Bills Committee on Companies Bill

Follow-up actions for the meetings held on 4 and 11 November 2011 relating to Part 4 and Part 5

Purpose

This paper sets out the Administration's response to the issues raised by Members at the Bills Committee meetings on 4 and 11 November 2011 relating to Part 4 ("Share Capital") (clauses 129 to 197 and sections 13 to 42 of Schedule 10) and Part 5 ("Transactions in relation to Share Capital") (clauses 198 to 285 and sections 43 to 48 of Schedule 10) of the Companies Bill (CB).

2. Our response to the use of "Note" in different clauses under both Parts is set out in paragraphs 41 to 49. For issues raised relating to changes in penalties for offences under both Parts[1], we will provide a separate paper to set out the changes in the penalties level of offences under the CB.

Administration's response

Part 4

Clause 135(4) – Exercise by directors of power to allot shares or grant right

3. Some Members suggested that the *mens rea* of "knowingly" should be stated expressly in clause 135(4), to bring clause 135(4) in line with section 549(4) of the UK Companies Act 2006 (UKCA 2006).

4. Under clause 135(4), "*a director commits an offence if the director (a) contravenes this section; or (b) authorizes or permits, participates in, or fails to take all reasonable steps to prevent, a contravention of this section*".

[1] Members enquired about (a) under clause 179(3), the reason for pegging a fine at Level 4 with a further daily default fine of $700; (b) under clause 262(3)(b), the reasons for increasing the maximum fine level from $125,000 to $150,000 under summary conviction; and (c) under clause 266(4), the reason for removing the indictment mode of prosecution.

5. Clause 135(4) has its origin in section 57B(6) of the CO[2]. A similar offence may be found in section 549(4) of the UKCA 2006[3] which provides that "*A director who knowingly contravenes, permits or authorizes a contravention of, this section commits an offence*".

6. We agree with Members' proposal and will introduce a Committee Stage Amendment (CSA) to follow the UK provision.

Clause 159(5) – Stock exchange to exhibit a copy of a listed company's notice for issuing a new share certificate to replace a lost certificate

7. Clause 159(5) requires that a recognized stock exchange market must exhibit, in a conspicuous place on the premises on which the stock market operates, a notice received from a listed company for issuing a new share certificate to replace a lost certificate under clause 159(4)(a). At the Bills Committee meeting on 9 April 2011 with deputations, the Law Society of Hong Kong submitted that this requirement was out-dated and suggested that instead, the notice should be required to be published on a dedicated webpage of the Hong Kong Exchanges and Clearing Ltd. (HKEx)'s website. At the meeting on 4 November 2011, Members considered that the Law Society's proposal should be pursued.

8. In the light of the Law Society's views, we propose to introduce a CSA to clause 159(5) to provide for an option for the recognised stock market to publish the said notice either on its website or a conspicuous place on the premises on which the stock market operates. We have consulted the Securities and Futures Commission and the HKEx on the said proposal and have obtained their agreement to the proposal.

Clauses 167(5), 192(4) and 222(5)[4] – "*For this/that purpose*" *vs* "*For the purpose of this section*"

9. The Assistant Legal Adviser queried the different uses of (a) "*For this purpose*" ("*就此而言*") in clause 167(5); (b) "*For that purpose*"

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[2] Section 57B(6) fo the CO states that "*Any director who knowingly and wilfully contravenes, or permits or authorizes the contravention of, this section shall be liable to imprisonment and a fine*".

[3] Section 549 of the UKCA 2006: "Exercise by directors of power to allot shares etc".

[4] Clause 222(5) is under Part 5.

("*為上述目的*") in clause 222(5); and (c) "*For the purposes of this section*" ("*就本條而言*") in clause 192(4). The Assistant Legal Adviser considered that the drafting as set out in (c) should be adopted across the board in the CB, as the formulation was in line with the drafting convention in other statutes.

10. According to the Law Drafting Division of Department of Justice, beginning a subsection with the phrase "*For this purpose*" is not a new drafting style in Hong Kong legislation. Precedents can be found in section 20E(3) of the Bankruptcy Ordinance (Cap 6), section 47D(2) of the Companies Ordinance (Cap 32) and rule 203(3) of the Companies (Winding-up) Rules (Cap 32H). From a drafting point of view, the use of "*For this purpose*" in clause 167(5) or "*For that purpose*" in clause 222(5) is in order.

11. Notwithstanding the above, we will review the drafting of these clauses and other clauses under the CB with a view to achieving clarity and consistency between similar provisions as far as practicable.

Clause 176(1) – Notifying class members of variation of class rights

12. Under clause 176(1), if the rights attached to shares in any class of shares in a company are varied, the company must give written notice of the variation to each holder of shares in that class within 14 days after which the date on which the variation is made. Some Members enquired whether the 14-day period would be sufficient. Members also asked about the means of communication by which notification can be effected, and the practices regarding similar matters under the Listing Rules.

13. We consider that the 14-day period is sufficient. This notice period is aligned with the notice period required for a general meeting (i.e. other than an annual general meeting) for limited companies under clause 561(1)(b)(i) (which re-enacts the current requirement under section 114(1)(b) of the CO). The 14-day notice period is generally in line with the requirement under the Listing Rules for convening general meetings.

14. In fulfilling the notice requirement, the notice must be given in writing. Under the relevant provisions of Part 18[5] of the CB which applies to companies incorporated in Hong Kong, the written notice by the company to its members can be in electronic form (clause 819) and hard copy form (clause 820), or by means of a website (clause 821). These provisions under Part 18 are generally in line with the requirements under the Listing Rules. Part 18 will be scrutinised clause-by-clause in the coming Bills Committee meetings.

15. Under Rule 2.07A of the Listing Rules, listed companies can send all corporate communication, including notices of general meetings, to their shareholders by means permitted under the law and regulations of their home jurisdiction and their constitutional documents, subject to the requirements in the Listing Rules. With a shareholder's consent, a company can fulfil its obligation to give the shareholder a written notice by making it available on its own website.

Clause 191 – Merger relief

16. Clause 191 provides for the merger relief. Members enquired about (a) the reason for the 90% threshold under clause 191(1); (b) views expressed by professional bodies in our public consultations; and (c) remedies available for aggrieved minority shareholders.

(a) Reason for the 90% threshold

17. The 90% threshold under clause 191(1) re-enacts the current law under section 48C(1) of the CO.

18. The current provisions for merger relief, as set out mainly in section 48C of the CO, were introduced in Hong Kong under the Companies (Amendment) Ordinance 1999. The provisions were mainly modelled on the corresponding provisions in section 131 of the UKCA 1985. Section 131 of the UKCA 1985 had its origin in section 37 of the UKCA 1981. The 90% threshold was introduced in section 37(1) of the UKCA 1981 and was kept in section 612(1) of the UKCA 2006.

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[5] Division 4 of Part 18 which re-enacts the existing Part IVAAA of the CO. Part IVAAA of the CO came into operation on 10 December 2010. For the paper on the policy issues of Part 18, please see Annex B to LegCo Paper No. CB(1)1671/10-11(04).

19. We understand from the available literature that the UK government's original proposal back in the 1980s was more restrictive. It was proposed then that the issuing company should have been formed for the express purpose of acquiring, or have been dormant until acquiring, the acquired company. A broader exemption based on the 90% threshold was then proposed and adopted[6].

20. We consider that the 90% threshold is optimal and should be maintained in the CB regime. If the threshold is raised, the requirement under the CB will become more stringent than that under the CO. This would not be to the benefit of companies. On the other hand, it would not be appropriate to lower the threshold given that (i) the group reconstruction relief applies only to a "wholly owned subsidiary"; and (ii) while there is no statutory definition of a "merger", the common understanding and sensible interpretation are that "merger" only occurs where there is a very high degree of convergence of ownership, which should be close to 100%.

(b) *Views of professional bodies in public consultations*

21. In our public consultation on "*Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure*" in 2008, we consulted the public on whether merger relief should be abolished or suitably modified on the assumption that par value would be abolished while the existing capital maintenance rules would largely be maintained.

22. The great majority of the respondents (including the Hong Kong Institute of Certified Public Accountants, Hong Kong Bar Association, Hong Kong Institute of Chartered Secretaries, Chartered Institute of Management Accountants (Hong Kong Division), Society of Chinese Accountants and Auditors, Hong Kong Association of Banks, Hong Kong Stockbrokers Association, etc.) considered that the merger relief should be maintained and apply to the amount in excess of the subscribed capital of the acquired company attributable to the shares acquired or cancelled[7].

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6 Please see the Hansard HL Deb 27 October 1981 vol 424 cc948 -949.

7 Please see paragraph 14 and 15 of the Consultation Conclusions for the 2008 consultation (available at http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cmrsap_conclusion_e.pdf). Please see pages 23 to 28 of the Compendium of Responses for the 2008 consultation for the

23. In the Second Phase Consultation on the Draft Companies Bill in 2010 covering, *inter alia*, Part 4, no respondents commented on these issues[8].

(c) *Remedies for aggrieved minority shareholders*

24. Aggrieved minority shareholders may seek redress under Division 2 (clauses 712 to 716) of Part 14 ("Remedies for Protection of Companies' or Members' Interests") which provides for remedies for unfair prejudice to members' interests. Part 14 will be scrutinised clause-by-clause in the coming BC meetings.

Section 27(3) of Schedule 10 – Meaning of "*relevant time*"

25. The Assistant Legal Adviser considered that there was ambiguity arising from the meaning of "*any other existing company*" under section 27(3)(b) of Schedule 10.

26. When read together with section 27(3)(a), "*any other existing company*" under section 27(3)(b) would mean a company which was formed and registered after the commencement date of this section but pursuant to the predecessor Ordinance. We will introduce a CSA to make it clear.

Part 5

Clauses 213(1) and 256(1) – Publish notice by the company in the Gazette "*before the end of the week after the week in which the special resolution…is passed*"

27. Clause 213(1) applies to reduction of share capital while clause 256(1) applies to payment out of capital for buy-backs. Under both clauses, the company is required to publish a notice in the Gazette "*before the end of the week after the week in which the special resolution…is passed*". Some Members enquired whether the timeframe can

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detailed comments of the respondents on the relevant issues (available at http://www.fstb.gov.hk/fsb/co_rewrite/ eng/pub-press/doc/cmrsap_conclusion_e.pdf).

[8] The Consultation Conclusions for the 2010 consultation can be found at http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/ccsp_conclusion_e.pdf

accommodate situations in which there are intervening holidays after the resolution is passed and the notice to be published in the Gazette.

28. According to the Government Logistics Department (GLD), generally speaking, the Gazette is to be published every Friday and the closing time for inclusion of a notice in the Gazette is 4:00pm of the preceding Monday (i.e. of the same week). Where Monday is a public holiday, or there are other public holidays during the week, the closing time would be advanced by the same number of working days. For example, where a Monday and Wednesday of the week are public holidays, the closing time would be advanced by 2 working days from Monday to the preceding Thursday. Likewise, where Friday is a public holiday, the Gazette would be published on Thursday and the closing time would be 4:00pm of the preceding Friday[9].

29. Given the above, to ensure that it is practically feasible for companies to publish notice in the Gazette as required, we will introduce a CSA to change the provisions such that the notice is to be published in the Gazette either before the end of the week (Week 2) after the week (Week 1) in which the special resolution is passed (i.e. the same as the current provisions), or before the end of the week following Week 2 (Week 3) provided that it is not possible to do so in Week 2 because of the Gazette cycle.

30. While we acknowledge that flexibility is needed in exceptional cases, thus the proposed amendment as set out in the preceding paragraph, we are not inclined to extend the timeframe across the board, as clauses 215(1) and 258(1) allow a creditor to object within 5 weeks after the special resolution is passed. If more time is allowed in all cases, less time will be left for the creditors to object, thus prejudicing the rights of the creditors.

<u>Clauses 218, 261, etc. – Delivery of certain document by companies to the Registrar of Companies (the Registrar) for registration within 14 days</u>

31. The period for documents to be delivered to the Registrar for

[9] Advanced closing time for the relevant issues of the Gazette can be found at GLD's website (http://www.gld.gov.hk/cgi-bin/gld/egazette/gazettefiles.cgi?lang=e&agree=1&acurrentpage=16).

registration under clauses 218 and 261 is changed from 15 days in the CO to 14 days in the CB to align with other similar provisions. Some Members were concerned that the shortened period may result in companies not having sufficient time to deliver the said documents to the Registrar.

32. Members' concerns are noted. Having reviewed the relevant provisions in the CB, i.e. those provisions that require delivery of certain document to the Registrar for registration or notification within 14 days[10], we will introduce CSAs to amend these provisions to extend the 14-day period to 15 days. We consider it desirable to undertake this alignment to minimise confusion to the companies.

Clause 240(4) – Resolution authorizing contracts for share buy-backs for unlisted companies: disclosure of contract details

33. The Assistant Legal Adviser was concerned that the meaning of the words "*those names*" in clause 240(4) was not clear. We will review the provision with a view to improving clarity of this clause.

Clause 271(1) – Prohibition on financial assistance by a company for acquisition of shares of the company and its holding company

34. The Assistant Legal Adviser considered that the meaning of the words "*the company*" in clause 271(1) was unclear. He was concerned that the reference to "*the company*" might be misinterpreted as referring to the holding company as well as the first-mentioned company in the clause, in which case the holding company would also be prohibited from giving financial assistance for the acquisition of the shares in the company. This would mean a change in the existing law.

35. There is no change in the law. Whilst we consider the current drafting of clause 271(1) to be sufficiently clear if read in context, to avoid possible confusion, we will introduce a CSA with a view to

[10] The relevant provisions include clauses 69(1), 83(5), 84(6)(a), (b)(ii) and (c), 85(5)(a), (b)(ii) and (c), 89(2), 90(2), 91(1), 102(2), 109(1), 161(4), 176(1), 178(1), 184(1), 186(1), 218(1), 220(1)(c)(i) and (ii), 225(1)(b), 261(1), 266(1), 281(2), 285(1), 305(2) and (3), 309(2) and (3), 312(3), 349(4), 350(4)(a) and (b), 353(1), 367(2), 408(3), 410(4), 418(3)(b), 462(4), 533(5), 609(2) and (3), 612(2), 618(2) and (3), 627(2) and (3), 630(3), 632(4) and (5), 636(1) to (4), 639(4) and (5), 643(1) and (2), 649(3), 673(1), 715(4), 781(1) and (6) and 783(1).

clarifying that the words "the company" refers to the company in its own capacity or as a subsidiary of its holding company.

Clause 277 – Exception for loans to employees

36. The general prohibition on giving financial assistance does not prohibit the making by a company of loans to its eligible employees for the purpose of enabling them to acquire fully paid shares in the company or its holding company to be held by them by way of beneficial ownership. The term *"eligible employees"* excludes a director. Some Members considered that a company may circumvent the financial assistance prohibition by first removing a director from office and changing his status to an "employee". The company could then provide a loan to the "employee" by making use of the exception in clause 277 and re-appoint the "employee" as a director thereafter. Some members also queried that in case a loan was made to an eligible employee and that employee was subsequently appointed as director but part of the loan remained outstanding, whether the company would need to call back the loan from that director.

37. It is noted that under clause 277(2), "*eligible employees*", in relation to a company, means persons employed "*in good faith*" by the company. This would provide a safeguard against the potential avoidance arrangement mentioned in the preceding paragraph. A similar approach is adopted in the UKCA 2006 (section 682(2)(d)).

38. Moreover, it is proposed to streamline the procedures for authorizing the giving of financial assistance in clauses 279 to 285. If a company intends to provide financial assistance to any of its directors, it could conveniently provide it lawfully by making use of these procedures, e.g. financial assistance not exceeding 5% of shareholders fund or financial assistance with approval of all members.

39. If we impose additional conditions, e.g. that the "employee" must not be a director of the company for a period of say, 3 years before the provision of the loan, it will create hardship to companies which genuinely make use of this exception to benefit its employees.

40. On the basis that the eligible employee was employed in good faith by the company, the fact that he is subsequently appointed as director does not retrospectively render a loan previously advanced to him by the company to be in breach of the prohibition. The provision does not require immediate recalling of any part of the loan which remains outstanding from him. However, the exception in this provision will not be available to the ex-employee once he is appointed to the position as director.

Use of Notes

General issue

41. The Assistant Legal Adviser expressed concern on the legal status of the examples cited in some of the Notes (c.f. other Notes that contain no examples but other information).

42. In this relation, we propose that as a general approach, such a Note (i.e. those containing example(s)) should be converted into an "Example". Currently, clause 2(6) of the CB, which provides that "*A note located in the text of this Ordinance is provided for information only and has no legislative effect*", only applies to Notes (whether it contains an example or otherwise). An "Example" would not be covered by clause 2(6) and will be construed together with the provision to which it is attached and be given legal effect accordingly.

Specific enquiries

43. The Assistant Legal Adviser also raised specific queries regarding the usability or appropriateness of some examples cited in the Notes.

44. As explained in the note on "Modernisation of Drafting" annexed to the LegCo paper on "Overall Policies of the Companies Ordinance Rewrite"[11] discussed at the Bills Committee meeting on 14 March 2011, examples in the Notes are included to illustrate how the

[11] LegCo Paper No. CB(1)1522/10-11(02).

provision concerned would work in practice. We would consider adding an example if it can assist general readers.

45. Our responses to the Assistant Legal Adviser's specific comments on the examples cited in some of the Notes are set out below –

(a) *Note after clause 155(1) – examples for pre-emption of rights in relation to transmission by law*

46. In this clause, it is considered that general readers may find it difficult to understand the meaning of "*transmission*" and "*by operation of law*", and therefore an example is added.

(b) *Note after clause 175(2) – example for other restrictions on the variation of the rights despite clause 175(1)*

47. Clause 175(1) provides for the restrictions on the variation of rights attached to shares. Then, in clause 175(2), it mentions "*any **other** restrictions*". Readers may wonder what this other "unspoken" restriction will be. We, therefore, consider that adding an example after clause 175(2) will be helpful and this example should be retained.

(c) *Note after clause 205(1) – examples to show permitted reductions of share capital*

48. Clause 205(1) of the CB restates section 58(1) of the CO. Section 58(1) of the CO provides that the company concerned "*may reduce its share capital **in any way***" and then goes on to provide that share capital may "*in particular, without prejudice to the generality of the foregoing power*" be reduced in the ways set out in subsection (1)(a), (b) and (c). The scenarios set out in subsection (1)(a), (b) and (c) of the CO are not exhaustive and are also just examples of how share capital can be reduced. The provision is in fact the same as the CB provision. Clause 205(1) does not change the way in which share capital may be reduced merely by moving subsection (1)(a), (b) and (c) to a Note (or as Example). Putting them under a Note (or as an Example) has the added benefit of improving the readability of the provision.

(d) *Section 27(2) of Schedule 10 – example to show calculation of fees to be exempted for existing companies that increase their issued share capital*

49. This provision involves the calculation of a fee which is not straightforward. When mathematic calculation is expressed in words, it is always difficult to understand. We consider an example telling readers how to reach the conclusion step by step with numbers can explain the calculation method better than words.

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