LC Paper No. CB(1)643/99-00

Ref: CB1/ BC/11/98/2

Bills Committee on
Companies (Amendment) Bill 1999

Minutes of meeting held on
Monday, 29 March 1999, at 2:30 pm
in Conference Room B of the Legislative Council Building

Members present	**:**	Hon Albert HO Chun-yan (Chairman) Hon James TIEN Pei-chun, JP Hon Eric LI Ka-cheung, JP Hon HUI Cheung-ching Hon CHAN Kam-lam Hon SIN Chung-kai Hon Mrs Miriam LAU Kin-yee, JP Hon FUNG Chi-kin
Members absent	**:**	Hon Kenneth TING Woo-shou, JP Hon HO Sai-chu, JP Hon CHAN Yuen-han
Public officers attending	**:**	<u>Agenda item II</u> Miss Julina CHAN Principal Assistant Secretary for Financial Services Mr T K YEUNG Assistant Secretary for Financial Services (Companies) Mr L W TING Assistant Secretary for Financial Services (Companies), Designate Mr G W E Jones Registrar of Companies Mr E T O' Connell

Registry Solicitor

Ms Shandy LIU
Senior Government Counsel

Clerk in attendance : Ms Estella CHAN
Chief Assistant Secretary (1)4

Staff in attendance : Miss Anita HO
Assistant Legal Adviser 2

Ms Connie SZETO
Senior Assistant Secretary (1)1

I Election of Chairman

Mr Albert HO Chun-yan was elected Chairman of the Bills Committee.

II Meeting with the Administration

(LC Brief (Ref:C2/1/11C(99)XII); LC Paper No. CB(3)1266/98-99; LS121/98-99, CB(1)1055/98-99)

2. The Principal Assistant Secretary for Financial Services (PAS/FS) briefed members on the purposes of the Companies (Amendment) Bill 1999 (the Bill) which included providing merger relief for companies in cases of mergers and reconstructions, introducing a new procedure for deregistering solvent, defunct private companies, removing the requirement to record and report the nationality of company directors and secretaries, and introducing some miscellaneous amendments to improve the drafting and procedures of the Companies Ordinance (Cap.32) (the Ordinance).

Merger relief

3. In response to members' enquiries, PAS/FS explained that the proposed amendments would provide merger relief to companies undergoing acquisitions, mergers and reconstructions in certain cases. The relief would be available, in cases of acquisition and merger, to a company which held 90% or more of the issued share capital of another company as a result of an arrangement for the issue of shares by the first company in consideration of the issue or transfer to the first company of equity shares in the second company. Merger relief would also be available to a group reconstruction where there was no material change in the shareholder structure of the group or assets leaving the group. Under the provisions, any share premiums arising from such activities needed not be

credited to the share premium account and the entities would be accounted for as though they had always been combined. Hence, the pre-acquisition profits or reserves of the acquired company would not be capitalised but would be available to the group for distribution. The Registry Solicitor (RS) added that the proposals would be clearly to the advantage of shareholders of companies, as upon merging the acquiring and acquired companies would be accounted for as one single entity, and share premiums would be freed up instead of being maintained as capital of the resultant company and be subjected to restrictive drawn down rules.

4. Mr Eric LI Ka-cheung said that the Hong Kong Society of Accountants (HKSA) had been heavily involved in formulating the proposals to permit merger relief and was in full support of the new provisions. He pointed out that while the existing provisions which required share premiums arising from cases of mergers and reconstructions of companies to be transferred to the share premium account and be treated as share capital were intended for the protection of creditors and shareholders, the capital maintenance requirement however, had precluded companies from the benefits of merger relief and discouraged merging and reconstruction activities of companies which were not only common but also necessary nowadays for achieving economies of scale and enhancing competitiveness. Moreover, the existing provisions were inconsistent with the international trend and practices of other jurisdictions where merger relief was permitted with a view to facilitating company acquisition and reconstruction activities.

5. In reply to members' enquiries about the legal requirement of overseas countries in respect of merger relief, PAS/FS advised that according to HKSA's findings, merger relief was not prohibited by law in the USA, Canada and Australia, but was regulated through accounting requirements. In Bermuda, in cases of merging, companies were required to put money in a share premium account but whose assets were distributable. Upon members' request, PAS/FS undertook to provide more information on practices relating to merger relief of major common law jurisdictions for members' reference.

Admin.

(*Post-meeting note*: The information had been circulated under LC Paper No. CB(1)1133/98-99 dated 16 April 1999.)

6. Mr James TIEN Pei-chun enquired about the bases for setting the 90% shareholding threshold for companies to enjoy the benefits of merger relief in case of acquisition. The Registrar of Companies (R of C) said that the Standing Committee on Company Law Reform (SCCLR) which studied the proposals had focused on the basic principle of merger relief. As far as he recollected, there had been no specific discussion on the threshold level. The provision was directly copied from the UK Companies Act 1985. Mr Eric LI pointed out that when

there were any outstanding shareholdings exceeding 10%, certain interest protection provisions relating to minority shareholding would apply.

7. On the concern that the new provisions might be abused by companies as a means to evade from tax liabilities through acquiring or merging with companies which were in deficit, Mr Eric LI remarked that there were already legal provisions in place to plug such loophole and no tax relief benefit was available upon such merging activities.

8. Noting that the proposals were modelled on the UK Companies Act 1985, Mrs Miriam LAU Kin-yee enquired about the reasons for not putting forward the legislative amendments earlier so that the Ordinance would keep in pace with the rapid development in the local and global business environment.

9. R of C said that the proposals regarding merger relief had been first considered by the SCCLR at its meeting in May 1993 when they had been approved in principle subject to a public consultation exercise being conducted. In the event, it took longer than expected to draft the Bill, particularly given the need to consult the HKSA very closely on the legislative proposals, and subsequently find an appropriate slot in the legislative programme. As a result, the delay in introducing the Bill was understandable. However, the proposals to introduce a new statutory procedure to deregister defunct, solvent private companies, were based on similar provisions in the Australian Corporations Law which had been further amended in July 1998. With regard to the overall review of the Companies Ordinance, the Consultants' Report had been submitted to the Government in May 1997 who had then asked the SCCLR to examine the Report's recommendations. It was expected that the SCCLR would complete its examination in late 1999. Subsequently, the Administration would consider the SCCLR's proposals to improve the legal framework for cojmpanies to ensure that it was condusive to the efficient running of business in Hong Kong.

Deregistration of solvent, defunct private companies

10. Mr James TIEN expressed support for the Bill as it would improve the environment for running businesses in Hong Kong. However, he was concerned that the new simplified procedure for deregistering companies might be abused by companies to evade from their outstanding liabilities. Moreover, there might be cases where liabilities could only be established after the companies were deregistered. He enquired about safeguards to protect the interests of creditors and other affected parties.

11. PAS/FS explained that as existing voluntary winding-up procedures for solvent companies were complex and time-consuming, many defunct private companies had relied on sections 291 and 290A of the Ordinance which empowered the R of C to strike off companies from the register that were

commercially inactive or failed to file annual returns for two consecutive years for getting rid of unwanted companies. Both sections were being abused by the private sector and over the past five years, the R of C had struck off 35,098 and 94,337 companies from the register under these two sections respectively. As no fee was payable for a company to be struck off under these two sections, Government was in effect providing a free corporate deregistration service to the private sector. Hence, the Administration proposed to introduce a formal but simplified procedure under which the R of C would consider applications for this purpose at a fee of $420 chargeable for each application. RS added that the new procedure would dispense with the unnecessary red tapes and bureaucracy involved in deregistration of companies and achieve the same purpose at a much lower cost.

12. On the concern about the possibility of abuse of the new procedure by companies as an avenue to evade from liabilities, R of C clarified that the new procedure would only be available for dissolving a solvent, defunct private company which had never commenced operation or had ceased to carry on business for more than three months and that it had no outstanding liabilities. The application for deregistration had to be agreed by all members of the company and accompanied with a ‘no-objection’ notice from the Commissioner of Inland Revenue certifying that the company had no outstanding tax liabilities. The new procedure would not be available to certain categories of companies set out in the Sixteenth Schedule, nor public companies and insolvent companies which were subject to winding-up procedures stipulated in other legislative provisions. In order to safeguard the interests of creditors, the amended section 292(3) required all the books and papers of the company to be kept for not less than five years after dissolution. Moreover, there would be adequate publicity to draw creditors' attention to the deregistration applications as the R of C would be required to publish a notice of the proposed deregistration in the Gazette and a three-month period would be allowed for aggrieved parties to raise objection against the proposed deregistration. RS said that the original proposal of requiring the applicant company to advertise for the proposed deregistration prior to applying to the R of C was considered cumbersome and costly and hence was not included in the new procedure.

13. PAS/FS supplemented that the proposed section 291AA(12) stipulated that the liability of the officers and members of the deregistered company was to continue and might be enforced as if the company had not been dissolved. RS added that criminal sanctions were included in the proposed section 291AA(14) where an applicant knowingly or recklessly gave any false or misleading information in his application would be liable to stringent penalties including heavy fines and imprisonment. In addition, Common Law also enabled creditors to take actions against directors, corporate officers and members of companies through civil proceedings. The proposed section 291AB provided that affected parties aggrieved by the deregistration of a company could apply to the court for

reinstatement of the deregistered company. Creditors could apply to the court to reinstate the company for the purpose of establishing whether there were any liabilities. In the event that liabilities were established, creditors could proceed with normal winding-up of the reinstated company. Another example of reinstatement of a deregistered company might be a case where lost assets of the company were recovered after the company had been deregistered. In such case, it was justified for members of the company to reinstate the company for the purpose of distributing the recovered assets.

14. The Chairman opined that while the new deregistration procedure would benefit small companies since winding-up procedures were simplified and cost incurred was low, due to the complicated accounts of large companies and the likeliness of large amount of outstanding liabilities involved, the new deregistration procedure might not provide sufficient statutory protection for the interests of creditors of large companies. He asked the Administration to consider only providing the new procedure to small capital-sized private companies and requiring large capital-sized companies to follow the existing voluntary winding-up procedure for their dissolution.

15. PAS/FS said that the new procedure was provided as an option to the existing voluntary winding-up procedure for solvent companies irrespective of capital size. As past experience revealed that the vast majority of private companies which had relied on sections 291 and 290A for deregistration were of small capital size, it was envisaged that small companies would be the major users of the new procedure. Moreover, since large capital-sized companies were usually non private companies, most of them were not eligible to use the new procedure. R of C added that as the Ordinance made no distinction between private companies or, for that matter, all companies based on their capital size, the Chairman's suggestion might complicate the other provisions of the Ordinance.

16. Mrs Miriam LAU queried the rationale for retaining R of C's power to strike off companies from the register under section 291. She opined that such residual power would be unnecessary with the introduction of the new procedure and was concerned that retention of the power might undermine incentives for companies to use the new procedure.

17. R of C explained that section 291 provided the R of C with a discretionary power to strike-off a company from the register. It has been retained in order to enable the R of C to remove, on his initiative, either any defunct companies which had not been deregistered under the new provisions or any company which it was necessary to strike-off for whatever reason. In other words, it was a residual, discretionary enforcement provision which R of C had to retain quite irrespective of the enactment of the new statutory deregistration procedure. Furthermore, there would be incentives for companies to use the new procedure

as, upon the enactment of the new legislation, no more 'applications' for striking off would be accepted; the new procedure would be simple, cheap and user-friendly compared with the procedure for a members' voluntary winding-up'; and defunct companies would still be subject to prosecution for failure to file annual returns until they were deregistered. Prior to the implementation of the Bill, the Companies Registry would issue an external circular to all professional bodies stipulating clearly that no further 'applications' for striking off under section 291 would be accepted. Consequently, defunct, solvent private companies would have to make use of either the new statutory deregistration procedure or the existing voluntary winding-up procedure.

Nationality of company director and secretary

18. Pointing out that there were restrictions on the nationality of directors of broadcasting corporations, Mr HUI Cheung-ching was concerned that the removal of the requirement to record and report the nationality of companies' directors might pose difficulties for enforcement of the nationality rule of directors of these corporations. In response, PAS/FS explained that as the nationality requirement of directors of broadcasting corporations was governed by other legislation relating to licensing of the broadcasting media, the proposed amendment should have no impact on this area.

III Any other business

Meeting with deputations

19. Members noted that the Hong Kong Institute of Company Secretaries had expressed interest in meeting the Bill Committee to express its views on the Bill. As the Chairman also suggested to invite views from Hong Kong Bar Association and the Law Society of Hong Kong, members agreed to invite all three organizations to attend the next Bill Committee meeting to be held on 20 April 1999, at 2:30 pm.

20. There being no other business, the meeting ended at 4:00 pm.

Legislative Council Secretariat
20 December 1999