Bills Committee on
Companies (Amendment) Bill 2002

Follow-up actions arising from the discussion
at the meetings on 24 April and 6 May 2003

Introduction

This paper sets out the outcome of the follow-up actions arising from the discussion at the meetings on 24 April and 6 May 2003.

Meeting on 24 April 2003

(a) Difference between a directors' resolution and a written record referred to in new section 153C

2. A record of a decision being taken is a written account of the decision whereas a resolution is the formal expression of a decision being taken. A written record referred to in new section 153C can include but does not necessarily have to be a directors' resolution. Whether such a written record can be recognized for the purposes of property transactions depends on the circumstances of each case e.g. whether its was signed by the director, whether it was recorded in a clear and legible manner.

3. Our policy intent regarding clause 55 is to cover the types of decisions made by directors of a company which have effect under the common law as binding the company even though not taken at a meeting of directors provided that all the directors agreed to or acquiesced in the decision. We are reviewing the wording of clause 55 (having regard to that of clause 44), with a view to making this policy intent clearer.

(b) Need to change the articles of a company

4. New section 2(13) provides that any provision of the Companies Ordinance (including the regulations in Table A) that refers to the directors of a company, the board of directors of a company, etc, shall, unless the context otherwises requires, apply with necessary modifications in relation to a private company that has only one director. For example, regulation 101 of Table A provides that the quorum necessary for the transaction of the business of the directors may be fixed by the directors, and unless so fixed shall be two. The effect of applying new section 2(13) to this regulation would be that in the case of a private company having one director, the quorum shall become one unless

so fixed by the directors otherwise.

5. The existing section 11 provides that in the case of a company limited by shares, if articles are not registered, or if articles are registered, in so far as the articles do not exclude or modify the regulations contained in Table A, those regulations shall, so far as applicable, be the regulations of the company in the same and to the same extent as if they were contained in duly registered articles. This means that the regulations contained in Table A (which by virtue of new section 2(13) cater for the scenario of one director) will apply to a company formed with one director unless there are any contrary provisions in the articles of the company.

6. We do not consider it appropriate for new section 2(13) to override the relevant provisions in the articles of a company as the articles constitute a contract between a company and its members as well as a contract between a member and each other member. They govern the operation of the company (including the extent of management powers conferred on its directors), and may vary from case to case, having regard to the nature of business and the wishes of the members. It may be that the falling of the number of directors of a company to one is unintended (for instance, by reason of the sudden death of a director and the company will elect a new director to fill the vacancy). Under such circumstances, the articles of the company which cater for the scenario of two directors need not and should not be amended. For example, the articles of a company may require any cheque in an amount of more than $1 million to be signed by two directors. If new section 2(13) were to apply to the articles, it would mean that where one of the directors died, the remaining director would be able to sign the cheque, which might not be what the company had intended. In any event, the articles of a company can be amended at any time by means of a special resolution.

(c) Civil liability of auditors

7. New section 161B(9)[1] provides that if the requirements in respect of disclosure of loans etc to officers (including directors and shadow directors) etc in a company's accounts are not complied with, it shall be the duty of the company's auditors to include in their report, so far as they are reasonably able to do so, a statement giving the required particulars. It is silent as to the consequence of a breach or the availability of remedy. Under such circumstances, the court will construe the wording of the statute to determine whether the legislature intends that a breach of such duty gives rise to a private cause of action. The basic proposition is that, in the ordinary sense, a breach of a statutory duty, does not, by itself, give rise to such action. There is also a

[1] This is drafted on the basis of existing section 161B(6).

general proposition that where the damage is physical and in particular, personal injuries, the claimant is on a stronger ground than where the damage is economic loss. In *R v. Deputy Governor of Parkhurst Prison, ex p. Hague* [1992] 1 A.C. 58, the House of Lords decided that the mere fact that no sanction is prescribed for breach of a statutory provision designed to protect particular individuals does not necessarily mean that a private right of action will be available. In the absence of any express provision in this section, the consequence of the breach or the availability of remedy arising from this section remains much a matter for the parties to argue in the court.

8. On the duty of care of auditors under common law, it is difficult to assess the impact of this section on such duty as the common law develops on a case by case basis and we are not aware of any case in which an auditor was alleged to have failed to ensure that particulars of loans to shadow directors were properly shown in the accounts of the company or the audit report. It remains to be seen whether the court, when asked to adjudge on the issue, will decide that an auditor owes a duty of care to the claimant and has breached his duty by failing to ensure inclusion of particulars of loans to shadow directors in the audit report. Furthermore, it is worth noting that unless the claimant personally suffers loss by reason of such failure and is able to establish a breach of such duty[2], it is unlikely that a claim will be brought against the auditor and even if it were brought, it will not be surprising if only nominal damages are awarded.

9. We are following up the point about overseas experiences and auditing guidelines on the disclosure of loans etc to officers etc.

(d) Response to the Hong Kong Society of Accountant (HKSA)'s further submission

10. The HKSA considers that in the absence of any requirement for a company to file particulars of its shadow directors under existing section 158 (as a result of the CSAs to clause 61), it would be difficult, if not impossible, for auditors to carry out their duty under new section 161B(9) as the particulars of shadow directors are an important source of evidence of their existence. We consider that our proposed CSAs (being prepared) to the existing section 161C, requiring shadow directors to disclose information relating to themselves for the purposes of section 161B (which requires the disclosure of loans etc to directors etc), would address the HKSA's concern.

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[2] The claimant would have to establish existence of a shadow director, a loan to such director, that it was reasonably able for the auditor to include particulars of such a loan in the audit report and that the auditor failed to do so.

Meeting on 6 May 2003

(a) Need for a separate section for one-member company

11. We understand the Bills Committee prefers to have a separate section that contains new section 158 (regarding the filing and retention of particulars of reserve directors) and new section 153A(6) (regarding the appointment of reserve directors). We are considering whether this approach should be adopted.

12. In response to the Members' concerns, we are considering revising clause 53 along the following lines -

(a) the proposed sections 153A(6)(a) and (b) would be combined into one provision to refer to the scenario where a company has one member who is also the sole director of the company;

(b) the nomination of a reserve director should be valid as long as the sole member and director (at the time of nomination) remains to be the sole member and director of the company; and

(c) the reserve director should be deemed to be a director upon the death of the sole member and director of the company.

(b) Response to the submission from the Hong Kong General Chamber of Commerce (HKGCC)

13. Our responses to the submission from the HKGCC are at Annex.

(c) Activation of the reserve director mechanism

14. Under proposed section 153A(6), the reserve director of a company will be deemed to be its director when the number of members and directors is reduced to zero. In response to Members' concerns, we are considering restricting the application of proposed section 153A(6) to the scenario of the death of the sole member and director.

(i) Mental incapacity

15. On an application made under section 7 of the Mental Health Ordinance (Cap. 136), the court may order an inquiry into whether a person is incapable, by reason of mental incapacity, of managing and administering his property and affairs. If the court decides so, it may under section 10A of the same Ordinance do or secure the doing of all such things as appear necessary or expedient for administering the person's property and affairs. Hence, given this mechanism, nomination of a reserve director is not necessary.

(ii) Imprisonment

16. If the sole member and director of a company is imprisoned, he can continue to act as the company's member, and also the director (if he is not subject to any disqualification order). If it is impracticable for him to continue acting as the director, he can appoint an alternate director for the period while he is imprisoned. Hence, we do not see the need to allow the company to nominate a reserve director.

(iii) Bankruptcy

17. If the sole member and director of a company is declared bankrupt by the court, his interests in the company will be vested in the trustee-in-bankruptcy. Hence, nomination of a reserve director is not necessary.

(iv) Disqualification

18. If the sole member and director of a company is subject to a disqualification order made by the court under Part IVA of the Companies Ordinance, he cannot continue to act as the director of the company but his rights as the sole member of the company are in no way affected. The sole member can appoint another person to be the director of the company. Again, nomination of a reserve director is not necessary.

(d) Scope of the term "conditional sales agreement"

19. On the basis of the definition in the UK Companies Act, the term "conditional sales agreement" is proposed to be defined to mean an agreement for the sale of goods or land under which the purchase price or part of it is payable by instalments, and the property in the goods or land is to remain in the seller (notwithstanding that the buyer is to be in possession of the goods or land) until such conditions as to the payment of instalments or otherwise as may be specified in the agreement are fulfilled. The words "the property in the goods

or land is to remain in the seller (notwithstanding that the buyer is to be in possession of the goods or land)" imply that the buyer would be able to take possession before the property or ownership in the goods or land is passed to him and that this is a term of the agreement. In other words, "conditional sales agreement" would cover transactions where the buyer can take possession of the goods or land prior to the payment of the full price of the goods or land. As these transactions would involve indirect financial assistance to directors (who would be able to enjoy the goods or land prior to the payment of the full price), we consider it necessary for them to be subject to the prohibition under the new section 157H. There should not be any difference in the application of the definition of the term "conditional sale agreement" to goods and that to land.

Financial Services Branch
Financial Services and the Treasury Bureau
May 2003

Annex

Responses to Further Submission from the Hong Kong General Chamber of Commerce

(a) Appointer of the reserve director

We consider it more appropriate for the appointment of a reserve director to be made by the company in general meeting as a director is an agent of the company, not of the sole member of the company and the appointment of a reserve director should be a power exercised by the company rather than the sole member.

(b) Notice of appointment
(c) Notice of appointment being activiated

2. Our CSAs to the existing section 158 provide that that if a company (having one member who is also the sole director) nominates a person to be its reserve director or revokes such nomination, it shall file with the Companies Registry a notice regarding the nomination (including the reserve director's consent to act) or revocation. If the reserve director is then deemed to be a director of the company, all the existing provisions applicable to the appointment etc of a director will then kick in.

(d) Number of members reduced to zero

3. In response to the suggestion made by the Bills Committee, we are considering revising the CSAs to provide that the provision deeming a reserve director to be a director should only apply to the scenario of the death of the sole member and director and that the nomination of a reserve director should be valid as long as the sole member and director (at the time of nomination) remains to be the sole member and director of the company. We do not consider it appropriate to apply the deeming provision to the scenario of there being no member for the time being capable of acting as such, as this would introduce uncertainty as to when the deeming provision would apply.

(e) Registration of grant

4. The existing section 69 of the Companies Ordinance provides that if the company refuses to register a transfer of any shares etc, the company shall, within 2 months after the date on which the transfer was lodged with the company, send to the transferor and the transferee a notice of the refusal and the transferee may apply to the court to have the transfer registered by the company. If the court is satisfied that the application is well founded, it may disallow the refusal and order that the transfer be registered forthwith by the

company. Regulations 24 – 26 of Table A confer the powers of registration to the directors of a company.

5. The difficulty of registering a grant of administration with a company that has no director would be likely to arise where the company has no member. Such difficulty is no different from other difficulties that a company having one member who is also the sole director may face in the event that such member/director dies. We have, in response to the Bills Committee's concerns, proposed a mechanism for the appointment of a reserve director.

(f) Other points

6. We would follow up these points as appropriate.