



THE
LAW SOCIETY
 OF HONG KONG
 香港律師會

THE COMPANY AND FINANCIAL LAW COMMITTEE OF THE LAW SOCIETY OF HONG KONG
 COMMENTS ON THE CONSULTATION PAPER BY THE STANDING COMMITTEE ON COMPANY LAW REFORM
 ON PROPOSALS MADE IN PHASE 1 OF THE CORPORATE GOVERNANCE REVIEW

Para	Subject	Proposal	Comments
6.13	Directors duties	No recommendation to set out directors' duties in a statutory enactment.	Agreed
7.09	Voting by directors re self-dealing	<p>Law should provide that an interested director should not vote at a board meeting on a matter in which he has an interest.</p> <p>The current exception in regulation 86 of Table A should not be included.</p> <p>Exceptions should include: (1) immaterial interest; (2) where director gives guarantee for loan repayment; (3) proposal for benefit of employees under which director may benefit.</p> <p>Amend s162(2) CO so that interested director makes an ad hoc disclosure in addition to advance notice.</p>	<p>Agreed subject to a private company exception. However where the votes of the remaining directors mean that the resolution would have been passed anyway if the director had abstained, the transaction should not be voidable.</p> <p>A workable exception should be available to private companies.</p> <p>We note the suggestion that an "immaterial interest" may be defined as one that does not give rise to a risk of actual conflict. How will this risk be measured? Does a risk of actual conflict mean any type of conflict of interest of whatever nature? How will these exceptions interrelate with exceptions included in a company's constitution? Such exceptions are usually more extensive than those provided for in the listing rules. In particular, the Listing Rules provide that a holding of up to 5% in a public company is not a material interest. We suggest a similar test is applied.</p> <p>This should only apply to public companies and not to private. What would be the penalty for failure?</p>

Para	Subject	Proposal	Comments
7.09 (contd)	Voting by directors re self-dealing (contd)	<p>Disclosure of relevant contracts, transactions, arrangements to shareholders; where significant, shareholder approval required.</p> <p>Law should be amended to clarify civil consequences of breach (voidable at instance of company).</p> <p>Widen ambit of s162 of CO</p>	<p>See our comments below</p> <p>Agreed but to what extent would a purchaser cease to be <i>bona fide</i> in the event that he had notice (actual or constructive) that an interested director had voted for the board resolution?</p> <p>We do not support widening the ambit to include relatives and associates. This would create considerable uncertainty for a director as to who was interested at any particular time and would require him to carry out enquiries in respect of which he could not compel answers. This level of uncertainty is not appropriate for statutory provisions.</p>
8.22	Shareholder approval for significant connected transactions	Adopt statutory provision along similar lines to section 320 UK Companies Act 1985 but not limited to non-cash assets only	Agreed subject to exemption for private companies. In relation to listed companies, the statutory provisions should provide for a "safe harbour" for compliance with listing rule provisions relating to connected persons (which we anticipate would impose super-equivalent obligations to those in the statutory provisions). Otherwise listed companies will be required to comply with two separate regimes which may be inconsistent. A listed company would also be able to rely on a determination from the HKSE or SFC

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8.22(contd)	Shareholder approval for connected transactions (contd)	<p>Should assets test be net asset value or gross value less intangibles and current liabilities?</p> <p>What percentage should trigger requirement for shareholders' approval?</p> <p>Should there be a <i>de minimis</i> figure and if so, what?</p> <p>How should connected persons be defined? (see 8.26)?</p> <p>Should an interested controlling shareholder abstain from voting?</p>	<p>as to the application of the connected persons provisions: where the consequences of any statutory breach are significant, the ability to receive such a determination in matters of complexity (and in particular with regard to interested shareholders and associates-see below-) is important.</p> <p>No preference but test should be capable of certain application.</p> <p>10% seems reasonable (Nb the application of the safe harbour means that this requirement would not necessarily apply for listed companies).</p> <p>We support a <i>de minimis</i> figure (Nb the application of the safe harbour means that this requirement would not necessarily apply for listed companies).</p> <p>Agreed although the definition should be conformed with that in the listing rules in relation to associates of a director.</p> <p>Provisions regulating voting by interested controlling shareholders are better dealt with in listing rules and not in statutory provisions. Whether a shareholder is interested is often difficult to determine and in the listed company context, may require a determination from the</p>

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8.22 (contd)	Shareholder approval for significant connected transactions (contd)	Should only the approval of the ultimate holding company be required? What consequences of breach are appropriate? (see 8.29)	HKSE or SFC. In any event an interest of a controlling shareholder should be material to require abstention. Agreed
9.08	Transactions between directors or connected parties with an associated company	Should proposal extend to directors of unlisted public companies and also private companies?	In addition to our comment above regarding <i>bona fide</i> and notice, we note that s322 Companies Act (UK) provides that a transaction will not be avoided where a third party acquires rights <i>bona fide</i> for value and without actual notice. Will the notice requirement be mirrored in this proposal? The proposal should not apply to private companies; in addition to an increased administrative burden, there may be quorum issues where there are no disinterested directors or shareholders. We agree that this matter should be regulated by listing rules, which would allow for a flexible interpretation of "associate". We support the extension of the listing rules to companies which are not subsidiaries, but which are <i>de facto</i> controlled by the listed company. Under accounting standards the presumption that a company is associated due to 20% voting control

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9.08(contd)	Transactions between directors or connected parties with an associated company(contd)	<p>CO should require approval of disinterested shareholders for transactions involving directors or connected persons and an associated company.</p> <p>The section 320 proposal above would also relate to arrangements between the associated company and directors of the company/holding company or persons connected.</p>	<p>can be rebutted; a statutory definition set at 20% of voting rights would be unduly onerous. We do not support the inclusion of associated companies in the definition of connected persons in legislation.</p> <p>We do not believe that this should be effected by statutory provision: see our comments above.</p> <p>We do not support this extension.</p>
10.29	Nomination and election of directors	<p>Statutory requirement for effective circulation of notices relating to a nominee proposed by shareholders (with period for nomination extended).</p> <p>Biographical details of candidate circulated with notices (private company exclusion).</p> <p>Use of formal procedures for nomination of directors encouraged as matter of best practice.</p> <p>Law should not prescribe any single voting procedure for listed companies. The cumulative voting procedure will not</p>	<p>This proposal should only apply to public listed or unlisted companies and not to private companies. Rather than allow private companies to opt out, it is sensible to exclude them altogether: see our general comments regarding the burden on private companies.</p> <p>Agreed</p> <p>Agreed</p> <p>Agreed</p>

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10.29 (contd)	Nomination and election of directors (contd)	<p>be mandated although listing rules should be amended to allow it.</p> <p>Right of shareholders to elect directors should not be capable of exclusion by articles.</p> <p>Director's reasons for resignation to be circulated to shareholders.</p>	<p>Agreed</p> <p>Agreed. This provision should not impose a duty upon directors to give reasons for their resignation for circulation, and should not require the company to circulate defamatory material.</p>
11.11	Role of the independent director	<p>Not yet practicable to impose a statutory duty on the independent director to perform a special monitoring role.</p> <p>Functions of non-executive directors to be set out in codes of best practice.</p> <p>Appointment of indirect directors or advisers with specific monitoring roles.</p>	<p>Agreed. A key issue (not considered in these proposals) is whether independent directors are truly independent and how this requirement is enforced eg a restriction on the number of the independent directorships held.</p> <p>Agreed with appropriate disclosure as to compliance with the code of practice in the company's directors' report.</p> <p>Agreed; this provision should be in listing rules (not legislation) and subject to a clear definition as to the scope of the function and to whom duties were owed.</p>

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13.18	Self-dealing controlling shareholder	<p>Shareholders should normally be bound by their approval of a self-dealing transaction (subject to exceptions).</p> <p>Connected transactions must be disclosed and subjected to a disinterested shareholders vote (extension of listing rule provisions to private and unlisted public companies); subject to certain exceptions.</p> <p>Voting must take place on a poll.</p> <p>Preservation of court's power to determine whether a transaction constitutes a waste of corporate assets.</p> <p>Failure to disclose and obtain approval means transaction voidable at instance of the company in the absence of <i>bona fide</i> third party rights or loss of restitution.</p> <p>Liability of interested shareholder to compensate the company where transaction is waste of corporate assets and interested shareholder has benefited (NB presumptions).</p>	<p>Agreed</p> <p>We favour the same approach as that which we propose under 8.22 above, namely a statutory provision which would include a "safe harbour" for compliance with listing rule provisions. We do not agree that the statutory provision should apply to private companies.</p> <p>Agreed, although we would recommend a wider review relating to requiring shareholder resolutions to be passed on a poll. The issue applies generally as to the disadvantages of passing shareholder resolutions by a show of hands where votes are required from independent shareholders. We note that this matter was discussed in the SEHK May 1999 Consultation Paper.</p> <p>Agreed</p> <p>See above regarding clarification of <i>bona fide</i> and notice.</p> <p>Agreed</p>

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15.25	The derivative action	<p>The introduction of a statutory derivative action.</p> <p>No separate hearing to assess standing.</p> <p>Court able to assess self-dealing transactions whether approved or otherwise.</p> <p>Ratification not a bar to commencement of proceedings.</p>	Agreed
16.27	Unfair prejudice	<p>Amend s168A CO to confirm Court has power to award damages to shareholders in circumstances of unfair prejudice.</p> <p>Amend to allow order for costs to shareholders.</p> <p>Amend to allow court to require controlling shareholders to buy out minority shareholders.</p> <p>Amend to allow shareholders of oversea companies to commence action for unfair prejudice.</p>	<p>Agreed</p> <p>Agreed</p> <p>Does s168(2)(c) require amending to provide for this?</p> <p>Agreed. Although there may be some practical difficulties in enforcing an award, this does not detract from the advantage to shareholders of being able to take action in Hong Kong.</p>
17.09	Personal rights	Law amended to confirm individual member can enforce rights in the memorandum and articles as personal rights.	Agreed

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18.05	Orders for inspection	Statutory court: application to allow shareholders access to company records (subject to conditions).	Although we agree with the proposal, we have concerns that it may promote “fishing expeditions”. To what information will the definition of “company records” extend for this purpose? Will the applicant be required to limit his application to a particular class of document?
19	Other court powers	<p>General power to injunct against breach of CO or fiduciary duties.</p> <p>Power to grant costs orders for shareholders in respect of corporate injury actions and unfair prejudice.</p> <p>Power of the court to make these orders should be extended to oversea companies registered under part XI CO.</p>	<p>Agreed</p> <p>Agreed</p> <p>Agreed</p>
20.09	Role of regulators	<p>Amend law to confirm that securities regulator is able without court approval to bring derivative actions against wrongdoers in relation to a company (including oversea companies) for breaches of duty, exercising this power in the public interest and on behalf of the company.</p> <p>SFC able to conduct civil proceedings on behalf of any public company or individual on request or after investigation.</p>	<p>Agreed</p> <p>Agreed</p>

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22.16	Filing of financial statements	Private companies with limited liability should file their financial statements with the CR for public inspection.	<p>We do not agree with this proposal, which places an unnecessary burden on private companies.</p> <p>Creditors or other stakeholders dealing with a private company can always request a copy of the latest accounts before doing business. A statutory provision of this nature would be avoided by private companies incorporating offshore.</p>
23.08	Management discussion analysis and	The listing rules on MD&A should be amended to include more qualitative and forward looking disclosure to match that proposed in the UK by the Operating and Financial Review (see 23.06).	Agreed but the disclosure requirements set out in 23.06 should be adapted for the Hong Kong market eg paragraphs (f) and (g) do not appear to be relevant. Should consideration be given to the application to unlisted public companies?

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24.05	Inconsistency between audited financial statements and other financial information in the directors report and other sections	Amend the CO to enable auditors to report on any inconsistencies between the audited financial statements and financial information contained in the directors' report. Should qualified privilege be extended accordingly?	Agreed; does "financial information" include commentary by directors on the financial accounts? We anticipate that auditors may be reluctant for their duties to be widened in this way. This is the logical extension of the widening of the duty
25.07	Accounting reference date	Amend the CO to provide for an accounting reference date, an accounting reference period and financial year.	Agreed
26.13	Standards setting process	Independent standard setting bodies are not required in HK. The composition of the FASC and the AuSC of the HKSA should be widened to cater for greater public involvement.	Agreed Agreed
27.12	Body to investigate financial statements	A body (similar to the UK's FRRP) to investigate financial statements and enforce any necessary changes to the companies' financial statements should be set up. Views sought on the body's functions; jurisdiction; mode of establishment.	Agreed in principle, although we would expect a number of practical issues to arise (eg who appoints the body, how it is funded, how does it interact with other regulators). Any such body would require staff of high calibre to operate effectively. Would the body investigate the accounts of both unlisted and listed public companies?

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28.16	Quality of audit practice and monitoring of audit practice	<p>What improvements should be made to the HKSA's Practice Review:</p> <p>Should firms auditing unlisted or listed public companies be subject to higher standards; greater frequency of reviews; additional scrutiny or a separate regulatory regime?</p>	We have no view on the merits of this proposal given its primary application to the accounting profession.
29.10	Revision of audited financial statements and related matters	<p>Directors to file warning document with CR where they become aware (by auditors or otherwise) of material misstatements in the financial statements.</p> <p>Auditors should file warning document where directors refuse to. CO to be amended to require directors to work with auditors to revise the financial statements.</p>	<p>Agreed. This information would be required to be disclosed by listed companies in any event.</p> <p>Agreed</p>

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