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13th September 2002 "By fax and e-mail"

Mr. Matthew Loo
Clerk to Bills Committee
Legislative Council Secretariat

Dear Mr. Loo,

Bills Committee on Companies (Amendment) Bill 2002

Thank you for your letter dated 7th August, 2002 inviting HKAB to make oral and written submissions to the Bills Committee. We set out in Appendix I our comments on the draft Bill for the consideration of the Bills Committee.

We do not wish to make oral representations to the Bills Committee meeting on 5th October, 2002.

Yours sincerely,

Eva Wong
Secretary

encl.

c.c. Dr. the Honourable D.K.P. Li
Deacons (Mr. J.W.C. Richardson)
Ms. Esther Fung, HKAB Representative on Companies Registry
Customer Liaison Group

APPENDIX I

COMPANIES (AMENDMENT) BILL 2002 – HKAB SUBMISSION

1. Clause 26 – Section 58 is amended to allow there to be no court confirmation of a reduction of share capital if the following conditions are met:
   (a) the company has only one class of shares;
   (b) all issued shares are fully paid-up;
   (c) the reduction is distributed equally to all shares; and
   (d) the reduction is credited to the share premium account of the company.

   There should be an additional condition namely to the effect that no cash is paid out of the company, in line with Recommendation 117 of the Report of the Standing Committee on Company Law Reform. If cash is paid out of the company, then creditors need to be protected by a court confirmation of the reduction of capital in the normal way.

2. Clause 33 – this provides an amendment to the provision regarding the entry of a satisfaction or release of a registered charge. The present practice is that the Registrar will enter a satisfaction or release on production to him of the release document signed by the holder of the charge together with a memorandum of satisfaction. The new procedure allows the Registrar to enter a satisfaction or release on evidence given to him in accordance with the new Section 85(3). This requires there to be provided a statement certifying the fact of satisfaction or release which can be given by a director of the company concerned or by the mortgagee or person entitled to the charge. It seems to us that the result of this amendment is that a satisfaction or release could be provided without the Registrar being given a copy of the document giving rise to the satisfaction or release and without any document signed on behalf of the mortgagee or person entitled to the charge. This clearly gives rise to the possibility of a release being entered based on a certificate of the company when in fact the property covered by the charge has not actually been released by the mortgagee or chargee. A certificate of the mortgagee or chargee should be required prior to release.

3. Clauses 42 and 44 – these provisions cater with the situation where a company has only one member and deal with the quorum requirements for a meeting and the recording of decisions by a sole member. There is case

authority to the effect that it is not possible to have a meeting of one person. It would be beneficial if these provisions were amended to the effect that a written resolution or record of a decision should be treated for all purposes of the Companies Ordinance and any Articles of Association as being equivalent to a resolution passed at a duly convened and quorate meeting.

4. Clause 55 – this contains a similar provision in relation to the record of a decision of a sole director of a private company. Again, it would be useful if this clause was amended to the effect that a record of a decision taken by a sole director should be equivalent to a resolution passed at a duly convened and quorate board meeting.

5. Clause 58

   5.1 Some amendments are made to Section 157H of the Ordinance (which previously prohibited loans to directors as well as the provision of guarantees or security for loans to directors) which extend the section to cover other transactions entered into by the company namely those of quasi loan and credit transactions. These terms are defined in the proposed new Section 157H(7). The definitions themselves follow the wording of the English Companies Act 1985 and, although it was a recommendation of the Standing Committee on Company Law Reform that Section 157H should be extended to cover a wider group of transactions with directors, no express discussion was recorded regarding the definition of the types of transaction to be covered by the new section. It seems, however, that looking at the definition of "credit transaction", it could cover transactions which do not necessarily involve any credit. In particular, it seems that the definition of "credit transaction" could include an ordinary contract for the sale of land which is conditional. It is very often the case that such contracts are conditional but this does not necessarily mean that they involve the extension of any credit as such. The definition could also include a tenancy agreement in respect of property. Again, as long as the rent is payable monthly and (as is normally the case) in advance, this also does not involve any credit. It may also be that other transactions are covered by the wide terms of paragraphs (a) and (b) of the definition of "credit transaction". These paragraphs should be tailored so that they apply to what in reality are credit transactions and not otherwise.

5.2 The new Section 157H contains a new sub-section (4) which prohibits a company from "taking part" in an arrangement which would have breached the main prohibitions if a director has obtained a benefit from the company or its holding company. The wording is not especially clear and could catch a transaction which does not involve any giving of credit to the director concerned. The section ought to be amended so that one of the conditions of the prohibition is that it involves some form of the giving of credit to the director concerned.

5.3 The new Section 157HA sets out the transactions which are excepted from the prohibitions contained in Section 157H. This section does not seem in all cases to adequately provide an exception to the provisions of the new Section 157H(2) (relating to the prohibition on the taking in an assignment of a prohibited transaction) or Section 157H(4) (relating to taking part in an arrangement which amounts to a prohibited transaction).

6. Clause 63 – the term "credit transaction "in the new Section 161B is used with the same meaning as under Section 157H. Accordingly the same comment as is made in respect of that section (see 5.1 above) applies to this section.

7. Clause 65 – the new Section 162B requires that in the situation where the company has only one shareholder and enters into a contract with that shareholder when that shareholder is also a director, the contract concerned must be set out in a written memorandum which is kept with the company's books. However, by virtue of sub-section (2), this requirement does not apply to contracts entered into in the ordinary course of business. We do not see why this should be the case as in the situation where a company has only one member and that member is also a director, the rationale of the section would seem to apply whether or not the transaction is in the ordinary course of business.

8. Clause 66 – Section 165 is amended to provide for the ability of a company to purchase directors' and officers' insurance for the benefit of an officer of the company or any auditor of the company. The relevant provision is Section 165(3) which provides that the company may purchase such insurance which

covers the officer or auditor for liability in respect of negligence, default, breach of duty or breach of trust (other than fraud). In addition, the insurance may cover the costs of defending any proceedings, civil or criminal taken against the person for negligence, default, breach of duty or breach of trust (and in this case including fraud) for which he may be guilty in relation to the company. Note that the insurance in respect of the costs of legal proceedings includes proceedings brought in respect of fraud. Whilst this is in line with the recommendations of the Standing Committee on Company Law Reform but in the light of recent events, it is questionable whether it is correct that the company should be entitled to purchase directors' and officers' liability insurance for the benefit of auditors and covering costs of defending proceedings in respect of fraud.

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