

**For Information
on 29 March 2001**

**Legislative Council
Panel on Financial Affairs**

**Proposed Legislative Amendments to the Companies Ordinance
as recommended by the Standing Committee on Company Law Reform
and Others to Streamline the Existing Requirements
or Facilitate Electronic Transactions**

Purpose

This paper informs Members of our proposed amendments to the Companies Ordinance (CO) as recommended by the Standing Committee on Company Law Reform (SCCLR) and others to streamline the existing requirements or facilitate electronic communications between a company and its shareholders.

Background

2. In February 2000, the Standing Committee on Company Law Reform (SCCLR)¹ published a report on the recommendations of a consultancy report of the review of the Companies Ordinance. The SCCLR report contains recommendations that cover a wide range of issues and varying degree of changes. Some proposals involve fundamental and structural changes aimed at simplifying the law, while others are changes which aim at rectifying anomalies and enhancing the functions of law in specific areas. The SCCLR has also identified a number of areas which require further study and consultation with the market.

¹ The SCCLR was formed in 1984 as a non-statutory advisory body to advise the Financial Secretary on amendments to the Companies Ordinance and other related ordinances.

3. On the basis of the SCCLR's recommendations, we have identified a total of 62 items for legislative amendments or further study. These items are divided into four phases for implementation. Phase I involves amendments to specific sections of the CO. Phases II and III involve areas for further study and consultation. Phase IV involves an overhaul of the CO.

4. Whilst we are following up the items in Phases II to IV, we are in a position to take forward the Phase I items in the current legislative session. We would also take this opportunity to implement a list of improvements to the CO for various purposes such as streamlining the existing requirements or facilitating electronic communication between a company and its shareholders.

Phase I Legislative Amendments

5. A brief description of Phase I items is at Annex. Their main aims are to clarify the duties of directors and enhance the rights of shareholders, including –

- (a) abolishing corporate directors which will result in individuals being held responsible for corporate acts;
- (b) making a director vicariously liable for acts and omissions of his alternates;
- (c) reducing the threshold for circulating shareholders' proposals from the present 5% to 2½% of the voting rights; and
- (d) giving every shareholder a personal right to sue to enforce the terms of a company's Memorandum and Articles of Association.

Amendments to replace the filing requirements of statutory declarations or affidavits processed by the CR with written statements

6. To make procedures simpler and more user-friendly, the CR proposes technical amendments to various provisions of the CO which currently require the filing of statutory declarations. The onerous filing requirements of statutory declarations or affidavits can be replaced with simple written confirmations or notices. Any person making a false statement in such a confirmation or notice can be prosecuted under section 349 of the CO. As such, it will have the same effect of making a false declaration.

Amendments to simplify incorporation of company and change of company name

7. To simplify the application procedures for the incorporation of a company and shorten the processing time span, the CR proposes amendments to various provisions of the CO to introduce new procedures for the incorporation of a company and change of company name. A specified form will be introduced as the application form to incorporate a company. The form will contain the same vital information about the company as is required currently. It will also contain a confirmatory statement of compliance in place of the statutory declaration currently required by section 18(2) of the CO. A specified form for an application to change a company name will also be introduced. It will no longer be necessary to lodge a special resolution for change of name with the CR as a notification of the same suffices.

Amendments to Part III of the CO to streamline requirements and improve the charge registration system

8. The CR proposes to simplify and enhance the efficiency of the charge registration system. Section 83(2) of the CO is to be amended to remove the requirement to state the amount secured by the charge in the certificate issued by R of C as 95% of current charges are all monies charges and the amount cannot be accurately stated and therefore the present requirement serves no real purpose. The scope of section 85 should also be widened to include releases of the whole of a charge and cases where the whole of the property charged has ceased to form part of the company's property or undertaking. Other minor amendments will also be proposed to improve the completeness of the public records.

Amendments to facilitate electronic communications by companies

9. The CR proposes amendments to the CO to enable a company to send to shareholders copies of accounts and reports required under the CO by electronic means and to publish those accounts and reports on its website, where the persons concerned have notified the company of their address for this purpose or have agreed to such publishing on the website.

Amendments to the winding-up provisions in the CO

10. The Official Receiver's Office proposes a number of technical amendments to the winding-up provisions in the CO. They include bringing the minimum debt amount below which a petition for winding-up cannot be presented from \$5,000 to \$10,000 (same as that for bankruptcy cases) and giving the Financial Secretary power to amend the amount in the future. Moreover, where a member of a company petitions the court for an order under section 168A of the CO in cases of unfair prejudice and the petition contains a prayer for a winding-up order as an alternative, the case should be allocated a winding-up number automatically, thus attracting a deposit under the Companies (Winding-up) Rules. If the court rules for a winding-up order, the winding-up proceedings may start immediately.

Way Forward

11. We aim to introduce the proposed legislative amendments into the Legislative Council in the current legislative session.

Financial Services Bureau
March 2001

Phase I Items

Item 1 : Prohibiting in the future incorporation of a company limited by guarantee with share capital

The amendment is to phase out the category of companies which are limited by guarantee with share capital, which serves little purpose.

Item 2 : Amending Regulation 82 of Table A along the lines of the UK Table A

2. The amendment is to remove the directorial autonomy rule, which provides that directors enjoy full autonomy in exercising their management powers. The only way in which shareholders can control the exercise of the powers vested by the articles of association in the directors is to alter the articles, or if opportunity arises under the articles, to refuse to re-elect the directors of whose actions they disapprove. There is uncertainty about the wording of Regulation 82 of Table A as regards whether it provides for the directorial autonomy rule.

Item 3 : Providing that directors' minimum qualifications should include requirement that all directors must be natural persons i.e. abolition of corporate directors

3. In principle, corporate directorships should be prohibited. Under a corporate directorship regime, an individual may be identified as the author of the impugned act or omission, but it is not easy to attach liabilities to him. In the interest of improved corporate governance, it is essential to be able to identify and hold an individual responsible for corporate acts. There should be a reasonable grace period of two years.

Item 4 : Providing for the removal of directors by ordinary resolution, notwithstanding any provision in the company's constitution

4. At present, directors may be removed by a special resolution. This fails to recognize that shareholders should have an overriding right to remove directors which is not given to them under the articles of association or which is contrary to the articles of association. The amendment provides that an ordinary resolution suffices.

Item 5 : Inserting enabling provisions in Table A to permit electronic communications

5. The amendment provides that a requirement that communications as between a company, its directors or members be effected in writing, a meeting be held or appointment of a proxy be made may be satisfied equally by any electronic means.

Item 6 : Providing that a director should be vicariously liable for the acts and omissions of his alternate, subject to contrary provision in the articles of association

6. The amendment is to make it a default rule that a director should be responsible for the acts and omissions of his alternate.

Item 7 : Extending the statutory provisions to cover in generic terms the provision of financial assistance to directors

7. At present, the CO prohibits a company from making loans to or providing security for loans to directors. The law is however unduly restrictive in that only loans and security for loans are covered. The definition of "loan" is narrowly defined to mean an advance of money to be repaid in the future. The amendment is to extend the prohibition to modern forms of credit such as credit-transactions and quasi-loans.

Item 8 : Providing a statutory definition of shadow directors

Item 9 : Defining a shadow director to include someone who can influence less than the whole board of directors

8. The amendment recognizes the existence of outside influence over the board of directors by defining shadow directors as someone who can influence less than the whole board of directors.

Item 10 : Clarifying the definition of manager to indicate a rank immediately below and reporting to the board

9. “Officer” in the CO is defined as including “a director, manager or secretary”. For the sake of clarification, the amendment defines a manager to mean a rank of executives immediately below and reporting to the board.

Item 11 : Permitting companies to insure directors and officers except in certain specified circumstances

10. The amendment allows companies to obtain insurance for directors’ liabilities save for fraud. Such insurance cover may include the costs of litigation, irrespective of the outcome of such litigation and even if such litigation involved an allegation of fraud of a director.

Item 12 : Reducing the threshold for shareholders’ proposals to 2½% of voting rights or 50 shareholders

11. Section 115A of the CO provides that on request by holders of not less than one-twentieth of the voting rights or 100 shareholders holding shares on which there has been paid up an average sum of not less than \$2,000 per person, the company must circulate the requisitionists’ proposals to shareholders entitled to notice of general meetings. The amendment is to reduce this threshold, which is considered high.

Item 13 : Providing for the concept of “record dates” for the payment of dividends, issue of notices of meetings and voting purposes

Item 14 : Stipulating a strict time limit (10 days) for completion of transfers of shares of public companies

12. Section 99 of the CO provides for the closure of the register of shareholders for up to 60 days. During this period, the company may catch up on registration of transfers of shares so that notices can be given to, votes accepted from and dividends distributed to those on the frozen register. This arrangement is not satisfactory as the closure of the register impedes transactions and allows persons who have no interests in the company to vote.

13. The amendment aims to replace this arrangement with the designation of record dates practised in North America. Directors will be empowered to fix “record dates” for the payment of dividends and the issue of notices of meetings. For example, notice of meetings is not required to be given to one not on the register as of the record date for the issue of notices of meetings. Moreover, a date before the date of the meeting should be declared the record date for voting purposes and a strict time limit (10 days) should be stipulated for the completion of transfers of shares of public companies.

Item 15 : Giving every shareholder a personal right to sue to enforce the terms of the Memorandum and Articles of Association

14. The amendment is to clarify the contractual position of a company and its members in relation to each other and to give every member a personal right to sue to enforce the terms of the Memorandum and Articles of Association.

Item 16 : Repealing the right to resort to the court under section 8 (Statutory procedure for amending the objects clauses of a company’s memorandum) as regards public companies

15. The CO provides for an elaborate procedure for changes to be made to the objects clause in a company’s constitution. In addition to requiring a special resolution, holders of not less than 5% in the nominal value of the company’s issued share capital or any class thereof may apply to the court for the alteration to be annulled. The court may confirm the alteration in

whole or in part or not at all and on such terms and conditions as it thinks fit (see section 8 of the CO).

16. The amendment is to repeal the right of dissenting shareholders in public companies to resort to the court. If a transaction is tainted with improprieties, it can and should be dealt with by other provisions of the law with a focus on such improprieties. If not, the dissenting shareholder can always sell his stake in the company. There is no need for him to resort to the court.

Item 17 : Providing that court approval for reduction of capital should not be required for the redesignation of par-value to a lower amount provided that the company has only one class of shares; the issued shares are fully paid-up; the reduction is distributed equally to all shares; and the reduction is credited to the share premium account

17. The amendment is to simplify the provision relating to reduction of capital by not requiring court approval where the reduction is a redesignation of the par-value to a lower amount subject to certain conditions.