For discussion
on 11 June 2009

The Legislative Council
Panel on Financial Affairs

Legislative Proposals in the Companies (Amendment) Bill 2009 and Business Registration (Amendment) Bill 2009

PURPOSE

This paper informs Members of the legislative proposals which are intended to be included in the Companies (Amendment) Bill 2009 and the Business Registration (Amendment) Bill 2009. Members' views on the legislative proposals are sought.

BACKGROUND

2. In briefing Members on the progress update of the Companies Ordinance ("CO") rewrite exercise at the meeting of the LegCo Panel on Financial Affairs held on 26 February 2009, we highlighted the need to amend the CO, ahead of the rewrite, to provide for electronic incorporation and filing of documents and other technical amendments. This is mainly to tie in with the implementation of Phase II of the Integrated Companies Registry Information System ("ICRIS II") which is expected to come on stream in late 2010/early 2011. In this connection, we also propose to improve the company name registration system with a view to expediting the company incorporation process and empowering the Registrar of Companies ("R of C") to tackle "shadow companies"[1], and to amend the Business Registration Ordinance (Cap. 310) ("BRO") to facilitate the provision of a simultaneous service for business registration at the time of incorporating/registering a company.

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[1] "Shadow companies" refer to those companies incorporated in Hong Kong with names which are very similar to existing and established trademarks or trade names of other companies and which pose themselves as representatives of the owners of such trademarks or trade names to produce counterfeit products in Mainland China bearing such trademarks or trade names.

3. In addition, we intend to take the opportunity to introduce a number of technical amendments to CO. These include:-

(a) introducing new provisions to allow companies incorporated in Hong Kong to communicate with their members through electronic and website communications;

(b) amending section 99(1) to allow listed companies to give notice of closure of its register of members in accordance with the Listing Rules instead of by advertisement in a newspaper;

(c) amending relevant provisions in Part IVAA to allow for multiple derivative actions;

(d) removing the statutory prohibition against scripless shareholding and trading in the securities market, to facilitate market discussions on and pave way for the introduction of scripless shareholding and paperless transfers; and

(e) rectifying certain technical discrepancies in the Chinese version of sections 57B(7) and 343(2).

The legislative proposals are explained below.

THE PROPOSAL

(A) Electronic Incorporation and Company Names

4. The Companies Registry ("CR") is currently working on ICRIS II which will facilitate electronic incorporation of companies and filing of documents with the CR. While section 347 of the CO as amended in the Companies (Amendment) Ordinance 2003 has generally allowed the incorporation of companies and filing of documents by electronic means, the CR has proposed some refinements to the incorporation procedure which will streamline and expedite the process. These include the use of digital signatures and passwords, signing of the incorporation form and issuance of the certificate of incorporation by electronic means. Legislative amendments to the relevant provisions in the CO will be required to enable these procedural changes.

5. As part and parcel of the company incorporation process, we propose to introduce changes to the company name registration system with a view to expediting the company name approval process. At present, the performance pledge for incorporation of companies is four working days. Most of the processing time is spent on scrutinising proposed company names to ensure that they are not objectionable for various reasons[2]. To expedite the company name registration system, we propose to bring forth the approval of company names prior to the company incorporation process, whereby a company name would be accepted for registration almost instantaneously if it satisfies certain preliminary requirements, namely, that it is not identical to another name on the register and does not contain words or expressions on a specified list[3]. Thereafter, if the company's name is found to be objectionable as being offensive, likely to give the impression of a government connection or contrary to the public interest upon further checking, the R of C will be empowered to direct the company in question to change its name within a specified period. The revised procedures would shorten the company incorporation processing time from four to one working day.

6. As a related issue, we propose to enhance enforcement against "shadow companies" by empowering the R of C to act pursuant to court orders to direct a "shadow company" to change its name and to substitute its name with the company registration number if the company fails to comply with the direction. At present, the R of C has only very limited power under the CO to deal with "shadow companies". There have been strong requests in recent years from the business community especially trademark/brand name owners in Hong Kong to strengthen our company name registration system to tackle possible abuses by "shadow companies". The proposals were also put forward for public consultation from April to June 2008 and they received overwhelming support from the respondents[4]. Authorities in Japan and the US have also expressed concerns about "shadow companies" exploiting the company registration system in Hong Kong for conducting counterfeiting activities mainly in the Mainland. In view of this, we propose to enhance the R of C's powers in this respect as a matter of priority.

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2 For example, a proposed company name must not be identical to the name of an existing company and its use 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" require prior approval.

3 Separately, we will review the list of words and expressions in the Companies (Specification of Names) Order in consultation with relevant Bureaux as some of the words may be outdated and should no longer be regulated (e.g. "Municipal" and "Building Society"). There will also be regular updating of the list in future.

4 The consultation conclusions were issued in December 2008 and are available on the website at www.fstb.gov.hk/fsb/co_rewrite.

(B) One-stop Service for Company Incorporation/Registration and Business Registration

7. Taking the opportunity of the development of ICRIS II, we intend to implement simultaneous application for company incorporation/registration and business registration for the purpose of enhancing the ease of doing business and providing a one-stop service to business community. Currently, applications for company incorporation/ registration and business registration have to be made separately. Section 2(1A) of the BRO states that a company incorporated in Hong Kong under the CO or a non-Hong Kong Company required to be registered under the CO shall be deemed to be a person carrying on business. It is liable to be registered under the BRO, irrespective of whether it has commenced operation. Considering the fact that the application for business registration by a local corporation can only be made upon the issue of a Certificate of Incorporation, we are of the view that it would be desirable to streamline and improve the application process in respect of company incorporation/registration and business registration.

8. We propose that, upon the implementation of electronic incorporation of companies by the CR, any person who submits an application for company incorporation/registration to the CR will be deemed to have applied for business registration at the same time and the Business Registration Certificate will be issued together with the Certificate of Incorporation (or Certificate of Registration in case of a non-Hong Kong company). Such service will be made available for both paper and electronic applications. With the implementation of the above simultaneous application, there is no need to make separate applications and the processing time for incorporating a company and registering a business by electronic means will be greatly reduced from four working days[5] to one working day or less.

9. In connection with the above, relevant legislative amendments will have to be made to the BRO to effect the simultaneous application for company incorporation/registration and business registration, e.g. deeming the application for company incorporation/registration as that for business registration, allowing the R of C to accept the application for business registration and issue the Business Registration Certificate on behalf of the Commissioner of Inland Revenue ("CIR"), etc. Currently, a company is required under the CO and the BRO to notify the R of C and the CIR respectively of any change in the business particulars. In order to provide more efficient and integrated customer-friendly services to the business sectors, we propose to treat the company's notification of the change in business particulars to the R of C as a

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[5] Under normal circumstances, an application for incorporating a company will be processed in four working days while business registration will be processed in 30 minutes for applications submitted to the Inland Revenue Department in person.

notification to the CIR. As a related issue, to facilitate the simultaneous application and other business registration applications through electronic means, the Inland Revenue Department ("IRD") has also proposed the use of electronic signature in these applications, and the issuance of business certificates in electronic mode for printing and display at the business premises. The legislative amendments will be included in the Business Registration (Amendment) Bill 2009, to be introduced together with the Companies (Amendment) Bill 2009.

(C) Facilitating Electronic and Website Communications

10. The recent amendments to the Main Board Listing Rules 2.07A, which came into effect on 1 January 2009, have allowed a listed issuer to send corporate communications to its shareholders by making them available on the listed issuer's website if the shareholders agree, or are deemed to have so agreed. At present, there are no similar provisions in the CO which provide for such mode of communications. As a result, listed companies which are incorporated in Hong Kong would not be able to make use of such facilities. We are therefore of the view that there exists a need to advance the introduction of relevant amendments from the CO rewrite exercise to the CO so that listed and unlisted companies incorporated in Hong Kong can also take advantage of the new procedure relating to website communications as their non-Hong Kong counterparts.

11. We propose to introduce amendments to the CO to set out the mechanism on communications by companies to shareholders along the lines of similar provisions in the United Kingdom ("UK") Companies Act 2006. The key details on how the mechanism operates as proposed in the Companies (Amendment) Bill 2009 are set out at Annex. In particular, the amendments will facilitate communications sent by companies to their shareholders by means of websites, including providing for a deeming procedure for the relevant consent to be given by the latter. The amendments would also encourage environmentally friendly practices. While companies will be permitted to communicate with their shareholders in an electronic form including websites, we propose to empower the shareholders to request the companies to deliver a hard copy of the document free of charge; and allow individual shareholders to choose not to communicate with the companies in an electronic form by giving prior written notice to the companies concerned. This is to safeguard the interest of those shareholders who do not have access to internet facilities.

(D) Exempting Listed Companies from Giving Notice of Closure of Register of Members by Advertisement in a Newspaper

12. Section 99(1) of the CO requires a Hong Kong incorporated company to give notice of closure of its register of members/debenture holders by advertisement in a newspaper. The Listing Rules have recently been amended to require a listed company to publish its notice of closure of register of members on the HKEx's website instead of in a newspaper.[6] As a result, a Hong Kong incorporated listed company has to publish its notice of closure of register of members both in a newspaper and on the HKEx's website. To streamline the requirements and to ensure a level playing field between listed companies incorporated in Hong Kong and elsewhere, we propose to amend section 99(1) to allow listed companies to give notice in accordance with the Listing Rules instead of by advertisement in a newspaper.

(E) Enabling Multiple Statutory Derivative Actions

13. The Companies (Amendment) Ordinance 2004 provides, among other things, a new statutory derivative action ("SDA") procedure. The relevant provisions are contained in Part IVAA of the CO which came into operation on 15 July 2005. The new SDA provisions allow a member of a company to bring an action or intervene in proceedings on behalf of the company in respect of "misfeasance"[7] committed against the company. Unlike some of the overseas jurisdictions[8], only members of the company (vis-à-vis members of a related company[9] of the company) have standing under section 168BC(1) of the CO to seek leave to commence a SDA or to intervene in proceedings. In other words, only "simple" derivative actions, as opposed to "multiple" derivative actions, can be brought under the new SDA provisions.

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6 See Rule 2.07C and Rule 13.66 of the Main Board Listing Rules which were implemented on 25 June 2007.

7 "Misfeasance" is defined as "fraud, negligence, default in compliance with any enactment or rule of law, or breach of duty" in section 168BB(2) of the CO.

8 For example, in Australia, provision is made (subject to leave of the court) for proceedings to be brought by a person who is "a member… of the company or of a related body corporate (section 236(1)(a), Australian Corporations Act 2001). New Zealand has taken the same approach under its Companies Act 1993, section 165(1)(a). In Canada, a complainant bringing a derivative action may be a shareholder of the corporation or any of its affiliates and may sue on behalf of the corporation or any of its subsidiaries (Canadian Business Corporations Act 1985, sections 238 and 239(1)). In Singapore, the immediate members of the corporation and any other person who in the discretion of the court is a proper person may apply for leave to sue on behalf of the relevant company (Singaporean Companies Act 1994, section 216A(1)).

9 A "related company" in relation to a specified corporation means any company that is the specified corporation's subsidiary or holding company, or a subsidiary of that specified corporation's holding company.

14. However, in a recent case *Waddington Ltd. v Chan Chun Hoo* CACV No. 220 of 2005[10], both the Court of Appeal ("CA") and the Court of Final Appeal ruled that a "multiple" derivative action is maintainable in Hong Kong under the common law and said that it is appropriate for the CO to be amended to cover "multiple" statutory derivative actions as there is no justification for excluding them from the statutory scheme[11]. In this connection, we propose to amend the CO to give standing to members of related companies[12] and thereby expand the scope of SDA to cover "multiple" derivative actions which would provide a simple and effective mechanism for shareholders of a related company to commence SDA on behalf of the company. The proposal would further enhance the protection of the interests of minority shareholders.

(F) Technical Amendments Paving the Way for Scripless

15. We propose to introduce technical amendments to the CO in order to provide for the enabling framework for scripless trading by removing, or providing exceptions to, the limitations arising from the provisions on scrip-based shares presently found in the CO. This would be an important first step in the legislative process to remove the obstacles for scripless shareholding and paperless transfers. The Securities and Futures Commission is currently working with the HKEx and the Federation of Share Registrars on the operational model for the proposed scripless environment, with a view to putting forward proposals for consultation. There is general market perception that the limitations in the CO would inhibit discussions on the operational model. They are construed as a lack of government support for a scripless market. A firm commitment to remove the statutory hurdle in the CO will help focus the market on the scripless initiative to enhance market efficiency and investor protection. The stockbroking community has expressed support for this approach.

16. The proposed amendments to the CO will be commenced only when the market has agreed to, and is ready to implement, an operational model for a scripless securities market. These will include the parameters governing how the proposed scripless environment will operate, including the types of shares and debentures that will be affected as well as procedural requirements relating to the holding, evidencing and transfer of shares and debentures without paper documents. Further legislative amendments would be pursued as necessary as the operational model takes shape.

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10 [2006] 2 HKLRD 896; [2008] HKEC 1498 (CFA)

11 Paragraph 26 of the CFA judgment per Justice Ribeiro (FACV No. 15 of 2007)

12 See footnote 9.

(G) Amendments to Rectify the Chinese Version

17. We will also seek to rectify the following discrepancies in the Chinese version of the CO:-

(a) Section 57B(7) of the CO provides that "*[n]othing in this section shall affect the validity of any allotment of shares or require approval for the allotment to the founder members of a company of shares in the company which, by signing the memorandum, they have agreed to take.*" The English version of the provision is interpreted to contain two limbs of principle, namely, "*nothing in this section shall affect the validity of any allotment of shares*" and "*nothing in this section shall require approval for the allotment to the founder members….*" The two limbs should be read independently of each other. The first limb was based on section 14(8) the UK Companies Act 1980.[13] The Chinese version of section 57B(7), however, renders the first limb being subject to the second limb.[14] This resulted in the court finding, in the case of *Wong Kam San v Yeung Wing Keung*,[15] that the exception under section 57B(7) only applied to allotment to subscribers (i.e. founder members) pursuant to the agreement in the subscription to memorandum.[16] This interpretation is inconsistent with the policy intention and the prevailing market understanding of the effect of section 57B(7), which is that a contravention of section 57B(1) does not nullify the effect of any purported allotment. In order to avoid any future legal uncertainty, we propose to amend the Chinese version of section 57B(7) to clarify that the two limbs are independent of each other. As a result, both the English and Chinese versions would be interpreted to mean that a contravention of section 57B(1) does not invalidate any allotment; and

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[13] According to the *Hong Kong Company Law Handbook (Tenth Edition) (2008)* p.225, section 57B may be compared with s 14 of the UK Companies Act 1890. It was inserted by No.6 of 1984, s 27. Section 14(8) was subsequently restated in section 80(10) of the UK Companies Act 1985. The policy intention is that failure to comply with this section (e.g. in case where directors contravene section 57B(1) and allot shares of the company without being authorised by the general meeting, other than in a pro rata offer case) does not affect the validity of any allotment of shares but may render directors liable to criminal sanction under sub-section (6). The unravelling of allotments could undermine investor confidence, have negative implications on the company and be unfair to unsuspecting allotees.

[14] It reads "如公司分配股份予公司的創辦成員，而該等股份是他們藉簽署章程大綱而同意承購的，則上述股份分配的有效性並不受本條影響，而本條亦不規定上述分配必須獲得批准。"

[15] [2007] 2 HKLRD 267

[16] By necessary implication, any allotment in contravention of section 57B(1) and outside the section 57B(7) exception was considered to be invalid in law.

(b) the Chinese equivalent of "principal" in section 343(2) should be changed from "委託人" to "主事人" to better reflect the correct meaning of the term and bring it in line with the same term adopted in section 249 of and Schedule 5 to the SFO.[17]

PUBLIC CONSULTATION

18. We have consulted the Standing Committee on Company Law Reform ("SCCLR") which had no objection to the above legislative proposals in the Companies (Amendment) Bill 2009. The CR and the IRD have respectively consulted their Customer Liaison Groups ("CLG") and Users' Committee on 12 May 2009. Members of both CLG and the Users' Committee were supportive of the relevant proposals. As noted in paragraph 6 above, the proposal to empower the R of C to tackle the problem of "shadow companies" was broadly supported by respondents in a topical public consultation conducted in the second quarter of 2008.

19. As regards the proposals to facilitate market discussion on the scripless operational models, the SFC together with HKEx and the Federation of Share Registrars plan to issue a consultation paper in the fourth quarter of 2009. The paper will discuss and seek views on different aspects of the operational model for implementing a scripless securities market in Hong Kong.

WAY FORWARD

20. We are drafting the legislative amendments in respect of the above proposals with a view to introducing them in the Companies (Amendment) Bill 2009, together with the Business Registration (Amendment) Bill 2009 for item (B) above, in the last quarter of 2009.

Financial Services Branch
Financial Services and the Treasury Bureau
June 2009

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[17] The proposed technical amendment to the term "委託人" in section 343(2) was raised by a member of the SCCLR. It was agreed to by the Law Draftsman.

Annex

Proposed Features of Electronic and Website Communication to be Enshrined in the Companies (Amendment) Bill 2009

We intend to introduce the following provisions in the Companies (Amendment) Bill 2009 to govern electronic and website communications[1] by a company with its members or debenture holders (the "recipient"):-

Communication in electronic form (other than by website)

(a) Communications in electronic form can be made by a company only with the recipient's agreement to an address specified by the recipient;

(b) A document is deemed to have been received by the intended recipient 48 hours after it has been sent by a company in electronic form unless the company's articles provide a longer period;

(c) A document sent in electronic form by a company is sufficiently authenticated if the identity of the company is confirmed in a manner as specified by the recipient; or where no manner has been specified, the communication contains a statement of the company's identity and the recipient has no reason to doubt the truth of that statement;

(d) A recipient may revoke his/her agreement to communicate in electronic form by giving prior written notice of not less than 7 days before any communication is to be made by the company; and

(e) A member of a company may request the company to deliver free of charge a hard copy of the document in addition to receiving the electronic copy.

Communications by means of website

(a) Communications by means of a website can be made by a company to its recipients only with their agreement (note: members/debenture holders of a company are not allowed to communicate to the company by means of website);

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[1] Communications in hard copy form between a company and its members/debenture holders currently provided in the Companies Ordinance will continue to be permitted.

(b) The recipient is deemed to have agreed to website communication if the company has requested him/her to agree to it and has not received a response to the request within 28 days, or if website communication is provided under the company's articles;

(c) The recipient should be notified by the company of posting of the document or information on the website;

(d) The information posted must be in a form which enables the recipient to read and retain a copy;

(e) A document is deemed to have received by the recipients 48 hours after its first posting or 48 hours after notice of posting (whichever is later) unless the company's articles provide for a longer period;

(f) The information must be kept posted on the website for the whole of any specified period or 28 days if no period is specified;

(g) The recipient may revoke his/her agreement to website communication by giving prior written notice to the company of not less than 7 days before any communication is to be made by the company; and

(h) The recipient may request the company to deliver free of charge a hard copy of the document in addition to receiving the website copy.