

2528 9016
2865 6778
C2/1/57/2 (04) Pt. 8
LS/B/1/04-05

[By Fax: 2877 5029]

27 January 2005

Ms Monna Lai
Assistant Legal Adviser
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Ms Lai,

Companies (Amendment) Bill 2004
Section 2(1) of the Proposed Twenty-third Schedule

I refer to your letter dated 24 December 2004. After consulting the Department of Justice and the Hong Kong Institute of Certified Public Accountants, we set out our responses to your observations on section 2(1) of the proposed Twenty-third Schedule of the Companies Ordinance (CO, Cap. 32) in the ensuing paragraphs.

The “Parent and Subsidiary” Situation

2. Before we respond to your questions about whether two undertakings can claim to be a parent undertaking of an undertaking under section 2(1) of the proposed Twenty-third Schedule, it is worth mentioning that the existing section 2(4)(a) of the CO may result in a *hypothetical* possibility, whereby a “parent company” may, for example, control the composition of the board of directors of a “subsidiary”

whereas another “parent company” may control more than half of the voting power of or hold more than half of the issued share capital of the “subsidiary”. Occurrence of this possibility is nevertheless remote, since in reality it is unlikely that an undertaking would, say, hold more than half of the issued share capital of the subsidiary but give up its right to appoint a majority of its board of directors of the subsidiary or its control of the voting power of the subsidiary. As far as we are aware, we have not come across any precedent case whereby two companies claim to be the parent company of a subsidiary under the existing section 2(4)(a) of the CO.

3. Section 2(1) of the proposed Twenty-third Schedule does not alter the *status quo*. Strictly speaking, it is also *hypothetically* possible under section 2(1) of the Schedule that more than one undertaking can satisfy the various criteria under which an undertaking is defined to be a parent undertaking in relation to another undertaking (i.e. subsidiary undertaking). Again, it is unlikely that an undertaking would, say, hold a majority of voting rights in the subsidiary undertaking but give up its right to appoint a majority of its board of directors or its right to exercise a dominant influence over the subsidiary undertaking. It is also relevant to point out that section 258 of the United Kingdom (UK) Companies Act 1985, which sets out the criteria to determine the “parent-subsidiary” relationship, contains no provision excluding or dealing with the occurrence of the above hypothetical possibilities. We are not aware of any difficulties in the actual operation of the relevant provisions in the company laws of the UK.

The “Grandparent, Parent, and Subsidiary” Situation

4. There is but one more usual situation, i.e. the “grandparent, parent and subsidiary” situation, where two companies prepare group accounts consolidating the accounts of a single subsidiary. In section 2(4)(b) of the existing Ordinance, a company shall be deemed to be a subsidiary of another company if the first-mentioned company is a subsidiary of any company which is that other company’s subsidiary. Section 2(3) of the proposed Twenty-third Schedule preserves the *status quo* whereby a parent undertaking shall be treated as the parent undertaking of undertakings in relation to which any of its subsidiary undertakings are, or are to be treated as, parent undertakings. In this circumstance, unless the “parent company” is a wholly owned subsidiary of the “grandparent company” and is thus exempt from preparing group accounts under section 124(2)(a) of the CO, both the “parent company” and “grandparent company” are required to prepare group accounts in respect of a subsidiary undertaking under the CO. According to our

knowledge, this does occur in real life.

Yours sincerely,

(Alan Lo)
for Secretary for Financial Services
and the Treasury

c.c.

Department of Justice

(Attn: Mr. K F Cheng, Law Drafting Division) 2869 1302

(Attn: Ms. Rayne Chai, Law Drafting Division) 2869 1302

(Attn: Ms. Beverly Yan, Civil Division) 2868 1068

Hong Kong Institute of Certified Public Accountants

(Attn: Mr. Roger Best) 2865 7864

(Attn: Mr. Paul Winkelmann) 2850 4092

(Attn: Ms. Elsa Ho) 2865 6603

Registrar of Companies

(Attn: Mr. Gordon Jones) 2868 5384