

## Bills Committee on Companies Bill

### Follow-up actions to be taken by the Administration for the meeting on 29 March 2011

#### Purpose

This paper sets out the Administration's response to the following issues raised by Members at the Bills Committee meeting on 29 March 2011:-

- (a) Part 1: The formulation of "responsible person" (Clause 3) (see paragraphs 2 to 23 below);
- (b) Part 3: Allowing a company to appeal to the Administrative Appeals Board (paragraphs 24 to 29); and
- (c) Part 16: Authorized representatives of non-Hong Kong companies (paragraphs 30 to 35).

#### Administration's response

##### Part 1

##### *The formulation of "responsible person" (Clause 3)*

#### **(I) Background on "responsible person"**

2. Clause 3 of the Companies Bill (CB) sets out the new formulation of "responsible person" as an officer or shadow director of the company or non-Hong Kong company who "*authorizes or permits, participates in or fails to take all reasonable steps to prevent, the contravention or failure*"<sup>1</sup>. An officer includes a director, manager or company secretary<sup>2</sup>.

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<sup>1</sup> Clause 3(2) and (3) reads as follows:-

- (2) For the purposes of the provision, a person is a responsible person of a company or non-Hong Kong company if the person—
  - (a) is an officer or shadow director of the company or non-Hong Kong company; and
  - (b) authorizes or permits, participates in, or fails to take all reasonable steps to prevent, the contravention or failure.

3. The predecessor of “responsible person” in the Companies Ordinance (CO) is “officer who is in default” under section 351(2), which is defined as “*any officer of the company...who knowingly and wilfully authorizes or permits the default, refusal or contravention...*”

4. The new formulation of “responsible person” is based upon the UK’s “officer in default” model under section 1121(3) of the UK Companies Act 2006 (UKCA 2006), which defines that an officer is “*in default...if he authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention.*”

## **(II) Prosecution threshold and legal liabilities**

### **(A) “Officer who is in default” under the CO**

5. The current formulation of “officer who is in default” renders it very difficult to successfully prosecute directors or officers in default. The evidential burden for the prosecution to prove “*knowingly and wilfully*” is high and they have to show that the officer indeed has knowledge and wilful intention. For example, in a Hong Kong case concerning failing to keep books of account contrary to section 274(1) of the CO<sup>3</sup>, the Court accepted that to establish “*knowingly and wilfully*”, there had to be an irresistible inference from the evidence that the officer knew that proper books of account were not being kept, and in the exercise of his will, authorized or permitted this failure.

6. This high evidential burden means a high prosecution threshold and that successful prosecution of officers in default is difficult and unlikely, even if the officers are reckless or have deliberately turned a blind eye to their obligations or duties, or simply claimed that they did

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(3) For the purposes of the provision, a person is also a responsible person of a company or non-Hong Kong company if—

- (a) the person is an officer or shadow director of a body corporate that is an officer or shadow director of the company or non-Hong Kong company;
- (b) the body corporate authorizes or permits, participates in, or fails to take all reasonable steps to prevent, the contravention or failure; and
- (c) the person authorizes or permits, participates in, or fails to take all reasonable steps to prevent, the contravention or failure.

<sup>2</sup> Clause 2 of the CB.

<sup>3</sup> *HKSAR v Tang Tze Hoo Anthony* HCMA 775/2008.

not know of their duties in situations where they clearly ought to have known.

7. The Standing Committee on Company Law Reform and a dedicated Advisory Group under its auspices agreed that the evidential burden of the current formulation of “officer who is in default” is too high, calling for reform following the model under the UKCA 2006.

**(B) “Responsible person” under the CB**

8. The new formulation of “responsible person” aims at lowering the prosecution threshold with a view to enhancing corporate governance. It will ensure that officers of a company will not be able to deliberately turn a blind eye to their obligations, duties and responsibilities under the CB so as to avoid liability.

9. It must be, however, reiterated that the formulation of “responsible person” does not impose strict liability, and should be construed adopting the presumption that it is incumbent upon the prosecution to prove *mens rea* in relation to each element of an offence. Thus, where a provision prohibits a particular act, the provision should be read as requiring proof of the officer’s voluntariness and intention or recklessness in the performance of that act<sup>4</sup>.

“Authorizes or permits, participates in”

10. In the new formulation of “responsible person”, the terms “*authorizes or permits, participates in*” all require knowledge. The *mens rea* requirement can be satisfied by proof of actual knowledge, wilful blindness or recklessness, but not negligence. The formulation will therefore cover officers who ought to have known of their obligations, if they had acted recklessly, not caring whether contravention takes place or not.

11. For an officer who “*authorizes or permits*” an act, knowledge of what is being allowed or authorized is required. A person cannot be said to allow a particular activity, far less “*authorize*” it unless he is aware of the activity being carried on<sup>5</sup>. This will not cover negligence<sup>6</sup>.

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<sup>4</sup> Brennan J in *He Kaw Teh v The Queen* [1984-1985]157 CLR 523 at 568-571 and confirmed by Mr Justice Ribeiro P.J. in *Hin Lin Yee & Anr v HKSAR* [2010] 2 HKLRD 826.

<sup>5</sup> See Archbold Hong Kong 2011 at paragraph 16-54.

<sup>6</sup> Knowledge is not imputed by mere negligence but by something more than negligence, something

12. The word “*permits*” standing alone, according to case law, requires proof of actual knowledge by the defendant or “wilful blindness” in the sense of actual suspicion on his part<sup>7</sup>. If a person is suspicious of certain matters but deliberately avoids finding out the truth, then that might potentially also come under the notion of recklessness<sup>8</sup>.

13. For “*participates in*”, mere presence alone is insufficient, there must be a participation in the act<sup>9</sup>. Thus, even if a man is present whilst an offence is committed, he takes no part in it and does not act in concert with those who commit it; he does not become an aider and abettor merely because he does not try to prevent the offence or fails to apprehend the offender<sup>10</sup>, unless he is under a duty to act<sup>11</sup>. Again, negligence will not be covered.

14. In summary, removal of the word “wilfully” enables situations of wilful blindness or recklessness to be caught. Removal of the word “knowingly” does not mean that knowledge is not required, as this requirement in the *mens rea* will still apply according to the case law.

#### “Fails to take all reasonable steps”

15. The phrase “*fails to take all reasonable steps*” is not new in the CO context and other statutes, e.g. section 155A(5)<sup>12</sup> of the CO,

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which one can describe as recklessness or shutting one’s eyes to the obvious : *Gray’s Haulage Co Ltd v Arnold* [1966] 1 WLR 534 at 536-537.

<sup>7</sup> In *R v Cheng Ching Kwong* [1986] 1 HKC 109, Silke J.A. adopted the test set out by Lord Parker C.J. in *Gray’s Haulage Co. Ltd. v Arnold* [1966] 1 WLR 534 as the test for “permitting”, as follows: “...actual knowledge or knowledge of circumstances which fixed them, as it were with a suspicion or knowledge of circumstances so that it could be said that they had shut their eyes to the obvious, or had allowed something to go on not caring whether an offence was committed or not.”

<sup>8</sup> The test for “recklessness” is now accepted as being that set out in *Sin Kam Wah v HKSAR* [2005] HKEC 792, as follows, “it has to be shown that the defendant’s state of mind was culpable in that he acted recklessly in respect of the circumstances if he was aware of a risk which did or would exist, or in respect of a result if he was aware of a risk that it would occur, and it was, in circumstances known to him, unreasonable to take the risk. Conversely a defendant could not be regarded as culpable so as to be convicted of the offence if, due to his age or personal characteristics he genuinely did not appreciate or foresee the risks involved in his actions.”

<sup>9</sup> *R v Borthwick* (1779)1 Doug 207.

<sup>10</sup> *Hale 439; Fost 350; Du Cros v Lambourne* [1907] 1 KB 40.

<sup>11</sup> *Rubie v Faulkner* [1940] 1 KB 571.

<sup>12</sup> Section 155A of the CO: Approval of company required for disposal by directors of company’s fixed assets.

sections 3<sup>13</sup>, 4<sup>14</sup>, 7<sup>15</sup> and 15<sup>16</sup> of the Companies (Revision of Accounts and Reports) Regulations (Cap. 32N), and sections 95<sup>17</sup>, 96<sup>18</sup>, and 97<sup>19</sup> of the Mandatory Provident Fund Schemes (General) Regulations (Cap. 485A), etc.<sup>20</sup>

16. In the CB context, the phrase “*fails to take all reasonable steps to prevent the contravention or failure*” will cover those negligent omissions where either nothing at all was done to prevent a breach, or what was done was so inadequate that it could not have been reasonably expected that a breach would have been prevented by such steps. The crux will be whether or not the officer has acted reasonably. In terms of the *actus reus* (i.e. guilty act) of the offence, what has to be proved is a failure to match up to an objective standard, as well as a causal link between that failure and the prohibited result. In considering whether an officer has failed to take all reasonable steps to prevent a breach in a criminal context, the Court would take into account all relevant facts and circumstances. It does not matter that the steps to prevent the breach are not successful as long as they are reasonable. In certain circumstances, no step at all or very scanty steps could reasonably be taken; in such a case there is no failure to take reasonable steps<sup>21</sup>.

17. For example, in the case of *R v Lo Hon Yiu Henry*<sup>22</sup>, the appellant had been convicted of failing to take all reasonable steps to lay both the balance sheet and the profit and loss account before the company

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<sup>13</sup> Section 3 of Cap. 32N: Matters to be included in revised accounts.

<sup>14</sup> Section 4 of Cap. 32N: Matters to be included in revised directors' reports.

<sup>15</sup> Section 7 of Cap. 32N: Approval and signature of revised directors' reports.

<sup>16</sup> Section 15 of Cap. 32N: Laying of revised accounts or directors' reports before general meetings.

<sup>17</sup> Section 95 of Cap. 485A: Approved trustee to ensure financial statements are audited.

<sup>18</sup> Section 96 of Cap. 485A: Approved trustee to appoint auditor to audit scheme account.

<sup>19</sup> Section 97 of Cap. 485A: Functions of Authority where approved trustee fails to appoint auditor under section 96.

<sup>20</sup> There are also some provisions in the current CO where directors would be criminally liable for failing to take all reasonable steps to secure compliance (namely, sections 121, 122, 123, 124, 129F, 141D, 161A, 161BA and 161BB) with a statutory defence providing that if the director can prove that he had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that those requirements were complied with and was in a position to discharge that duty, and there will be no imprisonment imposed unless the offence was committed wilfully.

<sup>21</sup> *Warwick University v De Graff* [1975] 1 WLR 1126 at 1131.

<sup>22</sup> [1985] 1 HKC 183.

in general meeting in breach of section 122 of CO. The Court held that statutory non-compliance is not an offence, if reasonable, *albeit* unsuccessful, steps were taken to ensure compliance, and it was a question of fact whether or not what had been done amounted to all reasonable steps<sup>23</sup>.

18. *Mens rea* or a mental element must also be established, as the offence is not one of strict liability. If the omissions were deliberate, or if, in the knowledge that there was a possibility that contraventions may be committed, the person fails to take all reasonable steps to prevent such contraventions, the required mental element would generally be satisfied<sup>24</sup>. In assessing whether or not an officer alleged to be in default as a “responsible person” had failed to take all reasonable steps to prevent a contravention, the Court would inevitably consider, *inter alia*, whether or not the officer knew that he was under a duty or obligation to take or ensure the taking of all reasonable steps to prevent the contravention, as well as the knowledge of the officer of other relevant circumstances leading to and/or surrounding the occurrence of the contravention.

19. Given the above, it is envisaged that in the CB, officers would generally not be regarded as having failed to take all reasonable steps to prevent a contravention if they have compliance systems in place and/ or have delegated to appropriate personnel responsibilities for compliance with the provisions of the CB. For example, where the company has failed to file certain documents in breach of the legislation, we do not envisage that a non-executive director would be liable if the filing responsibilities were delegated to particular personnel and there has generally been monitoring of the delegate’s performance which has not indicated any problems. If a particular director or company secretary was delegated responsibility for filing but failed to take all reasonable steps to ensure compliance, then there could be liability on the part of that person.

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<sup>23</sup> Likewise, in *R v Yung Leonora* [1994] 3 HKC 141, the appellant had been convicted of failing to take all reasonable steps to keep proper books and accounts in breach of section 121 of CO. Again, the Court considered all of the facts and circumstances in deciding whether or not in fact what had been done amounted to reasonable steps.

<sup>24</sup> See *Vehicle Inspectorate v Nuttall* [1999] 3 All ER 833 per Lord Nicholls and Lord Steyn.

### **(III) Treatment of companies providing professional services**

20. Under the CO and the CB, companies in the same category are subject to the same obligations, regardless of their nature of business. In considering officers' liabilities for default, the Court will have regard to all of the facts and circumstances of each case, e.g. the officer's knowledge, before determination (see paragraph 17 above). Officers of all companies cannot abdicate their duties entirely in relation to corporate compliance, but whether they will be liable in particular cases can depend on their position and responsibilities in the company concerned.

### **(IV) UK Companies Act 2006**

21. The new formulation of "responsible person" is modelled on section 1121(3) of the UKCA 2006 which defines that "*an officer is in default...if he authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention*". During the UK company law reform, the Company Law Review Steering Group (CLRSG) considered that restriction of liability to those officers who "*knowingly and wilfully authorise or permit the default, refusal or contravention...*" in section 730(5) of the UKCA 1985 (equivalent to section 351(2) of the CO) might be too narrow. The CLRSG, therefore, recommended revising the definition of "officer in default" along the lines of the formulation eventually adopted in the UKCA 2006<sup>25</sup>.

22. When the UK Companies Bill (later enacted as Companies Act 2006) was debated in the House of Lords, some Members of Parliament had requested reinstating the words "knowingly and wilfully" in the definition of "officer in default". In response to the request, Lord Sainsbury, then Parliamentary Under-Secretary of State, Department of Trade and Industry advised against such, with the following explanation:-

*"The clause as drafted does not contain the words "knowingly and wilfully" because we were concerned this might exclude liability for reckless officers, or officers who deliberately close their eyes to their responsibilities. It might also mean that officers would not be liable if they successfully claimed that they did not know that their act or omission constituted*

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<sup>25</sup> CLRSG, *Modern Company Law for a Competitive Economy – Final Report (Volume 1)* (2001), paragraphs 15.39, 15.40 and 15.54.

*an offence. These are prospects which risk undermining the effective enforcement of provisions throughout the Bill and the Companies Acts. I understand the concern underlying the amendment; namely, an innocent officer could in theory permit a contravention by being ignorant of its commission. But I would emphasise that an officer would be liable under this provision only if his ignorance constituted an act of tacit authorisation, permission or failure to take all reasonable steps. I would say that any officer who is so deliberately or recklessly ignorant of his responsibilities as to be liable in this way cannot be described as “innocent”, and it is right that he should be liable under this clause”.*<sup>26</sup>

23. There are as yet no decided cases on the formulation for “officer in default” under the UKCA 2006.

### Part 3

#### *Allowing a company to appeal to the Administrative Appeals Board*

##### **(I) Functions and composition of AAB**

24. The AAB is an independent statutory body established under the Administrative Appeals Board Ordinance (Cap. 442) in July 1994. It hears and determines appeals against a decision made in respect of an appellant and which falls under its jurisdiction. The Board’s jurisdiction extends over certain administrative decisions made under the Ordinances or Regulations set out in the Schedule to the AAB Ordinance, such as matters on security personnel permits and business registration fees.

25. At present, AAB consists of a Chairman and five Deputy Chairmen, who are all legal professionals, as well as 48 panel members. An appeal board for the purpose of hearing an appeal comprises the Chairman or a Deputy Chairman together with two panel members.

26. The Chairman, Deputy Chairmen and the Members of AAB are appointed by the Chief Executive. The current membership of AAB is at **Annex**.

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<sup>26</sup> 680 HL Debs, cols 367-368, 30 March 2006.

## (II) Reasons for allowing companies to appeal to AAB

27. Currently, under section 22A of the CO, where the Registrar of Companies (the Registrar) is satisfied that the name of a local company gives so misleading an indication of the nature of its activities as to be likely to do harm to the public, or that the name constitute a criminal offence, or that it is offensive or otherwise contrary to the public interest, the Registrar may direct the company to change its name. Under section 337B of the CO, where the Registrar is satisfied that the name of a non-Hong Kong company gives so misleading an indication of the nature of its activities in Hong Kong as to be likely to do harm to the public, she may issue a notice to the company to the effect that the company cannot carry on business under that name two months after the notice is served. Under both provisions, the company concerned may apply to the court to set aside the direction or notice.

28. In the Bills Committee on the Companies (Amendment) Bill 2010 and Business Registration (Amendment) Bill 2010, a Member expressed the view that given the cost and time involved in court proceedings, the Administration should examine the feasibility of having appeals against the Registrar's directions under section 22A of the CO to change names heard by AAB instead of by the court. We advised that it would take time to work out the amendments to the AAB Ordinance and proposed that the matter be considered in the CO Rewrite exercise instead. The Bills Committee agreed to our proposed arrangement<sup>27</sup>.

29. We consider it desirable to allow the companies to appeal against the Registrar's directions (under section 22A of the CO) to AAB instead of to the Court. In view of the similar nature of the right of appeal by a non-Hong Kong company against the Registrar's notice under section 337B, we consider that corresponding change should also be made. The relevant changes have been incorporated in **clauses 104 and 772** of the CB. Consequential amendments to the Schedule to the AAB Ordinance are made under **section 92 of Schedule 9** to the CB.

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<sup>27</sup> See Report of the Bills Committee on Companies (Amendment) Bill 2010 and Business Registration (Amendment) Bill 2010, LC Paper No. CB(1)2329/09-10, paragraph 26.

## Part 16

### *Authorized representative for non-Hong Kong companies*

#### **(I) Services and duties that authorized representatives of non-Hong Kong companies generally provide and perform**

30. The term “authorized representative” is defined in Part 16 of the Bill as meaning a person that is authorized to accept on the company’s behalf service of any process or notice required to be served on the company. By definition, the main duty of an authorized representative under the Bill is to accept service on behalf of a company.

31. Pursuant to clause 783(1) of the Bill, an authorized representative is required to notify the Registrar within 14 days of the date of dissolution if a registered non-Hong Kong company is dissolved.

32. Apart from the above statutory duties under the Bill, authorized representatives are commonly found to be entrusted with the duty to file returns on behalf of registered non-Hong Kong companies. But such other duties are not imposed by the Bill. Under both the existing CO and the Bill, authorized representatives only have very limited responsibilities.

#### **(II) Legal liabilities of authorized representatives under the Bill and for actions taken on behalf of non-Hong Kong companies in Hong Kong**

33. Under clause 783(3), an authorized representative would be held liable if he fails to notify the Registrar of dissolution of the registered non-Hong Kong company within the specified period.

#### ***Liabilities of an agent under the Bill***

34. Under the offence provisions in Part 16, every agent who authorizes or permits the contravention of the specified provisions, as listed hereunder, commits an offence. The term “agent” for the purpose of Part 16 is not defined in the Bill. An agent, in its ordinary meaning, means a person who acts on behalf of another. An authorized representative is an agent of a company in accepting service. He would also be an agent of a company for other business only if so appointed.

35. An agent would be held liable under the Bill if he authorizes or permits the following contraventions:

- (a) failing to apply for registration as a registered non-Hong Kong company (Clause 764(6));
- (b) failing to notify the Registrar of Companies of a change of the name or translation of the name of the company (Clause 766(10))
- (c) a registered non-Hong Kong company carrying on business in Hong Kong under a name in respect of which a notice (that the name is the same or too like an existing name or the name is misleading as to the nature of the company's activities as to be likely to cause harm to the public) had been served under Clause 768(1) after the expiration of two months from the date of service (Clause 769(2));
- (d) failing to deliver a return of another person as an authorized representative in the event the former authorized representative ceases to be a representative (Clause 774(4));
- (e) failing to deliver annual return for registration (Clause 776(3));
- (f) failing to deliver accounts for registration (Clause 777(3));
- (g) failing to deliver for registration a warning statement that the accounts will be revised (Clause 778(5));
- (h) failing to deliver return for registration in case of change of particulars relating to the charter, statutes, memorandum, directors, company secretary, authorized representative, address of the principal place of business and the registered office of a company (Clause 779(5));
- (i) failing to state the company's name and place of incorporation as required (Clause 780(7) and (8)).
- (j) failing to notify the Registrar of commencement of liquidation and the particulars of appointment of liquidator or provisional liquidator and any change (Clause 781(7));

- (k) failing to notify the Registrar of cessation of place of business in Hong Kong (Clause 782(3));
- (l) a non-Hong Kong company having a place of business in Hong Kong when it is no longer a registered non-Kong Kong company after having been struck off the Companies Register (Clause 786(5)).

36. As for legal liabilities of agent or authorized representatives for actions taken on behalf of non-Hong Kong companies otherwise than under the Bill, they would be governed by other legislation and the common law as the case may be.

**Financial Services and the Treasury Bureau**  
**Companies Registry**  
**11 April 2011**

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