

ABOUT THIS DOCUMENT

1. This paper is published by the Financial Services and the Treasury Bureau (“FSTB”) to consult the public on legislative proposals to improve various provisions in the Companies Ordinance (Chapter 32) (“CO”). This is the second of a series of public consultations on the rewrite of the CO. The first consultation on legislative proposals to improve the accounting and auditing provisions in the CO was conducted in the second quarter of 2007. The consultation conclusions have been issued and are available on http://www.fstb.gov.hk/fsb/co_rewrite. We plan to issue another consultation paper on other areas such as share capital, capital maintenance rules and statutory amalgamation procedures in mid-2008. After considering the views and comments on the individual subject areas, we aim to issue the Companies Bill in the form of a White Bill for public consultation in mid-2009.
2. A list of questions for consultation is set out for ease of reference after Chapter 5. Please send your comments to us on or before **30 June 2008**, by one of the following means:

By mail to: Companies Bill Team
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
Hong Kong

By fax to: (852) 2869 4195

By email to: co_rewrite@fstb.gov.hk
3. Any questions about this document may be addressed to Miss Carol Or, Assistant Secretary for Financial Services and the Treasury (Financial Services), who can be reached at (852) 2528 9077 (phone), (852) 2869 4195 (fax), or carolor@fstb.gov.hk (email).
4. This consultation paper is also available on the FSTB’s website <http://www.fstb.gov.hk/fsb> and the Companies Registry’s website <http://www.cr.gov.hk>.

5. Submissions will be received on the basis that we may freely reproduce and publish them, in whole or in part, in any form and use, adapt or develop any proposal put forward without seeking permission or providing acknowledgment of the party making the proposal.

6. Please note that names of respondents, their affiliation(s) and comments may be posted on the FSTB's website or referred to in other documents we publish. If you do not wish your name and/or affiliation to be disclosed, please state so when making your submission. Any personal data submitted will only be used for purposes which are directly related to consultation purposes under this consultation paper. Such data may be transferred to other Government departments/agencies for the same purposes. For access to or correction of personal data contained in your submission, please contact Miss Carol Or (see paragraph 3 above for contact details).

ACKNOWLEDGEMENT

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ABBREVIATIONS

ACA	Australia Corporations Act 2001
AGs	Advisory Groups
CA 2006	United Kingdom Companies Act 2006
CGR	Corporate Governance Review
CLRSG	Company Law Reform Steering Group (UK)
CO	Companies Ordinance (Chapter 32)
CR	Companies Registry
FSTB	Financial Services and the Treasury Bureau
SCA	Singapore Companies Act
SCCLR	Standing Committee on Company Law Reform
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance (Chapter 571)
SMEs	Small and Medium-Sized Enterprises
UCC	Uniform Commercial Code (US)
UK	United Kingdom
US	United States

EXECUTIVE SUMMARY

1. The FSTB launched a comprehensive rewrite of the CO in mid-2006. Public consultation on proposals to reform the accounting and auditing provisions of the CO was conducted in the second quarter of 2007. The consultation conclusions have been issued recently. The final proposals will be incorporated into a White Bill to be issued around mid-2009 for further public consultation.
2. The present consultation covers the following issues:

Company names (Chapter 2)

- (a) To tackle possible abuses of the company name registration regime by “shadow companies”, we propose empowering the Registrar of Companies (“Registrar”) to act on a court order directing a defendant company to change its infringing name, and substitute its infringing name with its registration number if the company fails to comply with the Registrar’s direction to change its name;
- (b) We propose that the Registrar may have a discretionary power to approve the registration of a hybrid company name comprising both Chinese characters and English alphabets or words where the applicant can show to the satisfaction of the Registrar that there is a genuine business need;

Directors’ duties (Chapter 3)

- (c) We seek public views on whether the directors’ general duties which are mainly found in case law should be codified to make them more accessible to the public. We would like to hear views on whether the UK approach should be followed. The UK has included a duty for directors to promote the success of the company having regard to a wider list of factors, such as the interests of employees, and the impact of the company’s operations on the community and the environment;

Corporate directorship (Chapter 4)

- (d) We propose that corporate directorship be abolished or restricted so as to improve the accountability and transparency of company

operations and the enforceability of directors' obligations. The option favoured by the SCCLR is to abolish corporate directorship altogether, subject to a reasonable grace period. An alternative is to follow the UK approach which requires that every company must have at least one director who is a natural person so that someone may, if necessary, be held accountable for the company's actions;

Registration of charges (Chapter 5)

- (e) We propose that the list of registrable charges be updated by including charges on aircrafts and interests in them and deleting or amending certain duplicated or obsolete items, such as the requirement to register charges securing the issue of debentures, and references to "bills of sale";
 - (f) We propose that the procedure of registration of charges be improved by making the instrument of charge available in full on the public register and by shortening the registration period from five weeks to 21 days so as to reduce the period whereby the charge is "invisible" to third parties; and
 - (g) We also invite initial views on whether there is any need to introduce an administrative mechanism for late registration of charges to replace the current system of applying to the court.
3. The Government will carefully study the comments received during this consultation before taking a final view on the proposals. Other issues, such as share capital, capital maintenance rules and statutory amalgamation procedures will be covered in another public consultation paper to be issued in mid-2008. The final proposals will be incorporated into the White Bill for further public consultation around mid-2009. We plan to introduce the Companies Bill into the Legislative Council, tentatively, in the third quarter of 2010.

CHAPTER 1

INTRODUCTION

Background

- 1.1 The CO¹ is one of the longest and most complex pieces of legislation in Hong Kong, with over 600 sections and subsections and 24 schedules. It provides the legal framework for the operation of all companies in Hong Kong². It, dates from 1932, was last substantially reviewed in 1984, and is broadly in line with the major UK company law reforms contained in the Companies Act 1948 and some subsequent reforms, such as those contained in the Companies Act 1976.
- 1.2 The CO has been amended several times in recent years³. The piecemeal approach to amending the CO, however, has its limitations. We have reached a stage where a comprehensive rewrite of the CO is needed to modernise our company law to further enhance Hong Kong's status as a major international financial and business centre. With the support of the Legislative Council, the FSTB launched a comprehensive rewrite of the CO in mid-2006.

Benefits of Rewriting the Companies Ordinance

- 1.3 The rewrite exercise will help modernise the CO and take forward reforms in respect of those areas which have not been reviewed previously, such as the capital maintenance provisions and company names provisions dealing with the problems posed by “shadow companies”⁴. Antiquated concepts, such as the underlying assumption of paper-based communications between a company and its members and the concept of “par value”, will need to be changed, updated or simplified.

¹ Available at <http://www.legislation.gov.hk>

² As at the end of 2007, there were 655,038 companies which were formed and registered locally in Hong Kong, of which 645,986 were private companies and 9,052 were public companies. There were 8,081 non-Hong Kong companies registered under the CO.

³ The amendments were covered in several amendment ordinances, most notably the Companies (Amendment) Ordinance 2003, the Companies (Amendment) Ordinance 2004 and the Companies (Amendment) Ordinance 2005. The amendments included, among other things, allowing the formation of one-member companies, enhancing shareholders' remedies (including the introduction of a statutory derivative action); and amending the definition of the term “subsidiary” for the purposes of group accounts to make it closely align with the International Accounting Standards.

⁴ These refer to those companies incorporated in Hong Kong at the CR with names which are very similar to existing and established trademarks or trade names of other companies and pose themselves as representatives of the owners of such trademarks or trade names when contracting with Mainland manufacturers to produce counterfeit products bearing such trademarks or trade names.

- 1.4 The rewrite will improve the structure of the parts and sections and enhance the clarity of the provisions of the CO so as to make the law more accessible to users. With streamlined and modernised provisions, our company law will meet more fully the needs of and help save compliance and business costs incurred by companies (local or non-Hong Kong) registered in Hong Kong, especially the SMEs. It will also benefit relevant stakeholders, such as company shareholders, directors, creditors and auditors. For example, by updating the provisions regarding directors' conflicts of interest and disclosure requirements, the rewrite will further strengthen corporate governance in Hong Kong. It is believed that all these will lead to enhanced market confidence in incorporating and registering companies under the new CO to undertake business in Hong Kong.
- 1.5 The rewrite also provides an opportunity for Hong Kong to leverage from the developments regarding company law in other major common law jurisdictions such as the UK, Australia, Singapore and New Zealand.

The Guiding Principles

- 1.6 The rewrite exercise is guided by the following key principles⁵:

- ***Catering for SMEs - “think small first”***

The provisions of the CO should be reframed and aligned with special regard to the needs of private companies, particularly SMEs. We aim to reduce compliance costs of companies, particularly private companies and SMEs.

- ***Enhancing corporate governance***

The rewrite aims to strengthen corporate governance⁶, taking into account the interests of stakeholders, such as members and creditors, and considering other relevant factors, such as corporate social responsibility initiatives in the company law of comparable

⁵ In addition, there are a few guiding principles concerning drafting and format:

- To consider expressing general principles of law that have been clearly established by decided cases by way of statutory statements, where appropriate.
- To rationalise and simplify the provisions and modernise the language; to make the new CO more readable and understandable without losing certainty and precision.
- To use schedules, subsidiary legislation or non-statutory codes, where appropriate, to contain detailed requirements to facilitate the regular updating of the law in the future.

⁶ Building upon the recommendations of the SCCLR in the CGR conducted from 2000 to 2003.

jurisdictions. Public companies should be subject to enhanced regulation where appropriate. For listed companies, the new CO should complement the regulatory regime contained in the SFO and the Listing Rules.

- ***Complementing Hong Kong's role as an international financial and business centre***

The rewrite will benchmark Hong Kong against other comparable jurisdictions such as the UK, Australia and Singapore in general while taking into account Hong Kong's unique business environment and our close economic relationship with the Mainland.

- ***Encouraging the use of information technology***

The new CO should promote the use of information technology, particularly in facilitating communications between companies and their shareholders as well as members of the public, and in encouraging environmentally friendly practices.

Progress Made and Future Work

- 1.7 In view of the extensive nature of the rewrite exercise, we have adopted a phased approach by tackling the core company provisions which affect the daily operation of live companies in Hong Kong in the first phase.
- 1.8 We consider it important to gauge the views of stakeholders and the general public in the process of the rewrite. In this connection, we have benefited from the advice of the SCCLR⁷ which plays a key role in advising on all major proposals to reform the CO, as well as that of four dedicated AGs comprising representatives from relevant professional and business organisations, academics and members of the SCCLR. With thanks and due credit to the efforts and generous support of the Chairmen and Members, the four AGs have now completed most of their work. The current membership of the SCCLR and AGs respectively is at **Appendix I**.

⁷ Members of the SCCLR include representatives of the SFC, Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as individuals from relevant sectors and professions such as accountancy, legal and company secretarial. Please see <http://www.cr.gov.hk> for further information.

- 1.9 We have commissioned an external legal consultant⁸ to study and formulate proposals on certain complex areas of the CO, including the share capital and debentures (Part II of the CO), distribution of profits and assets (Part IIA) and registration of charges (Part III).
- 1.10 We conducted a three-month public consultation on proposals to reform the accounting and auditing provisions of the CO from March to June 2007. A total of 32 submissions from 30 deputations were received during the consultation period. We have considered the submissions in consultation with the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group and the SCCLR. The consultation conclusions are now available on the CO rewrite website⁹. The final proposals will be incorporated into the White Bill to be issued around mid-2009 for further public consultation.
- 1.11 The White Bill will enable the public to comment on all the proposals in a holistic manner before the Companies Bill is introduced into the Legislative Council, tentatively in the third quarter of 2010.
- 1.12 The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver's Office, will be reviewed in the second phase. We intend to start a scoping and background study in late 2008 before formulating the details of the second phase. Those parts of the CO concerning prospectuses will be dealt with in a separate review by the SFC and likely to be transferred from the CO to the SFO.

Seeking Comments

- 1.13 Meanwhile, we have identified a number of topical issues where we hope to benefit from public comments before incorporating them into the White Bill. The present consultation covers the following:
- (a) company names;
 - (b) directors' duties;
 - (c) corporate directorship; and
 - (d) registration of charges.

The key proposals are described in Chapters 2 to 5 below.

⁸ Dr Maisie Ooi from the National University of Singapore was appointed the consultant for the consultancy study on the parts of the CO covering share capital, capital maintenance rules, registration of charges, debentures and remaining provisions in Part II of the CO. She is assisted by several experts from the UK, New Zealand and Singapore.

⁹ http://www.fstb.gov.hk/fsb/co_rewrite

- 1.14 The remaining issues, such as share capital, capital maintenance rules and statutory amalgamation procedures will be covered in another consultation paper to be issued in mid-2008.
- 1.15 To enhance the readability of each proposal, we will start with a brief background of the relevant issues and our considerations before presenting the details of the proposed changes or amendments. Where appropriate, we will make reference to similar provisions in other common law jurisdictions, such as the UK, Australia and Singapore. The questions for consultation are set out under different sections in each chapter and a list of all questions for consultation is extracted at the back of this document after Chapter 5.
- 1.16 As the proposed changes or amendments will have significant implications for companies and different stakeholders including the directors, shareholders, investors, creditors and relevant professionals, we would like to invite public comments before drafting the White Bill. The comments received will help us ensure that the relevant legislative proposals will suit Hong Kong's circumstances.

CHAPTER 2

COMPANY NAMES

A. “Shadow Companies”

Background

- 2.1 In recent years, the CR has received many complaints from owners of trademarks or trade names regarding “shadow companies”¹⁰. Authorities in the Mainland, Japan, the European Union and the US have also expressed concerns that such “shadow companies” exploit the company name registration system in Hong Kong to facilitate their counterfeiting activities in the Mainland.
- 2.2 At present, an owner of a trademark or trade name may, in a legal action for trademark infringement or passing off against a “shadow company”, obtain a court order to direct the latter to change its name. However, the Registrar has no authority under the current law to take any enforcement action even if such a court order is presented to the CR. Currently, the Registrar is only empowered, under section 22(2) of the CO, to direct a company, within 12 months of its incorporation, to change its name if, amongst other things, it is “too like” the name of another company on the Companies Register.
- 2.3 The Government has adopted a number of administrative measures to alleviate the problem, including:
- (1) enhanced publicity efforts by the Intellectual Property Department and the CR in the Mainland and Hong Kong to promote awareness of the differences between Hong Kong’s company registration and trademark registration systems;
 - (2) information posted on the CR’s website listing those companies which have failed to comply with the Registrar’s directions to change name; and
 - (3) placement of a warning statement in Certificates of Incorporation and Certificates of Change of Name highlighting the fact that registration of a company name does not confer any trademark or any other intellectual property rights as regards the name on the companies.

¹⁰ See footnote 4 above.

Considerations

- 2.4 There is a strong case for strengthening the company name registration regime to tackle any possible abuses by “shadow companies”. We have considered several options, having regard to the experiences in other major common law jurisdictions, including the UK, Australia, Singapore, Canada and New Zealand.
- 2.5 There has been a suggestion that the CR should not allow the registration of a company name which is identical or similar to any trademark registered under the Trade Marks Ordinance (Chapter 559). We do not think that this is a viable solution. As a matter of policy, it is inequitable to grant trademark owners monopoly over company names covering all kinds of business activities (including those in which such trademarks of relevant goods and/or services have not been registered). Our company name and trademark registration systems are distinct and independent, in line with the practice in other major common law jurisdictions, including the UK, Australia and Singapore. In practice, given the tremendous numbers of company name and trademark registrations¹¹, it is impossible for the CR to check each and every proposed company name against all registered trademarks while maintaining the current efficiency of the company incorporation regime.
- 2.6 We have also considered the feasibility of introducing a company names adjudication system similar to that introduced in the UK under the CA 2006¹². While details on how the adjudication system actually operates are yet to be available, the law provides that a person may apply to a company names adjudicator to object to a company’s registered name on the basis that it is identical or similar to a name in which he has already acquired goodwill. Under that system, the adjudicator will consider each side’s arguments at a hearing. If he upholds the objection, he is empowered to order the respondent company against which the objection is made to change its name. In theory, such a system may provide an alternative route for owners of trademarks or trade names to seek a quicker and possibly less costly form of relief than resorting to court proceedings. However, this system is not recommended for adoption in Hong Kong for the time being for the following reasons:

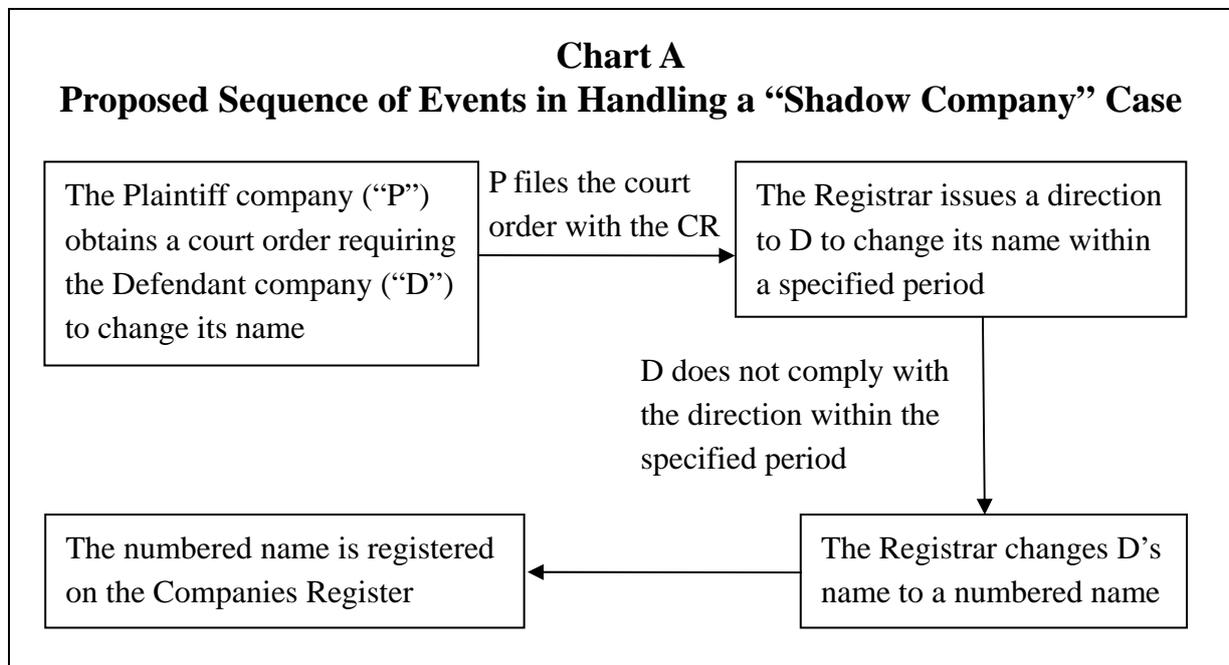
¹¹ As at the end of 2007, there were 655,038 registered companies and 217,692 registered trademarks.

¹² See sections 69 to 74 of the CA 2006 (<http://www.opsi.gov.uk/acts.htm>), which, according to the implementation timetable, will commence operation on 1 October 2008.

- (1) since it is believed that most “shadow companies” are formed by counterfeiters to carry out counterfeiting and passing off activities, it is unlikely that officers of “shadow companies” would attend the proceedings before an adjudicator;
- (2) such a system involves considerable administrative costs, such as providing support to the adjudicators and ensuring due process; and
- (3) there may be duplication of efforts between the adjudication system and the court, as some parties may also seek relief from the court against “shadow companies” in passing off actions.

Proposal

2.7 We suggest amending the CO to empower the Registrar to act on a court order directing a defendant company to change its infringing name. Upon receipt of such a court order, the Registrar may direct the defendant company to change its name within a specified period. If the defendant company fails to comply with the direction, the Registrar may substitute its infringing name with its registration number¹³ (“numbered name”). The proposed sequence of events is shown in Chart A.



¹³ It is a unique number allocated by the CR to each newly registered company upon its registration.

- 2.8 Such a proposal is in line with the company name registration system in operation in other major common law jurisdictions. Singapore amended its company law in 2005 to empower its Registrar of Companies to direct a company to change its name if the use of that name has been restrained by an injunction granted under the Trade Marks Act¹⁴. There are precedents in other jurisdictions, such as Australia, Canada and New Zealand, for empowering companies registrars to change a company's name to a number if it fails to comply with a direction to change name issued by the registrars¹⁵.
- 2.9 We also suggest granting the Registrar a power to reject registration of any company name which is the same as an infringing name which the Registrar has previously directed a company to change and is the subject matter of a court order.
- 2.10 We further propose that the power of the Registrar to change a company's name to a numbered name would also apply if the company does not comply with the Registrar's direction to change its name issued under section 22(2) of the CO (see paragraph 2.2 above).
- 2.11 We have considered the alternative of empowering the Registrar to strike a company off the register if it fails to comply with a direction to change name. This is **not** recommended as it may adversely affect the interests of third parties, such as creditors, and may result in uncertainties over liabilities and obligations of the company and its officers.
- 2.12 As a related issue, we are considering how to expedite the company name approval procedure to shorten the incorporation time. Currently, applications for the incorporation of companies are normally processed by the CR in four working days. The bulk of the processing time is spent on scrutinising the proposed names to ensure that they are not objectionable for various reasons¹⁶. Based on a suggestion made by the SCCLR, we intend to bring forth a name approval system whereby a

¹⁴ See section 27(2) of the SCA as amended by the Companies (Amendment) Act 2005, which came into effect on 30 January 2006 (<http://statutes.agc.gov.sg>).

¹⁵ See section 158(3) of the ACA (<http://www.comlaw.gov.au>), section 12(5) of the Canada Business Corporations Act (<http://laws.justice.gc.ca>) and section 24 of the New Zealand Companies Act 1993 (<http://www.legislation.govt.nz>).

¹⁶ For example, a proposed company name must not be identical to the name of an existing company, must not constitute a criminal offence nor be offensive or contrary to the public interest. In addition, names that would be likely to give the impression that the company is connected with the Central People's Government or with the Hong Kong Government or any department of either Government or that contain certain words or expressions such as "Chamber of Commerce" and "Trust" will require official approval. See section 20(1) and (2) of the CO.

company name would be accepted for incorporation if it satisfies certain preliminary requirements, for example, that it is not identical to another name already on the Registrar's register and does not contain words or expressions on a specified list. The Registrar would thereafter be given the power to direct a company to change its name within a specified period (say, three months following the incorporation) in case where, upon further checking by the CR, its name is found to be offensive, likely to give the impression of a government connection or contrary to the public interest. We expect that the incorporation time could be shortened significantly under the proposed system.

Question 1

- (a) Do you agree that we need to amend the law to empower the Registrar, upon receipt of a court order requiring a company to change its name, to direct the company to change its name within a specified period?**
- (b) If your answer to (a) is in the affirmative, do you agree that the Registrar should be further empowered to change a company's name to its registration number if the company does not comply with his direction to change its name within the specified period?**
- (c) If your answer to (a) or (b) is in the negative, what other option(s) do you suggest and why?**

B. “Hybrid Names”

Background

2.13 Currently, according to section 5(1) of the CO, a company may register with only an English name, or only a Chinese name, or an English name together with a Chinese name, but not a name which is in the combined form of Chinese characters and English alphabets or words (“hybrid name”).

Considerations

2.14 The registration of hybrid names is not a feature commonly found in other jurisdictions where most of them only allow company names to be registered in one language¹⁷.

¹⁷ For example, the UK, Australia and Singapore.

2.15 We do not see any major problems with the current situation in Hong Kong and are unaware of any strong demand for the registration of hybrid names¹⁸. We are concerned that a general permission for registration of hybrid names would create great confusion in company names and aggravate the problem of “shadow companies” in view of the possible permutations in combining Chinese characters, English words and even numeric symbols that could be translated into different but similar company names. However, there have been suggestions that hybrid names should be allowed as there might be a genuine business need in some cases.

Proposal

2.16 If there is broad public support, we are prepared to provide the Registrar with a discretionary power to approve the registration of hybrid names on a case-by-case basis. The applicant has to establish, to the satisfaction of the Registrar, that there is a genuine business need to register a hybrid name, for example, to register a Chinese name incorporating the applicant’s well known trade name which may include English words or alphabets, or vice versa.

2.17 On the other hand, we propose to generally allow, in the new CO, company names containing the phrases “X光” and “卡拉OK” (for X-Ray and Karaoke respectively) as exceptions, because they have no direct Chinese equivalents and they are used in other legislation¹⁹.

Question 2

- (a) Do you agree with the proposal that the law should be amended to provide the Registrar with a discretionary power to approve a “hybrid name” where the applicant can show to the satisfaction of the Registrar that there is a genuine business need?**
- (b) If so, what should constitute a “genuine business need”?**

¹⁸ In 2006 and 2007, the Registrar turned down 58 and 64 applications respectively for the registration of hybrid names.

¹⁹ The term “X光” is used, for instance, in Regulation 42 of the Child Care Services Regulations (Chapter 243A) and Regulation 54 of the Education Regulations (Chapter 279A), and the term “卡拉OK” is used in Karaoke Establishments Ordinance (Chapter 573).

Question 3

Do you have further views on how the current company name registration system could be improved, particularly for the purpose of tackling the problem of “shadow companies”?

CHAPTER 3

DIRECTORS' DUTIES

Background

- 3.1 We are considering whether directors' general duties should be codified in Hong Kong.
- 3.2 At present, the general duties of directors in Hong Kong are mainly found in case law²⁰. They can be classified into two broad categories, namely fiduciary duties²¹ and duties of care and skill²². Some common law jurisdictions such as the UK, Australia and Singapore have codified some of the fiduciary duties and the duties of care and skill in statute law. The main reason is that the case law on the topic is complex and often inaccessible to the public. Codification can improve clarity and certainty for company management and members.
- 3.3 There are, however, arguments against codifying directors' duties. For example, fiduciary duties cannot be codified without being stated in detailed terms in which case there will be a loss of flexibility. If codification co-exists with common law and its development through judicial interpretation, this may lead to greater uncertainty and would not resolve the question of accessibility.
- 3.4 The issue concerning whether to codify directors' duties in the statute first emerged in the Second Report of the Companies Law Revision Committee in 1973²³ and there were attempts for statutory statements in the Companies (Amendment) Bill 1980 and the Companies (Amendment) Bill 1991²⁴ respectively. The proposed legislative amendments, however, have not been enacted into law. The subject was last considered by the SCCLR in its CGR from 2001 to 2003. Noting that

²⁰ Other sources of directors' duties can be found in the company's memorandum and articles of association, directors' contracts with the company, specific provisions under the statutes (e.g. the CO) or the Listing Rules.

²¹ Fiduciary duties that apply to directors include: (i) duty to act in good faith in the interests of the company, (ii) duty to exercise powers for proper purpose, (iii) duty to refrain from fettering his own discretion, (iv) duty to avoid conflicts of duty and interest, and (v) duty not to compete with the company. They are based on the equitable principles.

²² Duties of care and skill require directors to exercise reasonable care and skill in the performance of the functions and the exercise of the powers of the directors. The duties are derived from the common law principles of negligence.

²³ It set out the recommendation of the UK Jenkins Committee in its Report of 1962 of a statutory statement.

²⁴ The respective wording in the Companies (Amendment) Bill 1980 and the Companies (Amendment) Bill 1991, reflected the recommendation of the UK Jenkins Committee in its Report 1962, was without prejudice to the common law and equitable principles.

the views of the respondents to the consultation exercise on the issue were equally balanced as to whether a statutory statement should be introduced, the SCCLR recommended the publication of non-statutory guidelines, stating the principles of law in Hong Kong in relation to directors' duties, to promote the awareness of directors of their duties²⁵. The SCCLR also suggested that the issue should be revisited after more experience is gained on the practical application of the statutory approach in those jurisdictions where such an approach has been adopted such as the UK.

- 3.5 Pursuant to the SCCLR's recommendation, the Non-statutory Guidelines on Directors' Duties in Hong Kong²⁶ were first issued by the CR in January 2004. The latest Guidelines issued in October 2007 are at **Appendix II**.

Recent Developments in the United Kingdom

- 3.6 In the UK, the CA 2006 introduces a statutory statement on directors' duties which covers the following general duties²⁷:

- (a) duty to act within powers;
- (b) duty to promote the success of the company;
- (c) duty to exercise independent judgment;
- (d) duty to exercise reasonable care, skill and diligence;
- (e) duty to avoid conflicts of interest;
- (f) duty not to accept benefits from third parties; and
- (g) duty to declare interest to proposed transaction or arrangement.

The relevant sections are extracted at **Appendix III**.

- 3.7 While the statutory duties replace the corresponding common law rules and equitable principles from which they derive, these duties are required to be

²⁵ In July 2001 and June 2003, the SCCLR published two consultation papers on proposals made in Phases I and II of the CGR respectively. The question of a statutory statement of directors' duties was put out for public consultation. In January 2004, the SCCLR issued its final recommendations. See paragraphs 7.01-7.12 at pages 15-20 of the SCCLR's *Corporate Governance Review - A Consultation Paper on Proposals Made in Phase II of the Corporate Governance Review* (June 2003) and *Corporate Governance Review - Final Recommendations*, available at <http://www.cr.gov.hk>.

²⁶ Copies of the Non-statutory Guidelines on Directors' Duties in Hong Kong were widely distributed at the offices and the websites of the relevant Government offices and public agencies such as the CR, the SFC, Hong Kong Exchanges and Clearing Limited, the Official Receiver's Office and the Hong Kong Monetary Authority. Directors are required to sign an acknowledgment that they have obtained a copy of and read the Guidelines when submitting a company's annual return.

²⁷ The CA 2006 is implemented by stages. Sections 170-181 (scope and nature of general duties, the general duties and supplementary provisions) commenced operation on 1 October 2007 except for sections 175-177 (duty to avoid conflicts of interest, duty not to accept benefits from third parties, duty to declare interest), 180(1), (2) (in part) and (4)(b) (approval or authorisation by members) and 181(2) and (3) (charitable companies) which will commence operation on 1 October 2008.

interpreted in the same way as common law rules and equitable principles. In other words, the courts should interpret and develop the general duties in a way that reflects the nature of the rules and principles they replace²⁸. This approach displays the UK Government's intention to achieve both the precision of the statutory statement and the continued flexibility and development of the law. However, the effectiveness of this intention is subject to trial after the statutory statement has been implemented²⁹.

- 3.8 The statutory duties do not cover all the duties that a director may owe to the company. Many duties are imposed elsewhere in the legislation, such as the duty to file accounts and returns to the Registrar of Companies. Other duties remain uncodified, such as the duty to consider the interests of creditors in times of threatened insolvency.
- 3.9 The remedies for breach of the statutory general duties have not been codified in the CA 2006. The CA 2006 states that the same consequences and remedies as are currently available should apply to breach of the statutory general duties³⁰. Where the statutory duties depart from their equitable equivalent, the court must identify the equivalent rule and apply the same consequences and remedies.
- 3.10 The UK goes beyond simply codifying the existing common law rules and equitable principles on directors' duties. It also attempts to modernise the law by introducing the principle of "enlightened shareholder value"³¹ under the duty to promote the success of the company. The duty requires a director to act in the way which he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and, in doing so, having regard to a list of wider factors, such as the interests of employees, suppliers and customers and the impact of the company's operation on the environment³². The

²⁸ See sections 170(3) and (4) of the CA 2006 at Appendix III and paragraph 305 of the official Explanatory Notes to the CA 2006 at http://www.opsi.gov.uk/acts/acts2006/en/ukpgaen_20060046_en.pdf.

²⁹ See comments in House of Commons Third Reading, Col. 1104 (19 October 2006) and also paragraph 3.11 below.

³⁰ See section 178 of the CA 2006 at Appendix III.

³¹ The concept of "enlightened shareholder value" is that, while the directors must promote the success of the company for the benefit of shareholders, this can only be achieved by taking due account of wider business factors (such as the interests of employees, suppliers and customers and the impact of the company's operation on the environment) rather than simply focusing on immediate or short term shareholder gratification. Some proponents pointed out that this is a new formulation with no grounding in common law, in contrast to the traditional and well understood principle of a director having a duty to act "bona fide in what they consider...is in the interests of the company" and the elements as listed in section 172 of the CA 2006 were considered desirable in the review of the CLRSO.

³² See section 172 of the CA 2006 at Appendix III. The UK Government considers that the traditional formulation of a director's duty to act in the interests of the company is not clear. As a company is an artificial legal entity, it is hard to understand what the "interests of the company" are. The UK Government believes that new formulation in section 172 of CA 2006 resolves any confusion as to what the interests of the

list is not exhaustive, but highlights areas of particular importance which reflect wider expectation of responsible business behaviour. The duty does not require a director to do more than good faith and reasonable care, skill and diligence³³.

- 3.11 There were heated debates in the UK during the process of introducing the statutory statement of directors' duties. While some commentators praised the statement for improving clarity and certainty and striking a good balance between precision and flexibility, others were concerned that the statement created new uncertainties and difficulties. For example, the requirement for directors to take into account various new factors in complying with the duty to promote the success of the company may pose new challenges to directors³⁴. A summary of the arguments for and against the codification of directors' duties in the UK is at **Appendix IV** for reference. Some of the provisions in the statutory statement have only come into force on 1 October 2007 while the others will commence operation later this year. Until there is case law in relation to the new duties, directors are left with uncertainty as to how the courts will interpret the new statutory statement.

Australia and Singapore

- 3.12 Some other common law jurisdictions like Australia and Singapore have also adopted statutory statements of directors' general duties. In Australia, statutory duties of directors have been introduced since 1991 and are mainly contained in sections 180 to 183 of the ACA³⁵. In addition to common law relief, additional consequences, such as civil penalties, disqualification orders and criminal convictions, may stem from breaches of the statutory directors' duties³⁶. In Singapore, the statutory

company are. It is also a common-sense approach that reflects the modern view of the way in which businesses operate in their community. See *Companies Act 2006: Duties of company directors, Ministerial Statements* (June 2007) at <http://www.berr.gov.uk/files/file40139.pdf>. On the other hand, some commentators have queried that the new formulation will cause serious complications for directors. There are also concerns over the addition of the elements to which the directors must have regard to and whether that would lead to prospect of litigation.

³³ See paragraphs 327 and 328 of the official Explanatory Notes to the CA 2006 (see footnote 28 above).

³⁴ See, for example, Briefing for Clause 158 of the Company Reform Bill printed on 24 May 2006 in the Parliamentary Brief (13 June 2006) by the Law Society of the UK.

³⁵ Section 180 imposes a duty to use care and diligence of a reasonable person in like circumstances and provides for the operation of the business judgment rule. Section 181 requires the exercise of powers and discharge of duties in good faith and in the best interests of the corporation and for a proper purpose. Sections 182 and 183 prohibit improper use of position and information to gain an advantage for the directors themselves or for any other person or to cause detriment to the corporation.

³⁶ Under section 180(1) of the ACA, the court may order the payment of a pecuniary penalty of up to A\$200,000. This is not a compensatory order. The purpose is to punish the director and to provide a general deterrence effect. See Julie Cassidy, *Directors' Duty of Care in Australia – a Reform Model* (June

statement of directors' duties is set out in section 157 of the SCA³⁷. The Australian and Singaporean approaches differ from the UK's in that the statutory duties in the ACA and the SCA have effect in addition to the existing common law and equitable principles and therefore the common law rules and codifying statute can be used together to develop the law³⁸.

Considerations

3.13 The issue concerning codification of directors' duties has recently been revisited by the SCCLR. Having considered the recent developments in the UK, the SCCLR suggested that the issue of codification of directors' duties should be brought up for public consultation. While the SCCLR saw some advantages in codifying directors' duties along the UK model to make the law clearer and more accessible to the public, it also noted that the UK approach on directors' duty to promote the success of the company might cause some concerns among the business community. The Government would therefore like to hear the views of the public before taking a final view on the issue.

Question 4

- (a) Do you agree that the general duties of directors should be codified in the Companies Bill?**
- (b) If your answer to Question (a) is in the affirmative, do you agree that the UK approach, including the duty to promote the success of the company for the benefit of its members as a whole having regard to such factors like the long-term consequences of a decision, the interests of employees, the impact of the company's operations on the community and the environment, etc., should be adopted? OR**
- (c) If your answer to Question (a) is in the negative, do you have any views on how the directors' duties could be clarified or made more accessible?**

2007), unpublished paper, pages 13-14.

³⁷ Section 157 of the SCA provide for a director's duties as follows:

“(1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.

(2) An officer or agent of a company shall not make improper use of any information acquired by virtue of his position as an officer or agent of the company to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the company.”

³⁸ See section 185 of the ACA and section 157(4) of the SCA.

CHAPTER 4

CORPORATE DIRECTORSHIP

Background

- 4.1 The SCCLR has recommended that corporate directorship for all companies incorporated in Hong Kong should be prohibited, subject to a reasonable grace period.
- 4.2 Since March 1985, all public companies and private companies which are members of a group of companies of which a listed company³⁹ is a member have been prohibited from appointing a body corporate as their director, whereas other private companies can continue to have corporate directors⁴⁰. In its *Report on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance* published in February 2000, the SCCLR noted that one feature of corporate directorship was that the delegate might change from time to time, making it very difficult to know who was responsible for the conduct of the business of a company. Furthermore, as the delegate of a corporate director was not personally a director of that company, his duties were not owed to the company and it would be difficult to attach liability to him for acts or omissions prejudicial to the company⁴¹. The SCCLR, therefore, recommended that in the interest of improving corporate governance which stressed a high degree of disclosure and transparency, corporate directorship should be prohibited, subject to a grace period of two years.
- 4.3 In view of the SCCLR's recommendation, in 2002, the Government consulted a number of professional bodies and stakeholders on the proposal to abolish corporate directorship. Over half of the respondents supported the proposal on, inter alia, the grounds that it would help enhance accountability, transparency, and corporate governance. However, there were concerns that the proposal would drive away many private companies established in Hong Kong and would have adverse implications for business, in particular, the ability to incorporate companies quickly and the flexibility provided by corporate directorship in the management of companies set up purely for asset holding purpose.

³⁹ "Listed company" means a company which has any of its shares listed on recognized stock market (sections 2(1) and 154A(3) of the CO).

⁴⁰ Section 154A(3) of the CO.

⁴¹ Available at [http://www.cr.gov.hk/en/standing/docs/Rpt_SCCLR\(E\).pdf](http://www.cr.gov.hk/en/standing/docs/Rpt_SCCLR(E).pdf). See Recommendation 43 at page 66 and paragraphs 6.19 and 6.22 in particular.

In view of such concerns and having regard to the economic climate at that time, it was considered not opportune to introduce the proposal then.

Recent Developments in Other Jurisdictions

4.4 Corporate directorship has been abolished in many other common law jurisdictions, such as Australia, Singapore, Canada, New Zealand, Malaysia and the US (under its Model Business Corporations Act). However, it is still retained in the UK and a number of offshore jurisdictions like the Cayman Islands and the British Virgin Islands. The UK has once considered to abolish corporate directorship in its recent Company Law Review in view of the difficulties in determining who was actually controlling a company and applying sanctions against corporate directors, but was concerned that an outright ban of corporate directors might harm those companies which made use of the current flexibilities in corporate directorship for entirely legitimate reasons. Nevertheless, in order to improve the enforceability of directors' obligations and to avoid the difficulties in pursuing corporate directors, the CA 2006 now requires that every company must have **at least one director who is a natural person** so that someone may, if necessary, be held accountable for the company's actions⁴².

Considerations

4.5 The SCCLR has recently revisited the issue of corporate directorship. While legitimate reasons may be found in some cases for corporate directorship, for example, a parent company may like to be a corporate director of its subsidiaries to facilitate group cohesion, the SCCLR recommended that the appointment of corporate directors to private companies should be prohibited in Hong Kong, subject to a reasonable grace period to allow for the phasing out of corporate directorships. The proposal is expected to improve the accountability and transparency of company operations and the enforceability of directors' obligations. It would also help address the concern of the Financial Action Task Force⁴³ ("FATF") over the lack of transparency of legal persons and arrangements which could be used as a vehicle for money laundering and terrorist financing.

⁴² Section 155(1) of the CA 2006, which, according to the implementation timetable, will commence operation on 1 October 2008. See also paragraph 3.3 at page 24, *Company Law Reform White Paper* published by the UK Department of Trade and Industry in March 2005.

⁴³ The FATF is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

- 4.6 As at the end of December 2007, some 42,890 companies out of a total of 655,038 companies incorporated in Hong Kong have corporate directors. While the percentage of companies having corporate directors is less than 10 percent, the Government is mindful of the need to ensure that the abolition of corporate directorship would not undermine Hong Kong's attractiveness as a place for doing business.
- 4.7 We would like to hear the views of the public before taking a final view on this matter.

Question 5

- (a) **Do you agree that corporate directorship should be abolished altogether in Hong Kong, subject to a reasonable grace period?**
- (b) **If your answer to Question (a) is in the negative, do you agree that the UK approach (i.e. a company should be required to have at least one natural person as its director), subject to a reasonable grace period, should be adopted?**
- (c) **If your answers to both Questions (a) and (b) are in the negative, do you have any suggestion on how to improve the enforceability of directors' obligations and to solve the difficulty of pursuing corporate directors?**

CHAPTER 5

REGISTRATION OF CHARGES

Background

- 5.1 The present law on the registration of charges is set out in Part III of the CO, sections 80 to 91. A company is obliged to send to the Registrar for registration particulars of every charge created by it that falls within the list of registrable charges set out in section 80(2).
- 5.2 The original instrument⁴⁴ (if any) by which the charge is created or evidenced must be delivered along with the prescribed particulars of the charge. The Registrar compares the charge document with the filed particulars and is required to issue a certificate of due registration if satisfied that the particulars are in order. Currently, it usually takes the CR nine working days to process an application for registration. If particulars are not submitted for registration within five weeks from the date of creation of the charge⁴⁵, then the company and its every officer in default is liable to a fine and, for continued contravention, a daily default fine. In practice, registration is done on the application of the charge holder whose economic incentive is stronger⁴⁶; failure to register means that the charge is void against the liquidator and any creditor of the company to the extent that it confers any security over the company's property or undertaking. There is a facility for registration out of time but this necessitates an application to the court.

General Considerations

- 5.3 There are a number of justifications that support the existence of statutory registration requirements in respect of charges created by companies. The main consideration is the provision of information for persons who wish to assess the financial position of the company, such as credit reference agencies, prospective charge holders, investors and financial analysts, who are able to ascertain from the register whether or not the

⁴⁴ In the case of a charge created out of Hong Kong comprising property situated outside Hong Kong, the delivery of a copy of the instrument creating the charge verified in the prescribed manner is sufficient for the purpose of registration.

⁴⁵ In the case of a charge created out of Hong Kong comprising property situated outside Hong Kong, the particulars and instrument creating the charge (or copy) should be delivered for registration within five weeks after the date on which the instrument (or copy) could, in due course of post, and if dispatched with due diligence, have been received in Hong Kong.

⁴⁶ The charge holder is also entitled to recover from the company the amount of any fees paid to the Registrar in connection with the registration.

assets of the company are encumbered. The registration requirement is also a key test for a receiver or liquidator in considering whether to acknowledge the validity of a charge.

- 5.4 The Hong Kong system for the registration of charges created by companies is largely based on the UK registration scheme. The UK-type registration is often compared with its US equivalent, a notice filing system which merely provides that a security interest may exist without definitively establishing its existence⁴⁷. Fully adopting the US system would require reform beyond the realm of company law. This would not be within the scope of this legislative exercise.
- 5.5 It appears that the existing regime has been working well and therefore, we do not recommend substantial changes or radical redesign. In this connection it should be noted that the CA 2006 has rearranged the present structure of the registration of charge provisions but no changes of substance have been made⁴⁸.
- 5.6 It may also be noted that the fundamentals of the UK system are also followed in other common law jurisdictions like Australia, Singapore and Ireland, though with some differences in detail. We have considered but rejected some of the changes considered or adopted in the UK or other jurisdictions as these changes are either unnecessary or inappropriate in the Hong Kong context. The proposed changes which we suggest **not to adopt** include:
- (a) comprehensively codifying the law on priorities where there is more than one charge over the same property created by a company;
 - (b) introducing an advance or provisional registration system;
 - (c) providing a legislative clarification of the kinds of retention of title clause that constitute a registrable charge;
 - (d) registering sale or absolute assignment of book debts (or receivables);
 - (e) registering pledges;

⁴⁷ The latter, which derives from Article 9 of the US UCC, provides a filing regime for all security interests regardless of whether the provider of the security is a company, some other form of business organisation or indeed an individual. The UK and Hong Kong registration schemes apply only where the security provider is a company. It should be noted however that New Zealand has moved over to a US-style registration system and a similar move is presently being considered in Australia though the outcome of the Australian review is far from certain. In England, the Law Commission proposed a form of notice filing system that would apply to traditional security interests as well as to sales of receivables (see the Law Commission Final Report (2005, Law Com No 296, Cm 6654)). The proposal met with a considerable amount of resistance from practitioners and has not been adopted.

⁴⁸ The Scottish system is somewhat different from the English system and the differences will increase with the implementation of the Scottish Bankruptcy and Diligence Act 2007.

- (f) registering trust receipts if they operate for more than a specified period of time;
 - (g) registering insurance policies; and
 - (h) registering fixed charges on shares (and other marketable securities).
- Our reasons are discussed briefly in **Appendix V**. On the other hand, we consider that a number of improvements may be made to the list of registrable charges and the registration procedure. These proposals are set out in paragraphs 5.7 to 5.35 below.

Question 6

- (a) Do you agree that the changes listed in Appendix V should not be adopted in Hong Kong?**
- (b) If not, please specify which of the changes you think should be introduced in Hong Kong and the reasons.**

Updating the List of Registrable Charges

5.7 The existing approach in the CO is to set out a list of registrable charges. We recommend the retention of this approach. We advise against adopting the alternative of an inclusionary or negative listing approach which would seek to make all charges registrable except those which would be specifically excluded. One of the major reasons is that it could create uncertainties as it might include a lot of complex financial transactions which are not registrable at the moment⁴⁹. Nevertheless, some updating to the list of registrable charges could be considered.

Item to be considered for inclusion

Aircrafts

5.8 While a charge on a ship or share in a ship is already registrable under section 80(2)(h), the list of registrable charges does not include aircrafts and interests in them and we recommend its extension in this fashion.

⁴⁹ Also the current system appears to be familiar to practitioners who do not seem to have encountered any major problems and the negative listing approach does not offer any effective solutions to the problems arising from the listing approach (for example, there would be definitional problems under both options and both options entail the need to regularly update the list of charges registrable or excluded).

Question 7

Do you agree that charges on aircrafts and interests in them should be made registrable?

Items to be considered for deletion

Charges Securing Issue of Debentures

- 5.9 We would like to invite views on whether section 80(2)(a) (along with sections 80(7) and (8)), which requires registration of charges securing the issue of debentures, should be deleted on the ground that it duplicates some other heads of registrable charges. Typically, issues of debentures are supported by a floating charge, or a fixed charge that is registrable by virtue of some other categories of registrable charges.
- 5.10 Moreover, section 80(2)(a) is not free of ambiguity since it is not altogether clear whether it catches the issue of a single debenture. This is because “debenture” is generally understood to refer to a document evidencing indebtedness and, whilst this section uses the term in the plural, the rules of interpretation provide that, unless the contrary intention appears, words in the plural include the singular. The effect of this could be to make almost every charge registrable, since a charge almost always exists to secure an indebtedness. However, that could not have been the legislative intent since it would render the other heads of registrable charges superfluous.
- 5.11 It is more likely that section 80(2)(a) is intended to refer to debt securities, hence the phrase “issue of debentures”. The definition of “debenture” in section 2 of the CO as including “debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not” does not statutorily change the position for Hong Kong as the definition is an inclusive one.
- 5.12 An alternative to deletion of the provision would be to clarify and redraft the statutory language along the lines recommended in the Diamond Report⁵⁰ in the UK. If one followed this approach, then the phrase used in section 80(2)(a) to describe an issue of debentures would follow the wording employed in section 80(7) which deals with the formalities of

⁵⁰ The full name of the Diamond Report is “A Review of Security Interests in Property” (HMSO, 1989). This is a report commissioned by the UK Department of Trade and Industry and which influenced the provisions of Part 4 of the UK Companies Act 1989 reforming the law relating to the registration of company charges. Part 4, however, was enacted but never implemented and has since been repealed by the CA 2006.

registration where a company creates “a series of debentures containing, or giving by reference to any other instrument, any charge to the benefit of which the debenture holders of that series are entitled *pari passu*”. As this in effect provides no further information other than merely clarifying the present practice, we do not recommend pursuing this line.

Question 8

Should section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures be deleted on the ground that it is redundant?

Bills of Sale

- 5.13 Section 80(2)(c) provides that a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale, is a registrable charge. It has been commented that the term “bill of sale” is antiquated and somewhat unclear in its coverage though essentially it means a charge over goods but subject to a long list of exceptions. Two approaches have been suggested to deal with this issue. One approach might be to update the provision along the lines of section 262(3) of the ACA⁵¹ which makes registrable a charge on personal chattels created or evidenced by instrument but with a list of exceptions that essentially mirrors the effects of the bill of sale legislation.
- 5.14 There is a view however that the provision is superfluous in the company context⁵² since charges on goods may not exist in isolation, being usually coupled with a floating charge over a company’s entire undertaking. Whatever is caught by the provision, after the exclusions are taken into account, may be largely irrelevant as a form of security in the Hong Kong context. The other approach therefore might be to delete section 80(2)(c) altogether as the reference to “bill of sale” is out of date and it is doubtful if there are any justifications for keeping it. The SCCLR is in favour of this approach although it should be noted that charges over goods continue to be registrable in other comparable jurisdictions like the UK⁵³, Australia and Singapore⁵⁴. We would like to hear the views of the public

⁵¹ Available at <http://www.comlaw.gov.au>

⁵² Bills of Sale under the Bills of Sale Ordinance (Chapter 20), which excludes companies (section 26), are themselves almost obsolete. To be effective against third parties, they should be registered in the High Court. The average number of registrations is about 10 per year.

⁵³ See section 860(7)(b) of CA 2006.

⁵⁴ See section 131(3)(d) of SCA.

before taking a final view.

Question 9

Would you prefer the reference to “bills of sale” in section 80(2)(c) of the CO to be:

- (a) retained as is;**
- (b) retained but clarified along the lines of section 262(3) of the ACA; or**
- (c) deleted?**

Item to be considered for clarification

Definition of Book Debts

- 5.15 We are of the view that the reference to “book debts” in section 80(2)(e) should be retained. However, we would like to invite views on whether a definition of “book debts” should be provided in the CO, and if so, whether it should be defined along the lines of section 262(4) of the ACA. The provision reads as follows: “The reference in...to a charge on a book debt is a reference to a charge on a debt due or to become due to the company at some future time on account of or in connection with a profession, trade or business carried on by the company whether entered in book or not, and includes a reference to a charge on a future debt of the same nature although not incurred or owing at the time of the creation of the charge but does not include a reference to a charge on a marketable security, on a negotiable instrument or on a debt owing in respect of a mortgage, charge or lease of land”.
- 5.16 The argument against defining “book debts” statutorily is that the term does not lend itself to a ready definition. Not defining it would also allow its meaning to evolve through future case law.
- 5.17 Regardless of whether the term “book debts” is to be defined in the CO, we recommend that it be clarified that a lien on subfreights is not within this head or indeed any other head of registrable charge. Essentially a lien on subfreights is a provision in the charterparty (lease) of a vessel stating that the shipowners shall have a claim upon all amounts due under sub-charterparties for payments in respect of the headcharter. The provision gives the shipowner the personal right to intercept sub-charter payments before they reach the charterer but the provision nevertheless seems to lack the proprietary characteristics of a charge⁵⁵. Registration

⁵⁵ Lord Millett in *Re Brumark Ltd: Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 at paragraph 41.

is also inconvenient from a commercial perspective since charterparties are usually negotiated by shipbrokers and not by lawyers and are normally of a relatively short duration.

- 5.18 We also suggest that cash deposits be expressly excluded from this head of registrable charge. “Cash deposits” could arguably be classified as a book debt. This type of charge should be excluded from registration as it is normally taken over credit balances with financial institutions, or charge-backs with another bank. Third party creditors would not be misled by the absence of registration since bank accounts are usually operated confidentially and it is reasonable to expect the depositary bank to have a superior claim to the credit balance. Moreover, charge-backs would ordinarily mirror the effect of a set-off which also does not require registration.

Question 10

- (a) Would you prefer the term “book debts” to be statutorily defined or left to the courts to define?**
- (b) If your preference is for a statutory definition, would you agree to a definition along the lines of section 262(4) of the ACA, or some other (please specify)?**
- (c) Do you agree that a lien on subfreights and cash deposits should be expressly excluded from the registration requirement?**

The Registration Procedure

Obligation to Register

- 5.19 Under the current law, the obligation to register particulars of a charge is imposed on the company creating the charge and not on the charge holder. It has been suggested that the law should be changed so as to make charge holders responsible for registering on the basis that such change actually reflected what is being done in practice. Nevertheless, it is considered that the obligation to register charges should remain with the company. This obligation should be treated in the same way as reporting changes in directors, secretary or other relevant information about the company where the onus is on the company. The company has a responsibility to maintain its records up-to-date. It is also appropriate to retain the criminal penalties on the company for failure to register charges.

Acceleration of the Payment Obligation

5.20 Under the current law, if particulars of the charge are not submitted for registration within the requisite period, the amount secured becomes immediately repayable. We note that automatic statutory acceleration of repayment as provided in section 80(1) of the CO may create problems for banks. Suggestions have been made that a discretion would be provided to the lender either to demand repayment or to waive statutory acceleration especially since the CO already contains provisions for late registration of charges. Accordingly, we recommend that the CO should be amended to provide that the lender has a right, but not a duty, to demand immediate repayment of the amount secured by the charge should a company fail to register a charge within the prescribed time.

Question 11

Do you agree that the automatic statutory acceleration of repayment in section 80(1) of the CO should be replaced with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time?

Registration of Instrument of Charge and the Issue of Incorrect Particulars

5.21 We believe that there is a strong case for reforming some of the mechanics of the registration process to streamline the whole process. The CO currently lays down an obligation to submit the instrument of charge along with prescribed particulars. The Registrar compares the particulars with the instrument of charge and, if satisfied that the particulars are correct, issues a certificate of due registration which is conclusive evidence that all the requirements as to registration have been complied with. The information appearing on the register that is open to public inspection is that gleaned from the particulars. Currently, the instrument of charge itself does not appear on the register and cannot be searched in this manner.

5.22 We suggest that there is considerable merit in registering the instrument of charge itself together with some simple particulars on a prescribed form⁵⁶. The implementation of this recommendation increases the amount of information that is available for public inspection as the whole instrument of charge will be made available for inspection. In this regard,

⁵⁶ Particulars that are required in the prescribed form may include basic information about the company, particulars of the chargee and date of creation of the charge.

companies or charge holders will have to exercise their own judgement in drafting the instrument if they do not want to include commercially sensitive information in the instrument. Currently, registration of the particulars of a charge merely gives constructive notice of the existence of the charge and does not give constructive notice of the contents of a charge instrument. If the charge instrument itself is registered, it may constitute constructive notice of all the terms in the charge instrument, including negative pledge clauses, to those who may reasonably be expected to search the register, such as banks, financiers and relevant professionals.

- 5.23 Moreover, with the implementation of an electronic filing system, the registration of the charge instrument and the prescribed particulars could be made easier and more efficient on an operational level. Registering the instrument would also assist in diminishing reliance on the particulars.
- 5.24 Conversely, if it is considered not desirable to file the instrument of charge, an alternative approach could be to follow the Singaporean approach where the filer is required simply to deliver the prescribed particulars. While the Singaporean registration office may require the instrument of charge to be produced for inspection, this is not done as a matter of course.
- 5.25 No matter which approach is adopted, the company and the charge holder are the ones most familiar with the charge details. It is their duty to record and verify the particulars entered into the prescribed form against the instrument of charge. The Registrar does not have any additional knowledge about the transaction, and the CR serves as the depository rather than the verifier of the details. We therefore consider it logical that the Registrar should no longer check or verify the particulars entered into the prescribed form and should only issue a receipt rather than a certificate of due registration. The receipt would certify that the particulars and the instrument (if required) have been submitted on a particular date. Such an approach would have the merit of shortening the whole registration process and reducing the ‘invisibility’ period so that other parties have access to the information sooner.

Question 12

- (a) Do you agree that both the instrument of charge and prescribed particulars should be registrable and open to public inspection?**
- (b) Do you agree that the Registrar should no longer issue a certificate of due registration, but a receipt showing the particulars submitted for registration, as well as the date on which the instrument of charge (if required) and the particulars are submitted for registration?**

5.26 As an additional measure to ensure accuracy in the particulars delivered for registration, it is for consideration if the charge holder should be precluded from relying on rights to security in excess of those referred to in the particulars. This proposal is modeled on a provision in the UK Companies Act 1989 but the provision is not retained in the CA 2006⁵⁷. It could be argued, however, that since the instrument of charge will appear on the register (subject to the acceptance of the proposal in Question 12(a)), searchers, typically banks and legal professionals etc., should themselves be able to verify the information in the particulars against the instrument of charge. Therefore, we are of the view that this additional step is unnecessary.

Question 13

If the charge instrument is not registrable as an answer to Question 12(a), should the charge holder be precluded from relying on rights to the security in excess of those referred to in the particulars submitted for registration?

Time Limits for Registration

5.27 There is an obligation to submit details of a charge for registration within five weeks from the date of the creation of the charge⁵⁸. The five-week period compares with 21 days in the UK. As we are proposing streamlining the registration procedure (see paragraphs 5.21 to 5.25 above), we are minded to recommend that the five-week period should be shortened to minimise the period where a charge is “invisible” to outside

⁵⁷ Part 4 of the UK Companies Act 1989 reforming the law relating to the registration of company charges was enacted but never implemented and has since been repealed by the CA 2006.

⁵⁸ See footnote 45 above.

parties. We therefore invite views on whether 21 days is the most appropriate period.

Question 14

- (a) Do you agree that the period to register a charge should be shortened?**
- (b) If so, do you think that 21 days is an appropriate period?**

Late Registration of Charges

- 5.28 If a charge has not been registered within the time required pursuant to section 80 of the CO, section 86 gives the court jurisdiction to make an order allowing late registration. The court may exercise the discretion to sanction late registration if the omission was accidental, or due to inadvertence or some other sufficient causes, or is not of a nature to prejudice the position of creditors or shareholders of the company, or on other grounds it is just and equitable to grant relief.
- 5.29 Where the court grants relief, it may do so upon such terms and conditions as seemed to be just and expedient. Although the court allows late registration applications in most cases without prejudice to the rights of intervening creditors, there are circumstances that applications are denied. Generally, where the company is in liquidation or in imminent liquidation, the court may refuse the order⁵⁹. The court would also serve as arbiter prior to registration if there are objections to the late registration by third parties such as liquidators or creditors.
- 5.30 There are about 10 late applications each month out of a total number of some 3,000 to 3,500 charges registered. Given that most late registration applications have been dealt with by the court on paper without a hearing, there has been a suggestion that the requirement of having to apply to the court for late registration should be abolished. Instead, it is suggested that applications for late registration could be submitted to and administered by the CR in lieu of the court. To prevent a substantial increase of cases of late registration as a result of introducing the new administrative mechanism, a higher late registration fee could be introduced.

⁵⁹ In the absence of exceptional circumstances, the court is unlikely to grant an order for extension of time for registration where the company whose property has been charged has commenced liquidation. Also, the imminence of liquidation of the company is a relevant factor to be considered by the court.

5.31 One possible option of an administrative mechanism is for late registration to be granted automatically but subject to two provisos:

- (1) late registration would be made without prejudice to parties with rights against the property of the company that forms the subject matter of the charge and who have acquired such rights before the charge is actually registered; and
- (2) late registration should be deemed to be ineffective (i.e. the charge is void against the liquidator and creditors of the company) if the company goes into insolvent liquidation within a certain period after the actual registration of the charge unless the charge holder relying on the late registration establishes that the company was solvent at the time that the charge was registered.

5.32 The first proviso mirrors the effect of the proviso normally attached to orders currently given by the court permitting the late registration of charges. Judicial interpretation of the proviso shows that only proprietary rights holders and hence secured, but not unsecured, creditors are protected. The second proviso tries to reflect what the court might order under normal circumstances. In particular, it would guard against the possibility of charge holders connected with the company (such as directors) not registering their charges and then making a late registration application when the company is about to go into liquidation. The specified period could be kept relatively short, say, 6 months or less, so as to minimize any possible uncertainty for the charge holder.

5.33 Nevertheless, there are two main concerns about such an administrative mechanism. Firstly, unlike the existing regime under which all charges which appear on the register are effective, there will be uncertainty over whether some of the charges as registered are effective until expiry of the specified period. The charge holder may be disadvantaged in certain situations as a result of such uncertainty. For example, under the current system, while the charge holder may be asked by the court to establish at the point of a late registration application that the company is not insolvent, the task would be less onerous than presenting retrospective evidence after a lapse of time. It may also be difficult for the charge holder to secure the necessary assistance or cooperation from the company to prove its solvency, especially at a time when the company in question has gone into insolvent liquidation. Secondly, the proviso in paragraph 5.31(2) could not fully replicate the current discretionary power exercised by the court. For example, the proviso excludes the possibility of a late registration being valid even if the company is insolvent at the

time of late registration when it would have been in the interests of the company and its unsecured creditors to do so⁶⁰.

- 5.34 A variant of the proposed administrative mechanism is to require an application for late registration to be supported by a statement in a specified form by the company's directors that no winding-up petition has been presented and that no meeting has been convened to pass a resolution for a creditors' voluntary winding-up petition⁶¹. Late registration would then be granted subject to the proviso in paragraph 5.31(1) only. It would remove the uncertainty for the charge holder mentioned in paragraph 5.33 above but would fail to address concerns about connected charge holders registering charges late when they realise that the company is on the verge of going into liquidation.
- 5.35 In view of the above complexities, we would like to hear views on the idea of replacing the court procedure for late registration by a purely administrative one before deciding whether to develop the proposal and incorporate it into the White Bill for further public consultation.

Question 15

- (a) What are your views on the viability and desirability of introducing an administrative mechanism for late registration of charges?**
- (b) If you think an administrative mechanism is desirable, what should be its essential features?**

⁶⁰ There is an overseas example where the court exercised such discretion – *Re Chantry House Developments plc* [1990] BCLC 813.

⁶¹ In the UK, the CLRSG suggested that late registration should be possible without application to the court provided that, at the time of registration, no winding-up petition had been presented and no meeting had been convened to pass a resolution for a creditors' voluntary winding-up petition. See *Modern Company Law for a Competitive Economy: Final Report* at paragraph 12.76. However, the recommendation has not been adopted in the CA 2006.

LIST OF QUESTIONS FOR CONSULTATION

- Question 1
- (a) Do you agree that we need to amend the law to empower the Registrar, upon receipt of a court order requiring a company to change its name, to direct the company to change its name within a specified period?
 - (b) If your answer to (a) is in the affirmative, do you agree that the Registrar should be further empowered to change a company's name to its registration number if the company does not comply with his direction to change its name within the specified period?
 - (c) If your answer to (a) or (b) is in the negative, what other option(s) do you suggest and why?
- Question 2
- (a) Do you agree with the proposal that the law should be amended to provide the Registrar with a discretionary power to approve a "hybrid name" where the applicant can show to the satisfaction of the Registrar that there is a genuine business need?
 - (b) If so, what should constitute a "genuine business need"?
- Question 3
- Do you have further views on how the current company name registration system could be improved, particularly for the purpose of tackling the problem of "shadow companies"?
- Question 4
- (a) Do you agree that the general duties of directors should be codified in the Companies Bill?
 - (b) If your answer to Question (a) is in the affirmative, do you agree that the UK approach, including the duty to promote the success of the company for the benefit of its members as a whole having regard to such factors like the long-term consequences of a decision, the interests of employees, the impact of the company's operations on the community and the environment, etc., should be adopted? OR
 - (c) If your answer to Question (a) is in the negative, do you have any views on how the directors' duties could be clarified or made more accessible?

- Question 5 (a) Do you agree that corporate directorship should be abolished altogether in Hong Kong, subject to a reasonable grace period?
- (b) If your answer to Question (a) is in the negative, do you agree that the UK approach (i.e. a company should be required to have at least one natural person as its director), subject to a reasonable grace period, should be adopted?
- (c) If your answers to both Questions (a) and (b) are in the negative, do you have any suggestion on how to improve the enforceability of directors' obligations and to solve the difficulty of pursuing corporate directors?
- Question 6 (a) Do you agree that the changes listed in Appendix V should not be adopted in Hong Kong?
- (b) If not, please specify which of the changes you think should be introduced in Hong Kong and the reasons.
- Question 7 Do you agree that charges on aircrafts and interests in them should be made registrable?
- Question 8 Should section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures be deleted on the ground that it is redundant?
- Question 9 Would you prefer the reference to "bills of sale" in section 80(2)(c) of the CO to be:
- (a) retained as is;
- (b) retained but clarified along the lines of section 262(3) of the ACA; or
- (c) deleted?
- Question 10 (a) Would you prefer the term "book debts" to be statutorily defined or left to the courts to define?
- (b) If your preference is for a statutory definition, would you agree to a definition along the lines of section 262(4) of the ACA, or some other (please specify)?
- (c) Do you agree that a lien on subfreights and cash deposits should be expressly excluded from the registration requirement?

- Question 11 Do you agree that the automatic statutory acceleration of repayment in section 80(1) of the CO should be replaced with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time?
- Question 12 (a) Do you agree that both the instrument of charge and prescribed particulars should be registrable and open to public inspection?
- (b) Do you agree that the Registrar should no longer issue a certificate of due registration, but a receipt showing the particulars submitted for registration, as well as the date on which the instrument of charge (if required) and the particulars are submitted for registration?
- Question 13 If the charge instrument is not registrable as an answer to Question 12(a), should the charge holder be precluded from relying on rights to the security in excess of those referred to in the particulars submitted for registration?
- Question 14 (a) Do you agree that the period to register a charge should be shortened?
- (b) If so, do you think that 21 days is an appropriate period?
- Question 15 (a) What are your views on the viability and desirability of introducing an administrative mechanism for late registration of charges?
- (b) If you think an administrative mechanism is desirable, what should be its essential features?

Appendix I

List of Members of the Standing Committee on Company Law Reform and Advisory Groups (as at 31 March 2008)

The Standing Committee on Company Law Reform

Chairman

Mr Benjamin YU Yuk-hoi, SC, JP

Non-Official Members

Mrs Anne CARVER

Mr Felix CHAN Kwok-wai, MH

Mr Vincent FAN Chor-wah

Mr Peter William GREENWOOD

Mr Stephen HUI Chiu-chung, JP

Ms Teresa KO Yuk-yin, JP

Mr Godfrey LAM Wan-ho

Mr John POON Cho-ming

Ms Edith SHIH

Ms Vanessa STOTT

Mr David Peter Robert STANNARD

Mr Carlson TONG Ka-shing, JP

Mr Paul Franz WINKELMANN

Mr Patrick WONG Chi-kwong

Ex-Officio Members

Mr Andrew John YOUNG (Securities and Futures Commission)

Mr Paul CHOW Man-yiu (Hong Kong Exchanges and Clearing Limited)

Mr Edward Lawson Griffin TYLER (Department of Justice)

Mr Eamonn O'CONNELL (Official Receiver)

Ms Ada CHUNG Lai-ling (Registrar of Companies)

Mr Stefan M GANNON, JP (Hong Kong Monetary Authority)

Mr John LEUNG Chi-yan, JP (representative of the Secretary for Financial Services and the Treasury)

Secretary

Mr Edward LAU Kar-ning

Advisory Group on Share Capital, Distribution of Profits and Assets
and Charges Provisions
(Advisory Group 1)

Chairman

Mr David Peter Robert STANNARD

Members

Mr Stephen BIRKETT
Mr Colin CHAU Yu-nien
Prof Stephen CHEUNG Yan-leung, JP
Ms Ada CHUNG Lai-ling
Ms Julianne DOE
Mr Dennis HIE Hok-fung
Mr Stephen HOPKINS
Ms Roxanne ISMAIL
Mr Simon LAI
Mr John LEUNG Chi-yan, JP
Mr Stefan LO Huoy-cheng
Ms Catherine MORLEY
Prof Philip St John SMART
Mr Lincoln SOO Hung-leung, JP
Mr William TAM Sai-ming
Dr Davy K C WU
Ms Wendy W Y YUNG

Alternate Members

Mr CHAO Tien-yo
Ms Tina LEE
Mr Richard LEUNG Wai-keung
Ms Sonia LEUNG
Mrs Patricia Mary McBRIDE
Mr Emil YU Chen-on
Mr Rimsky YUEN Kwok-keung, SC

Representatives of Government Departments

Mr Edward Lawson Griffin TYLER (Department of Justice)
Ms Thelma TONG (Department of Justice)
Ms Feliciana CHEUNG Siu-wai (Hong Kong Monetary Authority)
Mr William SHIU Wai-chuen (Land Registry)

**Advisory Group on Company Formation, Registration, Re-registration
and Company Meeting and Administration Provisions**
(Advisory Group 2)

Chairman

Mr Michael William SCALES

Members

Dr Douglas ARNER
Ms Anne CHAPMAN
Ms Ada CHUNG Lai-ling
Mr Russell Adam COLEMAN, SC
Mr Angus FORSYTH
Ms Gail HUMPHRYES
Mr IP Shing-hing, JP
Mr Vincent KWAN Po-chuen
Dr Alex LAU Kun-luen
Mr John LEUNG Chi-yan, JP
Mrs Natalia SENG SZE Ka-mee
Ms Vanessa STOTT
Mr William TSANG Yu-hei
Mr Christopher TO

Alternate Members

Mr Charles MANZONI
Mr Francis CHAN Chok-fai
Mr Brian HO
Ms Melissa Kaye PANG
Mr Paul MOYES
Mr Peter Michael TISMAN

Representatives of Government Departments

Mr Edward Lawson Griffin TYLER (Department of Justice)
Ms Thelma TONG (Department of Justice)
Ms Pancy FUNG Shuk-hing (Intellectual Property Department)
Mr Charles NG Siong-kwong (Invest Hong Kong)
Ms D I HARDWICK (Lands Department)

Advisory Group on Directors and Officers Related Provisions
(Advisory Group 3)

Chairman

Mr Patrick WONG Chi-kwong

Members

Mrs Anne CARVER
Mr Charles CHAU Chi-chung
Prof Stephen CHEUNG Yan-leung, JP
Ms Ada CHUNG Lai-ling
Mr Vincent FAN Chor-wah
Mr GOO Say-hak
Ms Molly HO Kam-lan
Prof Simon S M HO
Mr Stephen HUI Chiu-chung, JP
Ms Gail HUMPHRYES
Ms Teresa KO Yuk-yin, JP
Mr John LEUNG Chi-yan, JP
Mr Gareth Huw THOMAS
Mr Carlson TONG Ka-shing, JP
Mr Richard George WILLIAMS
Mr Paul Franz WINKELMANN
Mr Peter S H WONG
Ms Eirene YEUNG
Mr Rimsky YUEN Kwok-keung, SC

Alternate Members

Mr Brian HO
Mr Bernard HUI Man-bock, JP
Ms Mary LAM Shuk-man
Mr Peter K F NG, SC
Mrs Natalia SENG SZE Ka-mee
Mr Melvin SNG
Mr Tony TAM Chung-kit
Ms Kelly WICK

Representatives of Government Department

Mr Edward Lawson Griffin TYLER (Department of Justice)
Ms Thelma TONG (Department of Justice)

**Advisory Group on Inspections, Investigation
and Offences and Punishment Provisions**
(Advisory Group 4)

Chairman

Mr Godfrey LAM Wan-ho

Members

Ms Linda CHAN

Dr Raymond CHAN Siu-yeung

Mr Rock CHEN Chung-nin, JP

Ms Ada CHUNG Lai-ling

Mr Richard GEORGE

Mr Stephen JAMIESON

Mr John LEUNG Chi-yan, JP

Mr Richard LEUNG Wai-keung

Ms Alexandra LO Dak-wai

Ms Karen NGAI

Mr Thomas SO Shiu-tsung

Ms Vanessa STOTT

Ms Cynthia Y S TANG

Mr Emil YU Chen-on

Alternate Members

Mr Russell Adam COLEMAN, SC

Mr Amirali Bakirali NASIR

Mr Ian Grant ROBINSON

Ms Samantha SUEN

Miss Christabel YOUNG Tsz-lan

Representatives of Government Departments

Mr Edward Lawson Griffin TYLER (Department of Justice)

Ms Thelma TONG (Department of Justice)

Mr Ned LAI Ka-yee (Department of Justice)

Ms LAI Yuen-man (Department of Justice)

Mr CHAN Yiu-kwok (Hong Kong Police Force)

Ms Rita HO Shan-chun (Official Receiver's Office)

Appendix II

Non-statutory Guidelines on Directors' Duties issued by the Companies Registry

Introduction

In general the responsibilities and liabilities of directors derive from various sources, including the constitution of the company, case law and statute law. If a person does not comply with his duties as a director he may be liable to civil or criminal proceedings and may be disqualified from acting as a director.

Although case law sets out and elaborates on most of these significant principles, it tends to be complex and inaccessible. The objective of these guidelines is to outline the general principles for a director in the performance of his functions and exercise of his powers.

All directors should read these guidelines which are also readily accessible on the websites of the Companies Registry (www.cr.gov.hk), the Hong Kong Exchanges and Clearing Limited (www.hkex.com.hk), the Securities and Futures Commission (www.sfc.hk), the Official Receiver's Office (www.oro.gov.hk) and the Hong Kong Monetary Authority (www.hkma.gov.hk). Hard copies are also available at their offices.

Companies should give copies of these guidelines to new directors irrespective of whether they organise induction training for directors. In addition, directors are also encouraged to refer to more detailed reviews of the role and duties of directors in law. For example, the Hong Kong Institute of Directors (www.hkiod.com) has issued the Guidelines for Directors and the Guide for Independent Non-Executive Directors.

Directors should also refer to the Code on Corporate Governance Practices issued by the Hong Kong Exchanges and Clearing Limited (www.hkex.com.hk) to improve the manner in which listed companies are managed.

It is important to note that the statements in these guidelines are principles only and are not intended to be exhaustive statements of the law. Furthermore, statute or case law could require certain forms of conduct under specified circumstances. If directors are at all in doubt about the nature of their responsibilities and obligations, they should seek legal advice.

The general principles of directors' duties

Principle 1 Duty to act in good faith for the benefit of the company as a whole

A director of a company must act in good faith in the best interests of the company. This means that a director owes a duty to act in the interests of all its shareholders, present and future. In carrying out this duty, a director must (as far as practicable) have regard to the need to achieve outcomes that are fair as between its members.

Principle 2 Duty to use powers for a proper purpose for the benefit of members as a whole

A director of a company must exercise his powers for a “proper purpose”. This means that he must not exercise his powers for purposes that are different from purposes for which they were conferred. The primary and substantial purpose of the exercise of a director’s powers must be for the benefit of the company. If the primary motive is found to be for some other reasons (e.g. to benefit one or more directors and to gain control of the company), then the effects of his exercise of his power may be set aside. This duty can be breached even if he has acted in good faith.

Principle 3 Duty not to delegate powers except with proper authorisation and duty to exercise independent judgement

Except where authorised to do so by the company’s memorandum and articles of association (the “constitution”) or any resolution, a director of a company must not delegate any of his powers. He must exercise independent judgement in relation to any exercise of his powers.

Principle 4 Duty to exercise care, skill and diligence

A director of a company must exercise the care, skill and diligence that would be exercised by a reasonable person with the knowledge, skill and experience reasonably expected of a director in his position. In determining whether he has fulfilled this duty, the court will also consider whether he has exercised the care, skill and diligence that would be exercised by a reasonable person with any additional knowledge, skill and experience which he has.

Principle 5 Duty to avoid conflicts between personal interests and interests of the company

A director of a company must not allow personal interests to conflict with the interests of the company.

Principle 6 Duty not to enter into transactions in which the directors have an interest except in compliance with the requirements of the law

A director of a company has certain duties where he has a material interest in any transaction to which the company is, or may be, a party. Until he has complied with these duties, he must not, in the performance of his functions as a director, authorise, procure or permit the company to enter into a transaction. Furthermore, he must not enter into a transaction with the company, unless he has complied with the requirements of the law.

The law requires a director to disclose the nature of his interest in respect of such transactions. Under certain circumstances the constitution may prescribe procedures to secure the approval of directors or members in respect of proposed transactions. A director must disclose the relevant interest to the extent required. Where applicable, he must secure the requisite approval of other directors or members.

Principle 7 Duty not to gain advantage from use of position as a director

A director of a company must not use his position as a director to gain (directly or indirectly) an advantage for himself, or someone else, or which causes detriment to the company.

Principle 8 Duty not to make unauthorised use of company's property or information

A director of a company must not use the company's property or information, or any opportunity that presents itself to the company, of which he becomes aware as a director of the company. This is except where the use or benefit has been disclosed to the company in general meeting and the company has consented to it.

Principle 9 Duty not to accept personal benefit from third parties conferred because of position as a director

A director or former director of a company must not accept any benefit from a third party, which is conferred because of the powers he has as director or by way of reward for any exercise of his powers as a director. This is unless the company itself confers the benefit, or the company has consented to it by ordinary resolution, or where the benefit is necessarily incidental to the proper performance of any of his functions as director.

Principle 10 Duty to observe the company's memorandum and articles of association and resolutions

A director of a company must act in accordance with the company's constitution. He must also comply with resolutions that are made in accordance with the company's constitution.

Principle 11 Duty to keep proper books of account

A director of a company must take all reasonable steps to ensure that proper books of account are kept so as to give a true and fair view of the state of affairs of the company and explain its transactions. To avoid breaching the fraudulent trading provisions in section 275 of the Companies Ordinance (Cap. 32), a director must not allow the company to incur further credit knowing that there is no reasonable prospect of avoiding insolvency.

*Companies Registry
October 2007*

Appendix III

Extract of the United Kingdom Companies Act 2006

Part 10 A company's directors

Chapter 2 General duties of directors

Introductory

170 Scope and nature of general duties

- (1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company.
- (2) A person who ceases to be a director continues to be subject—
 - (a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and
 - (b) to the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director.

To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.

- (3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.
- (4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.
- (5) The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

The general duties

171 Duty to act within powers

A director of a company must—

- (a) act in accordance with the company's constitution, and
- (b) only exercise powers for the purposes for which they are conferred.

172 Duty to promote the success of the company

- (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
 - (a) the likely consequences of any decision in the long term,
 - (b) the interests of the company's employees,
 - (c) the need to foster the company's business relationships with suppliers, customers and others,
 - (d) the impact of the company's operations on the community and the environment,
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - (f) the need to act fairly as between members of the company.
- (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
- (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

173 Duty to exercise independent judgment

- (1) A director of a company must exercise independent judgment.
- (2) This duty is not infringed by his acting—
 - (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
 - (b) in a way authorised by the company's constitution.

174 Duty to exercise reasonable care, skill and diligence

- (1) A director of a company must exercise reasonable care, skill and diligence.
- (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—
 - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
 - (b) the general knowledge, skill and experience that the director has.

175 Duty to avoid conflicts of interest

- (1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.
- (2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).
- (3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.
- (4) This duty is not infringed—
 - (a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or
 - (b) if the matter has been authorised by the directors.
- (5) Authorisation may be given by the directors—
 - (a) where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or
 - (b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.
- (6) The authorisation is effective only if—
 - (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and
 - (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.
- (7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

176 Duty not to accept benefits from third parties

- (1) A director of a company must not accept a benefit from a third party conferred by reason of—
 - (a) his being a director, or
 - (b) his doing (or not doing) anything as director.
- (2) A “third party” means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.
- (3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.

- (4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.
- (5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

177 Duty to declare interest in proposed transaction or arrangement

- (1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
- (2) The declaration may (but need not) be made—
 - (a) at a meeting of the directors, or
 - (b) by notice to the directors in accordance with—
 - (i) section 184 (notice in writing), or
 - (ii) section 185 (general notice).
- (3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.
- (4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.
- (5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question.
For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.
- (6) A director need not declare an interest—
 - (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
 - (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or
 - (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered—
 - (i) by a meeting of the directors, or
 - (ii) by a committee of the directors appointed for the purpose under the company's constitution.

Supplementary provisions

178 Civil consequences of breach of general duties

- (1) The consequences of breach (or threatened breach) of sections 171

to 177 are the same as would apply if the corresponding common law rule or equitable principle applied.

- (2) The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.

179 Cases within more than one of the general duties

Except as otherwise provided, more than one of the general duties may apply in any given case.

180 Consent, approval or authorisation by members

- (1) In a case where—
 - (a) section 175 (duty to avoid conflicts of interest) is complied with by authorisation by the directors, or
 - (b) section 177 (duty to declare interest in proposed transaction or arrangement) is complied with,the transaction or arrangement is not liable to be set aside by virtue of any common law rule or equitable principle requiring the consent or approval of the members of the company. This is without prejudice to any enactment, or provision of the company's constitution, requiring such consent or approval.
- (2) The application of the general duties is not affected by the fact that the case also falls within Chapter 4 (transactions requiring approval of members), except that where that Chapter applies and—
 - (a) approval is given under that Chapter, or
 - (b) the matter is one as to which it is provided that approval is not needed,it is not necessary also to comply with section 175 (duty to avoid conflicts of interest) or section 176 (duty not to accept benefits from third parties).
- (3) Compliance with the general duties does not remove the need for approval under any applicable provision of Chapter 4 (transactions requiring approval of members).
- (4) The general duties—
 - (a) have effect subject to any rule of law enabling the company to give authority, specifically or generally, for anything to be done (or omitted) by the directors, or any of them, that would otherwise be a breach of duty, and
 - (b) where the company's articles contain provisions for dealing with conflicts of interest, are not infringed by anything done (or omitted) by the directors, or any of them, in accordance

with those provisions.

- (5) Otherwise, the general duties have effect (except as otherwise provided or the context otherwise requires) notwithstanding any enactment or rule of law.

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- (1) In their application to a company that is a charity, the provisions of this Chapter have effect subject to this section.
- (2) Section 175 (duty to avoid conflicts of interest) has effect as if—
 - (a) for subsection (3) (which disapplies the duty to avoid conflicts of interest in the case of a transaction or arrangement with the company) there were substituted—

“(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company if or to the extent that the company’s articles allow that duty to be so disapplied, which they may do only in relation to descriptions of transaction or arrangement specified in the company’s articles.”;
 - (b) for subsection (5) (which specifies how directors of a company may give authority under that section for a transaction or arrangement) there were substituted—

“(5) Authorisation may be given by the directors where the company’s constitution includes provision enabling them to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.”.
- (3) Section 180(2)(b) (which disapplies certain duties under this Chapter in relation to cases excepted from requirement to obtain approval by members under Chapter 4) applies only if or to the extent that the company’s articles allow those duties to be so disapplied, which they may do only in relation to descriptions of transaction or arrangement specified in the company’s articles.
- (4) After section 26(5) of the Charities Act 1993 (c. 10) (power of Charity Commission to authorise dealings with charity property etc) insert—

“(5A) In the case of a charity that is a company, an order under this section may authorise an act notwithstanding that it involves the breach of a duty imposed on a director of the company under Chapter 2 of Part 10 of the Companies Act 2006 (general duties of directors).”.
- (5) This section does not extend to Scotland.

Appendix IV

A Brief Summary of Arguments For or Against a Statutory Statement of Directors' Duties¹

Issue	For	Against
1. Clarity, Certainty and Predictability	<ul style="list-style-type: none"> ✧ The directors' duties in their present form are widely misunderstood and unclear in a number of areas. Codification will set out clearly the standard against which actions by directors would be measured. It will lead to more predictability. ✧ Setting out the main directors' duties in statute would emphasise their seriousness. If only general principles are set out, codified duties could still be developed by the courts. 	<ul style="list-style-type: none"> ✧ Codification does not always lead to predictability because judges still have to interpret the law. ✧ A broad statement of principles may not necessarily assist directors to clearly identify the extent of their duties nor would it help directors to determine how they should behave in any given set of circumstances. If directors' duties are partially codified, a director might be confused to discover that he was subject to other duties not set out in the statutory statement. Codification is unlikely to result in a comprehensive statement of law.
2. Accessibility	<ul style="list-style-type: none"> ✧ Codifying the law would improve accessibility. The law should aim to educate and inform directors, and not merely impose liabilities on them. A director might find it more easily, at least in general terms, what his statutory duties are before he acts. Professionals can also be 	<ul style="list-style-type: none"> ✧ If directors' duties are stated in general terms, the statute may have to be interpreted by the courts. A lay person has to seek professional advice. As a result, the law may not be much more accessible than it is at present.

¹ The views set out in the table are based on various publications in the UK, e.g. the consultation paper published by the English and Scottish Law Commissions entitled "Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties" (1998), the Joint Report issued by the two Law Commissions (1999), the UK Company Law Review's Final Report "Modern Company Law for a Competitive Economy" (2001) and Parliamentary Brief (13 June 2006) by the Law Society of the UK. The views expressed do **not** represent the position of the Administration.

	benefited from codification since it will reduce the need to examine earlier cases.	
3. Flexibility	<ul style="list-style-type: none"> ✧ The duties could be expressed in broad and general language which would be capable of being applied in a very wide range of situations. It would thus be capable of being developed as more and more examples were discovered which fall within the general terms. ✧ In the event of any ambiguity in the statutory statement, the courts could have regard to the general law that the statute was intended to codify. 	<ul style="list-style-type: none"> ✧ Fiduciary duties cannot be codified without being stated in detailed terms in which case there will be a loss of flexibility. ✧ To include duties that were not yet well-settled or were developing into statutory form might restrict the ability of the law to develop further and adapt to changing circumstances.
4. Others	<ul style="list-style-type: none"> ✧ Company law is used internationally. It is the norm for the company law of the developed jurisdictions to have a statutory statement of the directors' duties. ✧ Under common law, the courts can only develop the law as and when appropriate cases come before them. A more systematic and comprehensive approach might, therefore, be beneficial. It would bring in new requirements for responsible business behaviour, for example, the need to consider the company's impact on the community and the environment. 	<ul style="list-style-type: none"> ✧ There is a risk that codification may be a lengthy exercise and differences of opinion may emerge as a result of which it is impossible to achieve a consensus, in particular in area where the law has not become settled. ✧ The new requirement for directors to take into account various new factors relating to corporate social responsibility when making decisions will make it more difficult for directors to manage the affairs of their companies. It would also likely lead to wastage in management time and unnecessary expense on the company's part.

Appendix V

Possible Changes to the Registration Regime of Charges That Have Been Considered But Rejected

(A) Comprehensively Codifying the Law on Priorities

1. Under the current regime, while registration is not of itself a reference point for determining priorities, the holder of an unregistered but registrable charge is reduced to the rank of unsecured creditor in the event of the company creating the charge going into liquidation. Company charge registration is intended to prevent the implication of false wealth and its role in governing priorities appears to have developed almost by accident. It should be noted that the Australian model which seemingly sets out a comprehensive set of priority rules and the proposed Irish model which adopts a similar but less complex regime on priority rules do not, in effect, deal with all possible priority provisions. It seems that the present provisions are familiar to Hong Kong practitioners and there appears to be no demand for such rules to be restated in the CO.

(B) Advance or Provisional Registration System

2. Despite some overseas models, it is considered that there is no need to introduce a system of advance or provisional registration of company charges. Under such a system, registration could be effected before execution of a charge but the registration would lapse if a further or confirmatory registration is not made within a certain period of time. Provisional registration allows an intending charge holder to preserve its priority during negotiations for a loan by filing the requisite particulars in advance of the creation of the charge. The registered particulars provide notice of intention to take a charge and the priority of the charge is then determined by the date of the filing, even though this preceded its creation.
3. However, we are of the view that an advance or provisional registration system would not be more effective than the current regime in Hong Kong and consequently we do not recommend its introduction. One of the main reasons is that it would be a more complicated system as it requires registration of the same charge twice (i.e. provisional and final registration) and there is little information on how some overseas systems work as the relevant provisions have not yet been in force. Also, an advance/provisional registration system could easily be abused as

negotiations could take a long time to complete before the final registration and the borrower would then be tied to a lender whose charge is provisionally registered at the beginning of the negotiation.

(C) Retention of Title Clause

4. We do not recommend providing a legislative clarification of the kinds of retention of title clause that constitute a registrable charge. It appears that this has not been a major issue in Hong Kong, and it would be very difficult to provide a statutory definition. The question of whether a particular retention of title clause should be registrable is best decided by the courts as under the current practice.

(D) Sale or Absolute Assignment of Book Debts

5. We do not recommend bringing the sale or absolute assignment of book debts (or receivables), which is referred to as factoring, within the scope of the registration requirements. The CO currently only applies to the registration of charges and not to the registration of sales. In other words, a factoring transaction does not have to be registered but, where a company creates a charge over its debts, registration is a necessity. In the US under Article 9 of the UCC and in New Zealand under the Personal Property Securities Act, sales and charges over receivables have been assimilated for registration purposes. It is however considered that the sale/charge distinction should be maintained. The assignment of receivables is not a charge per se and should not be treated as such for registration purposes. While the Law Commission of England and Wales has recommended that absolute assignments, as defined narrowly and subject to certain exclusions, should be registrable, it should be noted that this recommendation has not been adopted in the CA 2006.

(E) Pledges

6. We do not recommend bringing pledges within the scope of the registration requirements. A pledge is a possessory security under which the security taker has possession either of the items given as security or of documents of title thereto. The class of assets capable of forming the subject-matter of a pledge is confined to goods and to documentary intangibles which are “documents embodying title to goods, money or securities such that the right to these assets is vested in the holder of the document for the time being and can be transferred by delivery with any necessary indorsement.”

7. A pledge is to be contrasted with a charge which is a non-possessory security. In the case of a charge there is no requirement of delivery of possession; either of the subject-matter of the security or of documents of title. Pledges do not come within the registration of charge provisions by reason of the fact that they do not constitute charges. Moreover, there is a rationale for not requiring registration of pledges in that possession of the assets, or of documents of title, by the security taker serves to alert third parties and, in particular, other creditors of the borrower to the possible existence of a security arrangement.

(F) Trust Receipts

8. We do not recommend bringing trust receipts within the scope of the registration requirements. A “trust receipt” is a document which permits a security taker (the pledgee) to release goods or documents of title back to the security provider (the pledgor) but under which the pledgor becomes an agent of the pledgee in respect of the sale of the goods and also a trustee of the sale proceeds. The arrangement allows the pledgee to maintain its pledge interest.
9. In the UK, the Law Commission recommended that “if negotiable instruments or documents of title have been pledged, or goods are held by a third party bailee to the order of a pledgee, and the collateral is released into the possession of the debtor for limited purposes such as sale, the pledge (and the pledgee’s interest in the proceeds) should be treated as a charge over the goods and their proceeds. The charge must be registered within 15 days unless the collateral is returned to the creditor’s possession before that time.”¹
10. In the Hong Kong context however, long term trust receipts are far from being the norm and it would be difficult to prescribe a suitable period to trigger the registration requirement. If it is decided to delete the bill of sale provision without any specific replacement to cover charges over goods (see paragraphs 5.13 and 5.14 above), there would seem to be even less reason to require the registration of trust receipts which effectively represent a form of security over goods.

¹ See Law Commission Consultative Report *Company Security Interests* (2004) at paragraph 3.112. It should be noted that the UK Companies Act 2006 did not adopt this recommendation.

(G) Insurance Policies

11. Charges on insurance policies are not registrable under the current Hong Kong legislative regime if one applies, by analogy, the leading English case of *Paul and Frank Ltd v Discount Bank (Overseas) Ltd*². In that case, it was argued unsuccessfully that a documentation which authorised the payment of the proceeds of an insurance policy to the defendant amounted to a charge on book debts.
12. In the UK, both the Diamond Report and the Law Commission of England and Wales have recommended the registration of charges over insurance policies. In view of the public notice function underlying the registration requirement, there might be a case to justify their inclusion³. However, the SCCLR considers that given the diversification of policies existing in the market, it is difficult to define “insurance policies”. Also, if a creditor sees a security over an asset, it would be logical for the creditor to expect that the security should extend to the insurance policy if the asset is insured. Unless the insurance industry advises otherwise, the SCCLR thinks that there should be no change in the law in this respect.

(H) Shares (and Other Marketable Securities)

13. Currently a floating charge over shares is registrable under the CO (as all floaters are registrable) but a fixed charge (whether legal or equitable) is not. We have explored whether any reforms should be made in respect of registration of charges over shares and other marketable securities and three possible options for reform have been considered. The first is the Australian model where charges on shares and other marketable securities are registrable subject to the following exceptions: (i) a charge created in whole or in part by the deposit of a document of title to the marketable security; or (ii) a mortgage under which the marketable security is registered in the name of the chargee or a person nominated by the chargee⁴. The second is the Singapore model which makes a charge on shares in a subsidiary registrable. The third is the UK approach, as set out in the Financial Collateral Arrangement (No 2) Regulations, which expressly excludes registration requirements in respect of fixed charges on shares and floating charges on shares where the charge holder has control.

² [1967] Ch 348

³ It should be noted that the CA 2006 has not adopted the recommendation for inclusion.

⁴ Section 262(1)(g) of the ACA. In other words it provides for registration unless the collateral taker has control over the document of title to the securities or the securities are registered in its name. Registration is not required since third parties will not be misled in such cases.

14. We are inclined not to make fixed charges on shares and other marketable securities registrable. It is considered that the present system in Hong Kong where fixed charges over shares are not registrable has not created any major problems. It is noted in particular that there might be strong market resistance to reform. Banks appear to prefer the present system as they have control over shares offered as security since such shares are often held in the name of chargee banks. Registration would be difficult in practice given the changing nature of investment portfolios which could result in frequent registration applications. There is also a trend in Europe and in the US, under the UCC, to remove registration requirements in respect of shares. Any change to make charges on shares registrable might also create problems if the securities market develops from a Central Clearing and Settlement System holding to scripless trading.