



## **CONSULTATION PAPER DRAFT COMPANIES BILL**

### **First Phase Consultation**

The Consultation Paper and Draft Bill circulated by the Financial Services and the Treasury Bureau in late December 2009 have been thoroughly considered by the Law Society's Company and Financial Law Committee, and the Securities Law Committee. The following represent the considered views of the Law Society on views on the specific questions raised in the Consultation Paper as well as commentary on the Consultation Draft on Parts 1, 2, 10-12 and 14-18 of the Companies Bill:

#### **I - Consultation Questions**

##### **Question 1**

In respect of members' schemes of listed companies, which of the following options do you prefer? Please explain the reasons.

Option 1: retain the headcount test;

Option 2: retain the headcount test but give the court a discretion to dispense with the test; or

Option 3: abolish the headcount test.

##### **Law Society**

We favour **Option 3 - the abolition of the headcount test so far as listed companies are concerned. The headcount test has been rendered largely irrelevant as investors could choose to deposit their shares with different brokers or use a number of nominees to hold their shares. Giving the court the discretion to dispense with the headcount test will create uncertainty which is not desirable for corporate exercises. In any event, even with the abolition of headcount test, the court still retains the discretion not to sanction a scheme of arrangement. Safeguards for minority protection could also be placed on Rule 2.10(b) of the Takeovers Code and reform initiatives in securities and investors protection legislation.**

##### **Question 2**

(a) If your answer to Question 1 is Option 3; do you think that the headcount test should also be abolished in respect of members' schemes of non-listed companies?

##### **Law Society**

We consider that the headcount test could be abolished for non listed companies. Schemes are uncommon for small private companies. Non listed public companies may use a scheme for corporate restructuring exercises. However, non listed public companies are subject to the Takeovers Code and the safeguard under Rule 2.10(b) would apply.

- (b) If your answer to (a) is yes, do you think that some form of additional protection should be provided for small shareholders? If so, what should such protection be?

**Law Society**

**No, please see our comments in paragraph (a) above.**

**Question 3**

If your answer to Question 1 is Option 2 or Option 3, do you think that the same approach should apply to creditors' scheme?

**Law Society**

**No. The headcount test should be retained for creditors' schemes. The position of creditors bears little resemblance to that of shareholders in the context of schemes of arrangements. The interests of the largest creditors do not usually align with the small creditors, and the circumstances of indebtedness owed by a company to these creditors may vary substantially. For example, some of the smaller creditors may not have been given the same quality information by the debtor company when compared with the largest creditors. The reasons for abolition of the headcount test of members' scheme do not apply to creditors' scheme.**

**Question 4**

- (a) Do you agree that directors' residential address should continue be made available for inspection on the public register?

**Law Society**

**Some members consider that it is not in the public interest that regulatory and enforcement agencies, creditors and liquidators be able to contact directors personally through their residential addresses (emphasis underlined). It should be enough that service of legal or court documents on the directors may be effectively made by delivery at the company's registered office. Under the current regime, there is no Hong Kong residency requirement for directors. Hence, directors residing outside Hong Kong can properly give a foreign address. Hong Kong's regulatory and enforcement agencies have no jurisdiction over persons residing outside our jurisdiction and for enforcement matters it is not too meaningful for foreign directors to give their residential addresses.**

**There is also no systematic check on whether the residential addresses of directors registered at the Companies Registry are valid. A person intending to evade obligations as a director can supply an overseas address or move elsewhere without difficulty.**

**Some members consider that directors' residential addresses should continue to be made available for public inspection for the following reasons:**

- (i) there have not been incidents of harassment or intimidation in Hong Kong occurring at directors' residences as a result of public disclosure of such information;**
- (ii) given directors are subject to various fiduciary duties and/or personal liabilities, the public disclosure of their residential addresses do not only facilitate service of notices and processes but probably enhances a sense of**

- responsibility on their part as they know they can be still contactable even if their companies are closed down or wound up; and
- (iii) the UK and Australian approaches have their respective problems and are not inexpensive to run.

Some members, on the other hand, favour a modernization of the current approach such that directors' residential addresses are not generally available for public inspection. The practice of disclosing this information in public registers appears to have developed with two main aims: (1) as a means of precisely identifying the director (particularly when carrying out checks as to disqualification, other directorships or business interests and personal creditworthiness); and (2) to facilitate service of process on a director.

While harassment and intimidation of directors of "controversial" companies is not currently an issue in Hong Kong, it may become an issue either locally or as a result of foreign activists obtaining information about directors resident in their country from overseas registers. The risk to individuals outweighs the benefit of making directors' residential addresses a matter of public record.

- (b) If your answer to (a) is in the negative, do you think that either:
- (i) the Australian approach (paragraph 7.8 and 7.9); or
  - (ii) the UKCA 2006 approach (paragraph 7.10(b)) should be adopted?

#### **Law Society**

For those members who favour a modernised approach, they support a move to the approach used in the UKCA 2006. The Australian approach is akin to that used in the UK prior to UKCA 2006. That approach proved defective in some respects and imposes a greater administrative burden on the registrar.

- (c) If you consider that either the Australian or the UKCA 2006 approaches should be adopted, do you have any suggestions on how to tackle the practical problems highlighted in paragraph 7.13(c) to (e) above?

#### **Law Society**

Paragraph 7.13(d) - The requirement for the Companies Registry to maintain a separate (confidential) register of residential addresses of directors does not seem particularly onerous. There is likely to be a fairly lengthy lead-in period for the new provisions to come into effect, giving plenty of time for the Registry to modify its systems in an appropriate manner. Furthermore, we are not convinced that updating two separate registers adds unreasonably to the Registrar's administrative burden. Making a failure to file changes to the directors' residential address a criminal offence, should sufficiently deal with any potential issues of inadvertent or intentional failure to notify changes to the Registrar.

Of greater concern is the issue of access. The whole purpose of making the residential addresses of directors confidential (i.e. for reasons of personal protection) will be negated if the net is cast as wide as suggested in paragraph 7.13(d). We would support a more restrictive approach. We believe the interests of shareholders, creditors,

**employees and the other parties mentioned will be adequately protected by a requirement for directors to declare an address for service.**

### **Question 5**

- (a) Do you think that there is a need to mask certain digits from the identification numbers of new records of directors and company secretaries on the public register?

**Law Society**

**No. Identification numbers should be recorded and disclosed in full as it is a unique piece of information for identifying a person; the name of a person is not. Persons with identical names are not uncommon.**

**An identification number is not a reliable tool for authenticating the identity of a person in electronic or telephone transactions. Use of identification number for authentication purpose is itself a misuse and should be discouraged.**

- (b) If your answer to (a) is yes, do you have any views on how to deal with personal identification numbers on existing records?

**Law Society**

**Not applicable.**

### **Question 6**

On the assumption that a new disinterested members' approval exception to prohibitions on loan and similar transactions in favour of directors and their connected persons will be introduced in respect of public companies, which of the following options do you prefer?

- Option 1: "relevant private companies" as defined in section 157H(10) of the CO should continue to be subject to more stringent regulations similar to public companies (including restrictions relating to quasi-loans and credit transactions, restrictions relating to connected persons and disinterested members' approval requirement);
- Option 2: extending the concept of "relevant private company" to cover companies associated with non-listed public companies;
- Option 3: modifying the concept of "relevant private company" by disapplying it to private companies having a common holding company with a listed/public company;
- Option 4: modifying the concept of "relevant private company" to cover only private companies which are subsidiaries of a listed/public company; or
- Option 5: abolishing the concept of "relevant private companies", i.e. all private companies should be subject to the same treatment.

Any other option (please elaborate)?

**Law Society**

**We prefer option 4 i.e. modifying the concept of "relevant private company" to cover**

only subsidiaries of a listed/public company. However, given that non listed public companies are not subject to the regulation of the Hong Kong Stock Exchange, clear definition of “disinterested members” should be included in the CO.

The other options are too stringent and will be casting the net too wide. For example, the acts of private holding companies of listed companies do not have a financial impact on the listed group and the requirement could easily be avoided by using offshore companies as holding vehicles.

### **Question 7**

Do you consider that the common law derivative action currently preserved in section 168BC(4) of the CO should be abolished in the CB?

#### **Law Society**

Some members are of the view that common law derivative actions should be preserved to allow members of foreign companies to bring a derivative action in Hong Kong. There are still a large number of companies which are incorporated outside Hong Kong without a Part XI registration but with most or all of its shareholders in Hong Kong and which are set up for a number of reasons such as tax planning and asset protection. For example, BVI companies are commonly used as holding or intermediate holding companies. Abolishing common law derivative action may deprive such shareholders effective remedy, without obvious benefits to the other members of the community.

Some members are of the view that the benefits in terms of simplicity and certainty, of operating a single statutory regime, outweigh the arguments in favour of retaining the parallel common law and statutory regimes.

Ribeiro PJ in *Waddington* pointed out that the co-existence of both the statutory and common law derivative actions may lead to problems where a member seeks to invoke both and that the co-existence of both the statutory and common law regimes is unusual in an international context and is a source of confusion and complication.

The learned judges went on to consider whether the removal of the common law right of action would prejudice shareholders of an overseas incorporated company to bring a derivative action in Hong Kong. They concluded that it would not, on the basis that the question of whether a derivative action is available is a matter of the law of the place of incorporation of the company concerned. Some of the language used by the judges in both *Waddington*<sup>1</sup> and *Konamaneni*<sup>2</sup> (referred to in *Waddington*) appear to suggest that an alternative interpretation is possible. However, until the matter is the subject of a judicial decision (and in that regard, it is important to note that the opinions of the judges in *Waddington* on this issue did not form part of the decision in that case) there is a small risk that shareholders in overseas incorporated companies which are not registered under the Companies Ordinance may be prejudiced by the removal of the common law right of action. It is important not to overlook this risk in the Hong Kong context, where foreign companies without Part XI registration are

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<sup>1</sup> See Lord Millett NPJ in paragraph 55, which reads (emphasis added) “If the question whether a derivative action is available is a question of substantive law, as the Bills Committee thought...”

<sup>2</sup> See Lawrence Collins J in paragraph 128, which reads (emphasis added) “In my judgment the courts of the place of incorporation will almost invariably be the most appropriate forum for the resolution of the issues which relate to the existence of the right of shareholders to sue on behalf of the company.”

common. For those members who favour the abolition of the common law derivative action, they suggest that it may be necessary to amend the statutory provisions in order to assist in claims by shareholders of overseas incorporated companies, rather than retaining the two separate regimes.

## **II - Comments on the “Explanatory Notes on the Draft Parts”**

### **Part 1 - Preliminary**

- (a) Reducing the types of companies that can be formed to five, namely, (i) private companies limited by shares; (ii) public companies limited by shares; (iii) private unlimited companies with a share capital; (iv) public unlimited companies with a share capital; and (v) guarantee companies that do not have share capital; and

#### **Law Society:**

**We agree with the proposed amendments to (i) streamline the types of companies and abolish the category of unlimited companies without share capital; and (ii) strengthen the enforcement regime.**

- (b) Replacing the phrase “officer who is in default” with “responsible person” and refining the definition to strengthen the enforcement regime (such as lowering of the threshold for a breach or contravention by removing willfulness as an element of the offence, inclusion of negligent acts or omissions and expansion of the categories of persons to be caught).

#### **Law Society**

**We have reservations about the proposal to replace the enforcement trigger of “*knowingly and wilfully authoris[ing] or permit[ting] the default, refusal or contravention*” by “*authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention*”. This essentially takes away the mental element in a breach which leads to liability and extends liability to negligent acts and omissions.**

**Whilst it would be a positive development for Hong Kong to strengthen its compliance standards, in reality the vast majority of companies in Hong Kong are privately-owned small enterprises managed by directors with no professional training and little or no understanding of laws and regulations. Lowering the mental standard to negligence will expose many of these persons to penalties. We would urge the Government to subject this issue to further public consultation and debate.**

**We note the proposed extension of liability for an offence to an officer of a corporate officer which commits such offence, where the first mentioned officer has caused the corporate officer to be in default. In line with the rationale of strengthening the enforcement regime, please consider if it is appropriate to also fix liability for such offence upon the corporate officer, similar to section 1122(1) of the UKCA 2006.**

#### ***Company, subsidiary and holding company***

**The definition of "company" in s.1.2 is tautologous. It says "a company means a company ...". This drafting leaves some scope for improvement.**

In some cases the definition gives rise to conceptual problems. Under s.1.2 the word "*company*" means "*a company formed and registered under the Ordinance or an existing company*". On a literal reading of this provision, the possibility of a company incorporated outside Hong Kong should have been excluded. However, this is obviously not the case in the definition for "*body corporate*" which includes a "*company*" incorporated outside Hong Kong.

Similarly, Part XI uses the word "*company*" for non-HK companies and thereby introduces a possibility that "*company*" could include both HK- and non-HK-incorporated companies.

However, we note that the new definitions of "*holding company*" and "*subsidiary*" should go a long way towards removing most remaining uncertainties about requirements or restrictions (e.g. financial assistance provisions) that affect a holding company or subsidiary, which at present seem to suggest that they could be circumvented simply by inserting an overseas-incorporated intermediary. Whether the revised definitions are appropriate cannot be evaluated in isolation, but must be read within the contexts in which the redefined terms are used.

#### *Listed company*

The revised definition of "*listed company*" leaves it unclear whether companies listed by depositary receipts are included.

#### *The "public"*

Ever since the 2004 enactment of the Securities and Futures Ordinance, the "*public*" for most securities law-related purposes has been expressly restricted to the Hong Kong public under Schedule 1 to the SFO. There was further clarification in 2004 with the enactment of Schedule 17 to the CO where, in paragraph 1 of Part 4, persons outside Hong Kong are specifically carved out from the definition of an "*offer*" for the purposes of the prospectus regime.

However, without a general definition of the "*public*" in the CO, some uncertainty remains especially in areas outside the Schedule 17 context. We would urge the Government to consider inserting a general definition of the "*public*", or clarifying the concept in each relevant provision.

#### *Shares held in a fiduciary capacity*

The new s.1.13 states that for the purposes of defining a "*holding company*" and a "*subsidiary*", powers exercised or shares held in a "*fiduciary capacity*" will be disregarded. Presumably the purpose is to exclude the likes of agents and trustees. However, there are a number of conceptual and practical difficulties with this approach:

- (1) The use of the term "*fiduciary*" (which is undefined under the revised law) brings in a large body of common law on the precise meaning of the term.
- (2) The application of this concept only to definitions of "*holding companies*" and "*subsidiary*" is inconsistent with the general concept of company membership under the Ordinance, which does not exclude fiduciary or agency holdings.

- (3) **Recognition of underlying equities (which in many cases may remain unresolved for some time) on a share or on voting powers may lead to the company being deadlocked from action pending the resolution of such equities.**
- (4) **For provisions such as s.124(1) where the subject company is required to do certain things in relation to its subsidiaries, the uncertainties left by the undefined fiduciary concept is less problematic, as the company is more likely to be in a position to identify its own holdings of shares or voting powers in a fiduciary capacity. For provisions such as s.28A or s.165 where a safe harbour or prohibition affects group companies, it can be difficult for the subject company to identify its own holding company by excluding interests held in a fiduciary capacity, especially as the subject company and its parent may both be public listed companies without the close connection normally found in privately-owned groups.**

**Similar considerations apply to 1.17 parent undertakings and subsidiary undertakings, with the additional complication that the fiduciary concept may not exist in jurisdictions where the relevant undertakings are incorporated.**

## **Part 2 – Registrar of Companies and Register**

- (a) Clarifying and enhancing the Registrar’s powers in relation to the registration of documents, such as specifying requirements as to the authentication of the documents to be delivered to the CR and manner of delivery and withholding registration of unsatisfactory documents pending further particulars;

### **Law Society**

#### ***“Unsatisfactory document”***

**In relation to the new provisions for the Registrar to reject registration of "unsatisfactory documents" which includes documents containing unnecessary material, there is a risk that if the company (which may or may not have the benefit of legal advice) attempts to file a document which contains both necessary and unnecessary materials, for example a list of resolutions some of which are required to be registered while some are not. In such a case, s.2.18(6) will subject the company to a charge that the necessary and relevant portions have not be filed in time, giving rise to penalties which may prove unnecessarily harsh in practice.**

**We would suggest that, in addition to the s.2.19 power to withhold registration and the 2.20 right to appeal, there be a "severance" provision to enable the Registrar to treat as duly filed the portions of the document which contain necessary and correct material, provided that the document as rectified under s.2.18(3) is re-filed within a specified time (e.g. 3 days).**

- (b) Clarifying and enhancing the Registrar’s powers in relation to the keeping of the register, such as rectifying typographical or clerical errors, making annotations, and requiring a company to resolve any inconsistency or provide updated information; and
- (c) Introducing a new court-based procedure for removing from the register information that is inaccurate, forged or derived from anything invalid, ineffective or done without the authority of the company.



**Law Society**

**We agree with the proposed amendments in sub paragraphs (b) and (c) above.**

**Part 10 – Directors and Secretaries**

(a) Restricting corporate directorship in private companies;

**Law Society**

**We do not support the proposal of restricting corporate directorship in a private company which is not a member of a non listed group. This will place Hong Kong in a less competitive position when compared with other jurisdictions that permit full corporate directorship.**

**If the proposal to require at least one natural person is maintained, consideration should be given to making available exemptions to companies where the rationale of enhancing corporate governance is less relevant. Examples of these exemptions are: (i) a company which is deemed to be dormant under section 344A of the CO; and (ii) a small private company that does not exceed certain prescribed financial thresholds measured against its net assets, turnover, profitability, etc.**

**Clause 10.3: For private companies that have only one member who is also the sole director of that company, the procedure in Clause 10.3 for nominating a reserve director does not reduce the number of ‘dead’ companies if the sole member cum director does not nominate a reserve director before his death.**

(b) Enabling the Registrar to give directions to a company relating to the appointment of directors and secretaries;

**Law Society**

**Consideration should be given to enhancing the Registrar’s power of enforcement in circumstances where the imposition of a fine is not effective to secure compliance. Possible measures include empowering the court to order the company to be struck off upon application by the Registrar where the company continues to be in default despite the imposition of a fine.**

(c) Codifying directors’ duty of care, skill and diligence;

**Law Society**

**We do not oppose the proposal of adopting an objective/subjective test with the objective test as the minimum standard. Given however that there is a lack of clear case authorities in Hong Kong in this respect, there is uncertainty how the Hong Kong courts will apply the mixed objective/subjective test and in the absence of sufficient clarity, this may operate unfairly on the directors and discourage more qualified persons to assume the role of a director. With this in mind, it might be helpful to observe the UK experience before deciding to implement such a change in Hong Kong.**

(d) Setting out rules on indemnification of directors against liabilities to third parties; and

**Law Society**

**We support the proposal but would suggest the following:**

- (i) **the indemnity in favour of the director must be recorded in writing, duly authorised and executed by the company giving it. Clause 10.20(2)(b) of the Companies Bill contemplated that indemnity provision may not be in writing and in such case, only a written memorandum setting out the terms of the indemnity is required to be kept by the company and disclosed to its shareholders. A permitted indemnity provision that is not in writing will create uncertainty;**
  - (ii) **the permitted indemnity provision should not cover any civil proceedings brought by a shareholder in a derivative or similar action in which judgment is given against the director. Clause 10.18 (2)(b)(ii) should be expanded; and**
  - (iii) **in Clause 10.18(2)(b)(ii), any penalty payable in respect of non-compliance with any regulatory requirement is excluded from the scope of a permitted indemnity. An exemption should be provided for a regulatory requirement that is a purely routine administrative matter and has inconsequential impact on the shareholders, for example, any default fine payable for failure to comply with any routine filing or registration requirement under the Companies Bill.**
- (e) Requiring ratification of conduct of directors by disinterested shareholders' approval.

#### **Law Society**

**We support the proposal but would suggest the following:**

- (i) **in Clause 10.22(6), ratification by disinterested shareholders is not required if there is a unanimous vote of all shareholders; a ratification may prejudice creditors. An unanimous vote to ratify should be valid only if the company is solvent as at the date of the passing of the resolution ratifying the act; and**
- (ii) **Clause 10.23(4) states that section 10.22 applies to conduct by a director on or after the commencement of that section. That means a negligent act or breach of duty occurring before commencement of section 10.22 can be ratified without approval by the disinterested shareholders. We believe that section 10.22 should catch any act of ratification that occurs after commencement of the section.**

#### **Part 11 – Fair Dealing by Directors**

- (a) Expanding the prohibitions on transactions to cover a wider category of persons connected with a director;

#### **Law Society**

**We support the proposal generally, subject to the following:**

- (i) **Clause 11.19 prohibits a public company to enter into a credit transaction. A credit transaction is broadly defined and includes supplies of goods and services to a director or a connected entity. The available exemptions (please also see comment on 11(b)) are different than that allowed under the Listing Rules. In certain respects, the Companies Bill is more stringent as, for example, the Listing Rules exempt the acquisition of consumer goods and services in the ordinary course of business of a listed issuer. More importantly, as the majority of public companies are listed companies, this will create two different regulatory regimes**

for “*connected transactions*”. This creates an additional administrative burden for listed issuers which do not seem to be outweighed by any benefits to shareholders;

- (ii) In addition to the approval of its members before making any quasi loans or entering into a credit transaction, a public company must also seek the approval of its holding company’s members under Clauses 11.17(2) and 11.19(2). However, if the holding company is incorporated offshore, this additional requirement does not apply. While the reasons for excluding offshore companies are understood, this will encourage the use of offshore companies as holding vehicles to minimise regulatory compliance. The exclusion of offshore companies will render the additional requirement largely superfluous. In any event, we consider that the additional requirement of having the transaction approved by a holding company’s shareholders does not serve any substantive purpose. If a holding company is itself a listed company, it will already be subject to the requirement in Clauses 11.17(1) and 11.19(1) and the Listing Rules; and
  - (iii) Under Clause 11.30, an infringing transaction can be validated if it is affirmed by the company within a reasonable period after it is entered into. To avoid uncertainty, a definite cure period should be stated which can be extended with a court order.
- (b) Introducing new exemptions from prohibitions on loans and similar transactions in favour of directors and connected entities;

**Law Society**

We consider that the available exemptions should mirror those under the Listing Rules to avoid having two different regimes for listed issuers. Specifically, the financial limits for small loans, quasi loans and credit transactions imposed under Clauses 11.21 and 11.22 are expressed in fixed sums of between HK\$150,000 and HK\$750,000. This does not take into account the company size and is too inflexible. An alternative is to express the limit as the lower of (i) a fixed sum which is higher than the current limits and (ii) a fixed percentage of the company’s net tangible assets value, akin to that provided for under Clause 11.25(2)(a).

- (c) Repealing the criminal sanction provisions in section 157J of the CO Ordinance;
- (d) Extending the application of the prohibitions on payments for loss of office;

**Law Society**

**We support the proposals in (c) and (d) above.**

- (e) Requiring members’ approval for a director’s employment exceeding 3 years and requiring a company to keep directors’ service contracts available for members’ inspection;

**Law Society**

**We support the proposal but would suggest that the director’s service contract in excess of 3 years must be recorded in writing, duly authorized and executed by the parties. Throughout Clauses 11.52 and 11.53, it is contemplated that such a service**

contract may not be in writing and in such case, only a written memorandum setting out its terms is required to be kept by the company and disclosed to its shareholders. Given the approval and disclosure requirement attached to a service contract of over three years, there ought to be proper formality requirements and the entire contract should be produced to the shareholders for approval and inspection.

(f) Requiring members' approval for substantial property transactions;

#### **Law Society**

We support the proposal generally subject to the following:

- (i) the available exemptions are too stringent. For example, the thresholds proposed, being HK\$1,500,000 or HK\$10,000,000, regardless of the size of a listed company is too inflexible and could be more restrictive than the de minimis thresholds under Chapter 14A of the Listing Rules. Please also refer to our comment on credit transactions about creating two different regimes for listed issuers;
- (ii) the manner of approval drafted seems to suggest that approval will need to be sought at different layers of intermediate holding companies. The resulting administrative inconvenience does not seem to be outweighed by any conceivable benefits to the shareholders as a whole; and
- (iii) under Clause 11.61, an infringing transaction can be validated if it is affirmed by the company within a reasonable period after it is entered into. To avoid uncertainty, a definite cure period should be stated which can be extended with a court order.

(g) Requiring disinterested members' approval in the case of public companies; and

(h) Widening the ambit of disclosure currently under section 162 of the CO.

#### **Law Society**

We support the proposals in (g) and (h) above.

### **Part 12 Company Administration and Procedure**

(a) Introducing a comprehensive set of rules for proposing and passing a written resolution;

#### **Law Society**

We support the proposal. In Clause 12.13, a company is required to send to each member and the auditor of the company a copy of the written resolution within 15 days after it is passed, failing which the company and every responsible officer are liable for a fine. The requirement to send to its auditors every written resolution passed will create unnecessary administrative burden for both the company itself and the company's auditors. As a company is required to maintain all resolutions in its book of minutes, subsequent inspection by the auditors during their audit work should suffice. We propose to remove the requirement of sending the auditor a copy of the written resolution.

- (b) Enhancing members' powers to require directors to circulate members' resolutions;
- (c) Requiring a company to bear the expenses of circulating members' statements relating to business of, and proposed resolutions for, AGMs, if they are received in time for sending with the notice of the meeting;
- (d) Permitting a general meeting to be held at more than one location by using audio-visual technology;
- (e) Reducing the threshold requirement for members to demand a poll from 10% to 5% of the total voting rights;
- (f) Giving members a right to inspect voting documents (including proxies and voting papers);
- (g) Clarifying the rights and obligations of a proxy;
- (h) allowing companies to dispense with AGMs by unanimous shareholders' consent;
- (i) Clarifying that the court may refuse to compel compliance with a request for inspection or a copy of the register of members, directors or secretaries if the right is being abused;
- (j) Empowering the Financial Secretary to make regulations to require a company to display its name and related information in certain locations and state prescribed information in documents or communications.

**Law Society**

**We support the proposals in (b) to (j) above.**

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

- (a) Extending the scope of the unfair prejudice remedy to cover "proposed acts and omissions";
- (b) Enhancing the court's discretion in granting relief in cases of unfair prejudice; and
- (c) Allowing a member of an associated company to bring a statutory derivative action on behalf of the company ("multiple derivative action").

**Law Society**

**We generally agree with the approach of widening the scope of the unfair prejudice remedy to cover "proposed acts and omissions" and enhancing the courts' discretion in granting relief in such cases so that we are more in line with the UK Companies Act. There is, however, a concern of a large number of small claims being brought to court by disgruntled shareholders in small private companies. These court claims can be substantial, time-consuming and costly on taxpayers. Consideration should be given to promoting (outside of the CO) alternative methods to enable disgruntled shareholders of small private companies to resolve their differences outside of court e.g. by providing for more detailed exit mechanisms in the articles of association (including Table A). We also suggest that if changes along the lines of the UK**

Companies Act were implemented, s.214 of the SFO (which empowers the SFC to bring actions against listed companies in cases of, among other things, unfair prejudice (or oppression against minority shareholders)) should similarly be amended.

We agree with the legislative amendments in relation to statutory derivative action as they (a) provide for an effective mechanism by which shareholders of a related company (not just the company itself) can bring a derivative action on behalf of the company; and (b) bring Hong Kong more in line with comparable jurisdictions like Australia, New Zealand, Canada and Singapore.

We also wish to make the following comments on the proposed amendments this part:

Section	Original Text	Proposed amendments
14.18(2)(b) - Court's general powers to order and direct	Without limiting subsection (1), the Court of First Instance may do any or all of the following under paragraph (a) or (b) of that subsection -  (a)...  (b) give a direction concerning the conduct of the proceedings or application;	Without limiting subsection (1), the Court of First Instance may do any or all of the following under paragraph (a) or (b) of that subsection -  (a)...  (b) give directions concerning the conduct of the proceedings or application;

### Part 15 – Dissolution by Striking Off or Deregistration

- (a) Extending the voluntary deregistration procedure to public non-listed and guarantee companies with some exceptions;
- (b) Imposing additional conditions for deregistration of defunct companies;
- (c) Streamlining the procedures for restoration of dissolved companies by court order; and
- (d) Introducing a new procedure of “administrative restoration” of a dissolved company by the Registrar.

#### Law Society

We agree with the proposed amendments in (a) to (d) in this part. We also wish to make the following comments on the proposed amendments this part:

Section	Original Text	Proposed amendments
15.29(6) - Effect of restoration on bona vacantia property or right	There may be deducted from the amount payable under subsection (5) the Registrar's reasonable costs in connection with the disposition or dealing to the extent that the costs have not been paid to the Registrar as a condition of a restoration under section <u>15.20</u> or	There may be deducted from the amount payable under subsection (5) the Registrar's reasonable costs in connection with the disposition or dealing to the extent that the costs have not been paid to the Registrar in complying with a condition for restoration under section <u>15.19</u> or

	<p>pursuant to a direction under section 15.26.</p> <p><i>Section 15.20 - Registrar's decision on application</i></p> <p><i>(1) the Registrar must notify the applicant of the decision on an application made under section 15.18.</i></p> <p><i>(2) If the Registrar grants the application, the company is restored to the Register on the date on which notification is given under subsection (1), and the Registrar must register the notification and publish in the Gazette a notice of the restoration.</i></p>	<p>pursuant to a direction under section 15.26.</p> <p><i>Note 1: see below provisions of 15.19 and 15.20 for comparison</i></p> <p><i>Section 15.19 - Conditions for granting application</i></p> <p><i>(1) The Registrar must not grant an application made under section 15.18 unless all the conditions specified in subsection (2), and any other conditions that the Registrar thinks fit, are met.</i></p> <p><i>(2) The conditions are -</i></p> <p><i>(a) the company was, at the time its name was struck off the Register, in operation or carrying on business;</i></p> <p><i>(b) if any immovable property situate in Hong Kong previously vested in or held on trust for the company has been vested in the Government under section 15.9(1), the applicant has obtained, at the applicant's own costs, the Government's confirmation that it has no objection to the restoration,;</i></p> <p><i>and</i></p> <p><i>(c) the applicant has delivered to the Registrar the documents relating to the company that are necessary to bring up to date the records kept by the Registrar.</i></p>
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## **Part 16 – Non-Hong Kong Companies**

- (a) Clarifying provisions for striking non-Hong Kong companies off the register and their restoration to the register; and
- (b) Modifying the penalty provisions to align with those of Hong Kong incorporated companies.

### **Law Society**

**We agree with the proposed amendments in (a) and (b) in this part.**

## **Part 17 - Companies not formed, but Registrable, under this Ordinance**

This relates to CO Part IX which provides for the registration of companies which are formed pursuant to any ordinance other than the CO or a former CO or otherwise

constituted according to law. No significant changes – only to remove the archaic provisions on “joint stock company” (as no such company currently exists).

**Law Society**

**We agree with the proposed amendments in this part.**

## **Part 18 – Communications to and by Companies**

(a) Setting out the rules governing communications to and by companies in electronic form; and

(b) Facilitating communications sent by companies to their members by means of a website.

**Law Society**

**Use of electronic communications, including website communications, should be encouraged from an environmental point of view and to ensure that Hong Kong is in line with international practices. For example, the amended Companies Act 2006 allows a company in the UK to send a document or information in electronic format to a person who has agreed and where such person has not revoked that agreement. Australia has taken a more radical stance in that the amended Corporations Act 2001 now requires shareholders to request a hard copy of the company’s annual report, otherwise, the company is only required to post a copy of its annual report on their website.**

**The CO currently requires express consent by a shareholder to written communications between it and the company to be given by electronic means. Pursuant to amendments to the Listing Rules which came into effect on 1 January 2009, a listed issuer can deem a shareholder to have consented to corporate communications being made available to him on the issuer’s website provided that certain procedures are followed (e.g. the procedure must be approved by shareholders’ resolution in a general meeting and allowed by the issuer’s constitutional documents, an individual request must be made to each shareholder, consent is deemed only when there is no response from the shareholder within a 28-day period and request must not be made again within 12 months).**

**The discrepancy between the requirements under the Listing Rules and the CO means that overseas incorporated listed issuers are subject to a less onerous standard than their Hong Kong counterparts. Therefore, we agree that there should be similar amendments to the CO so that both Hong Kong and non-Hong Kong incorporated listed issuers can benefit from the new procedures relating to electronic and website communications. Furthermore, unnecessary costs can be saved from printing and posting hard copies of corporate communications to all shareholders. This is more environmentally friendly and reflects the advances made in information technology.**

**It would be helpful if clarification could be provided on whether a corporate shareholder can be deemed to have agreed to receive electronic communications from the company of which it is a shareholder. Pursuant to section 18.11(3)(a)(ii), a document can be sent in electronic form if the corporate shareholder “is regarded under a provision of this Ordinance as having so agreed”. On the other hand, it seems that the provisions in Part 12 of the Companies Bill would not deem a corporate shareholder as having consented to receive electronic**



**communications from the company of which it is a member. Therefore, even if the shareholder is deemed to have agreed to website communications pursuant to section 18.13(4), it seems that the notification required under section 18.13(3)(c) would still need to be provided to the shareholder in hard copy, unless it has agreed that such notification can be sent to it in electronic form and whether all of the matters set out in this section are required to be notified every time something is posted on the website.**

## **DRAFTING COMMENTS**

### **Section 1.4(3)**

- We suggest adding a new subsection (f) for other person or entity specified by the Registrar to certify a translator’s competence in order to allow maximum flexibility in adding new categories of acceptable persons going forward.

### **Section 1.12 to 1.20**

- We note that the difference in the definitions of “holding company”/“subsidiary” and “parent undertaking”/“subsidiary undertaking” have been retained. These are most obvious when comparing Section 1.12(1) with Section 1.16(1)(b). We find the difference in the definitions confusing and possibly unnecessary. We note that the UK Companies Act 2006 (sections 1159, 1162 and Schedules 6 and 7) has adopted the IAS definition (i.e. Section 1.16(1)(b)) for both and to a large extent, has also made the provisions contained in the existing Schedule 23, CO, applicable to both. We would be grateful if the FSTB would give this matter further consideration.
- Aside from issues of consistency, we believe that the definition of “holding company” and “subsidiary” should depend only on control and not participation in profits. Thus the appropriateness of Section 1.12(1)(c), read together with Section 1.12(5), should in our view be revisited.

### **General comment regarding Part 2**

- Please consider adding a provision to deal with the point at which a document will be considered delivered to the Registrar.

### **Sections 2.16(2)(a) and (b)**

- What do “altered” document and “altered” signature mean? It is unclear why a document or signature that is “altered” would immediately be considered unsatisfactory as a result of section 2.16(1)(a).

### **Section 2.18(1)**

- Please consider changing the first part of the sentence to read “Where a document is delivered to the Registrar for registration, ...”.

### **Sections 2.18(1)(a) and (b)**

- Under section 2.16, a document is unsatisfactory if it falls within (among other things) subsection (2) of that section. Subsection 2.16(2)(c) would seem to cover the situation where a document is not properly delivered under section 2.11. If that is the case, section 2.18(1)(a) is unnecessary as it is already covered by section 2.18(1)(b).

**Sections 2.18(2) and (3)**

- There is no time limit on when the Registrar needs to revert as to whether a document is acceptable for registration. This could lead to uncertainty and raises concern especially where it is important to determine the exact date (and time) of registration of a document.

**Section 2.18(4)**

- This provides that even if a document is not properly delivered to the Registrar, the Registrar may register it if, in the opinion of the Registrar, the document is not unsatisfactory. This seems to be in conflict with section 2.16(1)(2)(c) which says that a document will be considered unsatisfactory if it is not properly delivered.

**Section 2.21(4)**

- This provides that penalty is payable from the 14th day after the date of notice of refusal to register is sent by the Registrar. However, under section 2.20, a person may appeal to the Court within 42 days if the Registrar refuses registration of a document. No penalty should be payable until the time for appeal has lapsed.
- In addition, for clarity, there should be a provision which states that the Registrar must provide reasons for its decision to refuse the registration of a document.

**Section 10.20(2)**

- There are a number of provisions in the Bill which refer to a “prescribed place” where documents are available for inspection. Presumably this will be a place in Hong Kong. We look forward to further elaboration as to the meaning of the term.

**Section 10.22**

- Ratification of conduct by director amounting to negligence has to be done by resolution of members who are unconnected with the director. In the context of many family owned companies in Hong Kong, this could lead to a problem that nobody could vote on the resolution. This may be too restrictive especially in the case where no unconnected parties’ position is prejudiced.
- Also section 10.22(3)(c) is redundant given that Section 10.22(3)(b) already covers trustees (please refer to the definition in section 11.2).

**Sections 10.31(3) and 10.33(5)**

- We consider it more appropriate that the liability rests on the officers in default instead of the company itself.

**Section 10.34(2)**

- There should also be a time limit on the retention of minutes of meetings held before the commencement of the provisions in the Companies Bill.

**Section 11.23(1)(a)(i)**

- Please consider defining “misconduct” to mean any negligence, default, breach of duty or breach of trust by the director, as in the case in section 11.24(5).

**Section 11.28**

- The words “section 11.16, 11.17” should be added before “section 11.18 or 11.19”.

**Sections 11.32(3) and (4)**

- The words “section 11.34” should be replaced by “section 11.33”.

**Section 11.40(1)(c)**

- Please consider including the words “the termination of” after “in connection with”.

**Section 11.63(5)**

- Please consider including two further exceptions to the requirement to declare material interests, as in the case under section 177(6) of the UK Companies Act 2006 - (i) if it cannot reasonably be regarded as likely to give rise to a conflict of interest; and (ii) the other directors are already aware of the interest.
- Further, it is noted that there is a change in the requirement under section 11.63(5)(a) from the existing requirement under section 162(2)(3) of the CO. It is assumed that this is an intentional change so that only the subjective awareness of the director would be taken into account.

**Section 12.130**

- We would prefer to see the definitions of “return date” removed from section 12.130(2) and section 12.130(4) and added to section 12.130(9). If not, it needs to be made clearer that section 12.130(2) is referring to private companies and section 12.130(4) is referring to public companies and companies limited by guarantee.

**Schedule to Part 12**

- Paragraph (b) of Part 3 of the Schedule would better read “... a certified translation of the document in English or Chinese”. We do not believe the words “(to be annexed to that document)” are required, as the concept is already included in the opening words to Part 3 of the Schedule, which instruct that the annual return is “accompanied by ...”.

**Section 14.18**

- We would suggest that a cross reference is made to section 14.8(5), in sections 14.8(1)(a)(ii) and 14.8(2)(a)(ii) for ease of reference.
- The English text of section 14.8(2)(a)(i) would better read “...and that would also constitute a contravention of this Ordinance;”. The same point arises in relation to section 14.8(2)(a)(ii) and 14.8(3)(b).
- We note that where a claim relates to conduct which took place prior to the commencement of section 14.8, and that conduct could not have given rise to a claim under the predecessor Ordinance, then it seems that it will still be possible for a claim to be brought under the new provisions. We wonder if this is the intention. In practice of course, the only circumstances in which this would occur is where the conduct consisted only of a breach of the company’s constitution and a claim can therefore be brought under section 14.8(4)(c).

### **Section 14.19**

- In our view, it would be preferable for the member / creditor right (currently in section 14.9(2)) to appear before the Financial Secretary's right (currently in section 14.9(1)). This reflects the importance of the rights in practice and would be consistent with the order used in section 14.3.

### **Sections 15.1 to 15.3**

- Please clarify how the striking off procedures in Part 15 would apply where a non-Hong Kong company has replied to the Registrar's letter(s) stating that it is not carrying on business or is not in operation. Furthermore, we suggest clarification be made on whether the deregistration procedures in section 291 of the predecessor Ordinance would continue to apply as if they had not been repealed if, before the commencement of Part 15, the Registrar has sent a letter to a company pursuant to section 291.

### **Section 15.9**

- We suggest that the criteria for determining whether a property or right is "properly available" to satisfy liabilities (e.g. if it is permitted in accordance with law) should be set out in section 15.9(4).

### **Section 15.14**

- We suggest clarification be made that the liabilities of directors etc., of a company which has been dissolved under section 291, 291A or 291AA of the predecessor Ordinance are to continue and may be enforced as if the company had not been dissolved.

### **Section 15.16**

- Section 15.16 requires directors of "a company dissolved under *this Part*" to keep the company's books and records for at least 6 years after the date of the dissolution. Accordingly, it is assumed that directors of a company dissolved under section 291, 291A or 291AA of the predecessor Ordinance would continue to be subject to the 5-year record keeping requirement under section 292(3) of the predecessor Ordinance. If that is the effect intended, we suggest that the requirement be set out in section 15.16.

### **Sections 16.4(3) and 16.5(6)**

- Please clarify the application of the Ordinance in following scenario: if the translation of the company's domestic name was previously registered pursuant to section 16.4(3), which name would be regarded as the company's "corporate name" after it informs the Registrar (pursuant to section 16.5(6)) of its decision not to use the previously registered translation name for carrying on business in Hong Kong? In such scenario, would the company be required to register another translation name if its domestic name is neither in Chinese or Roman script?

### **Sections 16.4(3), 16.5 and 16.6**

- We understand that the translation name of a non-Hong Kong company should be a "certified translation" of its domestic name. On the other hand, it appears that this may not be the case where the company has registered the translation name of its domestic name pursuant to section 16.4(3) but later adopts an additional Chinese/Roman script domestic name under section 16.5(1), or if a name ceases to be the company's domestic name as envisaged under section 16.5(3). It seems that in these scenarios, sections

16.5(8) and 16.6(7) may not apply and that the company's translation name on the Register could be different from the certified translation of its domestic name.

#### **Sections 16.5(5) and 16.5(6)**

- Sections 16.5(5) and 16.5(6) require a company to give notification to the Registrar within one month "after the date of a decision"/"after the date of the decision" of the events specified therein. As the exact date of the "date of a decision" may be subject to different interpretations and in case the specified event does not occur after the decision date, please consider replacing the references to "the date of the decision" in those sections with "the date of the addition"/"the date of the replacement"/"the date of the cessation" (as the case may be).

#### **Sections 16.7 and 16.9(5)**

- Section 16.9(5) provides that the Register would enter a company's approved name in the Register "as the name, in relation to the corporate name, under which the registered non-Hong Kong company is to carry on business in Hong Kong" and that a "fresh certificate of registration containing the corporate name and the name so entered" will be issued. It seems this means that the corporate name for which notice is served under section 16.7 would still be deemed as the company's "corporate name" even if it gives a misleading indication of the company's activities or is the same as another company's name. We wonder if this is the effect intended.

#### **Sections 16.21, 16.23 to 16.25**

- Please clarify how the striking off procedures in Part 16 and section 16.21 would apply where a non-Hong Kong company replies to the Registrar's letter(s) stating that it no longer has a place of business in Hong Kong.

#### **Section 16.32(4)**

- Under section 16.32(4), if, before the commencement of Division 8 of the Ordinance, a letter was sent to a non-Hong Kong company under section 291(1) of the predecessor Ordinance, then section 339A(2) and provisions in the pre-amended Ordinance relating to striking-off of defunct companies will continue to apply as if they had not been repealed. We suggest provisions be included to clarify whether this means that the provisions in the predecessor Ordinance in relation to the restoration of deregistered companies would continue to apply to such companies (including the provision that applications to restore such companies may be made within 20 years of the dissolution).

#### **Part 16 - the offence provisions**

- From the consultation paper, we understand it is intended that the offence provisions for non-Hong Kong companies in Part 16 should be aligned with those of Hong Kong companies so that offences of similar nature would not be treated differently because of the company's place of incorporation.

However, it is noted that the offence provisions for non-Hong Kong companies in Part 16 extend the punishments to the "agent of the company", whereas the provisions for Hong Kong companies impose liabilities on the "responsible person" of the company which, under section 1.3, does not include references to such agents.

The extension of the Part 16 offence provisions to "agents" of non-Hong Kong companies seems to frustrate the objective of equal treatment as it may subject the non-

Hong Kong companies to potentially more onerous obligations than those of Hong Kong companies despite that the nature of the offences may be similar.

Since the offence provisions in Part 16 already captured the company and its officers (which is broadly defined in the Companies Bill), further extension of the punishments to the “agents of the company” seems unnecessary. Moreover, as the offence provisions relate to obligations the responsibility for which rest with the company and its directors/officers, it seems unfair to impose liabilities for their breach on the agents, particularly since the definition of “agents of the company” is not provided in the Companies Bill and may include those who are not in a position to check or ensure the company’s compliance. We are also concerned that if the threshold for a breach is lowered as drafted, an agent could be punished for a technical “participation in” a contravention even if it does not have any control over the company’s compliance.

### **Sections 18.8 and 18.11**

- Section 1.2(3)(b) states that a document is regarded as being sent “in electronic form” if it is sent “by electronic means or by other means while in electronic form”. On the other hand, whilst sections 18.8(2)(a) and 18.11(3)(a) allow a document to be sent “in electronic form”, sections 18.8(2)(b)(i) and 18.11(3)(b)(i) require the document to be sent “by electronic means”. It therefore appears that a document will be regarded as sent if it is sent by electronic means but not “by other means while in electronic form”. Further, as section 1.2(3)(c) states that a document is sent by electronic means “if it is sent or supplied in the form of an electronic record to an information system”, it appears that the document will not be regarded as sent if it is sent via other electronic formats (e.g. on a CD). We wonder if this is the effect intended.

### **Sections 18.8(3), 18.11(4) and 18.13(6)**

- For clarity purposes, please consider replacing the words “has not revoked the agreement” with “is not to be regarded as having revoked the agreement”.

### **Section 18.11(3)(a)(ii)**

- For clarity purposes, please consider replacing the words “so agreed” in section 18.11(3)(a)(ii) with “has agreed, generally or specifically, that the document or information may be sent or supplied to the company in electronic form”.

### **Sections 18.13(4)(c)(ii) and (5)(c)(ii)**

- The reference to “*similar class*” in is unclear.

### **Section 18.17 (1)**

- The reference to “*request*” requires clarification on how such a “request” is to be made by members – see Listing Rule 2.07(3)(b) which indicates requests can be made by email.

**The Law Society of Hong Kong**  
**Company and Financial Law Committee**  
**Securities Law Committee**  
**23 March 2010**

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