For discussion
on 4 July 2005

Legislative Council
Panel on Financial Affairs

Rewrite of the Companies Ordinance

PURPOSE

Rewrite of the Companies Ordinance ("CO") can help ensure that the Ordinance provides Hong Kong with a legal infrastructure which meets its needs and commensurates with its status as a major international business and financial centre. This paper aims to keep Members informed of our latest thinking on the possible framework for taking forward the exercise.

BACKGROUND

2. The CO is one of the longest and most complex pieces of primary legislation in Hong Kong, currently with over 600 sections, and 20 schedules. It was last substantially reviewed in 1984, and is broadly in line with the major United Kingdom ("UK") company law reforms contained in the Companies Act 1948 and some subsequent reforms such as those contained in the Companies Act 1976.

3. In 1984, the Standing Committee on Company Law Reform ("SCCLR")[1] was also set up to ensure that the CO remained responsive to the day-to-day needs of the business sector and the community at large. Since then, virtually every year has seen at least one if not more companies amendment bills as a result of the SCCLR's work to keep the CO up-to-date.

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[1] The SCCLR was established in 1984 to advise the Financial Secretary on necessary amendments to the Companies Ordinance as and when experience shows them to be required. It also advises on amendments required to the relevant legislation on the securities side with the objective of providing support to the Securities and Futures Commission in administering the legislation. Members of SCCLR include representatives of Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and relevant Government departments, as well as personalities from the relevant sectors or professions such as accountancy, legal and company secretarial.

(A) Importance of the Companies Ordinance

4. Company law is of great importance to Hong Kong's economic well being and prosperity. It provides the legal framework which enables businessmen to form and operate companies which create wealth and employment for our community. Besides, it also has a regulatory function which sets out the parameters within which these companies must operate in order to safeguard the interests of those parties who have dealings with them such as shareholders and creditors.

5. As at 31 March 2005, there were 525,447 companies formed and registered in Hong Kong comprising 517,934 private and 7,513 public. By comparison, as at the same date, there were 245,172 unincorporated business entities, typically partnerships and sole proprietorships registered with the Business Registration Office of the Inland Revenue Department. This indicates that companies are the preferred form of legal entity for undertaking business in Hong Kong. Given the commercial importance of company law, it is therefore necessary that its underpinning assumptions and overall structure are modernized and able to meet the needs of our modern dynamic economy well into the 21st century.

(B) Reasons for rewriting the Companies Ordinance

(i) Implement the Recommendations in the SCCLR's Report

6. In 2000, the SCCLR published "The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance" ("The SCCLR's Report"). On the basis of the recommendations in the SCCLR's Report, a total of 62 items for legislative amendments or further study have been identified. Subsequently, the SCCLR undertook a major corporate governance review and issued two consultation papers in July 2001 and June 2003. As a result of this review, recommendations were made to amend various sections of the CO. Over the past few years, action to implement the recommendations in these reports has been taken in the context of a series of major companies amendment bills, most notably the Companies (Amendment) Ordinance 2003 and the Companies (Amendment)

Ordinance 2004. However, we have now reached a stage where action to follow up many of the remaining recommendations such as reform of the capital maintenance provisions, modernization of statutory language etc. can best be taken forward in the context of a rewrite of the CO. Besides, it would be much more desirable to implement some other recommendations such as the review of offences and penalty provisions, and investigation provisions through rewriting the CO as they will give rise to complex and difficult policy and legal issues such as whether civil penalties should be included/excluded for breaches of the CO provisions, whether the investigative powers should be widened etc. Another recommendation is the review/overhaul of the accounting/auditing provisions. In this regard, other than rationalizing the sequence of the relevant provisions and modernizing their terminology, the review covers a lot of major changes such as the introduction of new concepts (e.g. accounting reference dates and accounting reference periods); requirements relating to directors' remuneration and its disclosure; auditors' rights and obligations[2] and so on.

(ii) Resolve Problems Inherent in the Existing Companies Ordinance

7. In addition, there are problems inherent in the existing CO which can best be handled in the context of a rewrite of the Ordinance. For example, most of the core company law provisions regarding company administration, company general meetings, accounts and audit, company inspections, directors and other officers, loans to directors, arrangements and reconstruction and shareholder remedies etc are crammed into Part IV (Management and Administration) which, as a result, is the longest part of the Ordinance. There is a prima facie need to break up and rearrange this part in order to improve accessibility and clarity. Furthermore, antiquated concepts such as the underlying assumption of paper-based communication between a company and its members and the lengthy and "incomprehensible" provisions regarding directors' loans and directors' remuneration should be updated/simplified. Out-of-date provisions and the need to comply with regulatory provisions which may be streamlined will inevitably impose additional costs on business through, for example, the need to obtain professional advice more often than necessary.

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[2] For examples, auditors' duty to report on any inconsistencies between audited financial statements and financial information in other parts of the annual report, and their rights to obtain information and attend general meetings, as well as rules covering changes in auditors such as the right/duty of the outgoing auditor to pass information to the incoming auditor.

(iii) Keep Pace with International Developments

8. As a major international business and financial centre, Hong Kong's company law should not operate in isolation but should have regard to developments regarding company law currently taking place elsewhere in the world. Over the past decade, many major common law jurisdictions have either completed or embarked upon major programmes to reform their company law. In this respect, a number of major initiatives should be noted as follows:

(a) UK: Review of the Companies Act commenced in 1998. The White Paper on Company Law Reform setting out the UK Government's final proposals for comprehensive reform of the Companies Act was published on 17 March 2005.

(b) Australia: Australian companies law has been under continuous review and reform since 1991, major initiatives being the Corporation Law Simplification Programme which started in 1995 and the Corporate Law Economic Reform Programme which started in 1999.

(c) New Zealand: Completely new Companies Act enacted in 1993.

(d) Singapore: Company law reform commenced in 1999 and has resulted in the enactment of a number of companies amendment acts.

(iv) Benefits of the Rewrite

9. The rewrite would improve the structuring of the parts and sections and enhance the clarity of the provisions in the CO. With streamlined and modernised regulation, our company law will meet more fully the needs of, and help save compliance costs incurred by, more than half a million companies, both local and overseas, registered in Hong Kong. It would also benefit a lot of other relevant parties, such as company directors and auditors. Moreover, Hong Kong's position as an international business and financial centre will be enhanced as a result of the implementation of the SCCLR's recommendations that can best be

taken forward through a comprehensive review of the CO. These recommendations cover areas such as shareholders' protection, creditors' protection, and requirements regarding directorship. All these will lead to enhanced market confidence in using companies under the new CO to undertake business and make investments.

10. The rewrite will also provide an opportunity for Hong Kong to leverage from the developments regarding company law taking place around the world. In this respect, we note that one of the objectives of the UK company law reform is to facilitate the wider use of electronic communications and the simplification of procedures for the conduct of company businesses, such as the holding of annual general meetings. All these changes are expected to benefit the economy as a whole. Although it is difficult to quantify the amounts involved, there is at least a prima facie case that, by modernizing, rationalizing and simplifying our company law, there would be significant economic benefits to Hong Kong.

11. On the other hand, the consequences of not having a modernized CO should not be overlooked. Numerous users would need to continue to follow the existing CO which is difficult to understand and fraught with inherent problems (see paragraph 7 above). Companies and other parties concerned would continue to incur additional costs for complying with cumbersome and now out-of-date regulatory requirements such as sending documents to shareholders in paper as opposed to electronic form. Furthermore, without a comprehensive rewrite, it would be difficult to introduce further reform, such as the remaining recommendations of the SCCLR and the reform of the accounting/auditing provisions. Examples include arrangements relating to the holding of general meetings, election of directors, changes to accounting periods and so on.

(v) General Support

12. Given the above circumstances, we consider it timely to start the rewrite of the CO (rather than amending it in a "piecemeal" fashion). This view has also been echoed by Members of the Bills Committees considering companies amendment bills on several previous occasions and the SCCLR.

13. In July 2004, Members of the Panel were first briefed on the proposal to rewrite the CO. The proposal generally received positive

comments, with some Members highlighting the importance of putting in place an appropriate organizational structure and recruiting staff of the right calibre to undertake this very important and major exercise. Since then, the Administration has given further thought to the matter.

THE APPROACH TO THE REWRITE

14. After having consulted the SCCLR, we have come up with the proposed terms of reference at Annex.

15. We expect the rewrite to be a comprehensive exercise which would consist of legal research into the existing provisions of the CO and the corresponding provisions in other major common law jurisdictions, identification of issues associated with the provisions' operation and options to tackle the issues, formulation of recommendations and consultation with stakeholders, culminating in a new CO which meets the needs of modern day users and is on a par with international best practices. Apart from implementing the recommendations in the SCCLR's Report, the exercise will also take a critical look at some other complex areas which were basically untouched by the previous reviews such as share capital (Part II of the existing CO), and distribution of profits and assets (Part IIA).

16. It should be noted that a number of major aspects of the CO have already been reviewed and reformed in the context of amendments made in the Companies (Amendment) Ordinances 2003 and 2004. These amendments relate to, inter alia, various corporate governance reforms, incorporation procedures, shareholder remedies and non-Hong Kong companies. Furthermore, the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group has undertaken a detailed review of most of the accounting and auditing provisions in Part IV of the CO. All these will provide ground work for the rewrite.

17. Having regard to the extensive nature of the exercise and taking into account the volume and complexity of the work to be done, we consider it prudent to tackle the winding-up provisions in the CO[3], which are generally of a different nature from the rest of the CO and are administered by the Official Receiver's Office, in a second phase. The

[3] Namely, Parts IVA, V, VI and X of the existing Companies Ordinance and the relevant subsidiary legislation.

timing of this second phase of the rewrite, as well as its modus operandi and resource implications, will be dealt with separately. Furthermore, we will pay special attention to the outcome of the Securities and Futures Commission's current review of offers of shares and debentures, which may have an impact on the way forward in respect of the prospectus regime in Parts II and XII of the CO.

A POSSIBLE FRAMEWORK

18. The proposed rewrite will be a major exercise necessitating extensive legal research for the purpose of preparing draft drafting instructions ("DDIs"), consulting stakeholders and the public on policy and legal matters and subsequently drafting a new Companies Bill. To ensure that the Bill is a quality piece of work and available within a reasonable timeframe, it is essential that a robust framework be established, staff of the right calibre be recruited and adequate resources be allocated. Besides, it is important to involve relevant stakeholders at an early stage to make the new CO user-friendly and attuned to the needs of modern commerce. In view of these considerations, we envisage that the rewrite could be taken forward under the organizational framework set out in paragraphs 19 to 27 below.

(A) Within the Administration

19. A Steering Committee ("SC") would be formed to oversee the rewrite. The SC will consider and decide on major policy matters arising from the rewrite. It would be chaired by the Permanent Secretary for Financial Services and the Treasury (Financial Services) and would comprise the Registrar of Companies, Deputy Secretary for Financial Services and the Treasury (Financial Services) and other senior officials of the Companies Registry ("CR"), Official Receiver's Office as well as the Civil and Law Drafting Divisions of the Department of Justice ("DoJ") as members. Representatives of other bureaux/departments would attend on a need basis.

20. A dedicated Companies Bill Team ("CBT") comprising staff of the Financial Services and the Treasury Bureau and the CR would be formed to co-ordinate, support and take forward the rewrite exercise. The CBT would be responsible for conducting background research into the policy intention and operation of existing provisions of the CO and the

comparable positions in other common law jurisdictions. It would identify issues, formulate options and make recommendations, take the lead in consulting relevant stakeholders and, where necessary the public as a whole, prepare DDIs and issue a White Bill for public consultation. The CBT would also assist the Legislative Council ("LegCo") in scrutinizing the Bill.

21. The CBT would be supported by:

(a) Legal professionals in DoJ, in particular the Legal Policy, Prosecutions and Civil Divisions[4] who would advise the CBT on legal matters arising from the rewrite; and the Law Drafting Division which would prepare a White Bill and then, after a public consultation on the White Bill, a new Companies Bill for introduction into LegCo; and

(b) External Consultant(s) who is/are company law experts (see paragraphs 22 to 24 below) advising on company law matters in which the Administration currently does not have adequate expertise.

(B) Engagement of Consultant(s)

22. It is worth noting that certain topics in company law such as share capital (Part II of the existing CO), and distribution of profits and assets (Part IIA) are very complex and were largely untouched during the SCCLR's company law reviews over the past few years. Moreover, some do not form part of the CR's ordinary regulatory work and at present the expertise and experience within the Administration in these topics are rather limited. Much of the necessary expertise in these areas rests with legal experts in the non-government sector.

23. In order to address the above situation, a possible option is to engage external consultant(s) to advise on the rewrite exercise, mainly in the review and rewrite of the relevant provisions on subjects in which the Administration has limited experience and expertise.

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[4] Legal Policy (Human Rights, Basic Law and General), Prosecutions and Civil (Advisory and Commercial) Divisions of DoJ

24. The consultant(s) would provide services for a fixed-term (say about 36 months) until the commencement of the public consultation on the White Bill, with an option of a further extension to cover the drafting of the new Companies Bill. It is expected that the consultancy service may not be a full-time job for the expert(s). The services should take the form of a consultancy so that the consulting expert(s) in the private sector, including those who is/are practising, may choose to continue with his/her ongoing jobs if they so wish. The consultant may be a law firm, or a legal professional such as an academic, a retired practising lawyer or a retired judge supported by others having the required background, qualifications and experience.

(C) Consultation with Stakeholders Outside the Administration

25. The SCCLR is expected to play a key role in the exercise, including keeping an overview of the rewrite and advising on all the major proposals/recommendations arising from the rewrite.

26. At the operational level, there would be a need to involve the relevant stakeholders from the early stage of the rewrite, so that views and comments of all concerned stakeholders are ascertained to ensure that the new Companies Bill would suit Hong Kong's circumstances. These stakeholders include the relevant professional bodies[5], chambers of commerce, market practitioners and company law academics. Apart from gauging their views through means such as the issue of consultation documents, dedicated Advisory Groups comprising SCCLR members and the stakeholders' representatives can be formed to advise on specific matters.

27. Regarding public consultation strategy, a two-pronged approach may be adopted:

(a) A White Bill would be published for public consultation before we introduce a new Companies Bill into LegCo; and

(b) Before the publication of the White Bill, we would give active consideration to conducting consultation on

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[5] For example, the Law Society of Hong Kong, Hong Kong Bar Association, Hong Kong Institute of Certified Public Accountants and the Hong Kong Institute of Company Secretaries.

certain key policy issues which may have more far-reaching implications so that the outcome of the consultation could provide a good steer to the broad approach to be adopted in the White Bill. One example is the current capital maintenance regime in Part II of the CO.

RESOURCE REQUIREMENTS

28. As is evident from the preceding paragraphs, any overhaul of the existing law for incorporation, management and dissolution of companies will have wide and profound implications on a wide spectrum of stakeholders in the community. Hence, any review of the CO would require high level policy input and solid legal work. These tasks would require the dedicated efforts of a considerable number of both directorate and non-directorate officers who have suitable expertise and experience in legislative work, in addition to the support from other existing staff within the Administration. These officers would also be assisted by legal experts in the non-government sector.

(A) Staff Requirements

29. It may be useful to make reference to the relevant experience in other jurisdictions in order to assess the possible resources requirements for embarking on the rewrite exercise in Hong Kong. Members may wish to note that the UK DTI deployed a dedicated team of staff to undertake the review of the Companies Act. The DTI's companies bill team was established in July 2001 to take forward the work of turning the recommendations of the independent company law review into legislation. Although the size of the companies bill team has fluctuated according to which particular stage has been reached in the review, we understand that, during the heaviest middle phase of the project, the team comprised a total of approximately 22 staff of whom 12 were policy staff and 10 were lawyers. Of these, the ranks of two staff on the policy side and two staff on the legal side were pitched at a very senior directorate level while the ranks of most of the remaining staff were pitched at either deputy or assistant directorate level. In addition, the DTI team was supported by two parliamentary counsels who drafted the legislation. Furthermore, the companies bill team received considerable support from other very senior directorate staff in the DTI

and other bodies such as the Law Commission for England and Wales. All these suggest that a considerable number of staff with suitable expertise and experience would need to be deployed, if we wish to launch the rewrite exercise. Launching a rewrite without the provision of adequate resources would risk the quality of the work or drag the exercise beyond a reasonable timeframe.

30. We are now discussing with the relevant bureaux and departments on the total number of dedicated staff, both directorate and non-directorate, required for taking forward the rewrite. We will also critically examine the workload of the existing staff in the coming years with a view to meeting the staffing requirements through internal re-deployment as far as possible. However, it looks apparent that some additional posts would inevitably be needed for the rewrite, probably including a handful of directorate posts. These new posts would be time-limited to tie in with the timeframe of the rewrite. Once the staffing proposals are finalized, we will consult Members before seeking the Finance Committee's necessary approval.

(B) Consultancy Fees

31. For the proposed consultancy by legal experts, we estimate that the total non-recurrent expenditure, subject to negotiations with the selected consultant(s), would be about $19–22 million[6]. The estimate has been drawn up after having regard to the prevailing market charging rates for an expert of the required level of experience and expertise. We expect that the expert(s) should have proven knowledge of, expertise in, and no less than 15 years of relevant local experience in the area of company law and preferably with at least 10 years of it on the practising side.

FUNDING FOR THE REWRITE

32. The total financial cost of the creation of additional posts in the Administration and the engagement of external consultant(s) is intended to be met by the CR Trading Fund ("CRTF") and its impact, if any, on the fees charged by the CRTF will be examined when the staffing requirements are finalized.

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[6] Depending on the scope and duration of the engagement of the external consultant(s).

TIMEFRAME

33. On the assumption that the necessary approval would be obtained from the Finance Committee by end 2005, we envisage the following **tentative** timeframe for the rewrite, which, however, will be subject to the availability of adequate resources. As mentioned in paragraph 29 above, launching a rewrite without the provision of adequate resources would risk the quality of the work or drag the exercise beyond a reasonable timeframe.

	Activity	**Tentative Timing**
(a)	Finance Committee's approval	By end 2005
(b)	Formation of CBT and Engagement of Consultants	Q1 2006 – Mid 2006
(c)	Undertaking research and preparing DDIs and the White Bill	Mid 2006 – Mid 2009 (say 36 months)[7]
(d)	Consultation on the White Bill	Mid 2009 – End 2009
(e)	Revising the White Bill	Q1 2010 – Mid 2010
(f)	Introducing the New Companies Bill into the LegCo	Q3 2010

[7] Our previous estimate made in July 2004 was 24 months. Upon further consideration of the complexity of the exercise, and in the light of the latest thinking that public consultation would be conducted on certain major issues such as in the modernization of the capital maintenance provisions in Part II of the CO before the issue of a White Bill, we consider a period of 36 months to be a more pragmatic estimate of the time needed.

WAY FORWARD

34. Subject to Members' views on the possible framework and other related matters mentioned above, we would proceed with finalizing the staffing requirements proposal, and then consult Members before seeking the Finance Committee's necessary approval.

Financial Services and the Treasury Bureau
June 2005

Annex

Proposed Rewrite of the Companies Ordinance

Terms of Reference

1. Having regard to the need to :

   (a) ensure that company law in Hong Kong is as up-to-date as possible in order to enhance Hong Kong's competitiveness and attractiveness as a major international financial and business centre;

   (b) take account of company law reform and proposals for reform in comparable overseas jurisdictions, as well as local and international commercial, regulatory and legal conditions, standards and developments; and

   (c) identify and resolve problematic areas in company law which do not fall under (b).

   it is proposed to rewrite and restructure the Hong Kong Companies Ordinance ("the Ordinance") and its subsidiary legislation (excluding the winding-up related provisions under Parts IVA, Part V, Part VI and Part X of the Ordinance).

2. In rewriting and restructuring the Ordinance, specific attention should be paid to the following issues :

   (a) the recommendations in the Report of the Standing Committee on Company Law Reform ("SCCLR") on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance, other than those mentioned in (d), (f), (h), (i) and (j), which have not already been enacted into law;

   (b) the recommendations in the Consultation Papers on Proposals made in Phases I and II of the Corporate Governance Review by the SCCLR which have not already been enacted into law;

(c) the provisions of the United Kingdom Companies Bill produced consequent to the Company Law Review undertaken by the Company Law Review Steering Group and the United Kingdom Government's White Paper 'Modernizing Company Law';

(d) the re-categorization of companies in line with the SCCLR's recommendations as follows :

- private companies limited by shares (paragraph 5.79 and Recommendation 32)
- public companies limited by shares (both listed and unlisted) (paragraph 5.79 and Recommendation 34)
- companies limited by guarantee (paragraph 5.79 and Recommendation 36)
- unlimited companies (paragraph 5.79)

(e) the need to reframe and align the provisions of the Ordinance with the needs of private companies, which comprise the overwhelming majority of companies formed under the Ordinance and make appropriate differences between private and public companies;

(f) the provisions in the Ordinance which are applicable to public listed companies should be also made applicable to public unlisted companies (Recommendation 35);

(g) the Government's "Consultation Conclusions on Proposals to Enhance the Regulation of Listing" published in March 2004, which recommend the making of Rules under section 36 of the Securities and Futures Ordinance to give statutory effect to certain important Listing Rules, as well as the establishment of a new civil and criminal sanctioning regime for breaches of the new Rules;

(h) a separate part of the Ordinance should be dedicated to matters dealing with shareholders' rights and remedies (Recommendation 78);

(i) the overall organization of provisions regarding fundamental changes to a company, such as changing the scope of business or restructuring the share capital should be improved (Recommendation 101);

(j) the provisions of Parts VII and XIII regarding the administration of the Ordinance be consolidated and updated (Recommendation 142);

(k) the need to rationalize and simplify the statutory provisions wherever appropriate;

(l) the use of information technology and other means where appropriate to facilitate communications between companies, their shareholders, members of the public and the regulators;

(m) the use of schedules and subsidiary legislation to contain detailed requirements and the use of statutory instruments to facilitate regular updating of the law;

(n) the need to put in place appropriate transitional arrangements to minimize if not eliminate any problems resulting from the repeal of the existing Companies Ordinance and the enactment of the proposed Companies Ordinance; and

(o) any recommendations and issues which arise during the period of the rewrite.

3. Such other related matters as the Secretary for Financial Services and the Treasury may from time to time specify.