

Bills Committee on Companies Bill
Follow-up actions for the meetings
held on 4, 11 and 18 November 2011
relating to Parts 3, 4 and 7

PURPOSE

This paper sets out the Administration's response to the issues raised by Members at the Bills Committee meetings on 4 November 2011 relating to Part 3 (Company Formation and Related Matters, and Re-registration of Company), on 11 November 2011 relating to Part 7 (Debentures) and on 18 November 2011 relating to Part 4 (Share Capital) of the Companies Bill (CB).

ADMINISTRATION'S RESPONSE

Part 3

Clause 114 – Section 112 not to apply to certain cases

2. At the Bills Committee's request, we had earlier provided the Bills Committee with an analysis of clauses 112 to 114 of the CB via LegCo Paper No. CB(1)225/11-12(01), which was subsequently considered at the meeting of 4 November 2011. We note the Bills Committee's proposal that the scope of clause 114 should be limited to a company to which a licence under clause 98 relates (clause 98 companies) and is exempt from tax under section 88 of the Inland Revenue Ordinance (IRO). Under section 88 of IRO, charitable bodies can be exempt from tax.

3. The effect of the proposal is that clause 98 companies which are not charitable bodies with IRO section 88 tax exemption status) would not be covered by the exception provided under clause 114. Clause 112 would therefore apply to these companies. We are prepared to adopt the Bills Committee's proposal by introducing suitable Committee Stage Amendments (CSAs).

Part 4

Clause 146 - Registration of transfer or refusal of registration

4. Members asked whether the introduction of a right for the transferee or transferor of shares to request reasons for the company's refusal to register a transfer of the company's shares was inconsistent with the rights of a private company to restrict the right of transfer, and asked for information regarding relevant court cases.

5. The introduction of such right is not inconsistent with the right of a private company to restrict the right to transfer its shares. As defined in clause 10 of the CB, a private company is a company which, amongst other things, restricts a member's right to transfer shares. This is existing law and re-enacts section 29(1)(a) of the Companies Ordinance (Cap 32) (CO). There is no intention to change this.

Current law

6. A basic feature of registered companies is that their shares are freely transferable, and there is no power to refuse registration of a transfer unless the company's constitution gives a clear power to do so. In other words, there is a *prima facie* right for a shareholder to freely transfer his shares, which can only be altered by clear provisions to the contrary in the articles of association of the company. For a company to be a private company there must be a restriction on transfer in the articles of association of the company¹. A restriction on transfer must therefore be clearly expressed in the articles of association of the company, and it will not be implied by the courts².

7. The standard restriction on the transfer of shares in a private company in Hong Kong is the power of the directors to decline to register as a member any transferee of shares, in their absolute discretion and without assigning any reason therefor, whether or not such share has been fully paid³. The principles to be applied in cases where the articles of

¹ Section 29(1)(a) of the CO.

² *Greenhalgh v Mallard* [1943] 2 All ER 243, per Lord Greene MR at 237.

³ CO, the First Schedule, Table A Part II, Article 3 (Regulations For The Management Of A Private

the company confer a wide discretion on directors with regard to acceptance of transfers of shares, are clearly set out by Lord Greene MR in the case of ***In Re Smith and Fawcett, Limited***⁴:-

“They must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose. They must have regard to those considerations, and those considerations only, which the articles on their true construction permit them to take into consideration, and in construing the relevant provisions in the articles it is to be borne in mind that one of the normal rights of a shareholder is the right to deal freely with his property and to transfer it to whomsoever he pleases...the shareholder has such a prima facie right, and that right is not to be cut down by uncertain language or doubtful implications. The right, if it is to be cut down, must be cut down with sufficient clarity...Private companies are in law separate entities...they are much more analogous to partnerships than to public corporations. Accordingly, it is to be expected that in the articles of such a company the control of the directors over the membership may be very strict indeed. There are, or may be, very good business reasons why those who bring such companies into existence should give them a constitution which confers on the directors the powers of the widest description.”

8. The common law position is that there is no need for the directors to give any reason for their refusal to register a transfer⁵ and the court will presume that they have acted properly⁶. As a result, it is very difficult in practice to challenge any decision of the directors to ensure that they have acted *bona fide* in the interest of the company in coming to their decision, unless reasons are voluntarily given by the directors.

9. Under section 69(1B) of the CO, where a company refuses to register a transfer of any shares, the transferee has a right to apply to the court to have the transfer registered. Again, however, in the absence of

Company Limited By Shares).

⁴ [1942] Ch 304 at 306.

⁵ *Duke of Sutherland v British Dominion Land Settlement Corpn* [1926] Ch 746.

⁶ *Re Gresham Life Assurance Society, ex parte Penney* (1872) LR 8 Ch App 446; *Re Coalport China Co* [1895] 2 Ch 404.

reasons for refusal, it is difficult for any applicant to prove that registration has been wrongfully refused, as it is for the person making the allegation that the director's decision is improper to prove it.

10. The position is different under the CO for a transmission of shares by operation of law. In such cases, there is a right under section 69(1A) of the CO to request the company to give reasons for a refusal to register. The company is required to register the transfer if it fails to give reasons within 28 days of the request for reasons.

CB Proposal

11. Under clause 146(3) of the CB, the proposal is to introduce a similar right to request reasons, as is available on transmission of shares by operation of law under section 69(1A) of the CO, to the transferor and transferee in relation to a share transfer.

12. We consulted the public on the issue during the second phase consultation of the draft CB⁷. The majority of the respondents commented on this issue supported our proposal⁸, considering that there was a need to enhance transparency and to ensure proper exercise of the directors' duties to the benefit of the company.

13. In the UK the position is more stringent and, the giving of reason is mandatory if the company refuses to register the transfer⁹.

Application of the CB proposal

14. The requirement for directors to provide reasons upon request does not mean that private companies can no longer restrict

⁷ See Financial Services and the Treasury Bureau, *Consultation Conclusions on the Second Phase Consultation on the draft Companies Bill* (25 October 2010) (http://fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cssp_consultation_e.pdf), paragraphs 39 and 40.

⁸ Among the 36 respondents who commented on this subject, 21 (including those from the Chinese General Chamber of Commerce, Chamber of Hong Kong Listed Companies, Hong Kong Association of Banks, Hong Kong Institute of Certified Public Accountants, Hong Kong Institute of Directors and Law Society of Hong Kong, agreed that reasons should be provided; while 13 respondents (including Hong Kong General Chamber of Commerce and Society of Chinese Accountants and Auditors) disagreed; and two offered other comments.

⁹ Section 771 of the UK Companies Act 2006.

transfers of its shares pursuant to provisions in its articles conferring such a power. It will not interfere with a decision made legitimately, or substitute the court's decision for the directors' decision made in good faith, as to what they consider to be in the interests of the company. The new requirement does not change the legal principles applicable in deciding whether or not the directors' refusal to register a transfer is valid or not. The law remains that the directors must act in accordance with the articles of the company, and *bona fide* in what they consider to be the best interest of the company, and they must not act fraudulently, capriciously or for a collateral purpose.

15. There are various court decisions on the right to refuse registration¹⁰.

Conclusion

16. The right to request reasons in a transfer situation, similar to the right available under the CO in a transmission situation, will enhance transparency and will make it easier for shareholders to take action where they consider that the directors have not acted in accordance with the law, but the rights of private companies to impose restrictions on the transfer of their shares will not be affected.

Part 7

Clause 304 – Register of debenture holders

17. Members were concerned that there may be privacy issues in allowing the register of debenture holders to be open for public inspection and that debenture holders may not wish to have their particulars

¹⁰ See for example *Simon Fireman v Golden Rice Bowl Ltd* [1987] HKLR 981: where the court considered an application against refusal where the applicant was a chargee of the shares and observed that it was not entitled to interfere with a decision just because it disagreed with it, nor would it exercise its discretion so as to defeat the objects of the company. It would generally not be appropriate for the court to override a refusal to register where the transaction is temporary, such as mortgage of shares, *Choy Bing Wing v Max Share Ltd* [1993] HKCU 300. In *Lee Chee Ngor Moreta v Prudential Enterprises Ltd* [1991] 2 HKC 499, the court would not interfere with the refusal to register the widow and administratrix of a deceased member, which was in accordance with the articles of the company, despite the family nature of the company.

disclosed. The company may therefore have difficulty in entering such particulars in the register of debenture holders as required by the law.

18. The requirements to enter a debenture holder's name and address and keep a register of debenture holders for public inspection are existing law under the CO¹¹ which help to protect the interest of debenture holders as a whole. In the absence of an up-to-date record of the names and addresses of the holders of debentures forming part of a series, it would be difficult if not impossible for them to organise action in defence of their common interests where they may be required to contact each other.

19. It is also beneficial for an individual debenture holder to provide his correspondence address to the company so that the company can contact him when necessary, for example, where a liquidator is to be, or has been appointed.

20. In fulfilling the requirement to provide "name and address", the debenture holder is not required to provide a residential address, and may provide a correspondence address at which he can be contacted by the company or the other debenture holders. We do not consider there to be any privacy issues in allowing the register to be open for inspection. Similar requirements to enter the name and address of a debenture holder in the register of debenture holders for public inspection can also be found in Australia¹².

Clause 306 – Right to inspect and request copy

21. Members enquired whether or not there was a right for the Court to order immediate inspection in the event of non-compliance with a request for inspection under clause 306(1), similar to the rights provided in respect of obtaining copies of certain documents under sub-clauses (2), (3), (4) and (7)¹³.

¹¹ Section 74A(1)(a) of the CO for entering the debenture holder's name and address; and section 75 of the CO for inspection by the public. Similar requirements also apply to register of members under the CO (section 95(1)(a) of the CO for entering a member's name and address; and section 98 of the CO for inspection by the public).

¹² Sections 171(1)(a) and 173(1) of the Australia Corporations Act.

¹³ Sub-clauses (2), (3), (4) and (7), when read together, provide that a person may apply to the Court for an order to compel a company to provide to him a copy of certain document, e.g. the register of

22. Sections 75(4) and 75(5) of the CO provide that if inspection is refused, or a copy is refused, the Court may by order compel an immediate inspection of the register or direct that the copies required be sent to the person requiring them.

23. We do not propose to change the current law. The power of the Court to order an inspection will be re-enacted in the regulations governing companies' records and fees to be made under clause 648 of the CB. The regulations relating to inspection to be made under clause 648 will detail, for example, the notice period required for inspection, and the times when the register will be open, etc. It is considered more appropriate for these detailed provisions relating to the request for inspection to be contained in regulations. The regulations will also cover inspection of other registers and company records.

24. Members expressed concern on the meaning of the word "abused" in sub-clause (8)¹⁴ and asked whether or not this sub-clause was necessary given that sub-clause (7)¹⁵ has already provided the Court with a wide discretion to make an order. We agree with the observation and will introduce a CSA to remove sub-clause (8).

Clause 310 – Keeping of branch register

25. Clause 310(6) creates an offence if a company contravenes sub-clause (3)¹⁶. Members were concerned that sub-clause (3) does not set out a clear timeframe for compliance and is therefore uncertain.

26. We note the concern. The intention is to ensure that any entry made in the branch register must be included in the duplicate register kept at the registered office, so that the duplicate register has an updated database. We will introduce a CSA to provide a timeframe for

debenture holders. Sub-clauses (2), (3), (4) and (7) apply to the situation where a person is requesting a copy of documents from the company, but not inspection of the documents.

¹⁴ Sub-clause (8) of clause 306 stipulates that the Court "must not make an order under subsection (7) if it is satisfied that the rights given by subsection (2) or (3) (as the case may be) are being abused".

¹⁵ Sub-clause (7) of clause 306 stipulates that if "a company contravenes subsection (4), the Court may by order direct that the copy be provided to the person requesting it".

¹⁶ Sub-clause (3) of clause 310 requires a company that keeps a branch register to (a) "transmit to its registered office a copy of every entry made in the branch register as soon as possible after it is made" and (b) "cause to be kept at the place where the company's principal register is kept a duplicate of the branch register entered up from time to time."

compliance, which we propose to be two weeks after the entry is made in the branch register.

Clause 318 – Registration of transfer or refusal of registration

27. Members noted that if a company refuses to register a transfer of shares, the transferee or transferor has a statutory right to request the company to provide reasons for refusal (clause 146(3)). Members considered that the transferee or transferor of debentures should also have such a right.

28. Generally speaking, the entitlement to the rights attached to a share is conditioned upon registration as a shareholder of the company in the register of members. Under the CO, although the right of the transferee to apply to the court to have a transfer of shares registered is provided under section 69(1B), the burden of proving that directors have wrongfully disapproved a transfer would be difficult as directors are not required to provide grounds for their refusal. Hence, there is a new requirement under clause 146(3) to require a company to give reason upon request to address this problem.

29. Unlike “shares”, in the case of debentures, ownership generally does not depend upon registration and so the debt constituted or evidenced by the debenture is transferred in a manner similar to other choses in action. For a legal transfer, this will be governed by section 9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23), subject to any restrictions in the terms of the trust deed or agreement¹⁷.

30. In the light of the different legal effects between registration of shares and registration of debentures, it would be a disproportionate burden to require companies to give reasons upon request for refusal to register transfer of debentures.

31. In view of the above, and given that no apparent difficulty has

¹⁷ In summary, section 9 of Cap 23 provides that any absolute assignment of any debt or other legal chose in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to receive or claim such debt or chose in action, shall be and be deemed to have been effectual in law to pass and transfer the legal right to such debt or chose in action from the date of such notice.

been encountered regarding the registration of transfer of debentures under the current CO, there is no compelling reason to introduce a new requirement for the company to give reasons for a refusal to register a transfer of debentures upon request.

Clause 328 – Court may order meeting of debenture holders

32. Clause 328 provides that debenture holders may apply to the Court to convene a meeting to give directions to the trustee. This right may be excluded or varied by the terms of the debenture or trust deed. Members enquired whether this exclusion was based upon any overseas legislation.

33. Clause 328 replaces and improves section 75A of the CO¹⁸ to provide that the Court may order a meeting of debenture holders. The clause provides for the right for debenture holders holding at least 10% of the value of the debentures in total to apply to the Court to order a meeting for giving directions to the trustee. This is subject to any provisions in the debentures, or the trust deeds or other documents securing the issue of the debentures that exclude such right or require a higher percentage of debenture-holdings. This clause applies to debentures forming part of a series issued by the company and ranking *pari passu* (i.e. of the same rank) with other debentures of that series, and debenture stock.

34. Clause 328 is based partly on provisions in the Australia Corporations Act (ACA). The Australian provisions provide that holders of 10% or more of the nominal value of the issued debentures may require, the trustee may call or the Court may order a meeting of the debenture holders¹⁹. In the UK, meetings of debenture holders are

¹⁸ Section 75A of the CO provides that where the debentures or the trust deed or other document securing the debentures or stock provide for the holding of meetings of holders of debentures or stock, then subject to such provisions, such meetings shall be convened subject to the relevant provisions in the CO (sections 113, 114B, 114C, 114D(2) and 114E of the CO). In practice, however, section 75A is unlikely to be invoked, because if the debenture documents do not provide for meetings, the CO provisions would be of no assistance. Where the debenture documents do so provide, these documents (if professionally prepared) are likely to have their own provisions which will negate the application of the CO provisions.

¹⁹ Sections 283EA, 283EB and 283EC of the ACA. Requisition by debenture holders may be made to consider financial statements laid before last Annual General Meeting, or to give trustee directions in exercising powers. Trustee may call meeting in the event borrower or guarantor

governed by the terms of the covering trust deed and there is no statutory right to apply to court for a meeting to be held. Singapore has no general provisions on meetings.

35. We believe that this proposal strikes a reasonable balance between, on one hand, the right of the company to contract freely with the debenture holders on the terms upon which the debentures forming part of a series are issued; and on the other hand, enhancing protection for debenture holders.

Clause 330 – Immunity of trustees for debenture holders

36. Members queried why the trustee should not be liable for negligent acts or omissions if he acts in accordance with the directions given in a meeting of debenture holders.

37. Clause 330 is a new provision based on a similar provision in the ACA (section 283DC). Clause 330 complements clause 328, which is also a new provision. Clause 328 provides a right for debenture holders in some circumstances to apply to the Court to order a meeting for giving directions to the trustee. Clause 330 clarifies that the trustee is not liable for anything done by it in accordance with a direction given by a meeting of debenture holders held under clause 328.

38. Having considered Members' views, we agree that trustees acting in accordance with directions given by debenture holders in meetings called under clause 328 should be treated in the same manner as those in meetings called in accordance with the provisions of the trust deed or debenture. Accordingly, we will introduce CSA to delete clause 330.

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fails to remedy any breach when required by trustee. Court may order meeting to give directions to trustee. Please see paragraph 18 of Annex B to the LegCo Paper CB(1)2175/10-11(01).