Bills Committee on Companies Bill

Follow-up actions for the meeting held on 11 October 2011

Purpose

This paper sets out the Administration's response to the issues raised by Members at the Bills Committee meeting on 11 October 2011 relating to Part 2 and Part 3 of the Companies Bill ("CB"). Our response to Members' concerns on the offences in the CB will be provided in a separate paper.

Administration's response

Part 2 Registrar of Companies and Companies Register

Clause 43 – Registrar must make Companies Register available for public inspection

2. Clause 43 originates from section 305(1A) of the Companies Ordinance ("CO") which was introduced in 2004 on the suggestion of the Privacy Commissioner to expressly state the legitimate purposes of public inspection. Similar provisions are found in section 136 of the Securities and Futures Ordinance (Cap 571).

3. The application of clause 43(1)(a) is limited to circumstances for the purposes of ascertaining whether the member of the public is "dealing with" those persons set out in clause 43(1)(a). Notwithstanding clause 43(1)(a), clause 43(1)(b) provides that any member of the public may conduct a search on the Companies Register to ascertain the particulars of the company, its directors or other officers, or its former directors, or the particulars of the mortgagee, provisional liquidator or liquidator etc. The formulation of "dealing with" under clause 43(1)(a) is not a requirement under subparagraph (b).

Division 7 – Materials in Companies Register unavailable for public inspection

4. As explained in LegCo Paper No CB(1)1879/10-11(03) and at previous meetings, our proposal to withhold from public inspection directors' residential addresses and individuals' full identification numbers was introduced into the CB in view of the rising concerns over the protection of personal privacy and information as reflected in the views of the majority of respondents during the consultation held between December 2009 to March 2010. The current proposal regarding directors' residential addresses is in line with the position in the United Kingdom ("UK") which received more support than the Australian approach (i.e. a director allowed to substitute his usual residential address by a service address if his or his family members' personal safety is at risk). The Australian approach was thought to offer less effective protection to directors, as directors may only apply for substitution of residential addresses when there is a risk to their or their family's personal safety and such risk has to be established to the satisfaction of the Registrar of Companies ("Registrar") before the residential address may be substituted.

5. The protected residential addresses and identification numbers would continue to be made available to entities prescribed by regulations to be made by the Financial Secretary under clause 53 upon application to the Registrar. Taking into account Members' views, we tentatively propose that the prescribed entities should include –

(a) specified public authorities (e.g. Labour Department, Police, etc.) and regulators;

(b) liquidators and provisional liquidators;

(c) members of the relevant companies; and

(d) the individual to whom the information relates and any person authorized in writing by the individual to obtain the information.

6. We believe that the scope of prescribed entities would cover most persons who have a legitimate need to access the protected information. For creditors of the relevant companies, they may continue to serve any legal process on the registered office addresses of the companies and enforce their claims against the companies as at present. In the cases where access to the

directors is required, service may be effected on the correspondence addresses of directors which appear on the register. Where the correspondence addresses are ineffective for service, they may seek disclosure of the protected information by applying for an order of the Court under clause 54 or refer the matter to the Registrar who may take appropriate actions under clause 50 to verify the effectiveness of the correspondence addresses and make the protected addresses available for inspection if the correspondence addresses are found to be ineffective.

7. If members of the company will be included in the list of prescribed entities as proposed, we will delete the reference to "member" in clause 54(3)(a). The conditions for disclosure under clause 54(1)(a)(i) relate to the service of documents, which is narrower than clause 50(1)(a), which relates to communications sent by the Registrar to the director. We consider that it is inappropriate for an order to be granted by the Court under clause 54 merely because communications by any person (other than the Registrar) to the director have been unanswered. Any "communication" could be in any form and there may be legitimate reasons for not answering it (e.g. the "communication" is a junk mail or the director is out of town, etc.).

Clause 58 - Immunity

8. The position of outside contractors authorized by the Registrar to supply information or provide the relevant service or facility (i.e. protected persons under clause 58(5)) is dealt with in clause 58(2) and (3). These provide generally that if an error or omission was made in good faith and in the ordinary course of the discharge of duties (clause 58(2) and (3)), or as a result of any defect or breakdown in the service / facility / equipment (clause 58(3)), no personal liability will be imposed on the outside contractor.

9. Outside contractors falling within the meaning in clause 58(5) as protected persons have the immunity given by clause 58(2) and (3). Otherwise, outside contractors do not have immunity in relation to any negligence on their part.

Part 3 Company Formation and Related Matters, and Re-registration of Company

Clause 98 – Registrar's licence to dispense with "Limited" etc.

10. As at 30 September 2011, there are 773 existing companies issued with the licence to dispense with the use of the word "limited" in its name ("section 21 companies"). The number of such licenses issued since 2009 is set out in the table below. These companies are formed for promoting art, science, religion, charity or any other useful object, and intend to apply its profits, if any, or other income in promoting its objects, and to prohibit the payment of any dividend to its members. Following the case of *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531, the definition of "charity" is very wide and includes bodies formed to relieve poverty, for the advancement of education, advancement of religion and for other purposes beneficial to the community. Hence, most of the section 21 companies are in essence "charities" under law and, as a matter of fact, the vast majority of section 21 companies have been granted tax exemption under the Inland Revenue Ordinance (Cap 112) as charities. Clause 98 is just restating the existing law.

Year	**No. of licences issued**
2009	28
2010	27
2011 (up to end of September)	10
Total	**65**

Clause 112 – Transaction or act binds company despite limitation in articles etc.
Clause 113 – Transaction or act involving directors or their associates is voidable
Clause 114 – Section 112 not to apply to certain cases

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11. An analysis of the provisions is at **Annex**.

Financial Services and the Treasury Bureau
Companies Registry
28 October 2011

Annex

Note on Clauses 112 to 114 of the Companies Bill

Background

The Companies (Amendment) Ordinance 1997[1] abolished the application of the ultra vires doctrine in relation to corporate capacity[2] and also partially abolished the doctrine of constructive notice[3]. The result of the amendments is that any objects clause or restrictions contained in the Memorandum and Articles of a company would not restrict the legal capacity of the company, and a company has all the rights and powers and privileges of a natural person.

2. Our position is largely the same as the position in the United Kingdom ("UK")[4]. To supplement the relevant provision, the UK has enacted provisions to make it clear that a third party dealing with a company in good faith need not concern itself with whether or not the power of the directors to bind the company or to authorize others to bind the company is limited by the constitution of the company[5], except where the party to the transaction is an insider or a connected person[6] or where the company is a charity[7].

Companies Bill ("CB")

3. In the CB, we introduce similar provisions in clauses 112 to 114. These provisions are in effect a reflection, clarification and to some degree an extension of the common law "indoor management rule", also known as the rule in *Turquand's*[8] case.

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1 Ordinance No.3 of 1997.
2 Companies Ordinance ("CO") sections 5A, 5B(1) and 5B(3).
3 CO section 5C.
4 Section 39 of United Kingdom Companies Act ("UKCA") 2006.
5 Sections 40 of UKCA 2006 which restate section 35A and 35B of the UKCA 1985.
6 Section 41 of UKCA 2006 which restates 322A of UKCA 1985.
7 Section 42 of the UKCA 2006 which restates section 65 of the Charities Act 1993.
8 *Royal British Bank v Turquand* (1856) 119 ER 886.

The Common Law Position

4. The rule in *Turquand's* case protects third parties in their dealings with a company by qualifying the application of the common law principles of third parties having constructive notice of the contents of a company's constitution. The rule provides that a third party dealing with a company in good faith is entitled to assume that acts within the company's constitution and powers have been properly and duly performed and is not bound to inquire whether any internal procedures contained in the constitution regulating the conferment of authority have been complied with. *Turquand's* rule will not apply where the third party has been put on enquiry or has actual knowledge of the irregularity in the conferral of authority. It is also generally thought that the rule does not apply in relation to forgeries. For *Turquand's* rule to apply there is still a need for the person acting for the company to have authority within the law of agency. A person purporting to act as an agent of the company with no actual or ostensible authority cannot bind the company.

Clauses 112 and 113

5. Clause 112(1) provides that " *subject to section 114, in favour of a person dealing with a company in good faith, the power of the company's directors to bind the company, or authorize others to do so, is to be regarded as free of any limitation under any relevant documents of the company.*" It is very specific in its terms and may not apply in all cases of third parties dealing with a company. It is in addition to the common law indoor management rule, which may still have application in some circumstances. Neither *Turquand's* rule nor clause 112 sets out a complete code for third party dealings and there will also be interface with the law of agency. Where clause 112 is applicable in the specific circumstances set out in clause 112(1), it can be relied upon as an alternative to the common law indoor management rule.

6. Clause 113 provides clear rules for transactions involving directors or an entity connected with the director, including rules for indemnification of loss or accounting to the company for gains as a result of the transaction.

Differences between the CB and the Common Law

7. To provide clear guidance on the scope of the proposed statutory indoor management rule, clause 112 is drafted so as to apply in the specific circumstances set out in the provision. Clause 112 only applies if the third party deals with the company through the company's directors or a person authorised by the directors. The provision also only applies where the limitation on the power to bind the company is set out in the articles, or resolutions of the company or agreements between the members. While this would cover most third party dealings with the company and most limitations on the power to bind the company, the clause has a narrower scope of operation than the rule in *Turquand's case* as the latter is not confined to these situations.

8. There are also some other slight differences between clauses 112 to 113 and the common law. Clause 112 provides for a presumption of good faith on the part of the person dealing with the company. While a person who is not acting in good faith also cannot rely on *Turquand's* rule under the common law, the proposed statutory provision makes it clear that it is for the other party (usually the company) to prove that there was bad faith. Clause 112(2)(c) also provides that a person dealing with a company is not to be regarded as acting in bad faith by reason only of the person's knowing that an act is beyond the directors' powers. As noted earlier, knowledge of the irregularity will generally preclude a third party from being able to rely on the common law indoor management rule, but the mere fact of knowledge will not necessarily mean that the third party loses the benefit of the protections in clause 112.

9. In relation to directors dealing with the company, where clause 113 applies, the transaction is voidable at the election of the company (subject to clause 113(3)). Under the common law, if a director is unable to rely on *Turquand's* rule in respect of an irregularity (because of the common law exception relating to insiders[9]), then the transaction would be void unless ratified by the directors.

[9] *Morris v Kanssen* [1946] AC 459.

Clause 114

10. Clause 114 dis-applies the protection given by clause 112 where the company involved is a company which has been granted a licence under section 21 of the CO or clause 98 of the CB to dispense with the use of the word "limited" in its name, unless there has been full consideration given by the third party and there is no knowledge that the act done by the company is prohibited or beyond the powers of the company, or the third party does not know that the company has been granted a licence to dispense with the use of the word "limited" in its company name.

11. Companies granted a licence under section 21 of the CO or clause 98 of the CB are non-profit making. It is considered that donors to such non-profit making organizations are not as well placed or under as strong an incentive to ensure that their money is deployed appropriately as compared to members of a profit making organization[10], and therefore third parties dealing with such companies are not afforded the specific protection given by clause 112 in the specific circumstances set out in the clause. When clause 112 is dis-applied by clause 114, the common law will apply and the third party will not, for example, be given the benefit of the presumption of good faith.

12. We consider that these provisions will facilitate business by making clearer the rights of third parties dealing with companies in the specific circumstances set out in clauses 112 to 114.

[10] Gower and Davies, *Principles of Modern Company Law* (Eighth Edition), page 165, paragraph 7-13.