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Bills Committee on Companies Bill

Background brief

Purpose

This paper provides background information on the Companies Bill and summarizes the main concerns and views expressed by members when the relevant proposals were discussed by the Panel on Financial Affairs (the FA Panel).

Background

2. The Companies Ordinance (Cap. 32) (CO) provides the legal framework which enables the business community to form and operate companies. It also sets out the parameters within which companies must operate, so as to safeguard the interests of those parties who have dealings with them, such as shareholders and creditors. The last major review of the CO took place in 1984. Since then, there have been amendments from time to time to keep the CO attuned to business needs.

3. The Standing Committee on Company Law Reform (SCCLR)[1] was formed in January 1984 to advise the Financial Secretary on necessary amendments to the CO. In February 2000, 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". Initiatives to implement the recommendations in the Report have been taken in the context of a series of amendment bills, most notably the Companies (Amendment) Bill 2003 and the Companies

[1] 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.

(Amendment) Bill 2004[2]. At the FA Panel meeting on 5 July 2004, the Administration advised that a complete rewrite and restructuring of CO was necessary to modernize Hong Kong's company law in light of the experiences of comparable common law jurisdictions and to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre.

4. In mid-2006, a dedicated Companies Bill Team, led by a Deputy Secretary (Financial Services) and comprising both policy and legal staff, was set up within the Financial Services and the Treasury Bureau to take forward the CO rewrite. In addition to a Joint Working Group between the Government and the Hong Kong Institute of Certified Public Accountants (JWG) which was tasked with reviewing the accounting and auditing provisions in the CO, four dedicated Advisory Groups[3] commenced work in phases since October 2006 to review and advise on specific areas of the CO. Recommendations made by the JWG and the Advisory Groups were then considered by the SCCLR, which is the principal body advising the Administration on matters relating to the CO rewrite. The Administration has also commissioned an external legal consultant to study and formulate proposals on certain complex areas of the CO, including share capital and debentures, distribution of profits and assets and registration of charges.

5. Given the extensive nature of the rewrite exercise, the Administration has adopted a phased approach by tackling the core company provisions which affect the daily operation of live companies in Hong Kong in Phase I (i.e. the current phase). The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver's Office, will be reviewed in Phase II of the rewrite exercise.[4]

6. The Administration conducted three public consultations in 2007 and 2008 to gauge views on the more complex subjects, including --

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[2] The Companies (Amendment) Bill 2003 was introduced into LegCo on 13 June 2003 and was passed on 9 July 2004. The Companies (Amendment) Bill 2004 was introduced into LegCo on 8 October 2004 and was passed on 29 June 2005.

[3] The Advisory Groups comprise members nominated by the relevant professional bodies (including Hong Kong Institute of Certified Public Accountants, Law Society of Hong Kong, Hong Kong Institute of Chartered Secretaries, Hong Kong Bar Association, Hong Kong Institute of Directors and Hong Kong Association of Banks) and business organizations (including the Hong Kong General Chamber of Commerce and the Chinese General Chamber of Commerce), company law academics, Standing Committee on Company Law Reform members and representatives from relevant Government departments/agencies.

[4] According to the Legislative Council Brief on the Companies Bill, when the Companies Bill is enacted, all the provisions in the existing CO, except those provisions to be tackled in the Phase II Rewrite and provisions on prospectuses, will be repealed. Upon completion of Phase II Rewrite, all the remaining provisions will be merged with the Companies Bill to become one piece of legislation again.

(a) accounting and auditing provisions;

(b) company names, directors' duties, corporate directorship and registration of charges; and

(c) share capital, capital maintenance regime and court-free merger procedure.

7. Taking into account the views received, the Administration prepared draft clauses of the CB for further public consultation in two phases, which were launched on 17 December 2009 and 7 May 2010 respectively. During the two phases of consultation, 164 and 57 submissions were received respectively.

The Bill

8. The Bill, consisting of 21 parts and 10 schedules, was introduced into the Legislative Council on 26 January 2011. The objects of the Bill are to reform and modernize Hong Kong company law, to restate part of the enactments relating to companies, to make other provision relating to companies, and to provide for incidental and connected matters. According to the Administration, the proposed measures under the Bill aim at achieving four main purposes, namely (a) enhancing corporate governance, (b) ensuring better regulation, (c) facilitating business operation, and (d) modernizing the law. The more notable of the proposed measures for achieving these aims are summarized in paragraphs 8 to 13 of the report of the Legal Service Division of the Legislative Council Secretariat on the Bill (LC Paper No. LS26/10-11).

Major views and concerns of FA Panel members

9. The Administration briefed the Panel on Financial Affairs on the proposals to rewrite the Companies Ordinance (Cap. 32) (CO) at a number of meetings since October 2006 and the recent discussions were held on 4 January 2010, 7 June 2010 and 1 November 2010. During the earlier discussions on the broad legislative framework and major topical issues, Panel members were mainly concerned about the timeframe, the objectives and the approach of the rewrite exercise. Members shared the view that the CO rewrite exercise should leverage on the experiences of other common law jurisdictions in company law reforms or reviews, while the unique

circumstances of Hong Kong should be fully considered; and that the rewrite exercise should aim at keeping the CO up-to-date to meet present-day circumstances and to improve Hong Kong's business environment.

10. During recent discussions at the FA Panel meetings on 4 January 2010, 7 June 2010 and 1 November 2011, Panel members expressed concern on matters including the guiding principles for the rewrite exercise, the extent the reform proposals could enhance corporate governance of companies, and how to strike a reasonable balance between the concern of imposing onerous requirements/restrictions on company activities and the need to provide adequate protection for small investors. The issues raised are summarized in the following paragraphs.

Objectives of and guiding principles for the rewrite exercise

11. Panel members considered that the following principles should be adopted for the rewrite exercise --

(a) the CO should be in tandem with the corresponding legislation in other international business and financial centres;

(b) the CO should be able to cater for the needs of the future development of Hong Kong as a business and financial centre; and

(c) where changes to the CO would be conducive to attaining the objectives, the Administration should actively pursue such changes notwithstanding that technical difficulties in implementation were envisaged.

12. Some members highlighted the need to strengthen the protection of investors' interests, and pointed out that many investors had asked for enhancement of the disclosure requirements for listed companies and the legal backing for investors to seek remedies for damages arising from the misconduct of company directors. A member considered that the Administration should not pursue the objective of business facilitation at the expense of the need to enhance corporate governance of companies.

Corporate governance

13. On members' concern as to how the rewrite exercise would enhance protection for minority shareholders' interests, the Administration advised that this was one of the major objectives of the rewrite exercise, and relevant

enhancement proposals were included in the draft Companies Bill. For example, the directors' general duties of care would be codified. Shareholders' engagement in the decision-making process and their participation in the company's business would be enhanced, as the threshold requirement for shareholders to demand a poll at a company's general meeting would be reduced from 10% to 5% of the total voting rights. Rules on directors' self-dealing and connected transactions would also be strengthened.

14. Panel members were concerned as to how the Companies Bill would codify the standard of directors' duty of care, skill and diligence and the sanctions to be imposed. According to the Administration, only general principles were stated in the draft provisions. Such principles were based on the reasonable expectations of the public and shareholders on the performance of directors of listed and private companies. Similar to the existing arrangement under the common law, any company director who had breached the provisions, if enacted, would be liable to civil litigation actions.

15. A member expressed concern about the governance of charitable organizations, and pointed out that many charitable organizations were incorporated as guarantee companies and some operated as a trust fund. The Administration explained that under the current proposals, guarantee companies would be required to comply with more stringent disclosure requirements regarding their financial situation and submit their financial reports to the Companies Registry for scrutiny. The Law Reform Commission was also conducting a review of the legislation relevant to the regulation of charitable organizations.

Headcount test

16. Some members expressed concern about the implications on the protection for minority shareholders' interests if the headcount test was abolished. A member expressed the view that despite its possible loopholes/shortcomings, the headcount test served the function of safeguarding minority shareholders' interests. Panel members urged the Administration to work with the Securities and Futures Commission in reviewing the headcount test arrangements and measures for prevention of vote splitting, making reference to relevant arrangements in other major financial centres.

Disclosure of information on public register

17. Panel members expressed diverse views on whether the disclosure of residential addresses of directors and identification numbers of directors and company secretaries on the public register should continue. Some members opined that the Administration should follow the practices in the United Kingdom to discontinue the disclosure arrangement so that personal data privacy could be protected. However, a member opined that the disclosure arrangement should continue in order to protect public interest. The member disagreed with the proposal to remove the directors' residential addresses currently on the public register, and pointed out that the records might be related to other documentation, and could be useful in certain circumstances. The member also expressed concern that if only the service address and some digits of the Hong Kong Identity Card numbers of company directors were shown on the Companies Registry's public register, as proposed by the Administration, there might be identification problem as several persons might have the same name.

Restrictions on financial assistance for acquisition of shares

18. On the proposal to abolish restrictions on private companies giving financial assistance to a party for the purpose of acquiring its own shares, a member expressed concern that the proposal would facilitate takeovers that were in favour of substantial shareholders but were not in the interest of minority shareholders.

19. The Administration advised that some jurisdictions such as the United Kingdom had opted for the abolition of financial assistance restrictions on private companies and retained the restrictions on public companies. One major consideration was that despite the abolition of the restrictions, other means were available to protect the interests of minority shareholders. There were provisions in the CO based on which minority shareholders could initiate litigation to safeguard their interests. Improvements to the provisions in the CB such as codification of directors' duty of care, skills and diligence were proposed as well. The Administration was open to comments on whether the restrictions should be retained.

Directors' remuneration report

20. On the Administration's proposal of not introducing any requirement in the CO for listed or unlisted companies to prepare separate directors' remuneration reports, some members were concerned whether the proposal would be a setback and sought clarification on the Administration's stance on

the requirement for listed companies to prepare separate directors' remuneration reports and whether it would seek to incorporate this requirement into the Listing Rules and/or the SFO.

21. The Administration advised that it had yet to propose amendments to the Listing Rules or SFO to include the requirement. At present, all listed companies in Hong Kong were already required to disclose in their financial statements detailed information concerning the remuneration of individual directors and past directors under the Listing Rules. No significant non-compliance with this requirement had been identified by the Stock Exchange of Hong Kong. Since the Listing Rules were non-statutory in nature, the Administration was open to further discussions on whether the requirement should be codified into statutory rules. Taking into account that most listed companies were incorporated outside Hong Kong, any initiative to legislate the requirement should be better pursued through amendments to the SFO rather than the CO.

Relevant papers

22. The relevant papers are available at the following link --

http://www.legco.gov.hk/yr11-12/english/panels/fa/papers/fa_c1.htm

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