For Information
on 2 February 2009

Legislative Council
Panel on Financial Affairs

Progress Update on the Companies Ordinance Rewrite Exercise

PURPOSE

The Administration last briefed the Panel on Financial Affairs on the exercise to rewrite the Companies Ordinance ("CO") (Cap. 32) in May 2007. This paper aims to update Members on the latest development of the rewrite exercise and the conclusions drawn from the three topical public consultations completed since then.

BACKGROUND

2. As set out in the Legislative Council ("LegCo") Paper No. EC(2005-06)9, given the extensive nature of the rewrite exercise and the numerous issues involved, the CO rewrite exercise is being taken forward in two phases. Phase I of the rewrite, which commenced in mid-2006, focuses on the core company provisions affecting the daily operation of over 700,000 live companies. Phase II will deal with all winding-up related provisions in the CO.

3. In addition to a Joint Working Group between the Government and the Hong Kong Institute of Certified Public Accountants ("JWG") which was tasked with reviewing the accounting and auditing provisions in the CO, four dedicated Advisory Groups [1] ("AGs") commenced work in phases since October 2006 to review and advise on specific areas of the CO. Recommendations made by the JWG and the AGs were then considered by the Standing Committee on Company Law Reform ("SCCLR"), which remains the principal body advising the Administration on matters relating to the CO rewrite. A Steering

[1] The AGs comprise members nominated by the relevant professional bodies (including Hong Kong Institute of Certified Public Accountants, Law Society of Hong Kong, Hong Kong Institute of Chartered Secretaries, Hong Kong Bar Association, Hong Kong Institute of Directors and Hong Kong Association of Banks) and business organisations (including the Hong Kong General Chamber of Commerce and the Chinese General Chamber of Commerce), company law academics, Standing Committee on Company Law Reform members and representatives from relevant Government departments/agencies.

Committee ("SC") formed within the Administration, chaired by the Permanent Secretary for Financial Services and the Treasury (Financial Services), is responsible for supervising and steering the entire rewrite exercise, examining all major proposals discussed at the SCCLR, the JWG and the AGs.

PROGRESS OF THE REWRITE

4. The JWG and the four AGs have completed reviewing different areas of the CO. The JWG convened a total of 53 meetings to study in detail proposals to reform the accounting and auditing provisions, whereas the AGs have held a total of 38 meetings to examine proposals relating to various aspects of the CO.

5. The SCCLR has considered all major proposals put forward by the AGs and JWG. It accepted most of their recommendations and modified some of them. Those proposals were subsequently submitted to the SC for consideration.

Topical Public Consultations

6. In addition, we have conducted three topical public consultations in 2007 and 2008 to gauge views on certain complex issues. The public feedback was subsequently considered by the Administration in consultation with the SCCLR. The key consultation conclusions in these three topical consultation exercises are summarised in the paragraphs below.

First Public Consultation – Accounting and Auditing Provisions

7. The public consultation on proposals to improve the accounting and auditing provisions was conducted from 29 March to 29 June 2007. The proposals aim, inter alia, to –

(a) enhance the quality and usefulness of the information contained in annual accounts and related documents (e.g. improving the directors' report; introducing a directors' remuneration report; and empowering auditors to vet the auditable part of the directors' remuneration report);

(b) adopt new measures that would help enhance compliance with the accounting and auditing provisions of the CO (e.g.

enhancing certain rights of auditors to ensure truth and comprehensiveness in financial reporting); and

(c) save compliance and business costs incurred by companies (e.g. relaxing the qualifying criteria for private companies to prepare simplified accounts and facilitating companies to send out summary financial reports to members).

8. During the consultation period, we organised a public forum and attended several meetings and forums organised by various interested organisations to brief participants on the proposals and listen to their views. A total of 32 submissions from 30 deputations were received. The consultation conclusions were released on 26 March 2008[2].

9. Most of the proposals were generally supported by the majority of respondents. Nevertheless, there were a few proposals that have been modified in view of the comments received[3].

Second Public Consultation – Company Names, Directors' Duties, Corporate Directorship and Registration of Charges

10. The second topical consultation covering company names, directors' duties, corporate directorship and registration of charges was conducted from 2 April to 30 June 2008. During the consultation period, we sought views from various stakeholders through organising a public forum as well as a focus group meeting (on registration of charges). We also attended a series of meetings and forums organised by various interested organisations. A total of 61 submissions from 59 deputations were received. The consultation conclusions were released on 10 December 2008[2]. The key conclusions are summarized below.

---

[2] The consultation conclusions and the compendium of submissions are available at the "Companies Ordinance Rewrite" website (www.fstb.gov.hk/fsb/co_rewrite)

[3] The major modifications include –

- Withdrawing the proposal to extend the right to inspect a company's accounting records to managers and company secretaries because of concerns over accountability and confidentiality;
- Withdrawing the proposal for directors' reports to reflect any significant difference in the market value of the company's non-current operating assets and their book value because of concerns over imposing undue burden on directors; and
- Withdrawing the proposal to require directors to make a statement in the directors' report concerning their awareness of all relevant audit information being disclosed to the auditors due to concerns over practicability. Instead, we propose to make a director criminally liable if he intentionally withholds certain material information requested by the auditors.

Company Names

11. The proposal to empower the Registrar of Companies ("Registrar") to act upon a court order directing a defendant company to change its infringing name, and substituting its infringing name with its registration number if the company fails to comply with the Registrar's direction to do so, received overwhelming support from the respondents. We aim to introduce necessary legislative amendments to give effect to the proposal ahead of the CO rewrite, if possible.

12. It was originally proposed that the Registrar be provided with a discretionary power to allow registration of a company name which is a "hybrid name" (i.e. a company name which comprises both Chinese and English) if there is a "genuine business need". In view of the diverse views received and the concern about possible abuses involving infringing trademarks/trade names, we consider it prudent to put the proposal on hold for the time being. Nevertheless, the Companies Registry ("CR") will continue to allow phrases like "X 光" and "卡拉 OK" to be used in company names because they have no direct Chinese equivalents and have been adopted in other statutory provisions in Hong Kong laws.

Directors' Duties

13. The consultation indicates that the idea of codifying directors' general duties remains highly controversial. Responses are highly divided except that there is general concern over the proposal to incorporate the "enlightened shareholder value"[4] concept in the duties of directors. Consequently, we consider it premature at this stage to go down the route of comprehensive codification of directors' general duties. Nevertheless, we see merit in codifying the directors' standard of care, skill and diligence as proposed by some respondents. This would clarify the law and enhance corporate governance.

Corporate Directorship

14. The public's views were also diverse on whether to abolish or restrict corporate directorship in private companies. To strike a

[4] Based on the United Kingdom Companies Act 2006, 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.

balance between the need to enhance corporate governance, transparency and the legitimate need for flexibility in a business environment, we propose to allow the appointment of corporate directors in private companies on the condition that each private company must have at least one natural person as director. The United Kingdom has adopted a similar approach in its recent company law reform.

Registration of Charges

15. In response to the respondents' views, some technical amendments will be made to the relevant provisions, including, inter alia, expressly providing for inclusion or exclusion of certain charges to be registrable, requiring an instrument of charge to be registered with the CR and shortening the period of registering a charge from 5 weeks to 21 days.

Third Public Consultation – Share Capital, Capital Maintenance Regime and Statutory Amalgamation Procedure

16. The third topical consultation covering share capital, capital maintenance regime and statutory amalgamation procedure was conducted from 26 June to 30 September 2008. As in the previous two rounds of topical consultations, we organised a consultation forum to seek public views and a focus group to gather stakeholders' views. We also attended meetings and forums organised by interested organisations. A total of 40 submissions were received. The consultation conclusions will be released shortly.

17. The majority of the respondents indicated general support for most of the proposals. A few of the proposals have been refined having regard to respondents' comments. Major conclusions are set out in paragraphs 18-20.

Share Capital

18. A mandatory system of no-par (i.e. shares will no longer have par or nominal value) [5] for all companies with a share capital will be adopted. Having regard to the respondents' comments, a period of 24 months will be provided for companies to review their arrangements before migrating to no-par. The requirement for authorised capital (i.e.

[5] Under the existing regime, companies incorporated in Hong Kong and having a share capital are required to have a par value ascribed to their shares. Each share therefore has a fixed face value that is its par value, which is the minimum price at which shares can generally be issued.

the maximum amount that a company is permitted to raise by issuing shares) will be removed. Nevertheless, a company with a share capital may specify in its Articles of Association the maximum number of shares it can issue.

Capital Maintenance Regime

19. We will not adopt the solvency test approach to creditor protection across all forms of distribution[6]. However, the solvency test approach will be more broadly applied to reduction of capital, buy-backs and financial assistance. We will not introduce a balance sheet test as a second limb to the existing solvency test requirement (which, as currently provided in the CO, is a cash flow test)[7] in order to avoid imposing undue hardship on companies[8] and having regard to other technical concerns[9] as raised by some respondents.

Statutory Amalgamation Procedure

20. In view of the concern highlighted by some respondents on protection of the interests of minority shareholders and creditors, we will only introduce a court-free statutory amalgamation procedure for the amalgamation of wholly-owned intra-group companies where minority shareholders' interests would normally not be an issue.

Phase II of the Rewrite

21. The Official Receiver's Office has started the initial scoping of Phase II of the rewrite in late 2008, with a view to mapping out a more detailed work plan in due course.

---

[6] The current regime is commonly referred to as the capital maintenance regime. The premise of the doctrine is that creditors provide credit on the basis of an express or implied representation that consideration received for shares (the share capital) shall be applied only for the purposes of the business and that it shall not be returned to the shareholders except in a winding up after all creditors have been paid. The CO currently restricts payment out of capital to shareholders in several ways, such as the requirement that dividends shall be paid out of distributable profits and court sanction is generally required for the reduction of capital.

[7] The existing solvency test requirement is basically a cash flow test, and has been part of the capital maintenance rules (being an exception to financial assistance for unlisted companies and a condition to buy-backs out of capital by private companies) for some time.

[8] For instance, current accounting practices require revaluation of investment properties annually resulting in large fluctuation of asset values in the balance sheet. Such change of value of a company's long term assets normally does not affect a company's ability to meet its liabilities when due.

[9] For example, some respondents considered that proper application of the cash flow test rendered the balance sheet test redundant. Directors must, in considering whether their company can pay its debts as they fall due, have regard to the availability of assets, present and future, to meet liabilities, present and future.

Financial Resources for the Rewrite

22. As set out in LegCo Paper No. EC(2005-06)9 considered by the LegCo Finance Committee on 13 January 2006, the total cost of the rewrite exercise will be within HK$91 million, of which HK$69.406 million was earmarked for creating new posts in Financial Services Branch, CR and Department of Justice. The cost of the rewrite exercise is funded by the CR Trading Fund. The expenditure so far is in line with our projections, with approximately HK$43 million spent by the end of December 2008.

WAY FORWARD

23. We are preparing a draft Companies Bill incorporating all the above proposals. We aim at consulting the public on the draft provisions of the Bill in the fourth quarter of 2009 before it is introduced into the LegCo in the second half of 2010. We will continue to keep this Panel informed of the progress of the rewrite exercise.

Financial Services and the Treasury Bureau
January 2009