactions to directors under section 157H should be further reviewed in the context of the rewrite of the CO¹⁵.

4.3 Taking into account the recent reform in the UK under the CA 2006, AG3 and SCCLR revisited these earlier recommendations. Some of them had been modified as a result. The key recommendations by AG3 as

¹⁴ See Chapter 1 of SCCLR’s *Annual Report 2003/2004*, available at [www.cr.gov.hk/]

¹⁵ See Chapter 2 of SCCLR’s *Annual Report 2003/2004*.

endorsed by SCCLR are summarised below.

(a) **Financial assistance to directors and connected persons**

- There should be a new general exception from section 157H of the CO permitting public companies to make prohibited transactions under that section (such as making loans or quasi-loans) to their directors or persons connected with them if those transactions were approved by the company in general meeting. The new general exception of members' approval should apply to all prohibited transactions under section 157H.
- The approval should be by way of an ordinary resolution (unless the articles of the company provided for a higher majority). For public companies, it had to be made by disinterested shareholders (i.e. the relevant director and the person who received the loan should abstain from voting). The disinterested shareholders' approval requirement should not apply to private companies, no matter whether they are associated with listed companies or not. Nevertheless, the question of treatment of private companies associated with listed companies should be highlighted for public consultation at the Draft Bill stage and reviewed afterwards.
- If the parties involved in the transaction were directors of the holding company or persons connected with such directors, the transaction should also be approved by a resolution of the holding company.
- Non-Hong Kong companies and wholly-owned subsidiaries should be exempted from the members' approval requirement. The exemption for a wholly-owned subsidiary should be premised on the basis that approval at the holding company level would be required.
- As a pre-condition for the passing of a members' resolution for approving directors' self-dealing and connected transactions, a memorandum setting out certain prescribed matters should be made available to members of the company within a certain

timeframe along the lines of relevant provisions in the CA 2006¹⁶.

- A provision covering subsequent ratification of prohibited transactions (as in section 214 of the CA 2006) should be adopted in Hong Kong for all companies. It should be clarified that any subsequent ratification by a members' resolution would not affect the right of prosecution of those offences committed before the ratification.
- The prohibitions on quasi-loans and credit transactions, and the related arrangements in sections 157H(3), (4), (5), (6) and (7) of the CO as well as those in respect of persons connected with a director should apply to public companies only, and no longer apply to those private companies associated with a listed company. The issue should also be highlighted for public consultation.
- The term "connected persons" should be defined along the lines of section 252 of the CA 2006, subject to the following modifications: (a) "adopted children" should be included in the definition of "connected persons"; (b) the term "civil partner" as used in the CA 2006 should not be adopted.
- The formulation in section 254 of the CA 2006, namely, "a body corporate in which the director and the persons connected with him together hold 20% of the share capital or voting rights" should be adopted to define "corporation associated with a director".
- Certain additional exceptions to the prohibition on granting loans etc. to directors based on sections 205- 207 of the CA 2006 should be adopted. These include exceptions for expenditure on defending proceedings, in connection with regulatory action or investigation or for small loans, quasi loans and credit transactions, and related guarantees and security. Modifications should be made to some of the current exceptions in section 157HA of the CO, such as extending the exception on company

¹⁶ The relevant provisions in the CA 2006 are sections 197(3) and (4), 198(4) and (5), 200(4) and (5) and 224.

business to directors of the holding company and connected persons, and changing the formula for calculating the maximum amount of expenditure allowed along the lines of section 204 of the CA 2006¹⁷.

- Section 157I of the CO should be amended so that the civil consequences of a breach of the proposed provisions would be as follows: (a) the contract, transaction or arrangement would be voidable at the instance of the company subject to rights of bona fide third parties for value, the impossibility of restitution, or ratification (where permissible) within a reasonable time by shareholders (or in the case of public companies, by disinterested shareholders); and (b) the director or connected person concerned would be liable to account to the company for any gain and to indemnify the company for any resulting damage.
- The criminal offence in section 157J of the CO should be retained. The criminal penalties imposed for breaches of section 157H of the CO should cover all companies and their officers as in the current section 157J of the CO.
- The previous SCCLR's recommendation that criminal penalties might be imposed on the officers of public companies involved in the breach of the relevant provisions if the company was wound up within a year after the contract, transaction or arrangement should be dropped.

(b) Disclosure of directors of material interests in contracts, etc. and disinterested directors' voting

- Section 162 of the CO relating to disclosure by directors of material interests in contracts should be amended along the following lines:-
 - Disclosure to other directors should be required for both private and public companies. Disclosure to shareholders

¹⁷ Section 204(2) of the CA 2006 provides that the aggregate of (a) the value of the transaction in question and (b) the value of any other relevant transactions or arrangements should not exceed £ 50,000.

should be required for public companies only¹⁸.

- The ambit of disclosure should be widened to cover “transactions” and “arrangements” as well as contracts.
 - For public companies, the ambit of disclosure should be widened to include disclosure by directors of any material interest of his “connected persons” (in the absence of any such interest on the part of the directors concerned).
 - Directors should be required to disclose the “nature and extent” of their interests, instead of just disclosing the “nature” of the interests.
- In addition, certain provisions in the CA 2006 on the disclosure of interests should be adopted, including:-
 - provisions relating to declaration notices;
 - exemption from declaring an interest which the director had no knowledge of;
 - exemption where the terms of the director’s service contract that had been considered by a meeting of the directors or by a committee of the directors appointed for the purpose under the company’s articles;
 - where a company has a sole director; and
 - application of the requirement to shadow directors.
 - The disinterested directors’ voting provisions and the exceptions should be stated in the model articles of association instead of in the CO, so that they could be dis-applied by shareholders if they

¹⁸ The proposed requirement for disclosure of material interests to shareholders by public companies has not been endorsed by the Administration as it would be wider than the requirement under the Listing Rules, where disclosure of directors’ interests to members is subject to certain thresholds and the discretion of the Hong Kong Stock Exchange. The proposed requirement will create extra burden on listed companies which have a large shareholder base.

so wish. Accordingly, regulation 86(2) of Table A of the CO, which restricts an interested director from voting or being counted in a quorum except in certain specified circumstances, should be retained, subject to certain amendments to the exceptions.

- Regulation 86(3) of Table A of the CO which provides to the effect that transactions in which a director has an interest would be upheld and the director would be allowed to keep the profits should be retained, subject to the pre-condition that the director should duly disclose to the board and, in the case of public companies, also to the shareholders.

(c) Provisions relating to management contracts

- Section 162A of the CO should be retained, subject to such modifications as may be necessary to make it more effective, for example, requiring the management contracts to be reduced in writing.
- Section 162B of the CO, which provides for the disclosure of management contracts with a company having only one member who is also a director, should be retained.

(d) Payment to directors for loss of office

- Those provisions in the CA 2006 concerning payment to directors for loss of office (sections 215 to 222) should generally be followed subject to such modifications as may be necessary, taking into account the current CO provisions. The major changes include:
 - extending the requirements for members' approval to include payments to connected persons;
 - clarifying that compensation and consideration include non-cash benefits;
 - extending the requirements to include payments by a company to a director of the holding company and connected persons of such a director;

- extending the requirements in connection with the transfer of the undertaking or property of the company to include transfers of undertaking or property of a subsidiary;
- extending the requirements in connection with share transfers so as to include all transfers of shares in the company and in a subsidiary of the company, resulting from a takeover bid;
- excluding the persons making the offer for shares in the company and any associates of them from voting on any resolution to approve a payment for loss of office in connection with a share transfer;
- setting out the exception for payments in discharge of certain legal obligations;
- creating a new exception for small payments;
- clarifying the civil consequences of breach of the provisions;
- exempting non-Hong Kong companies and wholly-owned subsidiaries should be exempted from the members' approval requirement; and
- requiring the following persons to abstain from voting in the case of public companies –
 - (i) the relevant director;
 - (ii) the person who received the payment (if he was not the director himself);
 - (iii) the person who held any shares in trust for the director;
 - (iv) in cases where the compensation was made in connection with a share transfer, the person making the offer for shares in the company and his associates¹⁹.

¹⁹ Defined under section 988 of the CA 2006 to include a nominee, a holding company, a subsidiary and spouse (if the offeror is an individual) of the offeror.

(e) **Directors' service contracts**

- For both private and public companies, directors' long term service contracts should be subject to shareholders' approval. Sections 188 and 189 of the CA 2006 relating to directors' long-term service contracts and the supplementary provisions in sections 224, 225 and 281(3) of the CA 2006 relating to members' approval should be adopted. However, the threshold requirement should be a guaranteed term of employment exceeding three years.
- Sections 227 to 230 of the CA 2006 regarding directors' service contracts should be adopted²⁰.

(f) **Substantial property transactions**

- Instead of the SCCLR's previous recommendation providing, for public companies only, that connected transactions should be subject to disclosure and shareholders' approval if the total consideration or value exceeds certain de minimis thresholds consistent with those in the Listing Rules, sections 190 to 196 of the CA 2006 should be adopted in Hong Kong, subject to certain modifications. The key features include the following:-
 - (a) The relevant transactions should cover only acquisition of non-cash assets by directors or connected persons from the company, or vice versa, should be adopted.
 - (b) Regarding de minimis thresholds for the requirement to disclose and obtain shareholders' approval –
 - (i) for private companies, thresholds should be similar to those in section 191 of the CA 2006 (i.e. the value of the non-cash asset exceeds £100,000 or 10% of the company's asset value, provided that it is more than £5,000) should be adopted.

²⁰ Sections 227 to 230 of the CA 2006 contain provisions as to the definition of directors' service contract; copy of contract or memorandum of terms to be available for inspection; right of members to inspect and request copy and the application of the provisions to shadow directors.

- (ii) for public companies, monetary thresholds considerably higher than the ones in the UK should be adopted. Tentatively, it should be set at either (1) 10% of the company's net asset value which is over HK\$750,000; or (2) HK\$10 million.
- (c) The exceptions under sections 192 to 194 of the CA 2006, i.e., an exception for transactions with members and other group companies, an exception in case of a company in winding-up or administration and an exception for transactions on a recognised investment exchange, should be adopted.
- (d) The substantial property transactions provisions should be extended to transactions or arrangements between the company and shadow directors and persons connected with them.
- (e) Provisions similar to sections 190 to 196 of the CA 2006 making members' approval a requirement for substantial property transactions between the company and its directors, directors of the holding company or persons connected with them, should be adopted in Hong Kong for both public and private companies. For private companies, shareholders' approval would suffice. For public companies, the director and the connected person who was a party to the transaction and, in the latter case, the relevant director to whom that person is connected with, should abstain from voting.
- (f) There should be no criminal penalties. The civil consequences should be the same as those in respect of loan transactions, etc.
- (g) **Miscellaneous**
- Section 258 of the CA 2006, which provided for power for the Secretary of State to increase the financial limits, should be adopted.

- Section 259 of the CA 2006, which prevented the contracting out of the relevant provisions by choosing a foreign law to govern the transaction or arrangement, should be adopted in Hong Kong.
- Sections 323 and 327 of the CA 1985 prohibiting directors dealing in share options should not be adopted.
- The recommendation of the SCCLR's Sub-committee on Directors in the Corporate Governance Review that there should not be a register of directors' interests should be confirmed.

(II) Directors' and Auditors' Liabilities, Indemnity and Insurance

4.4 The SCCLR considered and endorsed the following recommendations made by AG3 relating to directors' and auditors' liabilities, indemnity and insurance.

(a) Directors' Liability

- Hong Kong's current approach under section 165(1) of the CO of not statutorily prohibiting a company from indemnifying its officers against liability owed to third parties and of leaving such indemnifications to common law rules should be changed. To make the law clearer and easier to understand, provisions similar to sections 232 (provisions protecting directors from liability) and 234 (qualifying third party indemnity provision) of the CA 2006 should be adopted in respect of indemnification of the liabilities of a company's officers to third parties.
- Non-director officers (i.e. the manager and secretary) should be carved out from the prohibition against exemption and indemnification under section 165 of the CO.
- The words "by virtue of any rule of law" should be removed from section 165(1) of the CO to clarify that the provisions and prohibition relating to directors' and auditors' liabilities were not limited to non-statutory liabilities.
- There should be a prohibition on "indemnification provided by a

related company” in respect of the liability of the officers of the subject company.

- As a consequence of the proposed extension of the prohibition to indemnification provided by related companies, the permission to insure provided by section 165(3) of the CO should be extended to cover the officers of related companies.
- Provisions similar to section 239 of the CA 2006 providing for ratification of acts of directors should be adopted, with such adaptations as may be necessary.

(b) Auditors’ Liability

- There is a need to change the current approach under section 165 of the CO of not statutorily prohibiting a company from indemnifying its auditors against liability owed to third parties and of leaving such indemnifications to the common law rules. The UK’s approach (i.e. a general prohibition against a company or an associated company²¹ from indemnifying in respect of an auditors’ liability owed to third parties subject to certain specific exceptions in section 533 of the CA 2006)²² should be adopted to make the law clearer and easier to understand.
- There should be a prohibition on “indemnification provided by a related company” in respect of the liability of the auditors of the subject company.
- The permission to insure in respect of auditors’ liability under section 165(3) of the CO should be retained. The permission should be expanded to cover the auditors of related companies.

4.5 Two of AG3’s recommendations in this respect had not, however, been

²¹ Section 256 of the CA 2006 provides that companies are associated if one is a subsidiary of the other or both are subsidiaries of the same body corporate. Section 165(5) CO defines "related company" to mean any company that is the company's subsidiary or holding company or a subsidiary of that company's holding company. The term "related companies" used in the CO and the term "associated companies" used in the CA 2006 are thus essentially the same as they both refer to companies within a group.

²² Section 533 of the CA 2006 permits the company to indemnify the auditor against the costs of successfully defending himself against a claim.

endorsed by the SCCLR, namely, a proposal to adopt provisions similar to section 235 of the CA 2006 which allowed indemnification of directors of corporate trustee which was set up and owned by a company to hold the pension funds for the employees of the company; and a proposal to introduce liability limitation agreement to allow auditors to limit their liability to a company by contract, as provided in section 534 of the CA 2006.

4.6 The reason for the SCCLR not endorsing the former proposal mentioned in paragraph 4.5 above was that only a very small number of companies would, in reality, be affected by the proposed exemption from the general prohibition against the provision of indemnity to directors of a company. As a result, there was no strong justification to create a set of complicated provisions for that purpose. With regard to the latter proposal, the majority of the SCCLR members had reservation on it although none had definitely rejected the idea. Their main concerns included the following :-

- (a) The proposal to allow auditors to limit their liability by contract might send a wrong message to the public that auditors could be less vigilant in performing their duties;
- (b) The singling out of auditors by allowing them alone to have the ability to limit their liability to their client by contract would have read-across implications on other professions; and
- (c) The shareholder approval requirement for the company to enter into a liability limitation agreement with its auditor could hardly be regarded as a safeguard for creditors as they were the persons most likely to be affected by the auditor's negligence or default. Given most listed companies in Hong Kong were management-owned, it could hardly safeguard the interests of minority shareholders either.

(III) Public Availability of Residential Addresses and Numbers of Identification Documents of Directors and Secretaries

4.7 The SCCLR considered and endorsed the following recommendations of AG3 with regard to the public availability of residential addresses of directors and secretaries.

- The residential addresses of directors and secretaries should not continue to be accessible to the public through a company's register of directors and secretaries or the Companies Registry ("CR")'s records (except for those addresses already on the public record)²³. Hong Kong should adopt:
 - (a) in respect of directors, the UK's approach in –
 - (i) sections 163, 165 and 167 of the CA 2006 which provided that a director's service address instead of his residential address be entered on the company's register and there should be a separate and secure register of residential addresses; and
 - (ii) sections 240 to 246 of the CA 2006 which restricted the use or disclosure of directors' residential addresses by the registrar to the permitted exceptions (e.g. disclosure to a specified public authority); and
 - (b) in respect of secretaries, the UK reform in abolishing the requirement for disclosure of a secretary's residential address and requiring only a service address for the company's register.
- The above recommendations should apply mutatis mutandis to –
 - (a) the particulars of directors and secretaries which were required to be disclosed in the annual return pursuant to sections 107 and 109 of the CO; and
 - (b) the particulars of a non-Hong Kong company's directors, secretaries and authorised representatives which were required to be disclosed pursuant to sections 333, 333C, 334 and 335 of the CO.

²³ The recommendations in paragraphs 4.7 (except the 4th bullet point) to 4.9 have not been endorsed by the Steering Committee overseeing the CO rewrite because of the complexities and problems involved in their implementation. Instead, the Government proposed that, so far as directors' residential addresses were concerned, the status quo should be maintained subject to the issue being highlighted for public consultation in due course.

- Section 1088 of the CA 2006, which provided for the making of regulations for application to make an address on the register kept by the registrar of companies unavailable for public inspection, should not be adopted in Hong Kong insofar as it was related to the residential addresses of directors and secretaries.
- No change should be made to the status quo of the public availability of the other personal data (including the number of Hong Kong identity card (“ID”) or passport) of directors and secretaries in the company’s register and the public records of the CR. Nevertheless, the recommendation concerning public availability of directors’ residential address and ID numbers was adopted only provisionally. The issue would be subject to further deliberations by the Steering Committee and would be highlighted for public consultation in the context of the draft bill.

4.8 As to which public authority should have the right to access the protected information, members generally agreed that the matter should be carefully considered and that liquidators should be included.

4.9 Regarding the way for application for disclosure of information, members generally agreed that a two-tier approach, namely, (a) to have one provision empowering the Registrar to allow disclosure of the protected information where there was non-service or difficulty of enforcement of court order, and (b) to have another provision empowering the court to allow disclosure for any other purposes which the court might consider appropriate, should be adopted in Hong Kong.

(IV) Shadow Directors

4.10 Members had endorsed general recommendations made by AG3 relating to shadow directors: -

- A composite definition defining the term “director” as including a shadow director should not be adopted in the CO. The current approach of providing separate definitions of the terms “director” and “shadow director” should be retained.

- The requirements in the CO regarding the disclosure and availability for public inspection of a shadow director's particulars in the company's register, its annual return and the CR's records should be repealed. However, a shadow director's potential liability for default in complying with section 158 (the register of directors and secretaries) and sections 107 and 109 of the CO (annual return) should be retained.

(V) Appointment of Directors and Secretaries

4.11 Members had considered and endorsed the recommendations made by AG3 relating to the appointment of directors and secretaries, subject to minor modifications to some of them: -

(a) Prohibition of corporate directors for private companies²⁴

- While members generally agreed that the appointment of corporate directors to private companies should be prohibited in Hong Kong, they recommended that the Administration should consider further whether an exception similar to section 155(2) of the CA 2006, which provided that the general requirement of having at least one natural person as the director of the company was met if the office of director was held by a natural person as a corporate sole or by virtue of an office, should be adopted in Hong Kong;

(b) Direction requiring appointment of directors²⁵

- The CO should have specific provisions to enable the Registrar of Companies to give direction to a company as well as its members requiring them to either appoint directors in compliance with the statutory requirements or to cause the company to cease business and to wind up within a specified period of time of two to three months unless extended by the Registrar;
- If the Registrar's direction was not complied with, the company, every officers and members in default shall be guilty of an offence

²⁴ This issue had been included in the topical public consultation paper launched in April 2008.

²⁵ This recommendation was not endorsed by the Steering Committee overseeing the CO rewrite because it would be very difficult for the CR to enforce it, especially in respect of causing the company to cease business and to wind up.

and liable to a fine;

- If the company had carried on business after the expiration of the time specified in the Registrar's direction, those persons who actually held themselves out as having the authority to continue the business of the company, and every member of the company who had knowledge of the company carrying on business in that manner should be liable for the payment of all the debts of the company contracted during that period of time; and
- It should be a defence if a member could show that he had taken all reasonable steps in the circumstances of the case to either appoint new directors to the company or cause the company to cease business and wind up.

(c) **Residency requirement for directors**

- There should not be any requirement for at least one of the directors of a company (including single director company) to ordinarily reside in Hong Kong.

(d) **Share qualification and requirement for directors**

- Section 155 of the CO relating to share qualification of directors should be repealed.

(e) **Validity of acts of directors and managers**

- Section 157 of the CO, which provided that the acts of a director or manager should be valid notwithstanding any defect that might be discovered afterwards, should be amended to apply only to directors, following the change in section 161 of CA 2006. It should not apply to secretaries as provided by section 204E of the Australian Corporations Act ("ACA") and section 151 of the Singaporean Companies Act ("SCA").
- Provisions similar to section 161(1) of the CA 2006²⁶ should be

²⁶ Section 161(1) of the CA 2006 provides that the acts of a person acting as a director are valid notwithstanding that it is afterwards discovered

- (a) that there was a defect in his appointment
- (b) that he was disqualified from holding office
- (c) that he had ceased to hold office
- (d) that he was not entitled to vote in the matter in question

adopted to expand and clarify the circumstances under which the validation provisions might apply.

(f) **Issues relating to the appointment and qualifications of secretaries**

- The appointment of secretaries for private companies should remain mandatory.
- There should not be any new statutory requirement that the secretaries of private companies and public companies must be natural persons.
- The current residency requirements for an individual secretary and a corporate secretary as provided by section 154(2) of the CO should be retained.
- It was not necessary to include a provision in the CO similar to section 171(1A) of the SCA, which imposed a duty on the directors of a company to ensure that the company secretary had the requisite knowledge and experience.
- There should be specific provisions in the CO to enable the Registrar of Companies to give directions to companies relating to the appointment of secretaries in compliance with the statutory requirements.
- As regards the approach to enforcement, it was agreed that an approach similar to section 272 of CA 2006, which provided for the direction to be given to a public company which, on failure to comply, would lead to an offence being committed by the company and officers in default, should be adopted in Hong Kong, with such adaptations as may be necessary.

(VI) Miscellaneous Provisions in the CO relating to Directors and Secretaries

4.12 In addition to the above, members also endorsed the following recommendations made by AG3 relating to directors and secretaries.

- Section 155C of the CO, which imposed a unique duty on directors of unlisted public companies to send a copy of the prospectus or statement in lieu of prospectus to their members within three weeks from the date of delivery of such documents to the Registrar of Companies, should be repealed.
- Sections 159 and 160 of the CO relating to directors and managers of limited companies having unlimited liability should be repealed.
- Section 164(1) of the CO restricting the assignment of office by a director or managing agent of a company and sections 164(2) to (4) of the CO which provided for certain duties of a managing agent of a company should be repealed.

CHAPTER 5

Company Administration and Procedures

Background

5.1 The SCCLR considered the recommendations made by AG2 on the following subjects relating to company administration and procedures, namely :-

- Resolutions and Meetings
- Voting and Proxy
- Registers, Registered Office Address and Annual Return

(I) Resolutions and Meetings

5.2 Based on the SCCLR's recommendations made in the Corporate Governance Review²⁷, AG2 re-examined the resolutions and meeting provisions of the CO, taking into account the changes brought about in the UK by the CA 2006 and other recent reform developments in Australia and Singapore.

5.3 As a result, AG2 came up with a set of more detailed reform recommendations with a view to simplifying and facilitating the decision making process of a company (including the use of electronic communications), encouraging shareholders' engagement in the decision-making process and improving the transparency of the procedure. These recommendations were subsequently considered and endorsed by the SCCLR.

5.4 The key proposals are as follows :-

(a) Facilitating electronic communications

- Shareholders should be able to use electronic means to make requests to the company for calling a meeting, circulation of

²⁷ Please see Chapter 1, pages 29 to 34 of the SCCLR's *Annual Report 2003/2004*.

proposed written resolutions, shareholders' resolutions and statements, and sending their appointment of proxies, if so agreed by the company. They could also signify their agreement to written resolutions and appointment of proxies in electronic form.

- Companies should be able to send to their shareholders notices of meetings, proposed written resolutions, shareholders' proposed resolutions and statements by electronic means or by means of a website, if so agreed by shareholders.
- A general meeting should be able to be held at more than one location by using real-time electronic communications.

(b) General meetings

- Both public and private companies should be allowed to dispense with AGMs if unanimous shareholders' consent was obtained, and dispensation should be in force unless a member, requested by notice an AGM to be held in a particular year or until the dispensation was revoked by an ordinary resolution.
- To encourage shareholders to propose resolutions for passing at general meetings and make statements relating to any business of general meetings, such shareholders' resolutions and statements should be circulated at the expense of the company if they were received by the company in time for sending with notices of the meeting.

(c) Written resolutions

- Unanimous approval for passing a written resolution should be retained. Lowering such a requirement might lead to possible "abuse of minority interest".
- The following procedures for proposing and passing a written resolution should be adopted –
 - (i) Members holding 2.5% of the total voting rights should be entitled to propose a written resolution and request the company to circulate it at its expenses. The threshold was

consistent with that of proposing a resolution in an AGM;

- (ii) All members should have the right to be informed of a written resolution, irrespective of whether they were entitled to vote on the resolution;
- (iii) There should be a time limit for passing a written resolution, beyond which the written resolution would lapse. It should be 28 days from the circulation date or any other period as specified in the articles; and
- (iv) A company should be required to inform every member of the passing of a written resolution within 15 days from the earliest date on which a director or secretary of the company was aware that it had been passed.

(d) Special resolutions

- The requirement to give 21 days for passing a special resolution should be changed to 14 days.

(II) Voting and Proxies

5.5 The SCCLR considered and endorsed the recommendations made by AG2 relating to voting and proxies. The major proposals are highlighted as follows :-

(a) General rules on voting

- The general voting rights of shareholders whether on a written resolution, a show of hands or a poll, should be made a default rule in the CO to ensure equality of voting either by one vote per share (on a written resolution or a poll) or one vote per person (on a show of hands).
- It should be made a default rule in the CO that the declaration by a chairman as to the passing or otherwise of a resolution on a show of hands or an entry in the minutes of the meeting of the declared result, should be conclusive evidence of that fact without such proof. If a demand for a poll follows but was subsequently

withdrawn, the declaration of that result of a show of hands should stand.

- The right of a company to provide in its articles a procedure on how any right to vote might be challenged and for the determination of such a challenge should be preserved.

(b) Right and procedure on a poll

- The threshold requirement for the right to demand a poll should be lowered from 10% to 5% of the voting rights as shareholders holding not less than 5% of the voting rights were now able to requisition an extraordinary general meeting. The consent of the chairman should not be required for withdrawal of a demand for a poll.
- The time that a poll should take place should be as directed by the chairman but should not be more than 30 days after the poll was demanded.
- The Model Articles should provide that the chairman might appoint scrutineers who needed not be members and that if a poll demanded was not taken forthwith, and the time and place at which it was to be taken were not announced at the meeting at which it was demanded, fresh notice of at least 7 days should be sent to shareholders.
- All calls or other payable should have been paid before voting.
- A company should be required to disclose the poll results to its shareholders. Detailed rules on matters like appointment on independent inspectors or assessors for vote taking and reporting needed not be prescribed by law but could be considered for inclusion in the Listing Rules.
- The chairman should not be required to disclose proxy voting information in advance.

(c) **Appointment of proxy**

- Appointment of proxy should be made a right of all members of a company irrespective of whether the company has share capital subject, however, to the company's articles. It was noted that companies limited by guarantee might wish to exclude non-members from attending their meetings and to confine a proxy to another member.
- Appointment of multiple proxies should be made an absolute right for all members of a company having a share capital. There should be no cap on the maximum number of proxies that a shareholder might appoint on the same occasion.
- The maximum 48 hours cut-off time for lodging proxies prior to a meeting should be retained. However, if a poll demanded at the meeting is not taken immediately but was held within 48 hours, the earliest cut-off time should be when the poll was demanded and a proxy appointment might be given to the company before the end of the meeting. If the delay was more than 48 hours, the earliest cut-off time should be 24 hours before the poll is taken. Non-working days should not be counted towards the minimum 48-hours notice required to appoint proxies.
- The acceptance of electronic proxies and electronic signatures should be expressly provided for in the CO. There should be guidance on how an electronic proxy is to be signed or authenticated.

(d) **Termination of proxy authority**

- The concept of irrevocable proxy should not be introduced into the CO.
- Subject to a company's articles, the termination of a person's authority to act as a proxy should not affect his counting towards the quorum of a meeting, any poll demanded by him or votes cast by him unless the company had notice of that termination before the commencement of the meeting. If there was a poll taken more than 48 hours after it has been demanded, the notice must be

received by the time that the poll was taken.

(e) Rights of proxy

- A proxy's right to vote and speak at a meeting should be placed on a statutory footing rather than being put in Table A of the CO.
- A proxy holding conflicting appointments should be allowed to vote on a show of hands.
- The way in which proxies (including multiple proxies) might participate in a demand for a poll should be clearly set out in the CO.
- Subject to any provisions of the company's articles, a proxy might be elected as the chairman of a general meeting.
- The common law principle that the appointment of a proxy would be revoked if the appointer attended and voted at the meeting should be made mandatory on a statutory basis.

(f) Voting by corporate representatives

- The current legal position that only one corporate representative be allowed (except for the recognised clearing house or its nominees) should remain unchanged.

(g) Absentee or electronic voting

- Noting that the UK and Australia had not yet introduced any provision on absentee postal and electronic voting, the proposal on absentee postal and electronic voting should be held abeyance but the Administration should keep in view developments in Australia and other comparable jurisdictions on absentee postal and electronic voting.

(III) Registers, Registered Office Address and Annual Returns

5.6 AG2 reviewed the provisions relating to registers, registered office and annual returns in the context of the CO rewrite at the meetings held on 10 December 2007. Their recommendations were subsequently endorsed

by the SCCLR. The key recommendations are highlighted as follows –

(a) Register of members

- The period of time for which a company was required to keep the records of its past members after their cessation to be members should be reduced from 30 years to 20 years.
- A company should be allowed to keep the records of the company's past members separately from the records of existing members.
- The CO should expressly provide for a mechanism along the lines of the CA 2006, whereby a company might refuse to comply with a request for inspection or a copy of the register of members if the request was not for a proper purpose. The period within which the company should be allowed to make an application to the court for an order directing the company not to comply with a request for inspection or a copy of the register of members should be 14 calendar days after the request was made.²⁸
- There should be criminal liabilities in respect of a person who (i) knowingly or recklessly made in a request for inspection or a copy of a register of members a statement that was misleading, false or deceptive in a material particular; or (ii) disclosed the information obtained from a register of members to another person, knowing or having reason to suspect that that person might use the information for an improper purpose.
- The current requirement that a company should give notice of closure of its register of members by advertisement in a newspaper should be abolished.

²⁸ This recommendation was not endorsed by the Steering Committee overseeing the CO rewrite. The proposed mechanism in the CA 2006 whereby a company would have to apply to the court if it wanted to refuse a request for inspection would increase the compliance costs of companies, especially SMEs. Under the existing arrangement, the burden rested with the individual making the request to apply to the court if his request was refused. In addition, in case a company refused a request for inspection, an individual could still search the CR's records for the information, except for companies limited by guarantee. The Steering Committee suggested that the status quo should generally be maintained subject to clarifying in the law that if a demand for an inspection of the register of members was for purposes which amounted to an abuse, the court would have the power to refuse to compel compliance with the demand.

(b) General provisions as to registers

- The registers and minute books of a company should be allowed to be kept at another place in Hong Kong, other than the registered office or a place where the work of making them up is done.
- There should be a requirement for prior appointment in respect of inspection of a company's registers or minute books for both public and private companies.
- The Financial Secretary should be empowered to make provisions by regulations for keeping, inspection and provision of copies of register and minute books.

(c) Registered office and publication of company name, etc.

- A company should be required to display its name on the company's website and the outside of the company's registered office, in addition to the current requirement of displaying it outside every office or place where its business was carried on.
- Provision concerning electronic display of company names along the lines of the CA 2006 should be adopted.
- A company should also be required to display its registration number in its public documents, including documents to be sent in electronic form. Nevertheless, there should not be any requirement for it to displaying the place of incorporation and the address of its registered office.

(d) Annual return

- The extent of particulars relating to members to be filed in annual returns should remain basically unchanged except that listed companies should only be required to state the particulars of members holding 5% or more of issued share of the companies should be adopted.

CHAPTER 6

Charges

Background

6.1 The SCCLR considered the recommendations put forward by AG1 relating to registration of charges and possible reforms to Part III of the CO²⁹.

6.2 The SCCLR endorsed all but four of those recommendations and made additional suggestions for four others. The endorsed recommendations included the following :-

(a) Registrable Charges

- The existing approach in the CO which listed out the registrable charges should be maintained while the list of registrable charges should be updated.
- Charges securing issue of debentures should be deleted³⁰.
- Charges on calls made but not paid should be extended to cover charges on instalments on the issue price³¹.
- It should be provided in the new CO that a lien on subfreights should not be registrable as a charge on book debts or any other head of registrable charge.
- There should not be a statutory definition of the floating charge in the context of the company charge registration provisions.
- Aircrafts and interest in them should be made a registrable charge.

²⁹ Part III of the existing CO is related to registration of charges with the Registrar and the company's own register of charges.

³⁰ Section 80(2)(a) of the CO.

³¹ Section 80(2)(g) of the CO.

(b) Charges and other security interest not requiring registration

- The list of registrable charges should not be extended to include equitable liens, fixed charges on shares and other marketable securities.
- The insurance industry should be consulted before a decision was made on whether charges on insurance policies should be made registrable.
- The new CO should declare expressly that charges over cash deposits would not be registrable.
- There should be no need for the legislation to declare expressly that debt subordination agreements did not constitute registrable charges.
- There should be no need for the legislation to declare expressly that pledges or possessory security interests did not require registration.
- Absolute assignment of receivables should not be brought within the scope of the registration requirements.
- There should be no need for a legislative clarification of the kinds of retention of title clause that constituted a registrable charge.

(c) The Registration Procedure

- The primary obligation to register details of a charge should remain with the company as stated in the existing CO. The criminal penalty on the company for failure to register should also be maintained.
- Part III of the CO should be amended to provide that the lender had the right to demand for statutory acceleration of the obligation to repay the amount secured by the charge should a company fail to register a charge within the prescribed time.
- The instrument of charge together with the particulars on a

prescribed form should be registered. The commercially sensitive information contained in the instrument could be hived off and stored in a separate document which would not be made available for inspection. The Registrar should not be required to check the prescribed particulars and it should be the obligation of the creditor and charge holder to verify the information in the prescribed particulars against the instrument which should also be made available for inspection.

- There should not be a statutory provision in the CO to provide for civil liability for any loss as a consequence of inaccurate information being supplied to the Registrar.
- The charge holder should not be allowed to claim greater security rights than those submitted in both the instrument of charge and the particulars for registration, in particular in situation where there was a discrepancy between the particulars and the instrument submitted for registration.
- On the assumption that the instrument would be filed together with the prescribed particulars and there would be no checking/verification done by the Registrar on the registered information, the Registrar should no longer issue a certificate of due registration as conclusive evidence that the instrument of charge had been validly registered. Instead, the Registrar should simply issue a certificate or receipt showing the particulars and the instrument had been submitted on a particular date.
- There should be no need to introduce a system of advance or provisional registration.
- The public should be consulted on the viability and desirability of introducing an administrative mechanism for late registration of charges in lieu of the current requirement for court application³².
- There should be no change in the policy of not invalidating

³² This recommendation was contained in the Consultation Paper on Company Names, Directors' Duties, Corporate Directorship and Registration of Charges issued by the Financial Services and the Treasury Bureau in April 2008.

unregistered charges over property acquired by the company.

(d) **Priorities**

- There should be no need to comprehensively restate in Part III of the CO the law on priorities where there was more than one charge over the same property created by a company.

(e) **Application to Non-Hong Kong Companies**

- The registration obligation should be confined to charges over property in Hong Kong created by foreign companies registered in Hong Kong.
- There should be no need to specify more fully in the legislation the definition of a company having a “place of business” in Hong Kong.
- There should be no need for the legislation to set out the rules for determining the location of property in the context of charges over property in Hong Kong created by registered foreign-incorporated companies.
- There should be no need for a charge over property which was situated outside Hong Kong at the time of creation or acquisition of the charge but which was subsequently brought into Hong Kong to be registered.

6.3 The four recommendations of AG1 which had not been endorsed by the SCCLR and the reasons behind are summarized in the table below.

AG1's Proposal	SCCLR's Comments and Recommendations
The reference to “bill of sale” in section 80(2)(c) of the CO should be replaced by updating the language but without changing the current law.	Section 80(2)(c) of the CO should be deleted altogether as “bill of sale” was a very much out-dated and redundant concept. However, the public should specifically be consulted on this before reaching a final decision.

<p>The reference to book debts should be retained and an attempt should be made to define the term. Section 262(4) of the Australian Corporations Act (“ACA”) could be a useful reference to start with.</p>	<p>The formulation of “book debt” in section 262(4) of the ACA was inappropriate and should not be followed. Instead, the term “book-debts” should be left as it was and no attempt should be made to have it defined. The case law could be relied on for its interpretation.</p>
<p>Trust receipts which would operate for more than a prescribed period of time should be considered for inclusion as registrable charges.</p>	<p>Long-term trust receipt was almost non-existent and in any event it would be very difficult to prescribe a suitable period that triggered the registration requirement. As it was recommended that the bill of sale provision should be removed, there was no basis to bring trust receipts within the category of registrable charges. Subject to public consultation, trust receipts should not be included as registrable charges.</p>
<p>The legislation should continue to render an unregistered, but registrable, charge void against a liquidator, and any creditor of the company. For “any creditor”, the meeting considered it should mean “secured creditor”.</p>	<p>Unregistered charges should be void against the liquidator and any creditor of the company as currently under section 80(1) of the CO. Hence, creditors should not be confined to “secured creditors”.</p>

6.4 The SCCLR made additional suggestions for four other AG1’s recommendations as summarized in the table below.

AG1’s Proposal	SCCLR’s Further Suggestions
<p>Subject to the outcome of the public consultation, members considered that there might be a merit to shorten the time limit for registering details</p>	<p>Subject to public consultation, the time limit for registration should be shortened to 21 days.</p>

of a charge to less than 5 weeks.	
There should be no need for a statement of the amount secured by the charge to be included in the list of registrable particulars since the information was neither useful nor accurate.	
Details of any negative pledge clauses should not become compulsorily registrable but the relevant form could be re-designed to facilitate the registration of a negative pledge on an optional basis by cross-referencing with the negative pledge clause.	The particulars requiring registration should be specified by the Registrar.
Details of a company's registered number should be included among the list of registrable particulars.	

CHAPTER 7

Arrangements, Reconstructions and Takeovers

Background

7.1 The SCCLR considered the recommendations made by AG1 on

- Arrangements, Reconstructions and Takeovers
- A Statutory Amalgamation Procedure

(I) Arrangements and Reconstructions

7.2 The SCCLR generally endorsed AG1's recommendations with regard to arrangements and reconstructions. The key proposals adopted are summarised below.

(a) Scheme of compromise and arrangement under sections 166 to 167 of the current CO

- The court should specifically decide on the composition of the classes of creditors and members at the preliminary application stage following an application by companies/promoters of a scheme. In this regard, the Chief Justice should be asked to consider issuing a Practice Direction to enable issues concerning the composition of classes to be identified and resolved by the court early in the proceedings.
- Section 166 of the CO should be amended –
 - (i) to clarify that the persons who might apply for a court order sanctioning a compromise or arrangement were the same as those who might apply to the court for an order for a meeting;
 - (ii) to require the court order to be delivered to the Registrar to be accompanied by a copy of the company's constitution if the order amended the constitution. A

company should be exempted from annexing a copy of the order to the company's articles issued subsequently if the effect of such order had been incorporated into the articles by amendment.

- The idea of amending section 166 of the CO to empower the court to impose a moratorium (stay of proceedings) so as to facilitate corporate rescue should be considered together with other insolvency-related issues in Phase Two of the CO rewrite.
- Accountants' or solicitors' reports should not be required for the purpose of a proposed compromise or arrangement, because they might not be a position to provide independent assessment as to whether the proposals were fair and reasonable. Therefore, the value of such reports was doubtful.
- There should not be any prohibition on the use of sections 166 and 166A of the CO when a compromise or arrangement had been proposed for the purpose of avoiding the operation of the provisions regarding takeovers.
- There was no need to add a requirement as in section 412(1)(a)(ii) of the ACA that the explanatory statement to accompany a notice to convene a scheme meeting should include information that was material to the making of a decision by a creditor or member and within the knowledge of the directors and had not previously been disclosed.³³
- The application of the provisions for facilitating reconstruction and amalgamation of companies under section 167 of the CO should be extended to cover companies liable to be wound up under the CO, which included both Hong Kong and non-Hong Kong companies.
- There was no need to impose additional requirements (e.g.

³³ The reason was that directors already had the duty, under the common law and the current provisions of the CO, to furnish substantial and sufficient information relating to a scheme, depending on its nature and complexity, to enable a creditor or a member to make an informed decision on the scheme.

drawing up of draft terms, directors' report and expert's report) in the CO on proposed compromises and arrangements involving mergers and divisions of public companies. The issues could be explored by the SFC in its regular review of the Takeovers Codes.

- The definitions of “property” and “liabilities” in section 167(4) of the CO should be revised to include rights and duties respectively of a personal character or incapable under the general law of being assigned or performed vicariously, subject to providing adequate avenue for address to the court by any aggrieved person.
- The scope of the court's power to make ancillary orders under section 167(1) of the CO should be expanded to cover “any order for the transfer or allotment of any interest in property to any person concerned in the compromise or arrangement”.
- A court-free statutory merger procedure/voluntary amalgamation regime as adopted in New Zealand and Singapore would be desirable for Hong Kong and a public consultation should be conducted to seek views on details of the model/modus operandi (see paragraphs 7.4 and 7.5 below).

(b) Takeover under sections 168, 168B and the 9th and 13th Schedule of the current CO

- There was no need to introduce provisions regarding impediments to takeovers similar to those in the CA 2006, which sought to override some defensive devices adopted by companies against takeovers, e.g. differential share voting structures, restrictions on transfer of shares, and limitations on share ownership.
- The provisions in the CO on “takeover offer”, “shares already held by” the offeror, and “shares to which the offer relates” should be clarified along those relevant provisions in the CA 2006.
- The thresholds for the triggering of the squeeze-out and sell-out rights should remain unchanged.
- The periods during which squeeze-out and sell-out rights may be

exercised should be revised along the lines of the relevant provisions in the CA 2006 to become “not later than three months from the end of the offer period”. This would provide more symmetry as compared with the present provisions in the CO.

- Provisions should be introduced in the CO to allow –
 - (i) an offeror, who was unable to achieve the necessary threshold because of untraceable shareholders related to the offer, to apply to the court for an authorization to give notice of compulsory purchase; and
 - (ii) a revised offer to be treated as the original offer so long as certain specific conditions were met (e.g. the original offer allowed a revision and an acceptance of the previous terms were to be treated as acceptance of the revised terms), as in the case of the UK and Singapore.

- In view of privacy concerns, it would not be appropriate to confer a right to a dissenting or minority shareholder to demand information about other dissenting shareholders.

(II) Statutory Amalgamation Procedure

7.3 The SCCLR endorsed the recommendation of AG1 that a court-free statutory merger procedure/voluntary amalgamation regime as adopted in New Zealand and Singapore would be desirable for Hong Kong, and considered further details with regard to the two overseas models³⁴.

7.4 As a result of deliberation, members agreed that –

- The Singaporean model of statutory amalgamation procedure was more preferable. The procedure was based broadly on a decision by the directors and members of the companies involved, a declaration of solvency by those directors, with provisions for notice to creditors and advertisement of the proposal and with a right for dissenting members

³⁴ The Singaporean court free amalgamation procedure was introduced on 30.1.2006 (section 215A to 215J of the SCA). The New Zealand court free amalgamation procedure was introduced on 1.7.1994 (sections 219 to 226 of NZCA). The issue of whether there should be a statutory amalgamation procedure in Hong Kong had been included in the topical public consultation exercise launched in June 2008.

and creditors to apply to the court for relief.

- There should be no need for the directors' declaration of solvency to be accompanied by an auditor's report opining that the declaration was not unreasonable, given all the circumstances. It was noted that engagement of an independent auditor to do the report would be very costly.
- There should be no need to provide dissenting members to an amalgamation proposal with a statutory right to be bought out, as it was believed that the members' right to object and lay an unfair prejudice claim to the court should be sufficient to protect their interests.
- In addition to the normal long form procedure for amalgamation of two or more companies, there should be a short form amalgamation for companies in the same group, being either an amalgamation between a holding company and one or more of its subsidiaries; or an amalgamation between two or more subsidiaries of the same holding company, where certain formal requirements under the long form procedure would be dispensed with. The short form amalgamation should be approved by a special resolution of the company as under the Singaporean model.

CHAPTER 8

Inspection and Investigation of Companies

Background

8.1 The SCCLR considered the recommendations made by CO Rewrite Advisory Group 4 (“AG4”) with regard to

- the company inspection and investigation provisions under sections 142 to 152F of the CO
- the CR’s general investigatory power

(I) Company Inspection and Investigation Provisions

8.2 The SCCLR’s endorsed all but one of the recommendations made by AG4 with regard to the company inspection and investigation provisions under sections 142 to 152F of the CO. They included the following :-

(a) The FS’s power to appoint inspector

- There should be an express provision in the new CO to the effect that the FS should be guided by the public interest when appointing company inspectors.
- The FS’s power currently under section 143(1)(c)(iii) of the CO to appoint a company inspector on the ground that its members had not been given all the information with respect to its affairs that they might reasonably expect should be removed.
- The “good reason” criterion for the FS to exercise his power to require production of documents under section 152A of the CO should be retained.

(b) Co-operation with Overseas Regulatory Authorities

- The new CO should include provisions on providing assistance to

overseas regulators and company inspectors if certain conditions, including reciprocity of arrangements, could be met.

(c) **Scope of target companies**

- The new CO should provide generally a wider power for inspection and investigation of companies incorporated outside Hong Kong but doing business in Hong Kong (whether or not having a place of business in Hong Kong), non-Hong Kong companies, listed companies and group companies comprising such companies wherever incorporated.
- Appointment of inspectors on the application of members under section 142 of the CO should be broadened to cover non-Hong Kong companies, in addition to Hong Kong companies.
- The scope of inspection under section 145 of the CO should be expanded to cover companies, partnerships or individuals associated or connected with the target company.

(d) **Strengthening the Powers of Inspectors and Investigators**

- The power of an inspector appointed under section 142 of the CO (upon application of members) or section 143 (by the FS in other cases) should be strengthened by including the power
 - (i) to ask for further particulars in respect of a record or document produced;
 - (ii) to require answers, statements and explanation given to be verified by statutory declaration;
 - (iii) to require a representation claiming “no knowledge” or “not in possession” of information or document to be verified by statutory declaration;
 - (iv) to enter and remain on company premises to inspect the originals of documents;
 - (v) to require a company to preserve documents for a certain period of time.
- The power of an investigator appointed under section 152A of the CO (by the FS) should include a general power to request the

provision of and verification of information.

(e) **Delegation of Power**

- Delegation of powers by an inspector under section 145A of the current CO should expressly be extended to cover the power to take evidence on oath.

(f) **Scope of Persons required to assist in an investigation**

- The scope of persons required to assist in a section 152A investigation should be expanded to include financial institutions, auditors and persons having dealings with the company and in possession of information, subject however to necessary safeguards, such as a system of certification by senior ranking officials that the assistance required was well justified.

(g) **Altering the scope of and suspending inspections**

- The new CO should expressly enable the FS to define the terms of the appointment and to limit or expand the scope of investigation, and to suspend an inspection at his discretion pending criminal proceedings.

(h) **Provisions concerning self-incrimination**

- There should be an express obligation on the inspector/investigator to inform a person required to provide explanations of the provisions concerning the use of self-incriminating evidence, similar to those in section 187 of the SFO.
- There should be express provisions in the new CO stating that
 - (i) self-incrimination would not be an excuse for not producing any record or document in addition to giving any answers and explanations;
 - (ii) records or documents obtained under compulsory powers should not be used in criminal proceedings against the person who produced the records if upon being reminded, the person made a claim of incrimination on the record or document.

(i) **Enforcing compliance with inspectors'/investigators' requirements**

- The existing provisions of the CO regarding search warrants should be improved by incorporating relevant features of the SFO and the Financial Reporting Council Ordinance (“FRCO”) such as the power to apply for a search warrant before a formal request for documents had been made; the power to retain any original record or document removed under the authority of a warrant for a period generally not exceeding 6 months; the issue of a search warrant to a specified person other than a police officer; the application of section 102 of the Criminal Procedure Ordinance³⁵ to property which had come into the possession of the inspector/investigator etc.

- The powers to enforce compliance should be strengthened/modified as follows :-
 - (i) the civil courts should be empowered to enforce compliance with any reasonable requirements by an inspector/investigator;
 - (ii) the court should have power not only to punish any failing person as if he had been guilty of a contempt of the court but also to order him to comply with the inspector’s or the investigator’s requirements.

- There should be power to impose restrictions on share dealings where there were difficulties in finding out information about the ownership of the shares.

(j) **Provisions protecting informers**

- There should be provisions in the new CO to give protection (by granting immunity from liability for disclosure) to persons who volunteered information to facilitate inspection/investigation. Such protection should be available to any person who gave

³⁵ Section 102 of the Criminal Procedure Ordinance provides inter alia that where any property has come into the possession of a court, the police or the Customs and Excise Service in connection with any offence, then, whether or not the offence was committed or appears to have been committed in Hong Kong, a court may dispose of such property in the manner provided in that section.

information.

- There should be protection against disclosure of the identity of the informers as evidence in court proceedings. But the court should have the power to cancel it if the court was satisfied that the informer had falsified the information.

(k) Dissemination of Inspector’s Report

- The dissemination of the inspector’s report under the CO should be subject to greater control including giving the FS the discretion to decide whether to provide a copy of the report to the company or shareholders, and to prevent premature access to a copy filed with a court.
- An inspector should be allowed to make letters or part of the report confidential prior to their dissemination to a possible witness.

(l) Statutory “gateway” for information flow

- The CO should enhance the confidentiality of information obtained from an inspection/investigation and define more clearly how such information might be disclosed to other regulatory authorities, through the introduction of a statutory “gateway” with reference to section 378 of the SFO and section 51 of the FRCO³⁶.

(m) Findings of Fact as Evidence of Fact in Court Proceedings

- The finding of fact by an inspector stated in his report should be regarded as prima facie evidence of that fact in civil proceedings.

(n) Restraining Orders

- In addition to the injunction order under section 350B of the CO, the FS should be permitted to apply to the court for other types of restraining order similar to those available under the SFO

³⁶ The SFO and FRCO have detailed provisions on confidentiality and the statutory “gateway” about the passing of information obtained from investigation/enquiry to a number of regulatory authorities, including, for example, the CE, the FS, the DoJ etc. (sections 378(3)(f) and (g) of the SFO). Any person obtaining the information pursuant to the statutory “gateway” shall not disclose the information to any person subject to certain exceptions, for example, for the purpose of seeking legal advice; in connection with judicial proceedings; pursuant to a court order; etc. The FRCO contains similar provisions to the SFO in this respect (section 51 of the FRCO).

including orders to

- (i) restore parties to their original position before the transaction;
- (ii) restrain or prohibiting the dealing of property;
- (iii) declare a contract to be void or voidable;
- (iv) restrict any person to be a director, liquidator, receiver or manager or to take part in the management of a corporation for a maximum of 15 years.

(o) **Clarifying provisions for recovering expenses**

- The provisions relating to recovering the expenses of inspection from other parties should be clarified along the following lines :-
 - (i) The inspector might make recommendations in his report as to the extent of the liability of the convicted person and other persons who were ordered to pay damages, to restore property or to pay costs, to repay the Government any expenses of and incidental to the inspection.
 - (ii) “Expenses of and incidental to” an inspection should include overheads and general staff costs of the FS and insurance premiums for the inspector.

8.3 The recommendation which had not been endorsed by the SCCLR was in relation to whom the power to early terminate an incomplete inspection should vest. The SCCLR considered that the FS, as opposed to the court as recommended by AG4, should be the proper authority to early terminate an inspection if it was well justified. The reasons being that :-

- the person with the power to appoint should generally have the power also to terminate;
- it would be time-consuming and costly for the court to go over all the documents involved in the inspection; and
- there were already sufficient safeguards against the FS’s decision.

(II) The Companies Registry's General Investigatory Powers

- 8.4 The SCCLR noted that the CR had only very limited investigatory power under the current CO and appreciated the difficulty it had in performing its regulatory role under the current provisions. However, that justification alone was not sufficient to argue for providing the CR with very wide and intrusive general investigatory powers as people nowadays were very wary about regulators having too much power.
- 8.5 The SCCLR considered some of the investigatory powers proposed by AG4 to be given to the CR, including, in particular, the power to require attendance and take statements, excessive and disproportionate to the nature of the offences involved. It recommended that the CR should review the offences provisions in the CO and come up with a revised set of investigatory powers which were commensurate with the offences involved.

CHAPTER 9

Functions of the Registrar of Companies

Background

9.1 The SCCLR considered the recommendations made by AG2 on the following subjects relating to the Registrar and her functions, namely :-

- Registration provisions of the CO
- Striking-off and de-registration of companies

(I) Registration Provisions of the CO

9.2 The SCCLR endorsed a series of proposals made by AG2 to clarify or define the powers of the Registrar to maintain (records concerning companies on a public register) and make them available for public search. The major proposals are summarized below³⁷.

(a) Application of the registration provision

- The registration provisions should apply not only to Hong Kong companies but also to non-Hong Kong companies, unless the context otherwise required.

(b) Power to determine fees and to reject documents for non-payment

- To enable the Registrar to provide value-added and tailor-made services to meet different requirements of customers, the Registrar should have the right to determine fees on a cost recovery basis where no fee had been set out in the regulations.
- The Registrar should be empowered to reject any document

³⁷ Notwithstanding the AG2's and the SCCLR's recommendations, on operational grounds upon the advice of the Registrar, not all the recommendations as set out in this paragraphs would be taken on board the Companies Bill as the Registrar considered that some of the recommendations were impracticable and some of the new powers proposed for her might not be appropriate in the Hong Kong context.

delivered to him for no-payment of the relevant fees.

(c) **Power to specify requirements and require documents to be delivered electronically**

- In view of the introduction of electronic filing of documents, the Registrar should be empowered to –
 - (i) specify requirements as to authentication and manner of delivery (save that the Registrar should not be authorized to require documents to be delivered by electronic means); and
 - (ii) reach agreements with individual companies with respect to the electronic filing of documents with the Registrar. The Financial Secretary should have the power to make rules to require any documents or any class of documents to be delivered by electronic means;
- The requirements for proper delivery should be clearly defined and those documents which failed to meet the requirements for proper delivery should be treated as not having been delivered. Nevertheless, the Registrar should have discretion to accept them for registration.

(d) **Right to refuse registration and require production of further documents, etc.**

- For the purpose of upholding the integrity of the register kept by the Registrar, the Registrar should be empowered to –
 - (i) refuse registration of documents on the grounds of non-compliance, inconsistency, extraneousness or doubts as to the signatory's authority. In addition, the Registrar should have the power to require the document to be appropriately amended or completed and resubmitted, or that a fresh document be submitted in its place or that a supplementary document be submitted; and
 - (ii) require a person who submitted a document to produce such document, information or proof of his authority as the Registrar might consider necessary in order to form an

opinion on whether to register the document. The only legal consequence of non-compliance with the requirement should be limited to the refusal of the filing of the document in question.

(e) **Right to rectify the register and make annotations**

- In order to allow rectification of the register, the Registrar should –
 - (i) be empowered, on application or at her own discretion, to rectify typographical or clerical errors on the register;
 - (ii) have the power to require a company to resolve any inconsistency on the register relating to it;
 - (iii) upon an order of the court, rectify or remove any material on the register that derived from anything invalid or ineffective or that was done without the authority of the company; and
 - (iv) be able to make annotation on the register recording any correction, rectification or removal made to the register, subject to any court direction.

(f) **Inspection of the register**

- Instead of keeping the documents delivered to the Registrar, the Registrar could keep electronic records of the documents. Section 305 of the CO on inspection, production and evidence of documents kept by the Registrar should be amended to provide for the right to inspect the “register” and the right to copy material on the “register”. What constituted the “register” should be clearly defined.
- The Registrar should provide for electronic means of application for inspection or copy of the register.
- A record of a document filed with the Registrar should be admissible in proceedings as prima facie evidence of the facts in them.

(g) **Liability of the Registrar**

- The Registrar should be exempted from any liability in connection with providing a service whereby documents might be delivered to the Registrar electronically subject to a proper system being maintained by her.

(h) **Offences relating to registration**

- The Registrar should be given the power to require a person whose information was included on the register to update the information or confirm the same on the register as accurate.
- The *mens rea* threshold for the offence of making false statement should be lowered so as to broaden the ambit of the offence. At present, section 349 of the CO provided that any person who willfully made a false statement to the Registrar would be liable to an offence.
- Section 349A of the CO which provided for the offence of dishonest destruction etc., of the registers books or documents should be updated to take account of filing and storage of document in electronic form.

(II) **Striking-off and De-registration of Companies**

9.3 The SCCLR endorsed all the recommendations made by AG2 relating to the striking-off and de-registration of companies. The key ones are summarized below.

(a) **Striking-off procedure**³⁸

- The striking-off procedure currently under the CO should be streamlined by synchronizing the publication of the first gazette notice (being the gazette notice of intention to strike the name of a company off the register) with the sending of the second letter to the company from the Companies Registry. At present, the first gazette was published one month after the second letter was sent.

³⁸ Striking-off of defunct companies are currently provided under sections 291 and 291A of the CO. Section 291 provides the Registrar with a discretionary power and a set of procedures to strike-off the register on company where she has reasonable cause to believe that the company was defunct.

(b) De-registration of companies³⁹

- De-registration of companies should apply to all companies irrespective of whether they are private or non-private. However, certain “public interest” companies listed in Schedule 16 of the CO should continue to be excluded.
- If a company was ordered to be struck off and dissolved by the court under section 291A of the CO, the liability of every officer and member of the dissolved company should continue and might be enforced as if the company had not been dissolved.
- Two additional requirements should be satisfied if a private company’s application to the Registrar for de-registration is to be granted, namely,
 - (1) the company should not be a party to any legal proceedings; and
 - (2) the company had no outstanding interest in any immovable property situation in Hong Kong⁴⁰.

(c) Restoration procedure

- A new administrative restoration procedure similar to the one under sections 1024 to 1028 of the CA 2006, should be adopted as an alternative procedure to restore to the register companies which have been struck-off by the Registrar of Companies under section 291 of the CO.
- The three routes currently available for restoration of dissolved companies through an application to the court under sections 290(1), 291(7) and 291AB of the CO⁴¹ respectively should be

³⁹ De-registration of companies are currently provided under section 291AA of the CO. Section 291AB provides for the reinstatement of a de-registered company. Under section 291AA, the company, a director or a member may apply to the Registrar to be de-registered if –

- (a) all the members agree;
- (b) the company has never commenced business or has ceased to carry a business or ceased operation for more than 3 months; and
- (c) the company has no outstanding liabilities.

⁴⁰ This additional requirement was proposed to be added by the Director of Lands and endorsed by AG2, the SCCLR and the Steering Committee overseeing the CO rewrite.

⁴¹ Section 290(1) provides that the court may make an order to declare the dissolution of a company

combined into one following the CA 2006 model⁴². The time limits for an application to the court for restoration should subject to certain exceptions be made within 6 years.

- The length of time during which a director of a company was required to keep all the books and papers of the company after its dissolution subsequent to the company being struck off or deregistered should be changed to align with the time allowed for restoration or reinstatement as recommended, i.e. 6 years in general.
- There should be express provision in the CO for change of name in circumstances where the restoration of a company has the effect that two companies with the same or very similar names appeared in the Registrar's index.

(d) Effect of revival

- There should be express provisions in the CO to the effect that where a dissolved company was restored to the register after the Government had disposed of its property vested in the Government as bona vacantia, the Government was entitled to deduct reasonable costs of disposal which had been incurred when reimbursing the restored company.

(e) Property of dissolved companies

- Section 292A of the CO should be revised to clarify that property vested in the Government pursuant to section 292 should remain subject to all liabilities attached to the property.
- Section 290C(1) of the CO should be revised to clarify that the restriction for the Government to disclaim immovable property should be limited to such property situated in Hong Kong only.

wound up and dissolved under certain specified provisions to be void at any time within 2 years of the dissolution.

Section 291(7) provides for the restoration of a company which has been struck-off and dissolved under that section. It allows the company, a member or creditor to apply to the court before the expiration of 20 years from the dissolution for the company to be restored.

Section 291AB(2) provides for the reinstatement of a de-registered company either because the Registrar has made a mistake or by the order of the court. An application under this section to the court can be made within 20 years of the de-registration.

⁴² Sections 1029 – 1032 of the CA 2006.

- The timeframes for executing a notice of disclaimer in section 290(3) should be extended from 12 months to 3 years from the date on which the vesting of the property under section 292 came to the notice of the Registrar, and from 3 months to 12 months after the receipt of a written application asking the Registrar to clarify whether he could disclaim.

CHAPTER 10

Offences and Punishment

Background

10.1 The SCCLR considered the recommendations made by AG4 relating to:-

- the general principles of law and policy issues with regard to offence and punishment provisions under the CO;
- new administrative measures for securing compliance of the company law obligations; and
- Registrar's certificate as prima facie evidence of the fact as to whether a document had or had not been delivered to the CR on a particular date for registration

10.2 Most of AG4's recommendations were endorsed. The more important ones are summarized below.

(I) General principles of law and policy issues

- The current regime of attaching criminal liability to both the company and the officers in default should be retained.
- An officer should be regarded as "in default" if he has authorized or permitted, participated in, or failed to take all reasonable steps to prevent, the contravention⁴³.
- If the default of the corporate officer was caused by the default of its officer, that culpable officer should bear the same criminal responsibility⁴⁴.

⁴³ Reference is made to section 1121(3) of the CA 2006. The current threshold to establish "in default" (i.e. knowingly and wilfully) was considered to be too high. The revised definition would make it easier for the prosecution to establish the offence.

⁴⁴ The SCCLR considered that this underlying principle in subsection (2) of section 1122 of the CA 2006 helpful but subsection (1) of the provision (i.e. "Where a company is an officer of another company, it does not commit an offence as an officer in default unless one of its officers is in default") should not be adopted because it would add an additional hurdle to prosecution. This

- Regulatory offences under the CO penalizing officers should not be made strict liability offences as far as officers in default were concerned.
- Daily default fine should be retained. Offences with the same level of fine should have the same level of daily default fine as in CA 2006.
- After convicting a defendant company or officer for failure to file annual returns and accounts, the sentencing court should be empowered to make an order requiring the company or the officer of the company to remedy the default within a specified period, and non-compliance of such order should be a criminal offence.

(II) New administrative measures for securing compliance of company law obligations

- The Registrar should be empowered to compound⁴⁵ certain offences under the CO. However, in the case of annual returns, the SCCLR was of the view that the Registrar should issue a reminder to all the companies prior to the due dates of filing. If any company failed to file its annual return after the due date, a compounding offer should be issued immediately.
- Compoundable offences should be limited to those offences which
 - (i) related to non-compliance of filing obligations and affixture of names or the like;
 - (ii) were punishable only by a fine or a fine and a daily default fine (i.e. not by imprisonment); and
 - (iii) triable summarily only.

(III) Registrar's certificate as prima facie evidence

- The Registrar should have the statutory power to issue a

modified AG4's recommendation that the whole section 1122 should not be adopted.

⁴⁵ If a regulator is empowered to "compound" an offence, he may offer a person who is reasonably suspected of having committed an offence an opportunity to avoid prosecution of that offence by paying an amount to the regulator and rectifying his breach, if applicable. If that person accepts such an offer, no prosecution will be initiated against him for that offence.

certificate admissible as prima facie evidence of fact as to whether a document has or has not been delivered to the CR on a particular date for registration.

- The Registrar's certificate might be issued
 - (i) for any legal proceedings initiated by the CR for prosecution;
 - (ii) to other public enforcement agencies upon application for any legal proceedings, and
 - (iii) to the public upon application and payment of a fee for any legal proceedings.

CHAPTER 11

Pre-Consultation on the Requirement to Publish Supplemental Prospectuses and the Right to Withdraw

Background

- 11.1 The SFC issued a pre-consultation letter on 16 January 2008 seeking views from a select group of market participants, including the SCCLR, on its proposed Withdrawal Mechanism (as defined in paragraph 11.2) in the context of an IPO of shares to be listed on the SEHK.
- 11.2 According to the SFC's proposal, the Withdrawal Mechanism comprised the obligation of an issuer to announce a material adverse change arising since the prospectus date, to publish supplemental prospectuses and to allow retail investors the right to withdraw.
- 11.3 The SFC's policy justification for the introduction of the Withdrawal Mechanism was that investors should be able to withdraw if an issuer had become aware of a new circumstance that had arisen since the prospectus date that would have been required to be disclosed in the prospectus if it had occurred prior to the prospectus date and was materially adverse from the perspective of prospective investors.

Recommendations

- 11.4 At the 207th meeting on 8 March 2008, the SCCLR considered the proposed Withdrawal Mechanism with the assistance of two representatives from the SFC. As a result of deliberations, members concluded that the proposed Withdrawal Mechanism, which allowed retail investors to withdraw even after the close of the IPO, was not workable in practice and suggested that it be dropped even though the intention behind the proposal was good. In coming to that conclusion, members had taken into account, inter alia, the

following :-

- If the adverse change was so material that it caused the withdrawal rights to be exercised, the deal should be terminated rather than to continue.
- The proposed Withdrawal Mechanism for the retail tranche of an IPO would have a significant impact on the placing tranche and the price fixed, thus creating a lot of practical difficulties and uncertainties which would effectively put an end to the IPO.
- It would be easier in practice for the issuer to stop and restart the whole IPO process as there was unlikely to be sufficient time for the issuer to complete all the necessary steps and required formalities subsequent to the happening of a material adverse change, such as the printing of the supplemental prospectus, the drafting and publication of notices etc.

11.5 Members noted that there were some examples of unequal treatment between the retail and institutional investors under the current IPO system as well as enforcement problems. They considered those issues more fundamental to improving the current IPO system and suggested that focus should be on them instead of a Withdrawal Mechanism.