
# COMPANIES BILL 2011
## Law Society's Submissions

### Introduction

**The Law Society supports the policy initiatives in the Bill as the existing Companies Ordinance has not received a thorough overhaul since 1984. We make the following submissions on the Companies Bill 2011:**

## Part 1: Preliminary Provisions

**1. Clause 2: Definition and interpretation: "Company"**:

In the First Phase Consultation, we made the following observations

"The definition of "company" in s.1.2 is tautologous. It says "a company means a company …" This drafting leaves some scope for improvement.

In some cases the definition gives rise to conceptual problems. Under s.1.2 the word '*company*' means '*a company formed and registered under the Ordinance or an existing company*'. On a literal reading of this provision, the possibility of a company incorporated outside Hong Kong should have been excluded. However, this is obviously not the case in the definition for "body corporate" which includes a '*company*' incorporated outside Hong Kong.

Similarly, Part XI uses the word '*company*' for non-Hong Kong companies and thereby introduces a possibility that 'company' could include both Hong Kong and non- Hong Kong incorporated companies."

1.2 **We note our observations have not been incorporated in the Bill and so the definition of 'company' remains problematic.**

1.3 **We recommend part (a) of the definition should be changed to "a company formed or registered under this Ordinance".**

## 2. Definition of "Public":

2.1 In the First Phase Consultation, we made the following observations:

> "Ever since the 2004 enactment of the Securities and Futures Ordinance, the '*public*' for most securities law-related purposes has been expressly restricted to the Hong Kong public under Schedule 1 to the SFO. There was further clarification in 2004 with the enactment of Schedule 17 to the CO where, in paragraph 1 of Part 4, persons outside Hong Kong are specifically carved out from the definition of an '*offer*' for the purposes of the prospectus regime.
>
> However, without a general definition of the '*public*' in the CO, some uncertainty remains especially in areas outside the Schedule 17 context. We would urge the Government to consider inserting a general definition of the '*public*', or clarifying the concept in each relevant provision."

2.2 **We recommend a definition of "public" be included in the Bill to address the concerns in paragraph 3.1 above.**

## 3. Clause 4(5): Certified translation

3.1 In the First Phase Consultation, we suggested "adding a new subsection (f) for other person or entity specified by the Registrar to certify a translator's competence in order to allow maximum flexibility in adding new categories of acceptable persons going forward."

3.2 The Administration declined to accept our suggestion and indicated there was no need to add a new subsection as Clause 1.4(6) provides that the Secretary may amend subsection (3) by order published in the Gazette as the Clause as drafted, provided sufficient flexibility.

3.3 **We note our suggestion was not taken up in the Bill. The Registrar of Companies should have authority to extend the list of persons with power to certify a translator's competence without involving the Secretary. The Registrar has such authority in relation to translations prepared outside of Hong Kong and there is *no rationale* for drawing such a distinction.**

## 4. Clause 13(1)(a) Shares held in a "fiduciary capacity"

4.1 In the First Phase Consultation, we noted "…clause 13 states that for the purposes of defining a '*holding company*' and a '*subsidiary*', powers exercised or shares held in a 'fiduciary capacity' will be disregarded. Presumably the purpose is to exclude the likes of agents and trustees but there are a number of conceptual and practical difficulties with this approach."

4.2 The Administration stated in its Consultation Conclusions that "Companies with common trustees holding shares should not be regarded as related companies merely on the basis of there being common trustees".

4.3 **Clause 13(3) excludes any share held by a body corporate or its subsidiary if the ordinary business of the body corporate or subsidiary includes the lending of money and the share is held or exercisable by way of security only. We recommend a review of the current draft in order to clarify that if the share is held by such body corporate when a security is enforced, such holding shall not be disregarded for the purpose of this Division.**

## 5. Clause 33: Documents containing unnecessary materials

5.1 In the First Phase Consultation, we expressed concerns on the appropriateness of the Registrar having the authority to decline registration of documents where he considers it to be improperly delivered or unsatisfactory, which includes documents containing unnecessary material. We submitted that for documents containing unnecessary material, there should be a "severance" provision to enable the Registrar to treat as duly filed the portions of the document which contain necessary and correct material.

**We reiterate our earlier submission that documents containing unnecessary materials should not be a ground for rejection by the Registrar and a "severance" provision should be added.**

## 6. Clause 34: Time limit on the Registrar to respond

6.1 In the First Phase Consultation, we noted:

"There is no time limit on when the Registrar needs to revert as to whether a document is acceptable for registration. This could lead to uncertainty and raises concern especially where it is important to determine the exact date (and time) of registration of any document."

6.2 The Administration maintained it was unnecessary to include any time limit. The Registrar is under an obligation to exercise the statutory power within a reasonable period of time. The Companies Registry's performance pledge states registration of general documents will be completed within 6 working days.

6.3 **We reiterate our earlier submission that a time limit to revert should be specified in the legislation.**

## 7. Clause 36(2): Registrar gives reason for refusal

7.1 In the First Phase Consultation, we suggested:

> "For clarity, there should be a provision which states that the Registrar must provide reasons for its decision to refuse the registration of a document."

7.2 The Administration agreed the Registrar should provide reasons.

7.3 **We note that, as drafted, Clause 36(2) of the Bill does not oblige the Registrar to provide reasons. We recommend the clause be re-drafted to make it obligatory for the Registrar to state reasons for refusal.**

## 8. Clause 47: Register may withhold protected information

8.1 As drafted the discretion given to the Registrar in this clause appears to be absolute on whether to decline to withhold protected information. We suggest this clause and subsections should be re-drafted so that an application, if made in accordance with the regulations prescribed under Clause 47(8) will be granted and if the Registrar declines to withhold protected information, such decision should be supported by reasons.

8.2 Under Clause 47(5), if a protected address is made available to the public for inspection on the ground that communication with the director has failed, protection will be lost for a minimum of 5 years. The 5-year period seems unduly long.

8.3 **We recommend a shorter period of 2 or 3 years as being more reasonable.**

## 9. Clause 50(1) Registrar may make protected address available for inspection

9.1 The Registrar may make a protected address available for inspection if communication sent by the Register to the director remains unanswered within a specified period.

9.2 **We recommend this subsection be clarified that an acknowledgement of receipt of the communication by the director without substantive reply would constitute an answer.**

## 10. Clause 50(4) Notice sent to the director

10.1 **We recommend the Registrar should send Notices <u>to both</u> the director's protected <u>and</u> correspondence address rather than 'either one'.**

## Part 3: Company Formation and Registration

### 11. Clause 104(3) Registrar may direct company to change name

11.1 **We note the proposal in the consultation draft contained a proposal that a company may appeal against the Registrar's direction to the court. However, the appellate forum has now been changed to the Administrative Appeal Tribunal. In our view, a compulsory change of company name may have a public interest element and therefore the court would be the most suitable forum.**

## Part 4: Share Capital

### 12. Clause 159(5) Publication requirements

12.1 We recommend that HKEx must publish the notice of intention to issue a replacement share certificate in a dedicated place on its website. The method of publication in this clause is outdated. Flexibility should be allowed for publication on the HKEx website.

### 13. Clause 161(1)(a) Public notice of issue of new certificate

13.1 **We recommend that any listed company which issues a new certificate must publish notice of that fact in the Gazette. Clause 159(2)(b)(ii), provides an exemption that such notices must be published in the Gazette if the value of the shares is below $200,000. A similar exemption should apply here.**

## Part 5: Transactions in relation to Share Capital

### 14. Clause 201(1)Solvency statement

14.1 In the Second Phase Consultation, we suggested the following amendment:

"A solvency statement in relation to a transaction is a statement that each of the directors making it has formed ~~the~~ *a reasonable* opinion that the company satisfies the solvency test in relation to the transaction."

14.2 **We recommend amending Clause 201(1) to include the word "reasonable". This corresponds to Clause 202 under which a director is criminally liable if he does not have reasonable ground to form the opinion.**

**15. Clause 219(1), Registration of return if no court application: Note 1**

15.1 In the Second Phase Consultation, we suggested the following amendment:

"The special resolution and the reduction of share capital take effect *on the day* when the return under section 5.20 or 5.21 in relation to the reduction is registered by the Registrar."

15.2 **We note this has not been included in the Bill and recommend reconsideration of our suggestion.**

**16. Clause 220(1), Registration of return if application to court: Note 1**

16.1 In the Second Phase Consultation, we suggested the following amendment:

"The special resolution and the reduction of share capital take effect *on the day* when the return under section 5.20 or 5.21 in relation to the reduction is registered by the Registrar."

16.2 **We note this has not been included in the Bill and recommend reconsideration of our suggestion.**

**17. Clause 270(1) Definition of "financial assistance":**

17.1 In the Second Phase Consultation, we suggested that given that under the streamlined whitewash procedures, the "cashflow" solvency test is adopted for private companies, the definition of "financial assistance" should be modified from "any other financial assistance given by a company if … (ii) the company has no net assets" to "any other financial assistance given by a company if … (ii) the net liabilities of the company are increased to a material extent by the giving of the assistance".

17.2 We also suggested the following amendment: "by way of a loan or any other agreement *or arrangement (whether enforceable or unenforceable, and whether made on the person's own account or with any other person)* under which any of the obligations of the person giving the assistance are to be fulfilled at a time when in accordance with the agreement *or arrangement* any obligation of another party to the agreement *or arrangement* remains unfulfilled; or".

17.3 **We note that our previous suggestions have not been taken up and recommend reconsideration of the same.**

## 18. Clause 279 Financial assistance not exceeding 5% of shareholders funds: Proposed "whitewash" authorizations

18.1 Irrespective of the apparent concession of the principle that there should not be any blanket exemption from the prohibition in respect of financial assistance given by private companies, we make the following observations on two of the proposed "whitewash" authorizations for the giving of financial assistance by all classes of company in the draft Companies Bill (as derived to some extent from the New Zealand Companies Act).

Clause 279 states:

*(1) A company may give financial assistance for the purpose of the acquisition of a share in the company or its holding company or for the purpose of reducing or discharging a liability incurred for such an acquisition if-*

*(a) the directors resolve, before the assistance is given, that-*

*(i) the company should give the assistance;*

*(ii) giving the assistance is in the best interests of the company; and*

*(iii) the terms and conditions under which the assistance is to be given are fair and reasonable to the company;*

*(b) on the same day that the directors pass the resolution, the directors who vote in favour of it make a solvency statement that complies with Division 2 in relation to the giving of the assistance;*

*(c) the aggregate amount of the assistance and any other financial assistance given under this section that has not been repaid does not exceed 5% of the aggregate amount received by the company in respect of the issue of shares and the reserves of the company (as that aggregate amount is disclosed in the most recent audited financial statements of the company);*

*(d) the company receives fair value in connection with the giving of the assistance; and*

*(e) the assistance is given not more than 12 months after the day on which the solvency statement is made under paragraph (b).*

*(2) The resolution of the directors under subsection (1)(a) must set out in full the grounds for their conclusions as to the matters referred to in subsection (1)(a)(i), (ii) and (iii).*

*(3) A reference in subsection (1)(c) to any other financial assistance given under this section that has not been repaid includes the amount of any financial assistance given in the form of a guarantee or security for which the company remains liable at the time the financial assistance in question is given.*

*(4) Within 15 days after giving financial assistance under this section, the company must send to each member of the company a copy of the solvency statement made under subsection (1)(b) and a notice containing the following information-*

*(a) the class and number of shares in respect of which the assistance was given;*

*(b) the consideration paid or payable for those shares;*
*(c) the name of the person receiving the assistance and, if a different person, the name of the beneficial owner of those shares;*
*(d) the nature, the terms and, if quantifiable, the amount of the assistance.*

*(5) If the company contravenes subsection (4), the company, and every responsible person of the company, commit an offence, and each is liable to a fine at level 3 and, in the case of a continuing offence, to a further fine of $300 for each day during which the offence continues.*

**18.2 Clause 279(1)(c) Financial assistance not exceeding 5% of shareholders funds**

18.1 We submit that the form of *de minimis* "whitewash", as presently drafted, is not yet a sufficiently comprehensive basis for the legal assessment of the permissibility of this "whitewash" for common circumstances in which financial assistance questions arise.

18.2 The *de minimis* "whitewash" requires an assessment of the "*aggregate amount*" of the financial assistance in comparison with "*the aggregate amount received by the company in respect of the issue of shares and the reserves of the company (as that aggregate amount is disclosed in the most recent audited financial statements of the company)*", i.e. a financial metric. In the absence of further legislative provision as to the meaning of "*amount*" in particular contexts, practical difficulties could arise e.g.:

(i) is the "*amount*" of a security synonymous with the "*amount*" of the obligation secured, regardless of the book and/or market valuation of that security?. If not, how does one measure the "aggregate amount" of the security provided? Will it be by reference to the book value or the market value of the security?
(ii) ? If a guarantee is given, there will be a contingent liability but the liability will not be reflected in the balance sheet unless the loan is not repaid. The giving of a guarantee will have neutral effect on a company's net assets. Is it the legislative intent to quantify the guarantee by reference to the guaranteed amount, regardless of whether the guarantee is subsequently enforced?
(iii) will an uncapped indemnity automatically fall outside the permissibility of "whitewash" by virtue of being for an "*amount*" which is unquantified. Again, it is not clear how section 279(1)(c) intends to quantify an all monies guarantee or other forms of indemnities (e.g. indemnity against breach of warranties etc). If it is intended that the *de minimus* whitewash procedure is to be of greater practical use, more legislative guidance on how to quantify the "aggregate value" of the financial assistance is needed.

18.3 The *de minimis* "whitewash" also anticipates a requirement for "*fair value*" to be given in connection with the financial assistance in order for the "whitewash" to be permissible and it appears from the residual drafting of the provisions that this extends beyond a purely fiduciary assessment. No legislative guidance has yet been given as to the intended content of the requirement.

18.4 The practical need for further guidance as to the content of both the financial metric and "*fair value*" requirement is particularly acute given the absence of explicitly prescribed third party supervision of the assessment (e.g. by way of auditors' report). As financial assistance remains a criminal offence on the part of the relevant company and its responsible officers, professional advice in the absence of further clarification as to the meaning of the statutory provisions will inevitably be cautious, which might limit the application of the *de minimis* "whitewash" to a greater degree than intended.
There are in any event likely to be practical difficulties in determining the "fair value" of the financial assistance. If a company offers financial assistance in the form of a guarantee, is a [x]% guarantee fee considered to be a fair value? There may not be readily available market transactions for a board to ascertain whether a [x]% guarantee fee is a "fair" value. Clear legislative guidance on "fair value" is required. Given that Clause 279 is meant to provide a *de minimus* exception, it would seem appropriate to dispense with the requirement of receiving "fair value" and to rely on the safeguards already embodied in Clause 279(1)(a) that the financial assistance has to be in the best interests of the company and that the terms of the assistance are fair and reasonable.

18.5 **Note to Clause 279**
If the giving of financial assistance by a company would result in a reduction in the company's share capital, the company must also comply with Division 3.

## 19. Clause 281: Financial assistance by ordinary resolution

*(1) A company may give financial assistance for the purpose of the acquisition of a share in the company or its holding company or for the purpose of reducing or discharging a liability incurred for such an acquisition if-*

*(a) the directors resolve, before the assistance is given, that-*
*(i) the company should give the assistance;*
*(ii) giving the assistance is in the best interests of the company and is of benefit to those members of the company not receiving the assistance; and*
*(iii) the terms and conditions under which the assistance is to be given are fair and reasonable to the company and to those members not receiving the assistance;*

*(b) on the same day that the directors pass the resolution, the directors who vote in favour of it make a solvency statement that complies with Division 2 in relation to the giving of the assistance;*

*(c) the company sends to each member of the company a copy of the solvency statement made under paragraph (b) and a notice containing the following information-*

*(i) the nature and terms of the assistance and the name of the person to whom it will be given;*

*(ii) if it will be given to a nominee for another person, the name of that other person;*

*(iii) the text of the resolution of the directors;*

*(iv) any further information and explanation that would be necessary for a reasonable member to understand the nature of the assistance and the implications of giving it for the company and the members;*

*(d) the giving of the assistance is approved by resolution of the company before the assistance is given; and*

*(e) the assistance is given-*

*(i) not less than 28 days after the day on which the resolution is passed under paragraph (d); and*

*(ii) not more than 12 months after the day on which the solvency statement is made under paragraph (b).*

*(2) The notice and copy of the solvency statement must be sent to each member under subsection (1)(c) at least 14 days before the day on which the resolution under subsection (1)(d) is proposed and may accompany notice of the meeting at which the resolution will be proposed.*

*(3) Despite subsection (1)(e)(i), if an application is made to the Court under section 282 in relation to the giving of financial assistance under this section, the financial assistance must not be given until the application is finally determined, unless the Court orders otherwise.*

*(4) The resolution of the directors under subsection (1)(a) must set out in full the grounds for their conclusions as to the matters referred to in subsection (1)(a)(i), (ii) and (iii).*

19.1 As drafted the provision would technically permit a "whitewash" in respect of financial assistance (e.g. by offeree security or guarantee for the acquisition debt) for a leveraged bid for a listed offeree which could be made conditional on acceptances giving bare majority control, with the offeree still maintaining its listing post-offer. Financial assistance "whitewash" under this provision would not technically require the de-listing of the listed offeree. The dangers to minority shareholders in a company after a successful leveraged takeover have already been identified by the Hong Kong Standing Committee on Company Law Reform as a driving force behind the financial assistance provisions.

19.2 Given that under the current regime, a Hong Kong listed company is prohibited in offering financial assistance, in order for a leveraged bid of the listed company to be made, a listed company would have to go through the privatization and de-listing procedures which requires, among others, affirmative votes of 75% or more. As mentioned in our previous submission, the financial assistance rules are useful both in preserving protection to creditors and minority shareholders. Under the proposed whitewash procedures, a controlling shareholder of a listed company with more than 50% voting control may take advantage of Clause 281 to facilitate a leveraged bid of shares of the listed company to the detriment of the minorities. Access to court for a restraining order pursuant to Clause 282 is not a satisfactory safeguard for public shareholders whose stake in the listed company may be too small to justify taking the matter to court. To offer better protection to public shareholders, we consider that the whitewash procedure should require the sanction of a "special resolution". This would have the advantage of creating a more liberal regulatory framework for corporate transactions and at the same time preserving protection for the minority shareholders.

19.3 The board materials must be sent to each member at least "14 days before the [ordinary] resolution … is proposed". Date of proposal of an ordinary resolution presumably is the date of the shareholders meeting. For clarity, the 14 days should count by reference to date of the shareholders meeting.

19.4 **Note to Clause 281**

If the giving of financial assistance by a company would result in a reduction in the company's share capital, the company must also comply with Division 3.

## Part 6: Distribution of Profits and Assets

### 20. Clause 294 Listed company may only make certain distribution

20.1 **Clause 294(1)**

**We suggest this clause be amended by adding the following words to the beginning: "Subject to section 293,"to make clear that a listed company has to satisfy the requirements in both clauses 293 and 294 in order to make a valid distribution.**

### 21. Clause 301(6) Interim financial statement specified for purposes of section 298

21.1 In the Second Phase Consultation, we suggested the following amendment: "A copy of the financial statement and of the accompanying directors' declaration must have been delivered to the Registrar *for registration*. If the …"

21.2 **We note our suggestion was not taken up in the Bill and recommend this clause be reviewed as the legislation should clarify whether interim financial statements are to be delivered for the purpose of registration.**

### 22. Clause 302(7) Initial financial statement specified for purposes of section 298

22.1 In the Second Phase Consultation, we suggested the following amendment: "A copy of the financial statement, of the accompanying directors' declaration, of the auditor's report of the financial statement, and of any written statement under subsection (9), must have been delivered to the Registrar *for registration*. If the …"

22.2 **We note our suggestion was not taken up in the Bill and recommend this clause be reviewed as the legislation should clarify whether interim financial statements are to be delivered for the purpose of registration.**

## Part 7: Debentures

### 23. Clause 308(3) Power to close register of debenture holders

23.1 In the Second Phase Consultation, we suggested the following amendment: "*Subject to Subsection (4)*, the period of 30 days mentioned in subsection …"

23.2 **We suggest the word "Subject to subsection (4)" at the beginning of the clause to clarify the period of 30 days may be extended by a majority of the debenture holders, but in any event not exceeding a further period of 30 days, i.e. no register can be closed for more than a period of 60 days in any year.**

## Part 15 Dissolution by Striking off or Deregistration

### 24. Clause 740(4) Dissolved company's property

24.1 **We suggest the phrase "properly available" in section 740(4) be amended to "available" to avoid giving an impression that there is a criteria for property being "properly available".**

### 25. Clause 761(6) Effect of restoration on bona vacantia property or right

25.1 **We note the cross-reference in the sub-section should be to section 749 instead of section 750.**

## Part 16 Non-Hong Kong Companies

### 26. Clause 786

30.1 We submit the extension of the Part 16 offence provisions to "*agents*" of non-Hong Kong companies appears to frustrate the objective of equal treatment as it may subject the non-Hong Kong companies to potentially more onerous obligations than those of Hong Kong companies.

**The Law Society of Hong Kong**
**Company and Financial Law Committee**
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