Bills Committee on Companies (Amendment) Bill 2002

Follow-up actions arising from the discussion at the meetings on 28 November 2002 and 6 December 2002

Introduction

This paper sets out the outcome of the follow-up actions arising from the discussion at the meetings on 28 November 2002 and 6 December 2002.

(A) Meeting on 28 November 2002

(a) Justifications for extending the prohibition from making quasi-loans etc to directors

2. To address Members' concerns, we agree that the legislative proposal to prohibit a company from making quasi-loans or entering into credit transactions to/as creditor for its directors etc., or providing guarantees or securities in connection with such quasi-loans or credit transactions should not apply to a private company except if it is a member of a group of companies one of which is a listed company. This notwithstanding, we would re-examine the scope of the prohibition in future should the situation warrant. In this regard, Members may wish to note that the UK's Company Review Steering Group[1] has taken the view that the provisions relating to quasi-loans etc in the UK Companies Act should apply to a private company and this recommendation is now being considered by the UK government.

(b) Provision of accommodation to directors

3. The new section 157H aims to extend the existing regime in respect of provision of loans etc to a company's directors to cover modern forms of credit such as quasi-loans and credit transactions. While the proposed extension would cover a tenancy agreement in respect of a property between a company and its director, it would not cover the provision of accommodation by a company to its director by way of a

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[1] The Company Review Steering Group comprising judge, lawyer, academics etc was set up in 1998 to manage a review of the UK's Company Law.

licence or permission to occupy premises in return for payments under such an arrangement. The director would not acquire any legal interest in the premises and the company can terminate the licence and regain the premises in accordance with the terms of the licence.

(c) Ratification of a decision to provide loans etc to directors

4. The suggestion of allowing a private company to ratify at a general meeting its previous decision in respect of loans etc to its directors has arisen from Members' concerns about the extension of the prohibition in respect of quasi-loans and credit transactions to cover a private company. Given that we now propose to exclude a private company (unless it is a member of a group of companies one of which is a listed company) from the prohibition (see paragraph 2 above), the need for pursuing the suggestion further should fall away.

(d) Interpretation of "purpose"

5. The new section 157HA(3)(a) provides that subject to the new section 157HA, nothing in the new section 157H shall be construed as prohibiting a company from entering into any transaction to provide any of its directors with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company. When deciding whether a transaction falls within the scope of the new section 157HA(3)(a), the court would look at the facts and circumstances of the case objectively. Given that the provision of accommodation by a company to its directors by way of a licence is not prohibited under the new section 157H (as explained in paragraph 3 above), there is no need to provide for in the Bill an exception in respect of leasing premises by a company to its directors.

(e) Transaction limit

6. Under the existing section 157H of the Companies Ordinance, a company, the ordinary business of which includes lending money or giving guarantees in connection with loans made by other persons, may provide a loan or guarantee to its director subject to certain conditions, which include, among other things, the following -

(a) the amount concerned is not greater and the terms are not more favourable than it is reasonable to expect the company to have offered to a person of the same financial standing but unconnected with the company; and

(b) the amount together with that in respect of other outstanding loans etc to the director does not exceed $500,000.

7. The transaction limit appears to be modelled on the proposals published in the consultation papers in the UK in late 1970s and was first included in the Companies (Amendment) Bill 1980. The then Members were content with the limit subject to the provision of an exception in respect of loans etc made to a company's director for the purpose of purchasing residential premises. This limit together with the exception was then included in the Companies (Amendment) Ordinance 1984. We are not inclined to take on board the suggestion that the limit should be updated with reference to the changes in the Consumer Price Index[2] over the years. An increase in the limit would lead to more risks to be borne by the company in question. A director of good financial standing should be able to obtain loans etc on commercial terms from the financial market.

(B) Meeting on 6 December 2002

(a) Filing a statement by one-member company

8. To address Members' concerns, we agree to take out the proposal of requiring a company to enter into its register of members a statement in respect of its number of members falling to one or increasing from one to two or more from the Bill. However, we do not favour the proposal of filing the same with the Companies Registry (CR) in that it would be difficult to justify the increase in the compliance burden on a company if there were no need to require the company to keep the statement in its register in the first place.

(b) Convening a meeting to appoint a director of a one-member company

9. There does not appear to be any provision in the Ordinance which provides that the surviving officers viz the secretary or manager of a one-member company can convene a meeting to appoint a director upon the death of the sole member (who is also the sole director) of the company. To address Members' concerns, we agree that an enabling provision should be added in the Bill to the effect that such company may, notwithstanding anything to the contrary in its articles, before the death of the member,

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[2] The percentage change in the Composite Consumer Price Index (CCPI) between 1984 and 2002 is 138% assuming a 3% decline in the CCPI in 2002.

appoint a person to act in the place of director upon the former's death, provided that the appointment is made by way of a statutory declaration or witnessed by 2 or more persons. Furthermore, we propose that in such case, the two-month period in the new section 153A(4) should not run from the date the office is vacated but from the date the probate or letter of administration in respect of the member's estate is granted by the court.

(c) Review the need for new sections 158(10)(a) and 161B(9)

10. While we consider it useful to keep the existing requirement under section 158 about filing with the CR by a company particulars of its shadow directors in that if a shadow director is identified, prosecution may be taken against him under that section (such requirement also found in other common law jurisdictions), in the light of Members' concerns, we agree to repeal the requirement. As regards the disclosure of loans etc made by a company to its shadow directors, our policy intent is to impose the reporting obligation on shadow directors as in the case of directors. To this end, we propose to amend the existing section 161C(1) to the effect that shadow directors are obliged to give notice in writing to their companies of matters relating to loans etc from the company. The requirement[3] in the new section 161B(9) should be seen together with this reporting obligation. It is worth noting that the same requirement is imposed on auditors in respect of loans etc to a company's directors in the existing section 161B(6) of the Ordinance.

(d) Contracts with sole member who is also a director

11. The new section 162B is modelled on section 322B of the UK Companies Act 1985 except that in the latter, a specific time limit of 7 days is not imposed in respect of recording the contracts and a body corporate is not to be treated as a shadow director of any of its subsidiary companies by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions. On the first point, we consider it necessary to have a specific time limit. On the second point, in the light of the Assistant Legal Adviser's concerns, we agree to follow the approach in the UK Companies Act 1985.

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[3] Where a company's account does not include particulars of loans etc to directors as required under the new section 161B, it shall be the duty of the company's auditor to, as far as he is reasonably able to do so, include a statement in his report giving the required particulars.

(e) Decision of Standing Committee on Company Law Reform (SCCLR) to exclude provision of indemnities to officers and auditors for liability incurred by them to a third party under new section 165(1)

12. The relevant record of the SCCLR's discussion is at Annex.

(f) Insurance for auditors against liabilities

13. The new section 165(3) aims to implement the SCCLR's recommendation to allow a company to obtain insurance for directors' liabilities save for fraud but that insurance should cover the costs of litigation even if such litigation involves an allegation of fraud of a director. As the existing provisions in the Ordinance concerning indemnity for officers apply equally to auditors, we consider it reasonable to adopt a similar approach in this section. As regards the concern that this proposal may give rise to conflict of interests on the independent role of auditors, we presume this should be addressed by the existing regulatory regime for the accountancy profession. We would, however, be happy to consult the Hong Kong Society of Accountants if necessary.

Financial Services Branch
Financial Services and the Treasury Bureau
January 2003

Annex

Record of Discussion of the
Standing Committee on Company Law Reform
on the Scope of Indemnities for Directors

The Secretary briefly explained that the paper reproduced extracts from the SCCLR's Report published in February 2000 which recommended (at Recommendation 75) that the Ordinance should confirm that indemnities may be given to directors for liability incurred to others in the course of performing their duties but that the scope of such indemnities should be studied further. He explained that the paper included a synopsis of the laws of various other jurisdictions which allowed indemnities to be given to directors. In most cases, these laws prevented companies giving an indemnity to a director for a wrong done to the company but permitted an indemnity to cover a director's liability towards third parties provided that he had acted in good faith. The Secretary said that the Report recounted what a member had said at the 142nd meeting of the SCCLR held on the 11 September 1999 namely that the omission of statutory indemnities for directors against liability incurred to others in the course of performing their duties has occasioned concern to directors. The uncertainty over the right to indemnity may deter competent persons from accepting directorships and was thus undesirable.

2. The member confirmed that this was still his opinion and he thought it reasonable that a company should be permitted to give an indemnity to its directors in respect of liability incurred towards third parties provided that they were acting in good faith. He also pointed out that directors may face substantial costs in respect of frivolous claims made against them and wondered whether the company could be permitted to reimburse directors on an interim basis for the expenses in defending such actions as they were being incurred. A member, although sympathising with the predicament facing such directors, did not think such a proposal should be enacted as it might actually reduce the scope of indemnity which can be given to directors. The member thought that the existing statute was very unclear. The member agreed with the extract from "Hong Kong Company law Legislation and Commentary by Roman Tomasic and E L G Tyler" annexed to the paper and said that the statute prohibits provisions in articles which gave directors a "carte blanche" to act imprudently. The member was, however, in favour of provisions in the Ordinance stating clearly that the company cannot indemnify a director for liability towards the company but can do so in respect of liability towards a third party provided that the person had acted in good faith. The member also

pointed out that it had been recommended that the company be able to pay the premiums for insurance cover for this purpose. The Secretary confirmed that draft drafting instructions had already been submitted to the Secretary for Financial Services to enable companies to insure their directors in this respect and it was hoped that these provisions would be contained in the next Companies (Amendment) Bill.

3. A member confirmed that the accountancy profession was in favour of companies being able to take out insurance to cover their directors in respect of actions brought by third parties. Members agreed with the views expressed on the subject. The Secretary confirmed that he would prepare draft drafting instructions and seek members' approval of them prior to submitting them to the Secretary for Financial Services.