

CFRED's Third Company Law Colloquium

PERSPECTIVES ON THE NEW COMPANIES ORDINANCE

The Process and Some Outcomes

by

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The views given are those of the presenter's
and do not necessarily represent those of DoJ

OBJECTIVES

to give a brief overview of the background to the new CO and the process of the reform and of some of the major changes

BACKGROUND TO THE NEW CO

The current Hong Kong Company Law, the Companies Ordinance 1932, Cap 32, came into operation on 1 July 1933

Mostly a copy of UK Companies Act 1929

Before Cap 32 there had been –

The Companies Ordinance 1865 based on the UK Act 1862 and the Companies Ordinance 1911 based on the UK Acts of 1907 and 1908

The UK regularly consolidated its Company Law after 1929, in particular in 1948, following the Cohen Committee Report 1945, and in 1967, following the Jenkins Committee Report in 1962. In 1962 the Governor of Hong Kong appointed a Companies Law Revision Committee (CLRC) to make recommendations as to the revision of the company legislation and as to whether legislation for the prevention of fraud in relation to investments was required. However various circumstances and in 1969 public concern over problems with mutual funds and other investments diverted the Committee to give priority to those problems (resulting in the Committee's report in 1971 on The Protection of Investors and leading to the Protection of Investors Ordinance 1974 and the Securities Ordinance 1974), so it was not until 1973 that the Committee was able to report on Company Law.

Most of the recommendations of the CLRC found their way into the Companies (Amendment) Ordinance 1984 (which according to one commentator was the great leap forward to 1948, in that Hong Kong in 1984 was catching up with the UK's 1948 consolidation).

The final recommendation of the CLRC's report was for the establishment of a Standing Committee on Company Law Reform and the SCCLR was established by the Administration in 1984. SCCLR tended to react to particular problems and not review the CO as a whole.

In the Budget speech on 2.3.1994 the then FS announced a thorough review of HK's CO

The Consultancy Report on the Review of the CO ("the Pascutto Report") 1997 (North American Business Corporations Acts model)

Report of SCCLR on the Pascutto Report February 2000 (the Overall Review of the CO/ORCO) recommended restructuring and rewriting of the CO and urged a full review of the CO

In 2000 SCCLR began Corporate Governance Review (CGR) and a more systematic look at the CO

SCCLR Consultation paper on Phase 1 of CGR July 2001

In 2001 Financial Services and Treasury Bureau (FSTB) proposed implementation of SCCLR recommendations by series of Companies (Amendment) Ordinances and then Rewrite of CO

Joint Working Group of Government and HKICPA (established March 2002)

Companies (Amendment) Ordinance 2003

Final Recommendations of Phase II of CGR January 2004

Companies (Amendment) Ordinances 2004 and 2005

13 January 2006 LegCo Finance Committee gave go ahead to CO Review and the task began mid 2006 with Phase I (ie the CO excluding winding-up and associated provisions)

Some Statistics

y/e 31/3/1961

BR 68,045

CR 4,342

y/e 31/3/1988

BR 392,831

CR 190,935

y/e 31/3/1989

BR 431,513

CR 223,055

y/e 31/3/1990

BR 465,221

CR 247,620

y/e 31/3/2012

BR 1,134,032

CR 968,665

end July 2012

CR 1,006,115

Hong Kong has more companies
per capita than other jurisdictions

end Sept 2012

Aus 1,950,851

end Sept 2012

UK 2,938,932

(first time incorporated
businesses exceed unincorporated)

NB : In addition many
Hongkongers incorporate in the
BVI, Cayman Islands, Bermuda,
etc

Some More Statistics

Non-HK Companies

Registered under CO PART XI

y/e 31/3/1965

588

y/e 31/3/1973

763

y/e 31/3/1983

1,740

y/e 31/3/1993

3,284

y/e 31/3/1996

4,604

y/e 31/3/1998

5,312

Listed companies

y/e 31/3/1968

60

y/e 31/3/1973

260

y/e 31/3/1987

276

y/e 31/3/1996

583 (241 HK inc'd)

y/e 31/3/1998

680 (200 HK inc'd)

Listed companies (Cont'd)

Non-HK Companies

Registered under CO PART XI

y/e 31/12/2009

7,912

y/e 31/12/2011

8,554

More than half registered
in 3 jurisdictions BVI,
Cayman Islands, Bermuda

Many more foreign companies
on SEHK than in other
jurisdictions

30/6/2011

1,448 (202 HK inc'd,
610 PRC companies)

cf at same date

Australia

2,034 93 inc'd
outside Aus

London

2,914 593 inc'd
outside UK

Singapore

773 312 inc'd
outside Sing

COMPANIES ORDINANCE REWRITE

See generally <www.fstb.gov.hk/fsb/co_rewrite/eng/home>

4 main objectives – to enhance corporate governance, improve regulation, facilitate business and modernise the law

Guiding Principles

- Catering for SMES – “think small first”
- Enhancing corporate governance
- Complementing Hong Kong’s role as an international business and financial centre
- Encouraging the use of information technology
- Making use of statutory statements of common law
- Plain drafting and improved layout of CO
- Provide flexibility future updating : use of schedules, subsidiary legislation
- Not seeking to compete with BVI etc and to benchmark HK against jurisdictions such as the UK, Australia and Singapore

Illustrations of New CO changes reflecting the Guidelines

- Plain drafting and improved layout
eg Plain English, may be more understandable, but usually increases length
For layout see Parts of the new CO (slides 19 and 20, below)
Detail put into subordinate legislation which may be amended by FS
thus providing
- Flexibility for updating
- Catering for SMEs – “think small first”
Current CO premised on public company
New CO more emphasis on SMEs
eg expanded provisions for written resolutions
Current CO s 116B New CO ss 548-561
eg new power to dispense with AGM
New CO s 613 – by all members by written resolution or at GM

- Enhancing corporate governance

eg strengthening accountability of directors

Private co must have at least one natural person as director (new CO s 457). This introduced to deal with problem of corporate directors – a compromise

eg statutory duty of care etc for directors (s 465) see below

eg enhancing shareholder engagement in the decision making process by circulation of members' resolutions (new CO ss 351-354, 615-616) and members' statements (ss 580-583)

reducing threshold for members to demand poll from 10% to 5% (s 591)

eg improving disclosure of company information

Public and larger private companies which do not qualify for simplified reporting and guarantee companies to provide business review in directors' report (ss 388, 911 and Schedule 5)

eg fostering shareholder protection

more effective rules with regard to directors' conflicts of interest-loans etc - with disinterested shareholder approval for transactions of public companies and their subsidiaries (Part 11)

Ratification of directors' breaches to be by disinterested shareholders' approval (s 473)

New headcount test (s 674)

Strengthening auditors' rights

to obtain information from wider range of persons (s 412)

- Complementing HK's role as international business and financial centre

eg ensuring better regulation by –

improving accuracy of the Companies Register (ss 31-44), improving registration of charges system (Part 8), refining the system for deregistration of companies (Part 15), improving the enforcement regime by, inter alia, new definition of “responsible person” for “officers in default” (s 3) (see below), new offence for inaccurate auditors' reports (s 408), new power for Registrar of Companies to obtain documents and information in relation to suspected offences of providing false or misleading statement (ss 873-876), new power for RoC to compound minor regulatory offences (s 899)

eg measures for facilitating business by –

streamlining procedures – inter alia, dispensing with AGM (s 613), new court-free reduction capital procedure (ss 215-225), expanded power for all companies to purchase own shares out of capital subject to solvency test (ss 257-266), financial assistance with solvency test (s 285), new court-free inter group amalgamation procedure (ss 222-226), new procedures for restoration of dissolved companies (Part 15)

eg facilitating simplified reporting for SMEs (ss 441-442), general meetings may be held at more than one location using electronic technology (s 584)

eg modernising the law –

abolishing par value for shares and authorised/nominal capital (ss 135 and repeal of Part 1 and First Schedule of current CO)

abolishing memorandum of association (s 67(1)) removing power to issue stock (s 138)

removing power to issue share warrants to bearer (s 139)

better protection to personal data – withholding directors' residential address and full ID numbers from search of register (ss 37-60)

clarifying the rules on indemnification of directors against liabilities to third parties (ss 467-472)

Company seal no longer mandatory (s 124)

- encouraging the use of information technology

eg use of electronic communications for company to members and to CR and vice versa (Part 18)

GMs at more than one location, above

CO REWRITE

Process

Tentative Time Table included White Bill to be published for public consultation mid to end 2009 and introduction of Companies Bill (CB) to LegCo in Q3 2010 (UK rewrite exercise took from 1998 to CA 2006). Change of plan re single White Bill, as interim legislation needed for e-incorporation and e-filing and electronic communications. Other topical issues, eg shadow companies, *Waddington* decision on multiple derivative actions, added.

Companies (Amendment) Bill gazetted 22.1.2010

passed 7.7.2010 and 6 of 7 Parts already in operation (Part 7 on paperless holding and scripless trading of shares to come into operation once the Scripless Securities Market established)

Those involved in the Rewrite

FSTB (FS) – CR

Companies Bill Team (CBT)

DoJ : CD Comm III and LDD

Research period –

Advisory groups (5) –

- AG1 on Share Capital, Distribution of Profits and Company Charges
- AG2 on Company Formation, Registration, Meetings and Administration
- AG3 on Directors and Officers
- AG4 on Inspections, Investigation, Offences and Punishment
- Joint Government/HKICPA Working Group to Review the Accounting and Audit Provisions of the CO (JWG)

Papers for AGs prepared by CBT

Recommendations by AGs

To SCCLR for review

External Consultant

Public consultation

Consultation Documents

see CO Rewrite website <www.fstb.gov.hk/fsb/co_rewrite/eng/home>

1. March 2007 on Accounting and Auditing Provisions with Consultation Conclusions March 2008
2. April 2008 on Company Names, Directors' Duties, Corporate Directorship, Registration of Charges with Consultation Conclusions December 2008
3. June 2008 on Share Capital, The Capital Maintenance Regime, Statutory Amalgamation Procedure with Consultation Conclusions February 2009
4. December 2009 First Phase Consultation on Parts of Draft Companies Bill with Consultation Conclusions August 2010
5. May 2010 Second Phase Consultation on other Parts of Draft Companies Bill with Consultation Conclusions October 2010

After consideration of responses and SCCLR's view

CBT prepared DDIs to LDD for clearance by CD Comm III

Blue Bill gazetted 14.2.2011

First LegCo Bills Committee meeting 25.2.2011

Final meeting 5.6.2012

44 meetings over 120 hours

Bill passed 12.7.2012

Parts of the new Companies Ordinance

- Part 1 - Preliminary
- Part 2 - Registrar of Companies and Register
- Part 3 - Company Formation and Related Matters and Re-registration of Company
- Part 4 - Share Capital
- Part 5 - Transactions in relation to Share Capital
- Part 6 - Distribution of Profits and Assets
- Part 7 - Debentures
- Part 8 - Registration of Charges
- Part 9 - Accounts and Audit
- Part 10 - Directors and Company Secretaries
- Part 11 - Fair Dealing by Directors

- Part 12 - Company Administration and Procedure
- Part 13 - Arrangements, Amalgamation and Compulsory Share Acquisition in Takeover and Share Buy-back
- Part 14 - Remedies for Protection of Companies' or Members' Interests
- Part 15 - Dissolution by Striking off or Deregistration
- Part 16 - Non-Hong Kong Companies
- Part 17 - Companies not Formed, but Registrable, under this Ordinance
- Part 18 - Communications to and by Companies
- Part 19 - Investigations and Enquiries
- Part 20 - Miscellaneous
- Part 21 - Consequential Amendments, and Transitional and Saving Provisions

SOME MAJOR CHANGES

Part 1 Preliminary

s 3 “Responsible person”

Cf current CO s 351 “officer in default” means any officer of the company, or any shadow director of the company, who knowingly and wilfully authorizes or permits the default etc.

Heavy burden of proof on RoC. Difficult to successfully prosecute officers (means companies rather than their officers prosecuted).

Original definition of “responsible person” in blue Bill was an officer or shadow director of the company who authorizes or permits, participates in or fails to take all reasonable steps to prevent the contravention or failure.

LegCo Bills Committee members’ concern as to “fails to take all reasonable steps to prevent”.

Administration agreed to remove those words.

Part 20 Miscellaneous

Contains miscellaneous provisions relating to offences, relief to officers or auditors of a company in proceedings for misconduct and security for costs, mainly restating provisions in the current CO and a new power for the RoC to compound specified offences

Offences and Enforcement

Penalties for offences currently mostly set out in the Twelfth Schedule of the current CO. Prior to 1990 the penalties had been in the individual sections, but with the introduction of Levels of Fine thought it would be more convenient, if changes in levels, if in a Schedule. The new CO reverts to the penalties being in the individual sections

Disregarding offences for corporate insolvency and prospectus offences, there are some 150 criminal offences listed in the Twelfth Schedule

SCCLR in its February 2000 Report on the Pascutto Report recommended (Rec 145) that the question of offences and punishment be further studied

CR review of offences and punishments in 2004. 22 questions, including decriminalisation considered and rejected by SCCLR, in its 21st Report for 2004/5 Ch 1. Wait and see how civil market misconduct under SFO worked. CO Rewrite Advisory Group 4 considered the issue in 2007 and recommended retention of criminal sanctions. Accepted by SCCLR 24th Annual Report 2007/8 Ch 10 Classification offences –

- (a) Dishonesty Offences : 3 CO s 152D(1), s 275(3) and s 349A(1)
- (b) Intermediate Offences : 33 incl. provision of false statement or information, breaches of directors' duties
- (c) Regulatory (Filing) Offences : 38 involving disclosure to CR and integrity of the Register

- (d) Regulatory (Non-filing) Offences : 10 eg misleading name, relating to companies dealing with public
- (e) Regulatory (Non-filing) Offences : 52 regulatory relations between company and directors and shareholders relating to internal procedure
- (f) Regulatory (Non-filing) Offences : 14 relating to keeping and inspection of company records

Range of terms of imprisonment and fines

Fine Levels Level 1 (\$0 to \$2,000) to Level 6 (\$0 - \$100,000).

Daily default fines

Changes to offences in new CO

Alignment of penalties

Minor offences aligned at Level 3

Daily default fine abolished for 19 non-filing offences

New power of RoC to compound offence new CO s 899

RoC gives notice to offender to offer opportunity to rectify default by paying an amount to the RoC as a compounding fee and remedying the offence within a specified period. If offender accepts and complies with terms of notice, no prosecution will be initiated

The 6 offences which are compoundable are listed in Schedule 7 to the new CO, mostly filing offences, eg ss 74(2), 124(3), (4), 662(6), 789(3)

Security for costs in action current CO s 357, extended by new CO s 905 to where plaintiff company incorporated outside Hong Kong

Part 10 Directors and Company Secretaries

Corporate directors Not permitted, except for private company (other than a private company that is a member of a group of companies of which a listed company is a member) Old CO s 154A / new CO s 456

Push to prohibit corporate directors altogether, as encourage money laundering, etc (Financial Action Group Task Force), though they may serve a useful purpose for trust companies etc. Compromise in new CO s 457 Private company (other than one that is a member of a group of companies of which a listed company is a member) must have at least one director who is a natural person. Existing companies have 6 months from commencement of s 457 to comply Schedule 11 Part 10 s 89

S 457 does not apply to a company which, on the commencement of the section, is deemed to be a dormant company under s 344A of the current CO : Schedule 11 Part 10 s 89)

Registrar's direction to company to appoint director or company secretary New CO ss 458, 476

Statutory duty of care, skill and diligence Debate whether to codify all the principal duties, including fiduciary duties, as in UKCA 2006. Some commentators had concerns about, e.g. UK s 172 (Duty to promote the success of the company) and need to have regard to “interests of the company’s employees”, “impact of the company’s operations on the community and the environment”.

The standard of the common law duty of care, skill and diligence in Hong Kong not entirely clear. The subjective test in the old case law generally agreed to be no longer appropriate, and while in most Common Law jurisdictions there were clear judicial statements as to an objective or objective/subjective test, there was no clear authority for this in HK. As compromise, decided to codify duty of care, skill and diligence based on UKCA s 174

New CO s 465(2) Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with –

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (objective), and

(b) the general knowledge, skill and experience that the director has (subjective)

(4) The duty... has effect in place of the common law rules and equitable principles as regards the duty to exercise reasonable care, skill and diligence

(5) This section applies to a shadow director...

s 466... the consequences of breach (or threatened breach) of the duty... are the same as would apply if the common law rules or equitable rules that s 465(1) replaces applied.

Validity of acts of directors

Current CO s 157 / new CO s 461 goes further eg where ceased to be a director

Exemption and indemnification of officers against liability to company and provision of insurance current CO s 165

Currently covers officers and auditors. Auditors have specific provision in new CO (s 415)

New CO s 468 Avoidance of provisions protecting director from liability. Restates s 165, but extends the prohibition to include any indemnity provided by a related company and extends scope of permitted liability insurance to directors of a related company.

Indemnity in relation to negligence etc in relation to third parties formerly covered by common law agency rules. New CO s 469 (Permitted indemnity provision) against liability incurred by a director to a third party.

Specified fines, penalties, costs etc not covered.

Permitted indemnities to be disclosed in directors' report (s 470) and copies to be kept (s 471) and to be available for inspection by members (s 472)

Ratification of conduct by directors by disinterested members' approval
New CO s 473

Ratification by a company of conduct of a director involving negligence, default, breach of duty or breach of trust in relation to the company

By resolution by the members of the company

... every vote by a member who is a director in respect of whose conduct the ratification is sought, or who is an entity connected with that director or holder of any shares in the company in trust for that director or entity, is to be disregarded

S 473(6) Nothing in this action affects –

- (a) the validity of a decision taken by unanimous consent of the members of the company; or
- (b) any power of the directors to agree not to sue, or to settle or release a claim made by them on behalf of the company

Corporate Capacity and Directors' Authority

Current CO - Powers of company – powers of natural person

New CO s 115

Where company's exercise of powers limited by memorandum of association (MA) (when new CO comes into operation MA will be abolished and any limitation on powers must be in articles of association (AA)) -

Under current CO, shareholders can seek to restrain act of company beyond powers (s 5B(2), but usually will not be able to act in time) and similarly under new CO s 116(3), unless the act to be done is in fulfilment of a legal obligation arising from a previous act of the company.

An act of a company is not invalid by reason only of it being beyond powers : current CO s 5B(3) and similarly new CO s 116(5)

Protection of outsiders

Directors often act on behalf of company (by decision of whole board or one director signing contract on behalf of company). Director as agent of company – actual or implied actual authority

Ostensible or apparent authority – where company represents (usually by conduct or position of director or job title) that director has authority and outsider relies on the representation and does not know or should suspect that director exercising power for purposes other than the purposes of the company

Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd [1964]2 QB 480, CA 505; *Hely-Hutchinson v Brayhead Ltd* [1968]1 QB 549, CA, 593

In Company Law there is a special rule, independent of agency – the rule in *Royal British Bank v Turquand* [1856]6 El & Bl 327 - the indoor management rule, ie outsider entitled to assume that all matters of internal management and procedure required by the articles have been complied with

But *Turquand* rule does not apply to forgeries, or where the person seeking to rely on the rule is not an outsider, or where the outsider has notice of an irregularity or is put on inquiry

A person is not regarded as having notice of any matter merely because the matter is disclosed in the articles of the company or a return or resolution kept by the Registrar of Companies : current CO s 5C; similarly new CO s 120

New additional provision for protection of outsiders in new CO s 117 (copied from UK CA provisions)

In favour of a person dealing with a company in good faith, the power of the company's directors to bind the company, or authorize others to do so, is to be regarded as free of any limitation under any relevant document of the company

A person dealing with a company is presumed, unless the contrary is proved, to have acted in good faith : s 117(2)(b)

A person dealing with a company is not to be regarded as acting in bad faith by reason only of the person's knowing that an act is beyond the directors' powers under any relevant document of the company : s 117(2)(c)

A person dealing with a company is not required to inquire as to the limitations on the power of the company's directors to bind the company or authorize others to do so : s 117(2)(d)

This provision does not affect any right of a member to bring proceedings to restrain the doing of an act that is beyond the directors' powers (unless the act to be done is in fulfilment of a legal obligation arising from a previous act of the company), nor does it affect any liability incurred by directors, or any other person, by reason of the directors' exceeding their powers

Dealing with a company. What if an imposter pretends he represents the company? The generally accepted view is that if a document is put forward as a decision of the board of a company by someone appearing to act on behalf of company, in circumstances where there is no reason to doubt its authenticity, the person dealing with the company in good faith should be able to take the document at its face value.

OTHER MAJOR CHANGES

Part 1 Preliminary

New CO ss 7 to 12 Types of companies

Types of companies that can be formed under the current CO	Types of companies that can be formed under the new CO
private companies limited by shares	private companies limited by shares
non private companies limited by shares	public companies limited by shares
private companies limited by guarantee without share capital	companies limited by guarantee without a share capital
non-private companies limited by guarantee without share capital	
private unlimited companies with a share capital	private unlimited companies with a share capital
non-private unlimited companies with a share capital	public unlimited companies with a share capital

(continued)

Types of companies that can be formed under the current CO	Types of companies that can be formed under the new CO
private unlimited companies without share capital	-
non-private unlimited companies without share capital	- (continued)
s 12 Public company not a private company and not a company limited by guarantee s 66 Types of companies that may be formed under new CO	

Part 2 Registrar of Companies and Companies Register

Clarification of Registrar's functions and powers in relation to registration of documents

Part 3 Company Formation and Related Matters, and Re-registration of Company

Greater role of incorporation form

s 68 (Content of incorporation form) Expansion of contents Schedule 2

Retiring the of Memorandum of Association

s 67 (Formation of company) no mention of memorandum of association

s 98 (Conditions of memorandum of association of existing company to be regarded as provisions of articles)

Subdivision 3 Content and Effect of Articles

Mandatory Articles

s 81 (Company name)

s 82 (Company's objects)

s 83 (Members' liabilities)

s 84 (Liabilities or contributions of members of limited company)

s 85 (Capital and initial shareholdings)

Model Articles ss 78 to 88 Companies (Model Articles) Notice

Part 4 Share Capital

Retiring the concept of par value

s 135 (No nominal value)

- (1) Shares in a company have no nominal value.
- (2) This section applies to shares issued before the commencement date of this section as well as shares issued on or after that date.

See Schedule 11 Part 4 Division 2 for transitional provisions eg treatment of share premium account and capital redemption reserve, references in contracts and other documents to par or nominal value

s 138 repeal of power to issue stock (cf current CO s 53(1)(c))

s 139 repeal of power to issue share warrants (ie share warrants to bearer (current CO ss 73, 97))

ss 140-141 (see s 57B of current CO applies only to allotment of shares). Shareholders' approval also required for grant of rights to subscribe for, or to convert securities into, shares (cf UKCA ss 549, 551)

Part 5 Transactions in relation to Share Capital

Covers reduction of capital, share redemptions and buy-backs and financial assistance by company for acquisition of own shares

Attempt to rationalise the complex rules in current CO ss 47A to 48 and ss 49 to 49S

A uniform solvency test

Reduction of Share Capital

New method (additional to court order) of special resolution supported by solvency statement (ss 215 to 225)

Share redemption and Buy-backs

New additional method of special resolution supported by solvency statement, objectors may apply to court

Financial assistance

General prohibition retained (s 275)

General exceptions – principal purpose exception (s 278) etc expanded (ss 277 to 282)

3 special cases (ss 283 to 284) including solvency statement with court application by objectors (ss 285 to 289)

Part 6 Distribution of Profits and Assets

Mostly restatement of current CO provisions

Part 7 Debentures

Mostly debentures dealt with in current CO along with shares. In new CO debentures given separate provisions aligning with shares provisions

Part 8 Registration of Charges

Part III of current CO retained with modifications

New registrable charges – charge on instalments due, but not paid, on issue price of shares (s 334(1)(f))

Charge on aircraft or share in aircraft (s 334(1)(h))

Charge for purpose of securing issue of debentures (current CO s 80(2)(a)) deleted

Charge-back of company's deposit with another (see LARCO s 15A for validity of charge) not regarded as charge on book debts of company (s 334(3)(b))

Ship owner's lien on subfreights for amounts due under charter not to be regarded as charge on book debts (s 334(4))

No automatic acceleration of repayment obligation if unregistered

Lender has option (s 337(6))

Copy charge to be on register (ss 335, 336, 338, 339), so third parties have notice of all terms

5 weeks' period for delivery of particulars etc reduced to one month (s 335(5) etc)

Part 9 Accounts and Audit

To update the accounting and auditing provisions to align with the Hong Kong Financial Reporting Standards.

New terminology : “accounts” become “financial statement” etc

Clarification of “financial year” with “accounting reference period” etc

Relaxing the qualifying criteria for private companies to prepare simplified financial and directors’ reports (in current CO s 141D) and to enable more private companies and small guarantee companies to prepare simplified financial and directors’ reports.

Directors’ Report to include Business Review

Contents of Report expanded in Regulation

Auditors – new provisions for appointment etc

Enhancing auditor’s right to information

Outgoing auditor to make statement of circumstances

Revamping summary financial reporting provisions and extending to companies generally

Current law CO ss 141CA to 141CH apply to listed companies only

New CO ss 441 and 442 companies (except those preparing simplified accounts) have choice whether to send copy summary financial report instead of copy reporting documents

Companies (Summary Financial Reports) Regulation

Controversial new offence for auditors (new CO s 408) if auditor knowingly or recklessly fails to include in report statement required by s 407(2)(b)(statement that the company's financial statement does not agree with the accounting records in any material respect) or by s 407(3)(statement that necessary and material information and explanation not obtained)

Covers where auditor natural person, the auditor and every employee and agent of auditor eligible for appointment as auditor; where auditor is a body corporate, every officer, member, employee and agent of auditor eligible for appointment as auditor; where auditor a firm, every partner, etc

Part 11 Fair Dealing by Directors

Contains provisions relating to situations in which a director is perceived to have a conflict of interest, including transactions involving directors or their connected entities which require members' approval (eg loans etc, payments for loss of office and directors' long-term employment) and covers disclosure by directors of material interests in transactions, arrangements or contracts Current CO ss 157H to 157J and 162 to 164

Prohibitions on loans etc to cover wider category of persons connected with director (ss 486 to 488)

New exemptions from prohibition on loans etc with prescribed approval of members New CO ss 500 to 504

New exception for small loans etc not exceeding 5% of net assets or called up capital s 505

New exception for expenditure on defending proceedings etc (s 507) or in connection with investigation or regulatory action (s 508), subject to conditions as to financial limit and requirements as to repayment

Decriminalisation current CO s 157J Civil consequences only. New CO ss 513 to 515

Requiring members' approval for substantial property transactions, ie company purchase from director or director purchase from company (see UKCA ss 190 to 196 derived from CA 1980). One of the "casualties" of the Rewrite. Recommended by SCCLR in 20th Annual Report 2003/4 ch 1 pp 11-17. Listing Rules Chapter 14A Connected Transactions – exemption for de minimis transactions, waivers. SCCLR's recommendation not followed up, as would remove flexibility of LR. The topic reviewed by CO Rewrite Advisory Group 3, who recommended following UK and SCCLR recommend adopting UKCA ss 190 to 196 with modifications in its 2007/8 Annual Report. Part 11 Division 5 of the Companies Bill published in December 2009 contained draft provisions. These were subsequently deleted from the Bill on the ground that it would have subjected the directors of Hong Kong listed companies to more stringent disclosure requirements than directors of non-Hong Kong listed companies.

Part 12 Company Administration and Procedure

Covers resolutions and meetings, procedure at meetings, registers, notifications to Registrar of changes to directors and company secretary, registered office, publication of name, annual returns

Significant changes include –

Procedures for proposing, passing and recording written resolutions (New CO ss 548 to 561 cf current CO s 116B)

Enhancing members' powers to require directors to circulate members' resolutions and statements

Meeting may be held at more than one location by using any technology which enables members to listen, speak and vote (s 584)

Reducing threshold for members to demand a poll from 10% to 5% of the total voting rights (s 591 of current CO s 114D)

Circumstances in which company not required to hold AGM (s 612 of current CO s 111(6)) if done by written resolution and one member company

Allowing all companies to dispense with the holding of an AGM by unanimous members' consent (s 613)

Regulations for inspection of company records and making and provision of copies (s 657) Company Records (Inspection and Provision of Copies) Regulation notice procedure etc

Facilitating use of electronic communications between company and members in electronic form or by website (ss 560, 572, 573, 599)

New CO s 571 notice for AGM 21 days

notice for any other meeting of limited company

14 days

Part 13 Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back

Contains provisions relating to schemes of arrangement or compromise with creditors or members, reconstructions or amalgamations of companies and compulsory acquisitions of shares following a takeover offer or following a general offer for a share buy-back Current CO ss 166, 166A, 167, 168, 168B and Ninth and Thirteenth Schedules

Headcount test current CO s 166 Re PCCW Ltd case

s 166(2) ... “majority in number” (“headcount test”) “representing three-fourths in value of the creditors... or members... .” (“share value test”) court may sanction scheme which will be binding on all creditors or members, ie court still has discretion whether or not to sanction scheme even if both tests are satisfied.

Listed companies must also satisfy rule 2.10(b) of the Takeovers Code, ie the number of votes cast against the scheme must not be more than 10% of the votes attaching to disinterested shares

S 166 commonly used in privatisations, where listed companies in liquidation sell their listing status, group reorganisations to create new holding company

Some relevant facts – the section originally only applied to insolvent company schemes until extended to non-insolvent schemes in 1900

Headcount test inconsistent with “one share one vote” principle

But most shares in listed companies within the Central Clearing and Settlement Scheme (CCASS) are registered in the name of HKSCC Nominees Ltd which votes one vote each way in a scheme vote

The problem of share splitting *Re PCCW Ltd case*

Australian amended s 411(4) of the Corporations Act in 2007 to give the court a discretion to approve a members' scheme if it is approved by a 75 per cent majority in value even though majority in number is not obtained ("unless the court order otherwise"), specifically to deal with share splitting. But subsequently the Australian Corporations and Markets Advisory Committee recommended that the headcount test be removed, but this has not happened yet

Choices for members' schemes – no change, abolish the headcount test or retain headcount test but give court discretion to dispense with it
Draft Bill issued with Second Phase Consultation Paper in May 2010 retained the headcount test in clause 13.8 and the general discretion to approve scheme or not

Blue Bill issued in January 2011 clause 664 followed Australian provision giving court discretion in relation to members' scheme to order otherwise even if headcount test satisfied and general discretion

New CO s 674 headcount test retained for creditors' or class of creditors' schemes, ie majority in number representing at least 75% in value of creditors or class of creditors voting and general discretion in court (s 673(2))

For members' schemes the headcount test and the general discretion is retained, but the court may order otherwise (s 674(1)(c)(ii)), and for an arrangement involving a general offer within the meaning of s 707 or a takeover offer the test is at least 75% in value of members voting and the votes cast against the arrangement do not exceed 10% of the total voting rights attached to all disinterested shares in the company (as defined in s 674(3)) (s 674(2)(a)(ii), (b)(ii))

Specific provision as to costs (s 676)

Part 14 Remedies for Protection of Companies' or Members' Interests

Restates with improved drafting and some extensions existing provisions (unfair prejudice remedy current CO s 168A, statutory injunction current CO s 350B, statutory derivative action current CO ss 168BC to 168BK and members' inspection of company's records current CO s 152FA to 152FE)

Part 15 Dissolution by Striking off or Deregistration

Streamlining the existing procedures for striking-off and restoration of companies and imposing new requirements to prevent abuse of the deregistration procedure Current CO ss 290 to 292A

Part 16 Non-Hong Kong Companies

Generally restating Part XI of the current CO as amended by Companies (Amendment) Ordinance 2004

Part 17 Companies not Formed, but Registrable, under the Ordinance

Deals with companies not formed under the new CO or a former CO, but usually under some other Ordinance, and eligible to be registered under the new CO. Mainly restates, with some modifications, Part IX of the current CO

Part 18 Communications to and by Companies

Relates to communications in electronic or hard copy form between a company and its members, debenture holders and other persons and also deals with communications sent by a company (particularly a listed company) to its members and debenture holders by means of a website. Largely restates provisions in Companies (Amendment) Ordinance 2010

Part 19 Investigations and Enquiries

Reorganizes and restates the existing provisions in Part IV of the current CO under Inspection (s 142 to 152) and Inspection of Companies' Books and Papers (ss 152A to 152F). Reference has been made in some of the new provisions to similar provisions on investigations under the Securities and Futures Ordinance and the Financial Reporting Council Ordinance. The power to inspect books is rephrased as power to enquire into the company's affairs. In addition the Registrar of Companies is given power to obtain documents or information to ascertain whether any conduct that would constitute certain specified offences under CO (s 750 false or misleading statement on application for deregistration and s 895 misleading, false or deceptive statements in returns etc, in both cases made knowingly or recklessly) has taken place (ss 873-876).

END

Thank you for your attention