

Bills Committee on Companies Bill

Overall Policies of the Companies Ordinance Rewrite

Purpose

This paper briefs Members on the overall policies of the Companies Ordinance (“CO”) rewrite exercise. It also seeks Members’ views on the revised approach to deal with the consequential amendments.

The Rewrite

2. The CO was last substantially reviewed and amended in 1984. Over the past two decades or so, the Standing Committee on Company Law Reform (“SCCLR”) and the Administration have conducted several major reviews of the CO with a view to modernising it and upgrading our corporate governance regime, resulting in recommendations to amend various sections of the CO. Some of those recommendations have been implemented by means of several amendment Bills. However, the piecemeal approach to amending the CO has its limitations. A comprehensive rewrite of the CO is needed to modernise our company law to further enhance Hong Kong’s status as a major international business and financial centre. In addition, other major common law jurisdictions such as the United Kingdom (“UK”), Australia, and Singapore have reformed their company laws over the past two decades. Rewriting our CO allows us to leverage from company law reforms in these jurisdictions and enhance our competitiveness. With the support of the Legislative Council (“LegCo”), we launched a comprehensive rewrite of the CO (“the Rewrite”) in mid-2006.

3. In view of the extensive nature of the Rewrite, we have adopted a phased approach by tackling the provisions which affect the operation of live companies in Hong Kong in Phase I of the Rewrite (i.e. the current phase). The winding-up and insolvency-related provisions will be reviewed in Phase II. The provisions on prospectuses in the CO will be

dealt with in a separate review by the Securities and Futures Commission in due course. When the Companies Bill (“the Bill”) is enacted¹, all the provisions in the existing CO, except those provisions to be tackled in Phase II Rewrite and provisions on prospectuses, will be repealed. As part of Phase II Rewrite, we plan to merge all the winding-up related provisions remaining in Cap 32 with the new CO².

4. While Phase II Rewrite will be implemented in the next legislative term, we have started an initial scoping study to determine the key areas relating to winding-up which need to be updated under Phase II. We are also identifying issues which will require consultation with stakeholders and/or the public. Our preliminary target is to introduce a Bill under the Phase II Rewrite into LegCo for scrutiny in the legislative year of 2013-14, around the same time when the Bill, if passed by LegCo, may come into operation.

Objectives

5. The reforms in the Bill aim to achieve four main purposes, as set out in paragraphs 6 to 9 below.

(I) Enhancing Corporate Governance

6. The SCCLR conducted an overall review of corporate governance in Hong Kong from 2000 to 2004. While many recommendations have already been implemented, some other recommendations that would require further legislative changes are taken forward in the Rewrite. The major improvements are –

- (a) clarifying in statute the standard of directors’ duty of care, skill and diligence with a view to clarifying the duty under the law and providing guidance to directors (clause 456);
- (b) limiting the effect of the appointment of corporate directors

¹ It will be given a new Chapter number when enacted. The existing CO will still be Cap. 32 but will be retitled as Companies (Winding Up and Miscellaneous Provisions) Ordinance.

² Provisions relating to prospectuses will be moved to the Securities and Futures Ordinance in a separate exercise.

by requiring every private company to have at least one natural person as director³ so as to enhance transparency and accountability (clause 448);

- (c) providing greater transparency and improving disclosure of company information, such as new requirements for public companies, large private companies and large guarantee companies to prepare a more analytical and forward-looking business review as part of the directors' report (clause 380 and Schedule 5); and
- (d) fostering shareholder protection, such as introducing more effective rules to deal with directors' conflicts of interests (Part 11).

(II) Ensuring Better Regulation

7. To ensure that the regulatory regime is effective and business-friendly, the Bill will introduce a number of improvements to the registration of charges scheme (Part 8) and other improvements to ensure accuracy of information on the public register (mainly Part 2). We will also strengthen the enforcement regime by giving the Registrar of Companies ("the Registrar") the power to obtain documents, records and information for enforcement of specified provisions in the Bill (Division 4 of Part 19) and the power to compound specified offences under the Bill⁴ (clause 887 and Schedule 7).

(III) Business Facilitation

8. We believe the Bill should facilitate business operation and cater for the needs of SMEs. The key ones are –

- (a) facilitating SMEs to take advantage of simplified accounting

³ Since 1985, all public companies and private companies which are members of a group of companies of which a listed company is a member have been prohibited from appointing a body corporate as their director.

⁴ In other words, the Registrar may offer a person in default an opportunity to rectify the default by paying the Registrar a compounding fee, where appropriate, and by remedying the breach constituting the offence. If that person accepts and complies with the terms of the notice, no prosecution will be initiated against him for that offence.

and reporting requirements and thus, reducing their compliance and business costs (Part 9 and Schedule 3);

- (b) dispensing with the requirement to hold Annual General Meetings subject to unanimous members' consent (clauses 602 and 603); and
- (c) simplifying some of the procedural requirements prescribed in the CO, such as introducing a court-free procedure for reduction of capital based on the solvency test (Subdivision 2 of Division 3 of Part 5) and a court-free statutory amalgamation procedure for wholly-owned intra-group companies (Division 3 of Part 13).

(IV) Modernising the Law

9. We seek to modernise the company law to meet the needs of the business community and public expectation. We will retire antiquated concepts that no longer serve any useful purposes such as par value⁵ of shares (clause 130). To facilitate regular updating of the law in the future, we use schedules or subsidiary legislation, where appropriate, to contain detailed operational requirements.⁶ We also modernise the language and re-arrange the sequence of some of the provisions in a more logical and user-friendly order so as to make the Bill more readable and comprehensible. We use reader aids such as notes, where appropriate, to assist the readers to understand the relevant provisions. A note on the modernisation of drafting is at **Annex**.

Consequential Amendments

10. For the bulk of consequential amendments to the current CO and other enactments arising from the Bill, we originally planned to submit a

⁵ Par value is the minimum price at which shares can generally be issued. Currently, companies incorporated in Hong Kong and having a share capital are required to have a par value ascribed to their shares.

⁶ An example on the use of Schedule is Schedule 2 "Content of Incorporation Form" (read together clause 63) which may be amended by the Financial Secretary by notice published in the Gazette and subject to negative vetting by LegCo. An example on the use of subsidiary legislation is Clause 650 which empowers the Financial Secretary to make regulations on the requirements to disclose company name and related information, subject to negative vetting by the LegCo.

separate Bill later this year to deal with them. While this arrangement is new to Hong Kong, it is a common practice in other common law jurisdictions, such as Australia and UK.

11. However, with the benefit of subsequent advice of the LegCo Secretariat, subject to Bills Committee Members' views, we now recommend an alternative approach: namely, to deal with the consequential amendments through Committee Stage Amendments. This ensures that the consequential amendments will be scrutinised by the same Bills Committee and is a more conventional arrangement. We therefore recommend adopting this approach.

Advice Sought

12. Members are invited to note the contents of the paper and provide their views.

**Financial Services and the Treasury Bureau
Companies Registry
7 March 2011**

Modernisation of Drafting

One of the purposes of the Companies Ordinance (“CO”) Rewrite exercise is to modernise the company law. Among the measures directed to this purpose is improving the structure of the parts and sections of the CO and enhancing the clarity of the provisions so as to make the law more accessible to users. It also includes modernising and re-arranging the sequence of some of the provisions in a more logical and user-friendly order so as to make the provisions more readable and comprehensible.

2. The Companies Bill (“the Bill”) has been drafted with these goals in mind and in accordance with current law drafting practices, including some recently introduced initiatives.¹ From the law drafting perspective, the overall objective was to improve the comprehensibility of the law in both the English and Chinese texts and to make the Bill more user-friendly in general. The main drafting improvements are –

- (a) Structure of provisions – Structural improvements have been made in an effort to reduce complexity and aid comprehension. The main structural improvement is the revision of the Part headings and the grouping of sections under new Division and Subdivision headings.² Another major improvement is the division of provisions into a greater number of sections and the grouping of provisions within a Part in a more logical order. For example, all general interpretation provisions have been placed at the beginning of the Part³ and exceptions to general rules have been placed together within the same Division or

¹ An information paper on the drafting of legislation was prepared by the Law Drafting Division, Department of Justice, for a meeting of the Panel on Administration of Justice and Legal Services of the Legislative Council held on 15 December 2009 (LC Paper No. CB(2)512/09-10(04)).

² e.g., Part XI of the CO (which relates to non-Hong Kong companies) consists of 19 long sections without Divisions or Subdivisions. On the other hand, Part 16 of the Bill (which corresponds to Part XI) consists of 32 shorter sections which are divided into 9 Divisions.

³ The CO is not consistent. For example, the general interpretation provisions in Part XI of the CO are placed at the end of the Part.

Subdivision.⁴ Related but widely-separated provisions have also been placed closer together.⁵

- (b) Length of provisions – The sections of the Bill are generally shorter in length than those in the CO, with fewer and less complicated subsections.
- (c) Cross-references – There are far fewer cross-references. Unnecessary cross-references have been eliminated wherever possible.
- (d) Section headings – The section headings have generally been made more informative (e.g., exceptions to general rules are clearly identified as exceptions) and efforts have been made to make them more concise.
- (e) Terminology – The wording used in the CO has been modernised and simplified and inconsistencies removed. Redundant or archaic terminology has been eliminated to the extent practicable.⁶ The wording has also been updated to match current drafting practices.⁷ In addition, to assist comprehension, new definitions have been created⁸ and more informative expressions have been employed.⁹
- (f) Gender neutral language – Gender neutral language has been used throughout the English version of the Bill.
- (g) Notes – Notes have been added to certain provisions as a readers' aid.

⁴ See, e.g., Subdivision 3 of Division 5 of Part 5 and Subdivision 3 of Division 3 of Part 11.

⁵ e.g., the penalties for the offences are set out in the relevant sections or Parts rather than in a Schedule at the end of the Bill as in the case of Schedule 12 to the CO.

⁶ e.g., in the English text, the word “said” in phrases such as “the said person” and Latin expressions such as “prima facie” and “bona fide” have been eliminated.

⁷ e.g., in the English text, “must” is used to impose an obligation rather than “shall” as in CO, and the offence provisions use the modern formula “commits an offence and is liable” rather than the now obsolete “shall be guilty of an offence and liable”.

⁸ e.g., the definition of “qualified private company” in clause 5.

⁹ e.g., “responsible person”, which is used as a general term in the Bill rather than “officer who is in default” in the CO; and “non-tendering member” (see clause 694) which is used in place of “relevant shareholder” in the CO (see section 1 of Schedule 13).

Use of Notes

3. One of the measures to modernize the drafting is the use of notes. The notes included in the Bill¹⁰ are intended to serve as aids to comprehension for the general reader. Although they are not included in every Bill, the practice of including notes to provisions (in one form or another) has a long history in Hong Kong. In most cases in the Bill, the notes draw the reader's attention to other relevant provisions of the Bill. For example, the note to clause 130(2) reminds readers that Division 2 of Part 4 of Schedule 10 contains transitional provisions relating to clause 130. Other notes provide the reader with factual information which is available elsewhere, such as the commencement dates of previous amendments to the CO.¹¹

4. In addition, there are a few notes, notably the notes to clauses 155(1), 175(2), 183(2), 205(1) and 207(3) and section 27(2) of Schedule 10 to the Bill, which provide examples of the situations in which the relevant section will apply or illustrate how it will work in practice. For instance, clause 155(1) states that the section applies if a company's articles give a member of the company a right to purchase shares on the occurrence of an event that constitutes *a transmission* of the right to the shares by operation of law, etc. The term "transmission" is a legal term which many readers may find difficult to understand. The note gives an example of a transmission to better assist their understanding, i.e., a "transmission of the right to shares on the death or bankruptcy of a shareholder".

¹⁰ See the notes to the definition of article in clause 2(1) and the notes to clauses 130(2), 133, 155(1), 162(3), 165(3), 166(4), 169(1), 175(2), 183(2), the definition of distributable profits in clause 198(1), and clauses 205(1), 207(3), 218(1), 225(1), 231(3), 237, 253(2), 261(1), 266(2), 272, 279(5), 280(2), 281(4), 285(1), 346(4), 420(1), 534(1) and 710(4). Notes are also included in sections 15, 27(2), 34(2), 39(1), 45 and 46 of Schedule 10 to the Bill.

¹¹ See, e.g., the note to section 15 of Schedule 10 to the Bill.

5. Members may wish to note the following extract from the information paper on the drafting of legislation submitted by the Department of Justice for the meeting of the Panel on Administration of Justice and Legal Services on 15 December 2009¹² –

“20. Reader aids – The use, where appropriate, of reader aids such as notes and examples will be encouraged. An ordinance-specific interpretation provision to clarify their status will be included in contexts in which clarification is required, while the question of a provision of general application is being considered.”

6. Clause 2(6) of the Bill states that a note is provided for information only and has no legislative effect. In other words, the notes are not intended to have a legal effect in the same way as a section of an Ordinance. Clause 2(6) is similar to section 2(5) of the existing Arbitration Ordinance (Cap. 341) (which is being replaced by a new Ordinance) and section 3(4) of the Legislative Council Ordinance (Cap. 542).

7. The wording used in Clause 2(6) and in the provisions noted above, in particular the words “has no legislative effect”, derive from the wording used in section 18(3) of the Interpretation and General Clauses Ordinance (Cap. 1), which provides that “[a] marginal note or section heading to any provision of any Ordinance *shall not have any legislative effect* and shall not in any way vary, limit or extend the interpretation of any Ordinance”. The rule in section 18(3) has been interpreted generally¹³ as meaning that a court is not entitled to have regard to the marginal notes or section headings for the purpose of ascertaining the meaning of an Ordinance. In other words, marginal notes and section headings are not to be used to resolve any purported ambiguities in the text. Clause 2(6) of the Bill is intended to achieve the same effect but the wording is expressed in more modern terms. By stating that the

¹² LC Paper No. CB(2)512/09-10(04).

¹³ See, e.g., *AG v. Asia Electronics Co. Ltd.* [1974] HKCA 62, CACC334/1974 (HC) (unreported) at para. 3; *Re An Application by the Official Solicitor (No. 1)* [1983] HKCFI 290, [1983] 2 HKC 259, HCMP2644/1983 (HC) (Full Bench) at para. 23; *Harknett v. Venning (Permanent Magistrate)* [1983] HKCFI 135, [1983] 2 HKC 348, HCMP1345/1983 (HC) (Full Bench) at para. 4; and *Inglis v. Loh Lai Kuen Eda (Permanent Magistrate)* [2005] HKCA 212, [2005] 3 HKC 115, CACV341/2004 (CA) at para. 14.

notes “are provided for information only”, the legislative purpose of the notes is made abundantly clear: they are provided only for the information of the reader and serve no other purpose. They are not intended to have any other effect, whether legal or otherwise.

**Law Drafting Division
Department of Justice
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