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Secretary for Financial Services
and the Treasury
Financial Services and the Treasury Bureau
(Attn: Mr Esmond LEE
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By Fax (2528 3345) and By Post

14 November 2002

Dear Mr LEE

Companies (Amendment) Bill 2002

I refer to your letter of 11 November 2002.

In the light of the wide scope of the new section 157H and the parties in breach will be subject to criminal sanctions, the Administration is urged to clarify the scope of the prohibition and the relevant civil liabilities and criminal sanctions:

1. "Credit transaction" is defined in the new section 157 H(7)(b) as "a transaction under which one party leases or hires land to another party in return for periodical payments". It is not uncommon that a company leases property belonged to the company to its director and the rent is paid periodically. Please confirm whether such tenancy agreement will fall within the definition of "credit transaction" as provided in the new section 157 H(7)(b)?

2. "Credit transaction" is defined in the new section 157 H(7)(c) as "a transaction under which one party disposes of land to another party on the understanding that payment is to be deferred ". It is not uncommon that a director of a company purchases property belonged to the company and part of the purchase price is paid by instalment(s) with the balance of the purchase price paid on completion. Please clarify the meaning of "payment is to be deferred". At what stage(s) should the payment be made in order **not** to fall within the definition of "credit transaction" as provided in the new section 157H(7)(c)?

3. The new section 157I(2) provides that "subject to subsection (3), a guarantee entered into or any security provided by a company in contravention of section 157H(1), (2) or (4) shall be unenforceable against the company".

The new section 157I(3)(b) provides that "subsection (2) shall not affect an interest in any property that has been passed by the company to any person by way of security provided in connection with any transaction or arrangement".

It appears that the cumulative effect of applying the new section 157I(2) and the new section 157I(3)(b) together will be:

- (a) On the one hand, the security provided by a company in contravention of section 157H(1), (2) or (4) shall be unenforceable against the company; and
- (b) On the other hand, if an interest in the property has been passed by the company to any person under that security, such interest will not be affected. Presumably, the party to whom an interest in the property has been passed can enforce his rights or interest in the property against the company notwithstanding that he cannot enforce the security against the company.

In these circumstances, please clarify the meaning of "an interest in the property passed by the company to any person by way of security" that is enforceable against the company under the new section 157I(3)(b) and the other rights in the security which is unenforceable against the company under the new section 157I(2).

4. The new section 157I(4)(a) provides that "a director of a company that has entered into a transaction or arrangement in contravention of section 157H(1), (2) or (4) shall be liable to account to the company for any gain that he has made directly or indirectly by the transaction or arrangement". It appears that "a director that has entered into the transaction" only covers a director who is a party to the transaction and excludes other director of the company who is not party to the transaction even though he has authorized or permitted the transaction.

The new section 157I(4)(b) provides that "a director of a company that has entered into a transaction or arrangement in contravention of section 157H(1), (2) or (4) shall be liable jointly and severally with other director liable under this subsection, to indemnify the company for any loss or damage resulting from that transaction, if-

- (i) he knowingly and wilfully authorised or permitted the transaction or arrangement to be entered into".

If the new S157I(4)(a) only covers a director who is a party to the transaction, it appears that the "other director liable under the new section 157I(4)(b)" refers to "other director who is also a party to the transaction" and exclude other director of the company who is not party to the transaction.

The new section 157I(4)(b) provides that such directors will be liable to indemnify the company for any loss or damage resulting from that transaction if they knowingly and wilfully authorised or permitted the transaction to be entered into. Does this mean that to be liable under this subsection, the act of entering into the transaction is not sufficient and the mens rea of the directors has to be proved?

5. The new section 157J(1) provides that "where a company enters into a transaction or arrangement in contravention of section 157H(1), (2) or (4), any director of the company who wilfully authorized or permitted the transaction or arrangement to be entered into shall be guilty of an offence". Is the burden of proof on the Administration?

The new section 157J(2) provides that "a person shall not be guilty of an offence under this section if he shows that, at the time the transaction or arrangement was entered into, he did not know the relevant circumstances". Will a director who knew the relevant circumstances at the time the transaction or arrangement was entered into and authorised or permitted the transaction be guilty of an offence if he cannot be proved to be of wilful intent?

As clause 58 is likely to be discussed in the meeting on 18 November 2002, it will be appreciated if your reply, in both Chinese and English, could reach us by close of play on 16 November 2002.

Yours sincerely

(Monna LAI)
Assistant Legal Adviser