For Information
On 4 January 2010

Legislative Council
Panel on Financial Affairs

Companies Ordinance Rewrite

First Phase Consultation on the Draft Companies Bill

PURPOSE

We last briefed the Panel on Financial Affairs in February 2009 on the exercise to rewrite the Companies Ordinance ("CO") (Cap. 32). This paper briefs Members on the latest progress of the rewrite and the public consultation on the draft Companies Bill ("CB").

BACKGROUND

2. As set out in the Legislative Council ("LegCo") Paper No. CB(1)678/08-09(05), three public consultations were conducted in 2007 and 2008 to gauge views on some complex issues relating to the rewrite[1]. The paper also highlighted the key consultation conclusions for members' information.

3. The Administration has considered the feedback received from the three public consultations on various reform proposals. Taking into account the recommendations and the advice of the Standing Committee on Company Law Reform, the four dedicated Advisory Groups and the Joint Working Group between the Government and the Hong Kong Institute of Certified Public Accountants, we prepared a draft CB for further public consultation.

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[1] The three consultations conducted in 2007 and 2008 covered (i) accounting and auditing provisions; (ii) company names, directors' duties, corporate directorship and registration of charges; and (iii) share capital, capital maintenance regime and statutory amalgamation procedure.

THE CB CONSULTATION

4. In view of the length of the CB and the numerous issues involved, the consultation will be held in two phases. The first phase of the consultation which will last for three months, was launched on 17 December 2009. It covers 10 Parts or roughly half of the CB. The proposals contained in the first phase consultation focus more on corporate governance issues.

5. The reform proposals contained in the CB mainly seek to enhance corporate governance, ensure better regulations, facilitate business and modernise the law. The key legislative changes in the CB are summarised below.

Enhancing Corporate Governance

6. To enhance transparency and accountability of companies and their operations, we will -

(a) codify the standard of directors' duty of care, skill and diligence;

(b) restrict the appointment of corporate directors by requiring every company to have at least one director who is an individual for the purpose of improving the accountability and transparency of company operations and the enforceability of directors' obligations;

(c) improve disclosure of company information by requiring public companies and larger private companies to furnish a more analytical and forward-looking business review as part of the directors' report;

(d) strengthen auditors' rights to obtain information for performing their duties;

(e) enhance shareholders' engagement in the decision-making process and facilitate their participation through the use of information technology, e.g. introduction of rules to allow electronic communications between a company and its members and permit companies to hold general meetings at two or more places using audio-visual technology; and

(f) foster shareholder protection by strengthening rules on directors' self-dealing and connected transactions, providing for multiple derivative actions and extending the scope of the unfair prejudice remedy.

Ensuring Better Regulations

7. To ensure that the regulatory regime is effective and business-friendly, we will -

(a) introduce electronic incorporation and expedited company name approval process to enable companies to be incorporated within one day[2];

(b) empower the Registrar of Companies ("Registrar") to tackle "shadow companies"[3], including acting on court orders to direct such companies to change their names and substituting a company's name by its registration number if it fails to comply with the direction to change its name[4];

(c) enhance the Registrar's powers to help ensure that the information on the public register is accurate and up-to-date and to obtain necessary information for enforcement;

(d) streamline those regulations which are outdated and no longer serve any purpose (e.g. removing the share qualification requirement for directors);

(e) streamline and update the regime of registration of charges; and

(f) improve the enforcement regime by updating the provisions on company investigations, offences and penalties.

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[2] The proposal will be included in the Companies (Amendment) Bill 2010 which is planned to be introduced into the LegCo in early 2010.

[3] These 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 pose themselves as representatives of the owners of such trademarks and/or trade names or produce counterfeit products bearing such trademarks or trade names.

[4] See footnote 2.

Business Facilitation

8. To save compliance and business costs, particularly of small and medium enterprises, we will -

(a) allow small private and guarantee companies to take advantage of simplified accounting and reporting requirements so as to save their compliance and business costs;

(b) allow companies to dispense with AGMs by unanimous members' consent;

(c) introduce cheaper and less time-consuming court-free procedures for the reduction of share capital and intra-group amalgamation; and

(d) streamline the buy-back rules for all companies subject to a solvency test.

Modernising the Law

9. To modernise the law to meet the needs of modern business and to make it more readable, we will -

(a) abolish the par value regime and adopt a mandatory system of no-par for all companies with a share capital;

(b) remove the requirement for authorised capital;

(c) enable scripless holding and trading of shares and debentures to tie in with the scripless securities market reform (details of which were included in a separate public consultation exercise launched in late 2009);

(d) allow electronic communications between a company and its members; and

(e) modernise the language and re-draft the statutory provisions in a more logical and user-friendly order.

10. In addition to the above, we have highlighted the following issues for consultation -

(a) "Headcount Test"[5]

We would like to consult the public on whether to retain or abolish the "headcount test" for approving a members' scheme of arrangement or compromise for listed companies. A table setting out three options and the arguments for and against the options is at **Annex A**. Besides members' schemes of listed companies, we would also like to consult the public on whether similar options should be adopted for members' schemes of non-listed companies and creditors' schemes.

(b) Disclosure of Residential Address of Directors and Identification Numbers of Directors and Company Secretaries

We would like to consult the public on whether the residential addresses of directors and identification numbers of directors and company secretaries should continue to be disclosed on the public register. The issues are summaried in **Annex B**.

(c) Relevant Private Companies[6]

We would like to consult the public on whether private companies associated with a listed or public company should be subject to more stringent regulations similar to public companies for the purposes of the provisions on fair dealings by directors.

(d) Common Law Derivative Action

We would like to consult the public on whether the common law derivative action should be abolished once the CO has been extended to cover "multiple" derivative actions.[7]

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[5] The "headcount test" refers to the requirement under section 166 of the CO which provides that, for a compromise or arrangement between a company and its members or creditors ("a scheme") to be approved, a majority in number of those who cast votes in person or by proxy at the meeting must have voted in favour of the compromise or arrangement.

[6] A relevant private company is a private company that is a member of a group of companies which includes a listed company.

[7] "Multiple" derivative action allows a member of an associated company of the specified corporation (i.e. the specified corporation's subsidiary or holding company, or a subsidiary of that specified corporation's holding company) to take a statutory derivative action on behalf of the specified corporation.

WAY FORWARD

11. The Administration plans to launch the second phase of public consultation covering the remaining Parts of the CB in March 2010. Based on the comments received, we will refine the draft Bill and we aim to introduce the CB into the LegCo by the end of 2010. We will continue to keep this Panel informed of the progress of the rewrite exercise.

Financial Services and the Treasury Bureau
December 2009

Annex A

The "Headcount Test"

- We would like to consult the public on the possible options on whether to retain or abolish the "headcount test" for approving a scheme of arrangement or compromise before taking a final view on the issue.

- Three options for **members' schemes of listed companies** and the gist of the arguments are summarised below -

Option	For	Against
1. Retaining the headcount test	• Giving minority shareholders an opportunity to have a say in the future development and structure of a company under a scheme • Reducing the possibility of schemes being oppressive to, or ignoring the interests of, minority shareholders	• Inconsistent with the "one share one vote" principle • Placing significant veto power in the hands of small shareholders vis-à-vis their financial involvement in the company • Difficulties for beneficial owners to express their views in a headcount test as most of the shares in listed companies are held by nominees and custodians • Possible abuses involving share splitting
2. Retaining the headcount test but give the court discretion to dispense with the test	• Opportunity for the court to look into the 'true' headcount position and decide whether a scheme should be sanctioned, taking into account whether voting is unfairly influenced by certain activities (e.g. share splitting)	• Uncertain as to how the court would exercise its discretion, which may deter companies from proposing a members' scheme, given the time, cost and uncertainty involved

Option	For	Against
3. Abolishing the headcount test	• Consistent with the "one share, one vote" principle • For listed companies, minority shareholders' interest already safeguarded by the requirements under the Code on Takeovers and Mergers	• Concern over the adequacy of safeguards for minority shareholders' interest

- **Members' schemes of non-listed companies**:

  - same approach as members' schemes of listed companies if **Option 1 or 2** is to be adopted;

  - seek public views on whether the same approach should apply if **Option 3** (abolishing the headcount test) is adopted.

- **Creditors' schemes**:

  - same approach as members' schemes if **Option 1** is to be adopted;

  - seek public views on whether the same approach should apply if **Option 2** (retaining the headcount test but give the court discretion to dispense with the test) **or Option 3** (abolishing the headcount test) is adopted.

Annex B

Disclosure of Directors' Residential Addresses and Identification Numbers of Directors and Company Secretaries

A. Directors' Residential Addresses

- We are inclined to retain the requirement for directors' residential addresses to be made available for public inspection on the public register. It is in the public interest that regulatory and enforcement agencies, and also stakeholders like creditors and liquidators be able to contact directors easily through their residential addresses, especially when the company is being wound up or dissolved.

- We have considered two approaches for protection of personal data adopted in the UK and Australia. There are, however, practical problems described in **Table A** below. Nevertheless, we would like to hear the views of stakeholders before taking a final view on the matter

Table A: Practical Difficulties of the Australian and UK Approaches

Approach	Brief description	Practical difficulties
The Australian Model	• A director may apply for substituting his usual residential address on the public register by an alternative address, if including his residential address in the public register will put at risk the director or his family members' personal safety.	• Difficult for the Companies Registry ("CR") to assess claims of personal safety risks. • Possible abuses by those who do not have any genuine claim of safety risks. • Difficult to deal with existing records of directors' residential addresses embedded in documents filed with the CR over the past decades.
The UK Model **(UK Companies Act 2006)**	• Directors can provide service addresses for the public register • Directors' residential addresses are kept on a confidential register to which access is restricted to specified public authorities and credit reference agencies • Existing addresses already on the public record will be purged upon application.	• Difficult to maintain a confidential register for a single category of information and to ensure that it is kept up to date • Difficult to decide who should have access to the confidential register. If access is only confined to public authorities, some current legitimate data users like creditors and liquidators will be disadvantaged. However, if the net is cast wide, the CR would have difficulty in handling numerous requests for access to the confidential register. • Difficult and in some cases impracticable for addresses in the existing records to be purged

B. Identification Numbers of Directors and Company Secretaries

- We would like to consult on whether certain digits of the identification numbers of directors and company secretaries should be masked on the public register.

- The arguments for and against masking certain digits are summarised in **Table B below**.

Table B: Arguments For and Against Masking Certain Digits in Identification Numbers of Directors and Company Secretaries

Option	For	Against
Maintain the full disclosure of identification numbers	• Easy and unique identifier for individual directors • Minimize the risk for the dishonest to escape creditors or otherwise engage in fraudulent activity	• Privacy concerns
Masking certain digits of identification numbers	• Better protection of personal data	• Difficult to decide who should have access to the full information • Difficult to purge identification numbers already existing in numerous documents kept by the Registrar