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Paper for the House Committee

Report of the Bills Committee on Companies Bill

PURPOSE

This paper reports on the deliberations of the Bills Committee on Companies Bill ("the Bills Committee").

BACKGROUND

The rewrite of the Companies Ordinance

2. The Companies Ordinance (Cap. 32) ("CO") was enacted in 1932 with its major provisions originated from the 1929 Companies Act of the United Kingdom ("UK"). The legislation provides the legal framework which enables the business community to form and operate companies. It also sets out the parameters within which companies must operate, so as to safeguard the interests of those parties who have dealings with them, such as shareholders and creditors. The CO was last substantially reviewed and amended in 1984. Over the past two decades, the Standing Committee on Company Law Reform ("SCCLR") and the Administration have conducted several major reviews of the CO resulting in recommendations to amend various sections of the CO. Some of those recommendations have been implemented by means of several amendment bills. However, the Administration considers that the piecemeal approach to amend the CO has its limitations and a comprehensive rewrite of the CO is needed to modernize Hong Kong's company law to further enhance its status as a major international business and financial centre. In addition, other major common law jurisdictions such as the UK and Australia have

reformed their company laws over the past two decades[1]. Rewriting the CO allows Hong Kong to leverage company law reforms in these jurisdictions and enhance its competitiveness.

3. The comprehensive rewrite of the CO ("the CO Rewrite") was launched in mid-2006 and led by a dedicated Companies Bill Team established under the Financial Services and the Treasury Bureau. A Joint Working Group was set up between the Government and the Hong Kong Institute of Certified Public Accountants ("HKICPA") for reviewing the accounting and auditing provisions in the CO, and four dedicated Advisory Groups comprising representatives from relevant professional bodies, business organizations, academics, regulatory bodies and Government Departments were established to advise on specific areas[2]. Being the principal advisory body for the Rewrite, SCCLR was consulted on all the main recommendations made by the Joint Working Group and the Advisory Groups. In the course of the Rewrite, the Administration conducted three topical public consultations in 2007 and 2008 to gauge views on a number of more complex subjects. Having considered the public views and other recommendations of SCCLR, the Administration published a draft bill for further public consultation in two phases from December 2009 to August 2010.

4. In view of the extensive nature of the CO Rewrite, the Administration has adopted a phased approach by tackling the provisions which affect the operation of live companies in Hong Kong through introduction of the Companies Bill ("CB"). The winding-up and insolvency-related provisions will be dealt with under the modernization of corporate insolvency law exercise. The provisions on prospectuses in the CO will be dealt with in a separate review by the Securities and Futures Commission ("SFC") and likely to be moved to the Securities and Futures Ordinance (Cap. 571) ("SFO"). It is the Administration's plan that when the CB is enacted[3], all the provisions in the existing CO concerning live companies will be repealed.

5. After the CB is enacted, a number of pieces of subsidiary legislation will have to be made before it can come into operation. Moreover, the Companies Registry will have to revise the forms and upgrade its

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1 UK Companies Act 2006 and Australia Corporations Act 2001.

2 The specific areas are: share capital; distribution of profits and assets and charges provisions; company formation, registration, re-registration and company meeting and administration provisions; directors and officers related provisions; and inspections, investigation and offences and punishment provisions.

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

information system to cater for the changes. It is estimated that the CB may commence operation around 2014.

THE BILL

6. The CB, which consisted of 21 parts, 909 clauses and 10 schedules, was introduced into the Legislative Council ("LegCo") on 26 January 2011. The objects of the CB are to reform and modernize Hong Kong company law, to restate part of the enactments relating to companies, to make other provision relating to companies, and to provide for incidental and connected matters. The proposed measures under the CB aim at achieving four main purposes, namely enhancing corporate governance, ensuring better regulation, facilitating business operation, and modernizing the law.

THE BILLS COMMITTEE

7. At the House Committee meeting held on 11 February 2011, Members agreed to form a bills committee to study the CB. Hon Paul CHAN Mo-po and Hon Starry LEE Wai-king were elected Chairman and Deputy Chairman of the Bills Committee respectively. The membership list of the Bills Committee is in **Appendix I**. The Bills Committee has held 44 meetings[4] with the Administration and received public views on the CB. Business and trade associations, professional bodies, the regulators, investor interest groups and the general public have been invited to give views on the CB. The Bills Committee has met with 30 deputations/individuals in three meetings for views on the CB and specific clauses, and received 89 written submissions from deputations/individuals. A list of organizations and individuals who have given views to the Bills Committee is in **Appendix II**.

DELIBERATIONS OF THE BILLS COMMITTEE

8. To facilitate consideration of the major policies and proposals covered in the CB in an organized manner, the Bills Committee has divided the 21 Parts and the 10 Schedules into ten groups with reference to the relevance of the issues and provisions covered under the Parts. The major deliberations of the Bills Committee are summarized in the ensuing part of

[4] 26 meetings were held in two-sessions.

this report. To assist members in scrutinizing the CB, the Administration has provided papers to explain the major proposals and policy issues in each Part, to compare the provisions in each Part and the relevant provisions in the CO and the company laws of comparable jurisdictions to facilitate the clause-by-clause examination of the bill, and to set out the various proposed Committee Stage amendments ("CSAs") in relation to each Part with marked-up version of the CSAs to facilitate members' consideration. The relevant papers with their hyper links are listed in **Appendix III**.

The four objectives of the Companies Bill

9. The Bills Committee supports the four major objectives of the CB. Members in general support the new initiatives to enhance corporate governance and ensure better regulation of the company law regime. They have stressed the importance to ensure that the new requirements in the CB would not affect Hong Kong's competitiveness as a corporate domicile and international financial centre. Noting that a high ratio of Hong Kong listed companies were incorporated overseas, members have urged the Administration to devise concrete measures to promote incorporation of companies in Hong Kong.

10. The Administration has explained that there are many relevant factors affecting a company's choice of its domicile, including the tax system, incorporation and disclosure requirements, transparency standards, jurisdictional competition and historical factor, etc. The Administration believes that Hong Kong has competitive edge over other jurisdictions in many of these aspects as revealed by the rising trend in the number of incorporations in Hong Kong from 2006 to 2010, and the total number of live local companies registered stood at 912 242 as at the end of June 2011. One of the guiding principles of the CO Rewrite is to benchmark Hong Kong against comparable jurisdictions like the UK, Australia and Singapore. The Administration is mindful of the need to maintain proper corporate governance standards without unduly discouraging Hong Kong incorporations. An appropriate balance has been struck in the CB in this regard. The CB would provide a modern and up-to-date legal infrastructure for the incorporation and operation of companies in Hong Kong, thus enhancing the competitiveness of Hong Kong as a corporate domicile.

11. On the objective to facilitate business operation, the Bills Committee supports the various initiatives to remove unnecessary requirements on companies and streamline procedures to facilitate their operation. Members have emphasized the need to ensure that the new

requirements under the CB will not increase compliance cost on companies, especially the small and medium enterprises ("SMEs") which account for over 90% of companies in Hong Kong, and will not impose burden on SMEs' directors and officers who often have limited resources, and with little professional training and legal knowledge.

Group 1: Parts 1, 3 and 17

Part 1

12. Part 1 -- Preliminary, is an introductory part that sets out the title of the new Ordinance, its commencement date, the interpretation and definitions of various terms and expressions that are used throughout the CB.

The new formulation of "responsible person" (clause 3)

13. A number of offence provisions under the CO (and the CB) punish not only a company but also officers of the company who are in default. Section 351(2) of the CO defines an "officer who is in default" as "*any officer of the company…who knowingly and wilfully authorizes or permits the default, refusal or contravention"*. As prosecution is difficult given that the evidential burden for proving "knowingly and wilfully" is very high, the Administration has introduced a new formulation of "responsible person" in the CB, which is modelled on the UK Companies Act 2006 ("UKCA 2006"), to replace "an officer who is in default". Under clause 3, "responsible person" is defined 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"*.

14. Members have expressed concern about the impact of the new formulation of "responsible person" on the legal liability of officers or shadow directors of a company, especially whether the formulation will attach criminal liability to acts of negligent omissions. Noting that the majority of offences under the CB which target "responsible persons" are regulatory in nature (e.g. failure to file various returns and documents on time to the Registrar of Companies ("the Registrar")) and that the current non-compliance situation for such offences is not serious, some members including Hon Andrew LEUNG, Hon Jeffery LAM and Hon WONG Ting-kwong have questioned the need to lower the prosecution threshold. In particular, they are concerned that the new formulation would impose an onerous burden on SMEs, whose resources

and legal knowledge are usually limited, and hence operators may easily overlook the numerous filing requirements. They consider that application of the new formulation to SMEs will run contrary to the objective of the CB to facilitate SMEs' operation and reduce their compliance costs.

15. The Administration has stressed that the new formulation of "responsible person" aims at lowering the prosecution threshold with a view to enhancing enforcement by extending the scope to cover reckless acts/omissions of officers. By removing the high evidential burden of "knowingly and wilfully", the new formulation 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. This will enhance corporate governance in Hong Kong which is among the major policy objectives of the CO Rewrite. As regards the liability of officers, the Administration has clarified that the formulation of "responsible person" does not impose strict liability, and it is incumbent upon the prosecution to prove *mens rea* in relation to each element of an offence. 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 mere 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.

16. On the limb of "fails to take all reasonable steps to prevent" in the formulation of "responsible person", members have expressed concern about its wide scope and that officers and directors of companies could be easily caught and become liable for the offences under the CB. They have sought information on local ordinances and overseas legislation which also adopt similar wording.

17. According to the Administration, the phrase "fails to take all reasonable steps" is not new in the CO context and other statutes. For instance, section 155A(5) of the CO, and sections 95, 96, and 97 of the Mandatory Provident Fund Schemes (General) Regulations (Cap. 485A) already impose liability for failure to take reasonable steps. The same phrase has been adopted in the UKCA 2006, and the same formulation is also used in a number of Acts in Singapore. The Administration has pointed out that 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, including 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. If officers have compliance systems in place and/or have delegated to appropriate personnel responsibilities for compliance with the provisions of the CB and generally monitors the situation, they would generally not be regarded as having failed to take all reasonable steps to prevent a contravention. For example, where the company has failed to file certain documents in breach of the legislation, it is envisaged that a non-executive director would not 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.

18. Members remain concerned about the impact of the phrase "fails to take all reasonable steps to prevent" on officers and directors, especially those independent non-executive directors who are not aware of any possible breach by the company, or directors of SMEs who are simply negligent and whose resources and legal knowledge were usually limited.

19. Having considered the views and concerns expressed by members, the Administration has proposed to delete the limb of "fails to take all reasonable steps to prevent" from the formulation of "responsible person". Members note that with the removal of the relevant limb, negligent omissions by officers will not be caught, the scope of culpable acts will be narrowed such that the circumstances under which liability may be incurred by officers for the breach by the company will be reduced and they will not be liable simply for failing to take reasonable steps to prevent a contravention by the company. The *mens rea* required under the remaining limbs, "authorizes or permits, or participates in", will be actual knowledge, wilful blindness or recklessness, but not negligence. The Administration has pointed out that as compared to the CO formulation of "officer who is in default", the prosecution threshold for the revised formulation of "responsible person" will still be lower as there is no need to prove "wilfulness", hence the policy objective of enhancing corporate governance and ensuring better regulation will still be achieved. The Bills Committee agrees with the proposal.

20. As for those provisions in the CO which already make directors responsible for "failing to take all reasonable steps to prevent" a breach, the Administration considers it appropriate to retain them in the CB since the offences involved are serious and it is necessary to impose liability on a director for failing to take steps to prevent a breach by the company to ensure compliance. In many of these provisions, the director is provided

with a statutory defence and the offences will not be punishable by imprisonment unless they were committed wilfully. The Bills Committee notes the Administration's position.

Types of companies that can be formed under the Companies Bill

21. Under the CO, eight different types of companies can be formed. Under the CB, companies that can be formed are streamlined into five types with abolition of some types of companies which are obsolete and re-grouping others into new categories. The types of companies that can be formed under the CO and the CB are set out in the table below --

Types of companies that can be formed under the CO	**Types of companies that can be formed under the CB**
private companies limited by shares	private companies limited by shares
non-private companies limited by shares	public companies limited by shares
private companies limited by guarantee without share capital	companies limited by guarantee without a share capital
non-private companies limited by guarantee without share capital	
private unlimited companies with a share capital	private unlimited companies with a share capital
non-private unlimited companies with a share capital	public unlimited companies with a share capital
private unlimited companies without share capital	--
non-private unlimited companies without share capital	--

The definitions of the different types of companies are provided in clauses 6 to 11.

Part 3

22. Part 3 -- Company Formation and Related Matters, and Re-registration of Company, contains provisions relating to company formation and registration, re-registration of unlimited companies as companies limited by shares and related matters.

Abolishing the Memorandum of Association (clauses 62 to 65, 70 to 80 and 93)

23. Currently, the constitutional documents of a company formed in Hong Kong are the Memorandum of Association ("MA") and the Articles of Association ("AA"). The MA used to contain the objects clause and the authorized capital of the company, while all provisions regulating the affairs of the company are contained in the AA. With the less significance of MA and the proposed removal of the authorized capital following the migration to no par, as well as to align with other common law jurisdictions such as Australia and New Zealand requiring companies to have only a single constitutional document, the Administration has proposed to abolish the requirement for an MA for companies. Clauses 63 to 65 and 70 to 80 set out the requirements of the incorporation form and AA respectively. Clause 73 empowers the Financial Secretary ("FS") to prescribe different model AA for different types of companies. These model AA replace Table A[5] and the other tables in the First Schedule of the current CO for companies incorporated after the commencement of the CB. Clause 93 provides that conditions (i.e. provisions in) of the MA of an existing company (i.e. a company formed and registered under a former CO), such as object clauses (if any) and members' liability, will be deemed to be provisions of the company's AA.

Matters relating to company name -- Registrar's licence to dispense with "Limited" etc. (clause 98)

24. Clause 98 provides the Registrar with the power to grant a licence to certain companies to dispense with the word "limited" in their name. Members have enquired about the purpose for the Registrar to grant such a licence and the target companies. The Administration has advised that clause 98 restates existing section 21 of the CO. 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. These companies are formed

[5] Table A in the First Schedule of the CO provides sample regulations for companies limited by shares to adopt in their articles of association.

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. Most of the section 21 companies under the CO are in essence "charities" under law and the vast majority of them have been granted tax exemption under section 88 of the Inland Revenue Ordinance (Cap. 112) ("IRO") as charities.

Providing statutory protection for persons dealing with a company (clauses 111 to 114)

25. Clause 111 provides that a company's exercise of powers will be limited by its AA after the elimination of the MA. Clauses 112 to 114 are new provisions modelled on relevant provisions of the UKCA 2006 to provide statutory protection for persons dealing with a company in addition to the common law indoor management rule. Clause 112 provides that if a person dealing with a company is acting in good faith, the power of the company's directors to bind the company will be deemed to be free of any limitation under the AA, any resolutions of the company or any agreement between the members of the company. Clauses 113 and 114 provide that the protection afforded to a person by clause 112, subject to certain conditions, will not apply where the party to a transaction with a company is an "insider" (e.g. a director of the company or of a holding company of the company) or where the company in question is an exempted company (i.e. section 21 companies under the CO).

26. The Bills Committee notes that these provisions will facilitate business by making clear the rights of third parties dealing with companies in the specific circumstances set out in clauses 112 to 114. The purpose is to provide better protection of the funds and assets of charitable and other non-profit companies. However, members consider that the scope of clause 114 should be limited to a company to which a licence under clause 98 relates (i.e. companies with licence to dispense with the use of the word "limited" in its name (clause 98 companies)) and is exempt from tax under section 88 of IRO (i.e. charitable bodies). The effect of the proposal is that clause 98 companies which are not charitable bodies with IRO section 88 tax exemption status would not be covered by the exception provided under clause 114. Clause 112 would therefore apply to these companies. In the light of members' suggestion, the Administration will move CSAs to effect the proposal.

Allowing a company to appeal to the Administrative Appeals Board in relation to company names (clauses 103 and 104)

27. Currently, under section 22A of the CO, where the Registrar is satisfied that the name of a local company gives a misleading indication of the nature of its activities as to be likely to do harm to the public, or that the name constitutes 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. The company concerned may apply to the court to set aside the direction or notice. The power of the Registrar in this regard is restated under clause104 but instead of applying to the court to set aside the Registrar's direction, the provision provides that a company may appeal to the Administrative Appeals Board ("AAB").

28. Members have enquired about the reasons for allowing companies to appeal to AAB. The Administration has explained that the change was proposed by the Bills Committee on the Companies (Amendment) Bill 2010 and Business Registration (Amendment) Bill 2010. During scrutiny of the former bill, 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 be heard by AAB instead of by the court. As it would take time to work out the amendments to the AAB Ordinance, the Administration undertook at that time to take up the matter in the CO Rewrite and the proposed arrangement was agreed by the relevant Bills Committee. 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 of the CO, the Administration has also incorporated the relevant change in clause 772 to allow non-Hong Kong companies to appeal to AAB. Noting that AAB is an independent statutory body established for hearing and determining appeals against administrative decisions made by the authorities under a number of ordinances or regulations, such as matters on security personnel permits and business registration fees, the Bills Committee supports the proposal.

Making the keeping and use of a common seal optional and relaxing the requirements for a company to have an official seal for use abroad (clauses 119, 120 and 122)

29. Section 93(1)(b) of the CO stipulates that every company shall have a common seal with the company name engraved in legible characters. Clause 119 states that a company may have a common seal, thus making

the keeping and the use of a common seal optional so as to facilitate business and simplify the mode of execution of documents by companies.

30. Members consider that where a company chooses to have a common seal for executing its documents, the seal should be affixed in a proper form. In the light of members' comments, the Administration will introduce CSAs to clause 122 to clarify that the seal must be affixed in accordance with the provisions of the company's articles. Members agree with the amendment as it accords with the provisions in the model AA that will deal with the affixing of the common seal and makes it clear that the affixing of the seal in a manner contrary to the procedure set out in the articles is not proper execution.

Part 17

31. Part 17 -- Companies not Formed, but Registrable under this Ordinance, mainly restates, with some modifications, current Part IX of the CO, which provides for the registration of companies which are/have been formed in pursuance of any Ordinance other than the CO or a former CO. The Administration has re-arranged the sequence of the provisions in Part IX of the CO in a more logical and user-friendly order. The opportunity is also taken to remove the archaic provisions on "joint stock company" under sections 310 to 312 of the CO in consideration that there is no incorporated joint stock company in Hong Kong. The Administration is of the view that even if any unincorporated joint stock companies were still in existence, they could be dissolved and incorporated as new companies under the CB. In relation to clauses 795 to 797, members note that companies not formed under the CB may seek registration as unlimited companies upon delivery of the required documents to the Registrar. The Administration has advised that as at 31 January 2012, there are 13 unlimited companies on the Register. All of these companies are private companies and are incorporated under the CO.

Group 2: Parts 16 and 18

Part 16

32. Part 16 -- Non-Hong Kong Companies, contains provisions relating to companies incorporated outside Hong Kong that have established a place of business in Hong Kong. The provisions essentially restate the existing Part XI of the CO, which has been substantially amended by the Companies (Amendment) Ordinance 2004, mainly with a view to simplifying the filing requirements.

Clarifying provisions for striking non-Hong Kong companies off the register and their restoration to the register (clauses 784 to 789)

33. Section 339A of the CO empowers the Registrar to remove the name of a non-Hong Kong company from the register if there is reasonable cause to believe that the company has ceased to have a place of business in Hong Kong, by applying the CO provisions relating to the striking off of local defunct companies (i.e. section 291 of the CO), with such adaptations as are necessary. Such a legislative provision by way of reference may give rise to uncertainty. Clauses 784 to 789 expressly set out the steps that the Registrar should take before striking a non-Hong Kong company off the Companies Register, the procedures for a director or member of a non-Hong Kong company that has been struck off the register to apply to the Registrar for the company's restoration to the register, and the conditions for granting such an application.

34. The Bills Committee notes that clause 788(2)(a) states that one of the conditions for the Registrar to grant an application for restoration of registration of a non-Hong Kong company is that the company had, at the time its name was struck off, a place of business in Hong Kong. Members have expressed concern that a non-Hong Kong company would not be able to apply for restoration under clause 788 if it temporarily did not have a place of business in Hong Kong at that point in time its name was struck off the register. In view of the concern, the Administration will introduce a CSA to amend clause 788(2)(a) to the effect that it is a condition for restoration that the non-Hong Kong company has, at the time of making the application under section 787, a place of business in Hong Kong and had, at any time within the period of six months before the name was struck off the register, a place of business in Hong Kong.

Authorized representative for non-Hong Kong companies (clause 783)

35. Members note that under the offence provisions in Part 16, other than the company and every responsible officers, every "agent" who authorizes or permits the contravention of the specified provisions will commit an offence. However, under clause 783(1), an "authorized representative" of a registered non-Hong Kong company is required to notify the Registrar within 14 days of the date of dissolution if the company is dissolved. Clause 783(3) provides that it is an offence if the authorized representative fails to comply with clause 783(1). Members have enquired about the difference in the responsibilities and liabilities of an "agent" and an "authorized representative" of a non-Hong Kong company, in particular the regulation over their breaches of requirements under the

CB where they have acted under the instruction of the non-Hong Kong companies. Moreover, noting some deputations' view that extension of the offence provisions in Part 16 to cover "agents" may subject the non-Hong Kong companies to potentially more onerous obligations than those of Hong Kong companies as the offence provisions already capture the company and its officers, members have enquired about the rationale for the extension of the offence provisions to agents.

36. On the difference between an "agent" and an "authorized representative", the Administration has explained that "agent" for the purpose of Part 16 is not defined and the term will be construed in its ordinary meaning, i.e. a person who acts on behalf of another. On the other hand, the term "authorized representative" is defined in Part 16 to mean 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." Therefore, an authorized representative besides acting as an agent of a company in accepting service, would also be an agent for other business if so appointed by the company. The Administration has further explained that under both the existing CO and the CB, authorized representatives only have very limited responsibilities. Apart from the statutory duties under clause 783(1), 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 CB. On the other hand, the offence provisions applicable to agent under the CB include failing to apply for registration as a registered non-Hong Kong company (clause 764(6)), failing to notify the Registrar of a change of the name or translation of the name of the company (clause 766(10)), and failing to notify the Registrar of cessation of place of business in Hong Kong (clause 782(3)), etc. On the concern about the extension of legal liabilities to agents under the CB, the Administration considers the proposal appropriate for improving enforcement of the law. To address the concern, the Administration has pointed out that the offence provisions in Part 16 have been drafted to the effect that only agents of a company who authorize or permit a contravention would be liable, which is in line with the current position in section 340 of the CO.

37. In relation to the offence of the failure of an authorized representative of a non-Hong Kong company to notify the Registrar of the dissolution of the company under clause 783(3), clause 783(4) provides a defence for the authorized representative that he has taken all reasonable steps to secure compliance with the requirement. The Bills Committee considers that the defence for the authorized representative should cover the situation that he genuinely was not aware of the dissolution of the

non-Hong Kong companies. The Administration has taken on board the suggestion and will introduce a CSA to provide a defence if the authorized representative "did not know, and had no reason to believe, that the company was dissolved".

Requirements for non-Hong Kong companies to register and submit returns (clauses 762, 764, 765 and 778)

38. Clause 764 provides that any non-Hong Kong company which has a place of business in Hong Kong must apply to the Registrar for registration. The definition of "place of business" as provided in clause 762 includes a share transfer office and a share registration office. The Bills Committee considers that the definition of "place of business" should ensure that all non-Hong Kong companies which are "carrying on business" in Hong Kong would be covered and should plug the possible loophole where non-Hong Kong company may evade the legal responsibility to register which is an important means to protect interests of parties dealing with these companies. Members have requested the Administration to review the definition and criteria requiring non-Hong Kong companies to register in the light of practice in other jurisdictions.

39. The Administration has advised that in the UK, the threshold for registration is the opening of a UK establishment, which means a place of business or branch of an overseas company. While the term "place of business" is not defined in the UKCA 2006, it is considered sufficient to meet the established place of business test if only activities incidental to the main business of the company are carried on in the UK. For example, an overseas company which sets up only warehouse or administrative facilities will be regarded as having established a place of business and therefore be required to register in the UK. In Singapore, a combination of thresholds is adopted in the Singapore Companies Act ("SCA"), namely the carrying on of business and establishment of place of business. There is a definition on "carrying on business" but no definition of "place of business". According to the Administration, the threshold of registration under the CO for companies incorporated outside Hong Kong has followed the position in the UK adopting the "place of business" but the exact definition has evolved over time. It is also the view of SCCLR that the threshold of registration should be maintained as besides the difficulty in formulating a definition of "carrying on business", there is no certainty in the "carrying on business" test as compared with the "place of business" test, resulting in companies registering in Singapore just to be on the safe side. Moreover, the presence of a well-settled body of case law on what constitutes an established place of business would facilitate the interpretation of the

concept. For instance, the court has held that a company has an established place of business, if it has a specified or identifiable place at which it carries on business which has more than a fleeting character, and there is some visible sign or physical indication that the company has a connection with particular premises. Given the above, the Administration considers it desirable to use the concept of establishment of a place of business rather than adopting the new test of carrying on business.

40. The Bills Committee notes that clause 778 provides that a non-Hong Kong company may cause accounts that have been registered to be revised and it has to deliver a warning statement to the Registrar within 7 days if there is such a decision. Given that it may take non-Hong Kong companies more time to file the statement than local companies, members have suggested that a period longer than 7 days be allowed. In view of members' suggestion, the Administration has agreed to introduce a CSA to replace the time limit of "7 days" with "15 days". Members note that the revised limit is in line with the proposed change for companies to deliver documents to the Registrar for registration or notification under the CB.

Part 18

41. Part 18 -- Communications to and by Companies, relates to communications in electronic or hard copy form between a company and its members, debenture holders, and other persons. It also deals with communications sent by a company to its members and debenture holders by means of a website.

42. Clauses 816 to 818 (Division 3) deal with communications to a company by a natural person (i.e. who is not company). A document is deemed to have been received by the company 48 hours after it has been sent by electronic means, or any longer period as specified in the company's articles (for members), the instrument creating the debenture (for debenture holders) or any other agreement (for other persons), as appropriate. Clause 817 provides that if the document or information is sent or supplied by post to a company by a natural person, it is deemed to have been received by the company on the following working day after posting or otherwise as specified in the company's articles (for members) or instrument creating the debenture (for debenture holders), or any other agreement (for other persons), whichever is the later. If the document is sent by hand, it is deemed to have been received by the company when the document is delivered.

43. Clauses 819 to 825 (Division 4) govern communications by a company to other companies and natural persons and restates the existing Part IVAAA of the CO. In particular, clause 821 restates that a company may communicate with its members, debenture holders and other persons by means of a website, if so permitted by its articles or a members' resolution and if the recipient consents to the use of website communications. If the recipients are members or debenture holders, they will be taken to have agreed to receive information from the company via a website if they have been asked individually for their acceptance and have not responded within 28 days of the company's request. Companies are required to notify intended recipients each time any material is published on a website. The document or information should be available on the website throughout the period specified by the applicable provision of the CB or the Companies (Winding Up and Miscellaneous Provisions) Ordinance, or where no such period is specified, a period of 28 days.

Clause 812 (Time specified for purposes of sections 816(7)(b), 817(5)(a), 819(7)(b) and 820(5)(a))

44. Clause 812 provides where the document or information is sent or supplied by post, it is to be regarded as being received at the time it would be delivered in the ordinary course of post. Members have sought clarification on the meaning of "delivered in the ordinary course of post". The Administration has explained that it is the following working day after posting. In view of members' queries, the Administration will introduce CSAs to clause 812 to clarify the meaning by removing the reference to "the ordinary course of post" and expressly states that the time refers to "the second business day after the day on which the document or information is sent or supplied". Members agree with the proposal and note that the change will align with the Practice Direction issued by the High Court in respect of delivery in the case of ordinary post under the relevant rules of court governing proceedings in the High Court, District Court, Lands Tribunal and Family Court. It should be noted that the deemed receipt of the document or information by post will be rebuttable where the contrary is proved.

Clauses 816 and 819 (Communication in electronic form)

45. Members note that deputations including The Hong Kong Institute of Chartered Secretaries ("HKICS") and some listed companies have expressed concern that the "48 hours" limit specified in clause 811 for the purpose of clauses 816(7), 819 and 821 may not cater for the operation of

companies. In order to provide flexibility to companies, the Administration will move CSAs to clause 811 to the effect that the 48 hours requirement will be subject to any provisions in the company's articles, the instrument creating the debenture or any other agreement.

46. Members have also raised concern that while clause 816(7) and clause 819(7) provide for deemed receipt of a document or information, the document or information may not actually be received. In view of members' concern, the Administration will introduce CSAs to the clauses to provide that the deemed receipt of the document or information in electronic form will be rebuttable where the contrary is proved.

Clause 820 (Communication in hard copy form)

47. Clause 820 provides that a document may be sent by hand or by post in hard copy form to an address specified in section 813. Members have sought clarification on whether a mail box in a post office will be considered an address. The Administration has confirmed that an address can be a post office box number. Similar to the CSAs introduced to clauses 816 and 819, the Administration will introduce CSAs to clause 820 to provide that the deemed receipt of the document or information sent or supplied by post will be rebuttable where the contrary is proved.

Clause 821 (Communication by means of website)

48. Members note that as for requests under clause 821(4)(b) or 821(5)(b), a member or debenture holder of a company would be regarded as having agreed to receiving document or information by means of website if he does not respond to the company's request (if required) within 28 days from the date on which the request is sent. Members are concerned that the request from the company may not have been successfully delivered to the recipient and both the sender and the recipient may not be aware of failure of the delivery. Under such circumstances, the member or debenture holder may still be regarded as having agreed to receive the information by means of website. Taking into account members' concern, the Administration will introduce CSAs to clause 821 to the effect that the deemed agreement will be rebuttable if it is proved that the member or debenture holder has not received the request sent by the company.

Group 3: Parts 2 and 12

Part 2

49. Part 2 -- Registrar of Companies and Companies Register, contains provisions relating to the Registrar, the Companies Register and the registration of documents by the Registrar.

Clause 23 -- Registrar may issue guidelines

50. Clause 23 provides the Registrar with a new power to issue guidelines to provide guidance on the operation of any provision in the CB. Such guidelines are not subsidiary legislation (clause 23(3)). Contravention of the guidelines will not attract civil or criminal liability but the guidelines are admissible in evidence in legal proceedings if they are relevant to determine a matter in issue (clause 23(5)). According to the Administration, at present, the Registrar only issue guidelines as an administrative measure. The clause has been drafted with reference to relevant provisions in the Financial Reporting Council Ordinance ("FRCO") (Cap. 588) and the UKCA 2006.

51. Members have expressed concerns about the purpose of clause 23(5) and possible conflict between contravention of the guidelines resulting in no liability and allowing the guidelines to be admissible as evidence in legal proceedings. The Administration has responded that clause 23(5) seeks to state expressly the current common law position on contravention of a guideline and the admissibility of guidelines in legal proceedings for the purpose of clarity. Some members opine that compliance with the guidelines can be used as a defence for persons in legal proceedings and the clause would facilitate the court adopting the guidelines in consideration of a case. There is no conflict in the clause.

The Registrar's powers in relation to the registration of documents and keeping of Companies Register (clauses 29, 33 to 36, 37 to 42 etc.)

52. Currently under section 348 of the CO, the Registrar may refuse to register a document but the grounds for refusal are not entirely clear. Clauses 29 to 34 empower the Registrar to refuse to register an unsatisfactory document (e.g. a document which is internally inconsistent or inconsistent with the information already on the Companies Register) or to withhold registration of a document pending further amendments or provision of further particulars (e.g. requesting the person to take certain remedial actions such as producing further information or evidence,

amending or completing the document or applying for a court order). The clauses are drafted with reference to relevant provisions in the UKCA 2006 (e.g. the provision on Registrar's requirement as to form, authentication and manner of delivery of documents) and the Australian Corporations Act 2001 ("ACA") (e.g. the provisions on Registrar's refusal to register or withholding registration of unsatisfactory documents).

53. The Bills Committee notes the views expressed by The Law Society of Hong Kong ("LSHK") that there should be a time limit for the Registrar to revert as to whether a document is acceptable for registration. In this regard, members agree with the views on setting a time limit for the Registrar to give a notice of refusal and stipulating clearly the obligation of Registrar to give reasons for the refusal. The Administration is of the view that it is unnecessary to set a time limit because the Registrar is obliged to exercise the statutory power within a reasonable period. Moreover, given that the time taken to consider each case will depend on a number of factors, such as the circumstances of each case and the time needed by the person to submit supplementary information, it will be undesirable to set a time limit in this regard. Regarding the obligation of Registrar to give reasons on refusal, taking into account members' views, the Administration will propose CSAs to clause 36 to replace the word "may" by "must" to make clear the Registrar's obligation.

54. At present, the Registrar adopts administrative measures in appropriate cases to accept the filing of "amended" documents to rectify documents which contain errors and to annotate the information in the Companies Register so as to provide supplementary information. In order to provide such measures with statutory footing, clauses 37 to 42 provide expressly powers for the Registrar to annotate information on the register to provide supplementary information, e.g. the fact that the document in question has been replaced or corrected; and to request companies or their officers to resolve inconsistencies in information on the Register or to provide updated information.

55. Clause 37 seeks to empower the Registrar to require a company to resolve inconsistency between information in a document registered by the Registrar and other information on the Companies Register. Members consider that the provision should clarify that both the document and the information on the Companies Register should relate to the same company. The Administration will introduce CSAs to clause 37 to this effect. In relation to the criminal liability under clause 37(3) on the company and responsible person of the company for failure to comply with the Registrar's requirement, members are concerned that it may not be possible

for the company or responsible person to resolve the inconsistency in information in certain cases. In the light of members' concern, the Administration will introduce CSAs to provide a defence for a company to establish that it has taken reasonable steps to comply with the requirement.

Accessibility to information on residential addresses of directors and company secretaries and full identification numbers of individuals in the Companies Register (clauses 26, 47 to 54)

56. At present, directors and company secretaries of companies incorporated in Hong Kong and registered non-Hong Kong companies are required by the CO to provide their residential addresses and identification numbers ("ID numbers") to the Registrar for incorporation and registration purposes. Such information is available on the Companies Register and can be inspected and copied by the public. To address rising concerns over the protection of personal privacy and information as reflected in the views of the majority of respondents in previous consultations on the draft CB, there are new provisions in Part 2 for restricting access to the residential addresses of directors and company secretaries and full ID numbers of individuals. For directors, the CB requires the provision of correspondence addresses in addition to residential addresses. Only specified public authorities and other specified persons will be allowed access to the directors' residential addresses kept on a confidential record of the Companies Registry. The directors' correspondence addresses will be shown on the Companies Register. Regarding the ID numbers of individuals, certain digits in the ID numbers will be masked on the public register. Access to the full ID numbers will similarly be restricted to specified public authorities or other specified persons. The remaining digits of the ID numbers (together with the name) should be sufficient to identify individual persons. Certain related provisions are set out in Parts 3, 12 and 16 of the CB. For company secretaries, the CB no longer requires them to disclose their residential addresses but only to provide correspondence addresses for incorporation and registration purposes. Key provisions to implement the above proposal include clause 49 which provides that the Registrar must not make the directors' residential addresses contained in specified categories of documents delivered to the Registrar for registration for public inspection. Clause 49 also covers the protection of full ID numbers of all persons in a similar manner. Clauses 50 and 51 provide that, in case communication with a director at the director's correspondence address is not effective, the Registrar may, after considering the representations of the director and the company concerned, put the director's residential address on the Companies Register as the director's correspondence address and thereby make it available for public

inspection. The effect of the Registrar's decision in this regard will last for five years. Clause 53 permits the use or disclosure of the protected information (under clause 49) by the Registrar for purposes of communicating with the director or individual, the performance of the Registrar's functions, or disclosing to entities prescribed by regulations made under the clause. Clause 54 provides that a creditor or member of the company concerned or any other person having a sufficient interest may have access to the protected information by applying to the court for an order for disclosure by the Registrar of the protected information. In view of the huge volume of existing records bearing residential addresses and ID numbers filed with the Companies Registry, clause 47 provides that the information already on the register before the commencement of the CB will only be withheld from public inspection upon application and payment of a fee.

57. Some members including Hon Andrew LEUNG and Hon WONG Ting-kwong have expressed support for the above proposals to address concerns over protection of data privacy, possible misuse of personal data, and personal safety problems. Other members including Hon Miriam LAU and Hon Albert HO have reservation over withholding all information on directors' residential addresses from public inspection as the disclosure of such information may be required for preparation of legal documents or conducting legal proceedings, and correspondence address may not facilitate effective communication with directors. While some deputations including SMEs associations, The Hong Kong Institute of Directors ("HKIoD"), support the proposal to withhold public access to information on directors' residential addresses and full ID numbers on grounds to protect personal privacy, some deputations such as The Hong Kong Association of Banks ("HKAB") opines that provision of such information is justified for law enforcement and would enhance a sense of responsibility on the part of directors. Furthermore, there is concern about the unduly long period of five-year for disclosure of a director's residential address if communication with his correspondence address is ineffective. The Bills Committee has enquired about the approach taken by other jurisdictions in protecting directors' personal data and considers that there should be procedures allowing access to protected information on legitimate need, such as to facilitate law enforcement. There is also suggestion that the Registrar should verify the validity of a director's correspondence address when there are complaints about ineffective communication with the director at the address. Such action of the Registrar should be set out in the relevant practice note of the Companies Registry.

58. The Administration has advised that proposals in the CB broadly follow the approach for protection of directors' residential addresses in the UK, which received more support than the Australian approach, under which a director is 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 appears to offer less effective protection as directors may only apply for substitution of residential addresses after the risks to personal safety are established.

59. The Administration re-iterates that the proposal to restrict access to residential addresses and identification numbers of directors and company secretaries seeks to strike a balance between protection of privacy and the need to identify and contact directors. As regards concern about the five-year period under clause 50, the Administration has explained that it strikes an appropriate balance between protection of privacy of directors' residential addresses and maintaining an effective mechanism for public information. Protected information would continue to be made available to entities prescribed by regulations to be made by the FS under clause 53 upon application to the Registrar. Taking into account members' views, tentatively prescribed entities should include specified public authorities (e.g. Labour Department, Police, etc.) and regulators, liquidators and provisional liquidators, members of the relevant companies, and the individual to whom the information relates and any person authorized in writing by the individual to obtain the information. It is believed 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.

60. Members have also expressed concern about the transitional arrangements for the existing residential addresses shown in the Companies Register. They note that such information will automatically be recorded as "correspondence address". To withhold such information from public disclosure, directors and company secretaries are required to make

application and pay the necessary fee to change the information to companies' registered addresses or provide new correspondence addresses. As the requirement is not user-friendly and cumbersome, members have urged the Administration to streamline the procedures by replacing the existing information on residential addresses of directors and companies secretaries in the Companies Registry with the companies' registered addresses.

61. The Administration has advised that for companies which already exist before the commencement of the CB, the Companies Registry will not have the correspondence addresses of the directors and the company secretaries. It is therefore necessary for the Companies Registry to record, at the commencement of the CB, their residential addresses as the correspondence addresses. Notification of change of correspondence address may be delivered subsequently by the company to the Registrar for registration. Having considered members' suggestion, the Administration will introduce CSAs so that the Companies Registry would record, at the commencement of the CB, the addresses of the companies' registered offices (or principal places of business of registered non-Hong Kong companies), instead of the residential addresses of the directors and company secretary, as the correspondence addresses. However, even with this amendment, the residential addresses would still appear on various documents filed with the Companies Registry before the commencement of the CB. In view of the huge volume of these existing records bearing residential addresses, these addresses will only be withheld from public inspection upon application and payment of a fee in accordance with clause 47.

Part 12

62. Part 12 -- Company Administration and Procedure, governs resolutions and meetings, keeping of registers, company records, registered offices, publication of information relating to companies and annual returns.

Written resolution and proposing threshold (clauses 538 to 551)

63. Section 116B of the CO provides that anything which may be done by a company by resolution in a general meeting may be done, without a meeting and without any previous notice, by a resolution signed by all members of a company (written resolution) but there are no statutory rules that provide for the necessary procedures. Clauses 538 to 551 provide for the procedures for proposing, passing and recording written resolutions.

Clause 551 allows a company's articles to set alternative procedures for passing a resolution without a meeting, provided that the resolution has been agreed to by members unanimously.

64. Members note that the threshold for proposing a written resolution and requesting its circulation by a company is 2.5% of the total voting rights of members (clauses 539 and 542) or a lower threshold as specified in the company's articles. Noting that the thresholds in UK and Singapore are both 5%, members have suggested the CB to adopt the 5% threshold. The Administration has explained that the current threshold of 2.5% is adopted from the threshold for proposing a resolution in an annual general meeting ("AGM") under section 115A(2)(a) of the CO, which is restated in clause 605(2)(a). It also aligns with the threshold for circulation of members' statements in a general meeting (clause 570(2)(a)). However, having considered that the threshold for calling a general meeting is 5% (clause 556(2)), and taking into account members' views, the Administration has agreed to move CSAs to raise the threshold to 5%.

Circulation of written resolution and accompanying statements (clauses 543 and 544)

65. Clauses 541, 543 and 544 are new provisions requiring a company to send a proposed written resolution and statement (which is no more than 1 000 words) to all members and allowing the sending by electronic means. The court, on application by the company or an aggrieved person, can relieve the company of the obligation to circulate the members' statements if it is satisfied that the right to require circulation is abused.

66. Members sought clarification on what would constitute an abuse under clause 544(1). The Administration has explained that the test in the corresponding section of the CO (section 115A(5)) is whether the rights are being abused to secure needless publicity for defamatory matter. The scope of abuse in clause 544 has been widened in line with section 295 of UKCA 2006. The term "abuse" in clause 544 will adopt its ordinary meaning and may include making a bad or wrong use of something. For instance, the right to make the statement may have been abused if the statement is of marginal relevance to the company's main activities or if it is given in bad faith or in pursuit of any private or collateral interest. However, the court may not regard the right as being abused where dissemination of the information is in the interest of shareholders. Members are of the view that the evidential threshold for "abuse" will be higher than "defamation", hence defeating the purpose of clause 544. The Administration has been requested to review the clause and consider

including "defamation" in the clause. Moreover, members consider that the limitation of the statement to 1 000 words under clause 541 may be unrealistic. In order to prevent abuse by members, the Bills Committee has suggested that the concerned member of the company should be allowed to make request for circulating one statement only. The Administration has taken on board members' views and will move CSAs to clauses 544 and 541 accordingly.

Passing of written resolution

67. Clause 547 provides that, subject to any provision of the company's articles, if two or more eligible members are joint holders of shares of a company, the person whose vote counts for signifying agreement to a proposed written resolution under clause 546 is the joint holder whose name appears first in the register of members (i.e. the senior holder). Members consider that the provision has not taken into account practical difficulties preventing the senior holder from signifying his agreement, such as health reasons. Members have requested the Administration to review the clause. Taking into account members' view, the Administration will introduce CSA to the effect that if any holder has signified their agreement, subject to any objection by a more senior member, then the other joint holders are to be regarded as having signified their agreement. The seniority of members is determined by the order in which their respective names appear in the register of members of the company.

Resolution at meetings (clauses 552 to 554)

68. Clause 552(1) states that a resolution is validly passed if it is passed in a general meeting in accordance with provisions in the CB and the company's articles. Members have sought clarification on whether the CB or the articles would prevail in case of conflict. Taking into account members' views, the Administration will introduce CSAs to provide that, except for those specific provisions which are expressly stated to be subject to a company's articles or which expressly state the articles may provide otherwise, the CB shall prevail over the articles in case of conflict.

Calling meetings and notice of meetings (clauses 555 to 569)

69. Clause 561(1) sets out the requirement on the notice period for holding a general meeting of a company (i.e. 21 days for an AGM; in respect of other meetings: 14 days for a limited company and 7 days for an unlimited company). Clause 561(3) allows a shorter notice period: in the case of an AGM, if there is unanimous agreement from all the members of

the company, and in any other cases, agreement by a majority in number of the members together representing at least 95% of the total voting rights at the meeting. Members are concerned about possible abuse on the provision to give shorter notice of meeting. To protect the interest of minority shareholders, members have suggested raising the threshold to 100%. The Administration considers it inappropriate to tighten the requirement further to 100% members' approval as the proposed threshold is already very high and is in line with the relevant thresholds in the UK, Australia and Singapore. The proposed threshold will provide sufficient safeguard for protection of minority shareholders' interests. Despite the high threshold of 95% to agree on a shorter notice for a meeting, it will be useful to small private companies with a few shareholders, subsidiaries or family controlled companies where they may find it necessary to obtain members' approval for an imminent transaction or to meet a deadline.

70. To enhance protection for minority shareholders, some members have required the Administration to consider prescribing provisions in Part 12 for members of a company to propose changes to the date and time of a general meeting and for directors' meetings. The Administration is of the view that the intention of the CB is to provide a general framework for companies to hold meetings without over regulation. Other major common law jurisdictions, like the UK, Australia and Singapore, also do not have detailed provisions on meetings of members and directors. Specific and detailed requirements tailored to suit the needs of individual companies can be provided in the articles if a company considers it necessary.

Circulating members statements relating to business of, and proposed resolutions for annual general meetings (clauses 570 to 572, 605 and 606)

71. Clause 570(2) provides a member with the power to request the company to circulate a statement (not more than 1 000 words) concerning the business to be dealt with at general meetings, upon request from members representing at least 2.5% of the total voting rights of all the members who have a relevant right to vote, or at least 50 members who have a relevant right to vote and has paid up an average sum, per member, of at least $2,000. Under clause 572, if the meeting concerned is an AGM and the member's statement is received in time for sending with the notice of the meeting, the expenses will be borne by the company. Otherwise, the expenses will be paid by the members concerned. Clauses 605 and 606 contain similar provisions in respect of members' proposed resolutions for AGMs. A circulation request must be received by the company not later than 6 weeks before the AGM, or if later, before the time at which

notice of meeting is given. The company is obliged to circulate the resolution at the company's expense.

72. Noting that the threshold for request for circulation of statement under the UKCA 2006 is 5% of the total voting right, and considering that the paid-up sum of $2,000 per members would not be a meaningful amount, members have suggested the Administration to raise the threshold and to delete the paid-up sum.

73. The Administration has responded that the threshold of 2.5% restates section 115A(2) of the CO. While the Administration considers that the current 2.5% threshold should be maintained, it has agreed with members that the threshold of 50 members is sufficient and there is no need to retain the requirement on the paid-up sum. The Administration will propose CSAs to remove the requirement in clauses 570(2)(b) and 605(2)(b).

Meeting procedures and voting at meetings (clauses 574 to 585)

Holding meetings at two or more places

74. The current CO does not have express provision permitting a general meeting to be held at two or more places. To keep up with technological development and subject to any provision of the company's articles, clause 574 permits a company to hold a general meeting at two or more places using audio-visual technology that enables the members of the company to exercise their right to speak and vote at the meeting.

75. Members note that in other common law jurisdictions, the relevant provisions have adopted the wordings like "technology that gives members as whole a reasonable opportunity to participate" and "electronic means", which better cater future development in communication technologies. As the objective of the provision is to enable members of the company to exercise their right to listen, speak and vote at a meeting, having considered the Bills Committee's views, the Administration will move a CSA to replace "audio-visual technology" by "technology" so as to give more flexibility to companies.

76. On whether the CB should include provisions on the procedures for companies in conducting meetings at two or more places, such as the verification of the identities of members participating in meetings held at two or more places and conducting secret ballots by electronic means, the Administration considers it unnecessary to regulate the procedures for

conducting dispersed meetings. Given that the procedures may change as technology evolves, companies should be allowed to make their own rules according to their needs and circumstances. A company may set out rules and procedures for holding a dispersed meeting in its articles.

Members to demand a poll

77. Members note that clause 581(2) provides that the threshold for members to demand a poll at a general meeting is 5% of the total voting rights, while the existing threshold is 10% (section 114D of the CO) which is the same as adopted in the UK and Singapore. Members have requested the Administration to review the threshold.

78. The Administration has advised that the 5% threshold for demanding a poll is in line with the threshold for members' requisition for an extraordinary general meeting in clause 556(2), which restates section 113 of the CO. The 5% threshold in section 113 of the CO was enacted in 2000 pursuant to a recommendation in the Consultancy Report on Review of the Hong Kong Companies Ordinance to facilitate shareholders holding a small percentage of voting shares to call a meeting with a view to promoting accountability of the management to shareholders. The 5% threshold is in line with the position in Australia and the recent recommendation in Singapore to lower its current threshold from 10% to 5%. Therefore, the Administration considers that the proposed 5% threshold should be adopted. The Administration has also explained that after commencement of the CB, a provision in a company's articles adopting a higher threshold than 5% would be void as provided in clause 581(2).

<u>The rights and obligations of proxies</u>

79. The system of proxy voting helps ensure that the views of members who are unable to attend a meeting in person will still be voiced and considered. The CB contains proposals to clarify the rights and obligations of a proxy. For example, clause 586 provides that a member of a company is entitled to appoint a proxy and that a proxy may exercise all or any of the member's rights to attend and to speak and vote at a general meeting. Clause 581(3) authorizes a proxy to demand a poll. Clause 592 expressly provides that a proxy may be elected as the chairperson of the general meeting, subject to any provisions of the company's articles.

Liabilities of a proxy elected as the chairperson of a meeting (clause 592)

80. Members have expressed concern about the legal liability of a proxy elected as the chairperson of a general meeting if he fails to properly perform the role and function of the chairman, and under such situation, the liability of the member who appointed the proxy.

81. The Administration has explained that the relevant provisions are modelled on the UKCA 2006. In terms of legal liabilities on a proxy acting as chairman, the position would be the same as anyone else acting as chairman. As in other common law jurisdictions like the UK, a person appointed as proxy is a "lawfully constituted agent". As for the liability of the member who appointed the proxy, it is the common law principles that, if the proxy acts within the scope of authority, the member, as principal of the proxy, is liable for the proxy's act. The Administration considers it unnecessary to specify in the CB the legal liability of the parties under common law as there is no intention to depart from those principles.

Annual general meeting (clauses 600 to 606)

82. Every company is required to hold AGMs under section 111 of the CO. A company may dispense with holding AGMs if everything that is required or intended to be done at the meeting is done by written resolutions, and a copy of each of the documents (including any accounts or records) which under the CO would be required to be laid before the meeting is provided to each member of the company. To simplify the decision-making process, clause 603 allows a company to dispense with the requirement for holding of AGMs by passing a written resolution or a resolution at a general meeting by all members. After passing such a resolution, the company will no longer be required to hold any subsequent AGMs. However, the financial statements and reports originally required to be laid before an AGM will still need to be sent to the members under clause 421(3) of Part 9. Also any member may request the company to convene an AGM for a particular year. The company may revoke the resolution by passing an ordinary resolution to that effect, in which case, the company will be required to hold subsequent AGMs. For a single member company, clause 602(2)(a) provides that such a company is not required to hold an AGM at all.

83. Clause 600 modifies the existing requirement in the CO by replacing the Registrar's power with the court's power for application of extending the period allowed for holding an AGM. Members are of the view that it will be more cost-effective and efficient for the Registrar to

consider such applications. Similarly, there is suggestion to empower the Registrar for extending the period for laying or circulating financial statements and reports (clauses 420(1) and 422(1)).

84. The Administration has pointed out that under sections 111(2) and 122(1B) of the CO, the court may give directions to a company where there is default in holding an AGM, and for laying accounts before that meeting. The court has wide powers to give directions relating to the supervision of the process and has frequently exercised the power to regularize companies' non-compliance which may have continued for periods as long as 10 years. As applications may involve complicated issues of fact and law and may include relief sought under other sections of the CO, the Administration considers the court a more appropriate forum to adjudicate the issues concerned which is better equipped to give directions on all the matters arising from such applications. Given that the period for holding an AGM is aligned with that for laying or circulating annual financial statements and reports, for expediency, applications for extension of time for such purposes should be dealt with exclusively by the court, as provided in clauses 420(1), 422(1), 600(5) and (7). Members note that the position in the UK is the same as the proposal in the CB.

Records of resolutions and meetings (clauses 607 to 612) and registers of a company (clauses 616 to 644)

85. Members have expressed concern that the requirement for a company to keep records of resolutions and meetings, etc. and a former member's entry on the register of members for 20 years in clauses 608 and 617 respectively is too long vis-à-vis the requirement of seven years for keeping accounting records in clause 373(2). They have requested the Administration to consider shortening the period.

86. According to the Administration, the current CO is silent on the period for keeping records of resolutions and meetings, etc., as is the position in Australia and Singapore. The UKCA 2006 (section 355(2)) introduces a 10-year minimum period for keeping records of resolutions, meetings or decisions of sole members. Clause 608(2) is modelled on the UK provision but has adopted a period of 20 years to align with that for retaining the register of former members in clause 617(5). Taking into account members' concern about the 20-year period, the Administration has agreed to introduce a CSA to reduce the period to 10 years. As for the requirement to keep a former member's entry, section 95(1)(c)(ii) of the CO provides that entries relating to a former member may be destroyed after 30 years. The period is reduced to 20 years in the CB after considering

various factors including, the 20-year period for reinstatement of a company being struck off. Having considered members' views and the relevant period of 10 years in the UKCA 2006 (section 121) and seven years in Australia (section 169(7) of the ACA) and Singapore (section 190(1) of the SCA), the Administration will introduce a CSA to clause 617(5) to change the period of 20 years to 10 years.

Place for keeping records and registers of a company available for inspection (clauses 609, 618, 632 and 639)

87. Clause 609 provides that a company must keep its records available for inspection at the company's register office or a prescribed place (to be set out in regulations under clause 648). Similar requirements for a company in keeping its registers of members, directors and company secretaries are provided in clauses 618, 632 and 639. Members have suggested that companies should be allowed to keep its records and registers in more than one places as many companies in Hong Kong have to keep records in different warehouses. It follows that records and registers may not be available for inspection at the place where they are kept. Members have also suggested adding a defence that a company would not be liable for failing to provide records for inspection due to circumstances that are out of its control (e.g. the records have been destroyed by fire). In view of members' suggestions, and taking into account the requirements in the UK, the Administration will introduce CSAs to clauses 609, 618, 632 and 639 to allow a company to keep its records and registers at more than one place in Hong Kong, allow inspection to take place at a place other than the place(s) at which the records are kept (provided that there should be no more than one inspection place). With regard to the suggestion to introduce a defence for failure to provide records for inspection due to circumstances beyond the company's control, the Administration is of the view that since *mens rea* is required to be proved beyond reasonable doubt for prosecution of a "responsible person" in order to secure a conviction, it is not necessary to provide the statutory defence in this respect.

88. Clause 626 (register to be proof in the absence of contrary evidence) provides that the register of members is prima facie evidence of the matters therein. Clause 626(2) follows section 102(2) of the CO but the time limit of 30 years for adducing evidence to challenge the accuracy of an entry in the register is reduced to 20 years. Members have expressed concern about the reduction in time limit may prejudice the rights of shareholders, and requested the Administration to consider maintaining the 30-year time limit or leaving the matter to the court. After review, the Administration will propose a CSA to delete clause 626(2) in order to address members'

concern. This CSA would have the effect of removing any limitation on admissibility of evidence for the purpose of rectification of the register by the court.

Group 4: Part 9

Part 9

89. Part 9 -- Accounts and Audit, contains the accounting and auditing requirements for companies, such as provisions in relation to the keeping of accounting records, the preparation and circulation of annual financial statements. There are proposals to facilitate business by allowing SMEs to take advantage of simplified accounting and reporting, to enhance corporate governance by requiring public and other large companies to include an analytical business review in directors' reports and enhancing auditors' right to information.

Reporting exemption for companies (Division 2 (clauses 358 to 362)

90. Section 141D of the CO provides that a private company (other than a company which is a member of a corporate group and certain companies specifically excluded) may, with the written agreement of all its shareholders, prepare simplified accounts and simplified directors' reports in respect of one financial year at a time. Companies meeting the above requirements are qualified for reporting based on the SME-Financial Reporting Standard ("SME-FRS") according to the Small and Medium-sized Entity-Financial Reporting Framework ("SME-FRF") issued by the HKICPA[6]. Currently the SME-FRF is not applicable to groups of companies or guarantee companies at all.

91. Clauses 358, 359, 360, 361 and Schedule 3 set out the qualifying conditions for companies to prepare simplified financial and directors' reports along the following lines --

(a) A private company (except for a banking/deposit-taking company, an insurance company or a stock-broking company) will automatically be qualified for simplified reporting if it is a "small private company", i.e. a private company that satisfies any two of the following conditions --

[6] The SME-FRF sets out the conceptual basis and qualifying criteria for the preparation of financial statements in accordance with the SME-FRS. The SME-FRS contains detailed specifications and disclosures in relation to the preparation of financial statements. The SME-FRF and SME-FRS are available at the website of the Hong Kong Institute of Certified Public Accountants.

(i) total annual revenue of not more than HK$50 million;

(ii) total assets of not more than HK$50 million;

(iii) no more than 50 employees.

(b) A private company that is the holding company of a "group of small private companies", i.e. a group of private companies that satisfies any two of the following conditions is qualified for simplified reporting --

(i) aggregate total annual revenue of not more than HK$50 million net;

(ii) aggregate total assets of not more than HK$50 million net;

(iii) no more than 50 employees.

(c) A "small guarantee company" or a guarantee company that is the holding company of a "group of small guarantee companies" as described in clause 362 (total annual revenue must be not more than HK$25 million) is also qualified for simplified reporting.

92. The qualifying conditions in Schedule 3 may be amended by the FS by notice published in the Gazette and the notice is subject to negative vetting by LegCo. The simplified reporting requirements enjoyed by companies falling within the reporting exemption are as follows --

(a) preparation of financial statements in compliance with the applicable accounting standards i.e. SME-FRS and FRF, which are less onerous than the full Hong Kong Financial Reporting Standards ("HKFRSs")[7];

(b) exemption from disclosure of auditor's remuneration in the financial statements;

(c) exemption from preparing a business review and from disclosure of other information in a directors' report; and

[7] HKFRSs contain an extensive set of the recognition, measurement and disclosure requirements that has been fully converged with the International Financial Reporting Standards.

(d) the auditor must state his/her opinion in the auditor's report as to whether the financial statements have been properly prepared in compliance with the new Ordinance, which includes compliance with the applicable accounting standards. There is no requirement to state whether the financial statements give a true and fair view of the financial position and financial performance of the company.

93. The Bills Committee notes that a number of deputations including SMEs associations and Chambers of Commerce have expressed support to further relax the criteria to allow more companies to benefit from the simplified reporting. There is a suggestion to extend the use of SME-FRS to private companies/groups of any size when members holding certain voting rights in the company approve and no member objects. Members recognize that relaxation in the qualifying criteria for private companies for simplified reporting would help relieve operating costs of larger companies which do not qualify for using the SME-FRS, and considers that allowing private companies/groups to adopt simplified reporting with their members' approval will not undermine members' interest. The Bills Committee has urged the Administration to review the qualifying criteria for adopting simplified reporting.

94. The Administration is of the view that since "large" private companies in general have more complex accounts, it may not be appropriate for them to prepare simplified accounts in accordance with SME-FRS which is designed for SMEs. During consultation of the draft CB, deputations including HKICPA have expressed concern on the appropriateness of allowing "large" private companies to prepare simplified accounts in accordance with the SME-FRS even with the prescribed approval of members. The SCCLR also supported removing the option for private companies/groups of any size to opt for the use of SME-FRS based on approval by members. The Administration has pointed out that for "large" private companies/groups, they can still prepare accounts in accordance with the Hong Kong Financial Reporting Standard for Private Entities which is less onerous in terms of disclosure requirements than HKFRS. In other comparable jurisdictions like the UK, companies and groups may apply the simplified reporting framework only if they meet the size criteria.

95. At the Bills Committee's request, the Administration conducted a public consultation on the qualifying criteria in December 2011. As the qualifying criteria for simplified reporting in the CB are intended to be aligned with the size criteria in SME-FRF issued by HKICPA, the

Administration has invited HKICPA to review the criteria in the SME-FRF. After considering the views received in the consultation exercise and conclusions of HKICPA's consultation, the Administration has proposed to --

(a) double the size criteria as proposed by HKICPA (i.e. HK$100 million assets, HK$100 million revenue and 100 employees while maintaining the "two out of three" approach as set out in paragraph 91); and

(b) preserve the option under section 141D of CO for private companies (not being members of corporate groups) to adopt simplified reporting.

96. Members note that the proposal in (b) above is to address deputations' concern that certain companies previously qualified for simplified reporting under the CO (i.e. those single private companies not meeting the size criteria but having obtained the written agreement of all their members) will now be excluded. Under the revised proposal, a private company which is not a member of a corporate group may still adopt simplified reporting even though its scale exceeds the revised size criteria, provided it has secured the written agreement of all its members.

97. As regards whether private companies/groups meeting a higher size criteria should be allowed to prepare simplified report if members of the company so resolve, the Administration has advised that there are merits in considering the proposal for larger companies/group to opt in if members holding at least 75% of the voting rights so resolve and no other members object, subject to their size not exceeding a higher threshold, so as to extend the benefit of the proposal to a larger group of companies. While there are views that a threshold at $500 million in revenue or assets is on the high side, the Administration considers that the threshold can be suitably lowered to $200 million. In other words, private companies/groups satisfying any two of the following conditions, with the approval of members holding at least 75% of the voting rights and no other members objecting, may adopt simplified reporting --

(a) aggregate total annual revenue of not more than HK$200 million net;

(b) aggregate total assets of not more than HK$200 million;

(c) no more than 100 employees.

98. Members including Hon WONG Ting-kwong, Hon Jefferey LAM and Hon Andrew LEUNG generally support the above three proposals, which they regard to have struck the right balance between protecting shareholders' interests and facilitating business operation and reducing compliance cost of companies. With the relaxation on the qualifying criteria, it is expected that an overwhelming majority of private companies will automatically qualify for simplified reporting. According to a survey by the Census and Statistics Department, 97% of establishments had both business receipts not exceeding HK$100 million and number of persons engaged not exceeding 100. To ensure the criteria set on revenue, total assets and employees would cater for market changes, members have stressed the need for the Administration to conduct timely review of the thresholds in each proposal at regular intervals, beginning say after two years of the implementation of the simplified reporting regime.

99. On the other hand, the Bills Committee considers it important to ensure the relaxation in the qualifying criteria for simplified reporting would not prejudice the interests of shareholders and investors to have fuller financial information on the company. In this regard, members have sought information on provisions offering protection to minority shareholders with respect to company records.

100. As for protection of minority shareholders with respect to company records, the Administration assures the Bills Committee that there are provisions in Part 14 to enable company's members to apply for court order to inspect company's books and paper (clauses 728 to 731). These clauses seek to restate the relevant provisions in the CO.

<u>The financial year of a company (clauses 363 to 367)</u>

101. At present, the CO does not provide for a company's accounting reference period. The CB introduces provisions for the determination of the financial year of a company to deal with the beginning and end date of a company's first financial year and subsequent financial years (clause 363). That is determined by reference to a company's accounting reference period (clause 364) and accounting reference date (clauses 365 and 366). Clause 363(2) provides that a company's accounting reference period is the same as its financial year except that the company's directors may alter the last day of the financial year by plus or minus 7 days, so as to allow for a certain degree of flexibility in fixing the financial year. The end date of the financial year can be altered by a directors' resolution, subject to a number of conditions and exceptions set out in clause 367.

102. While the Bills Committee welcomes the provisions to clarify the financial year of a company in the CB, there is reservation over the proposal to allow a director to adjust the financial year end date up to seven days. Having considered members' views, the Administration will introduce CSAs to remove directors' power to make the adjustment.

Directors' reports (clauses 380 to 382)

103. The directors' report is basically a report of the company information that people may wish to know about but is not included in the accounts. Under the CO, the report must be approved by the board of directors, and a copy must be sent to every member and debenture holder of the company together with a copy of the accounts and the auditor's report. To provide more useful information for members of the company and to enhance shareholder engagement, under the CB, all public companies, and large private companies or large guarantee companies not qualified for simplified reporting are required to prepare as part of the directors' report, a business review which is more analytical and forward-looking than what are currently required under the CO. The contents of a business review include a fair review of the company's business, a description of the principal risks and uncertainties facing the company, and an indication of likely future development in the company's business. Large private companies may opt out of the requirement to prepare a business review if so approved by a special resolution of the members. Clause 380 and Schedule 5 provide for the directors' duty to prepare a directors' report and the detailed requirements of a business review.

104. The Bills Committee notes that deputations have expressed different views on the requirement for a business review in the director's report. While deputations including The Real Estate Developers Association of Hong Kong ("REDA") and HKAB consider it unnecessary to impose a statutory requirement on this aspect, HKICPA and HKIoD support the proposal. There are also views to extend the scope of business review to cover the company's policies and performance in relation to human rights and labour issues in order to enhance the corporate social responsibilities of companies.

105. Members have enquired the reasons for not requiring a company to prepare separate directors' remuneration report. The Administration has advised that, during consultation on the draft CB, the majority of respondents did not support the proposal on concern that it would be too onerous and would increase compliance costs for unlisted companies, the

vast majority of which are SMEs. Hence, for unlisted companies, the CB will restate the existing requirements under section 161 of the CO for accounts to include information on directors' emoluments, retirement benefits and compensation for loss of office and to further include new disclosures to be prescribed in regulations to be made under clause 378 of the CB. As for listed companies, any improvements to the disclosure of the remuneration of directors of listed companies should be better considered under the Listing Rules and/or SFO. The Administration has invited SFC and the Hong Kong Exchanges and Clearing Limited to keep under review the compliance and effectiveness of the relevant Listing Rules.

Auditors and auditor's report (Division 5 clauses 383 to 411)

Offences relating to contents of auditor's report (clauses 398 and 399)

106. Clause 398 requires that if the auditor is of the opinion that the financial statements of the company are not in agreement with its accounting records in any material respect, or the auditor has failed to obtain all the information or explanations that are necessary and material for the purpose of the audit ("the two statements"), the auditor must state that fact in the auditor's report. Clause 399 imposes a criminal sanction on a person for "knowingly or recklessly" causing the two statements to be omitted from the auditor's report. The Bills Committee notes that HKICPA has expressed grave concerns on clause 399, including the consequences of the clause and the potential implications for criminal liability of its members. HKICPA has also questioned the need for imposing criminal sanctions on auditors given the Institute's power to discipline its members, and raised concerns covering timeframe for prosecution, materiality, professional judgement, persons liable to prosecution and the primary responsibility of investigation. HKICPA notes that similar legislation on criminal sanctions against auditors exists in the UKCA 2006. However, it is of the view that the relevant provision was included in the law as part of a package to bring about auditors' liability reform in the UK. HKICPA considers that clause 399 should not be introduced on its own when there is no similar package for auditors.

107. Members including Hon Miriam LAU, Hon Audrey EU and Hon Ronny TONG share the concern that although the offence is not punishable by imprisonment, a criminal record relating to the work of an auditor could spell the end to his auditor career. On the other hand, the Bills Committee notes the support from SFC, and deputations including Federation of Hong Kong Industries ("FHKI"), The Hong Kong Electronic

Industries Association and The Institute of Certified Management Accountants -- Hong Kong Office for clause 399 on its benefit in enhancing the accountability of auditors and integrity of the financial reporting system thus inspiring investors' confidence in the auditor's work and the company's accounts. In the light of deputations' concerns, members have requested the Administration to reconsider the scope of the offence, i.e. whether an officer, partner, employee and agent of the auditor, who himself is eligible for appointment as auditor of the company, should be liable for offences relating to the contents of the auditor's report, and to consider other measures to allay the concerns.

108. The Administration has stressed that the criminal sanction under clause 399 is necessary for enforcement of the auditor's duty for making the two statements. The clause is modelled on section 507(2)(a) and (b) of the UKCA 2006. The relevant sections were introduced in the UK due to a number of reasons, including the problems caused by the failures and practices of some audit firms, the collapses of Enron and WorldCom, the problems caused by audits that went wrong and the government's aim to achieve proper and effective audit. Though the limitation of liability by contract was also the context of the introduction of the new crime, it is noteworthy that the legislature has also taken into account the high threshold of the offence, that the new offence does not criminalize negligence and the interest of third parties who rely on the company's account. The Administration has also advised that the offence under clause 399 is a summary offence for enforcement against non-compliance with the requirements in relation to contents of the audit report. It is a separate and distinct offence that would be enforced independently from the disciplinary proceedings pursued under the Professional Accountants Ordinance (Cap. 50). As regards HKICPA's concern that reckless omission of a required statement from the audit report without proof of any dishonest or fraudulent intent should not be covered by the offence, the Administration has pointed out that only the person who "knowingly or recklessly" causes the required statement to be omitted would be liable. In this regard, mere negligence would not constitute recklessness. The provision is sufficiently clear and the threshold for conviction is very high. Therefore, the provision has sought to uphold the accuracy of financial reports while not being too onerous for auditors.

109. The Bills Committee further notes that some deputations have cautioned against applying clause 399 to employees of the auditor and junior persons involved in the audit. SFC has suggested revising the wording of the clause to better reflect the intention to cover senior members of an audit team who may not qualify to act as an auditor and to

exclude junior persons involved in an audit. Taking into account the views expressed by the Bills Committee and deputations, the Administration will propose CSAs to remove the references to officer, partner, employee and agent of the auditor from clause 399. It would make clear that only the persons who sign the auditor's report or perform managerial functions in relation to the audit under the immediate authority of the person who signs the auditor's report, and who knowingly or recklessly caused the two statements to be omitted from the auditor's report would be liable.

110. Members consider that it is of paramount importance to ensure that an effective regulatory regime for auditors, who have a statutory duty to report on the financial statements prepared by companies, is in place in Hong Kong. They generally agree that the imposition of appropriate criminal sanctions on auditors' deliberate omission of important information in the auditor's report is appropriate. Some members including Hon Jeffrey LAM, Hon Albert HO and Dr Hon Philip WONG have pointed out that small investors have high expectation of the company's auditor in playing an independent gatekeeper's role in respect of the company's financial reporting. Any omission of important financial information would adversely affect investors' interests. They agree with the CSAs proposed by the Administration. Hon Abraham SHEK has expressed reservation over the high threshold of "knowingly and recklessly" for the offence and he opines that the maximum penalty for the offence should be increased to include imprisonment.

Auditor's right to obtain information (clause 403)

111. It is important for an auditor to have access to relevant information regarding the state of affairs of the company to ensure that he can perform his oversight functions in an effective manner. Noting the restricted right of auditor to obtain information under the CO, clause 403 empowers auditors to require information and explanations they may reasonably require for the performance of their duties from a wider range of persons, including a person holding or accountable for any accounting records of the company, any such person or former officer of the company at a time to which the information and explanation relates, as well as those persons in the company's Hong Kong and non-Hong Kong incorporated subsidiaries. Failure to comply with the requirement in clause 403 will be subject to criminal sanctions under clause 404.

112. The Bills Committee notes the concerns expressed by some deputations including Economic Synergy ("ES"), HKAB, REDA and

HKIoD about the need to extend the scope of persons for providing information to auditors, the burden and increased cost on the company. Moreover, members are concerned that imposing criminal sanctions on failure to provide information to auditors would be harsh. In particular, there may be difficulties for persons in non-Hong Kong incorporated subsidiaries to comply with the requirement since these persons may be prohibited by legislation in their respective jurisdictions from disclosing the required information. Under such cases, the Administration may encounter difficulties in enforcing the requirement on these persons.

113. The Administration has explained that the requirement under clause 403(4) and (6) is for the company "to take all reasonable steps" to obtain the relevant information or explanation from the non-Hong Kong subsidiaries or specified persons as required by the auditor. It is clear from the provision that, if the company has taken all reasonable steps as soon as practicable but cannot obtain the information or explanation from a non-Hong Kong subsidiary, the company and its officers would not be liable under the current formulation. Taking into account members' suggestion and for the avoidance of doubt, the Administration has agreed to introduce a CSA to provide an express defence for company and its officers in case they fail to obtain the information or explanation requested by the auditor concerning a non-Hong Kong subsidiary owing to restrictions imposed by overseas legislation.

Group 5: Pars 4 and 5

Part 4

114. Part 4 -- Share Capital, contains provisions relating to the core concept of "share capital" and its creation, transfer and alteration.

Mandatory system of no-par for all companies (clauses 130, 144, 165, 189 to 194 and Schedule 10)

115. Par value (also known as "nominal value") is the minimum price at which shares can generally be issued. According to the Administration, this concept does not serve the original purpose of protecting creditors and shareholders as it does not necessarily give an indication of the real value of the shares. There are provisions in the CB for the migration to mandatory no-par, and relevant concepts, such as nominal value, share premium, and requirement for authorized capital, will be abolished. Deeming provisions in Schedule 10 will ensure that contractual rights

defined by reference to par value and related concepts will not be affected by the abolition of par.

116. Dr Hon Philip WONG has expressed reservation on the proposal to introduce a mandatory no-par system for companies. Noting that the Hong Kong business community and investors have no difficulties with the par-value concept, he enquired about the rationale for the proposal and the development in other common law jurisdictions.

117. The Administration has pointed out there are practical problems associated with a par value system, including giving rise to an unnecessarily complex accounting system, inhibiting a company from raising new capital, creating unnecessary work for share registries and costs, and misleading the unsophisticated investor as the par-value does not reflect the real worth of a share. During the public consultations conducted in 2008 and 2010, the majority of the respondents (including major Chambers of Commerce and professional bodies) supported migration to a mandatory no-par regime and agreed that a mandatory system would be simpler for all concerned while an optional no-par system would require legislating for and administering two parallel systems resulting in added costs and complexity. The Administration has advised that there is growing recognition and acceptance of a no-par system in other comparable common law jurisdictions. Australia, New Zealand and Singapore have adopted mandatory no-par system without any apparent difficulties.

Requirement of shareholders' consent for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares (clauses 135 and 136)

118. The allotment of shares is generally determined by directors. Under section 57B of the CO, directors are only entitled to do that with prior approval of the company in a general meeting. The requirement of shareholders' approval is mandatory and notwithstanding any provision in the company's articles to the contrary. However, there is no requirement for shareholders' approval for the grant of an option to subscribe for shares or a right to convert any security into shares. It is only the subsequent exercise of the option or the right of conversion that would result in an allotment which would require shareholders' approval. To enhance protection of minority shareholders against dilution, clauses 135 and 136 extend the requirement of shareholders' approval for allotments of shares to the grants of rights to subscribe for, or to convert securities into, shares. If approval is given for the grant of an option, there would not be a need to

obtain further approval of the allotment of shares pursuant to that option. The Bills Committee notes that this proposal accords with the position in the UK. On the offence for contravention of the requirement under clause 135, some members have suggested that the *mens rea* of "knowingly" should be stated expressly in clause 135(4) to bring it in line with the relevant provision in the UKCA 2006. The Administration has agreed to introduce a CSA accordingly.

Company to give reasons explaining its refusal to register a transfer of shares upon request (clause 146)

119. Section 69(1) of the CO requires a company which refuses to register transfer of shares or debentures to send a notice of such refusal to the transferor and transferee within two months after the transfer was lodged with the company but there is no requirement for the notice to be accompanied by the reasons for the refusal. Clause 146 requires companies to give reasons explaining their refusal to register a transfer of shares upon request within 28 days after receiving the request. The Administration has advised that there was majority support for the proposal during the public consultation in 2010 considering that there was a need to enhance transparency and ensure that directors only exercise their powers for proper purposes. Under section 69(1B) of the CO, where a company refuses to register a transfer of any shares, the transferee has a right to apply to the court to have the transfer registered. The right to apply for court order is restated in clause 147. The new requirement for companies to give reasons of refusal of shares transfer upon request will make it easier for shareholders to take action in this respect. The proposal also accords with the position in the UK except that in the UK, the giving of reason is mandatory if the company refuses to register the transfer. In response to members' enquiry, the Administration has confirmed that the right for the transferee or transferor of shares to request reasons will not affect the rights of private companies to restrict the right of transfer of their shares.

Requirements relating to class rights (clauses 171 to 188)

120. Clauses 171 to 188 aim at clarifying and simplifying the existing requirements under the CO for a variation of class rights of shareholders. Members note that 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 the date on which the variation is made. Some members have enquired whether the 14-day period would be sufficient and the means of communication by which notification can be effected. The Administration

has advised that the 14-day period is sufficient and is aligned with the period required for a general meeting (i.e. other than an AGM) for limited companies under clause 561(1)(b)(i), as well as generally in line with the requirement under the Listing Rules for convening general meetings. The Administration has also pointed out that written notice is required for the purpose of clause 176(1), and the company can send the notice to its members in electronic form (clause 819) and hard copy form (clause 820), or by means of a website (clause 821). These communication arrangements are generally in line with those under the Listing Rules.

Part 5

121. Part 5 -- Transactions in relation to Share Capital, contains provisions concerning "capital maintenance" (reduction of capital and purchase of own shares (buy-backs)) and related rules (financial assistance by a company for the purpose of acquiring shares in the company or its holding company).

Uniform solvency test for different types of transactions under Part 5 (clauses 199 to 203)

122. There is discrepancy under Part II of the CO in the solvency tests (based on cash-flow/liquidity) applicable to buy-backs by a private company and financial assistance by an unlisted company. Clauses 199 to 203 apply a uniform solvency test for buy-backs and financial assistance by all companies, and extend its application to the court-free procedure for reduction of capital. There is no requirement for a company to attach the auditor's report to the solvency statement. In making a solvency statement that the company satisfies the solvency test in relation to the transaction concerned, the directors must inquire into the company's state of affairs and prospects and take into account contingent and prospective liabilities of the company. The solvency statement must be made and signed by all directors for buy-backs and reductions of capital, and made and signed by a majority of directors for financial assistance. The positions are different in overseas jurisdictions. There are two types of solvency tests in the UK, one applies to buy-backs and the other applies to a court-free procedure for reduction of capital. In Singapore, the solvency tests include a "balance sheet" test (i.e. the assets of the company should exceed the value of its liabilities after the relevant transaction has taken place). In Australia, a different test is used, which requires that the relevant transaction must not materially prejudice the company's ability to pay its creditors.

123. Members note that in the Administration's consultations conducted in 2008 and 2010, there were views from respondents to modify the solvency test to include a balance sheet test as this would provide a more comprehensive and objective approach to the assessment of solvency of a company and thus a better safeguard for creditors. The Administration is of the view that a balance sheet test is a snapshot report of the affairs of the company as at a particular date. The test does not reflect the assets coming into the company afterwards and fails to project any expected deterioration of revenues. Requring the balance sheet test as a second limb to the solvency test may cause undue burden to companies and is not particularly useful, especially in an economic climate where the values of assets and liabilities are highly volatile. The Bills Committee also notes that there is a suggestion to remove the requirement for all directors to make and sign the solvency statement for buy-backs and reductions of capital in order to simplify the procedures and enable more companies to benefit. As such requirement follows the existing requirement in section 49K of the CO, the Administration considers it desirable to retain the requirement so as to provide sufficient safeguard to shareholders.

124. As regards the proposal to remove the requirement for the uniform solvency test to be accompanied by an auditor's report, some members have expressed concern about safeguard for shareholders and creditors. The Administration has explained that as a solvency statement is a forward-looking business judgment, its validity hinges on the directors' assessment of the solvency of the company. The auditor can only express his opinion on the directors' assessment based on the latter's assumptions made in the forecast. Under the current law, the auditor does not certify that the directors' assessments and forecast are correct. Inclusion of an audit requirement for the uniform solvency test appears to be onerous for companies and brings little benefit for creditors and shareholders. There are adequate safeguards under the CB to protect creditors and shareholders for buy-backs, as well as reduction of capital. For example, reduction of capital or buy-backs must be supported by a special resolution passed by disinterested shareholders (clauses 210, 212, 253 and 255). Also, the company is required to publish notice of the proposed reduction or buy-back in the Gazette, and in a newspaper or give written notice to each creditor (clauses 213 and 256). A creditor or shareholder may apply to the court for cancellation of the special resolution for the transaction (clauses 215 and 258).

Court-free procedure for reduction of capital based on a solvency test (clauses 210 to 220)

125. At present, the CO only allows a reduction of share capital if the shareholders approve by a special resolution and if the reduction is approved by the court (sections 58 to 63 of the CO). Clauses 210 to 220 provide for a court-free procedure for reduction of capital, subject to the solvency test. The procedure would be faster and cheaper and can be utilized by all companies. Key features of the procedure include requirement of a solvency statement signed by all directors in support of the proposed reduction, members' approval by a special resolution, publication of notices in the Gazette and registration of the solvency statement with the Companies Registry by the company, and right of creditor or non-approving member of the company to apply to the court for cancellation of the resolution.

126. With regard to the requirement for the company to publish the notice of a passed special resolution in the Gazette under clause 213(1), some members are of the view that the time allowed between passing of the resolution and the publication of the notice in the Gazette may not be sufficient if there are intervening holidays, or black rainstorm warning or gale warning days. To ensure that it is feasible for companies to meet the requirement, the Administration will introduce a CSA to clause 213(1) to the effect 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.

All companies allowed to purchase their own shares out of capital, subject to a solvency test (clauses 252 to 261)

127. Under the CO, the general rule is that a company can only buy back its shares using distributable profits or using the proceeds of a fresh issue of shares (sections 49A and 49B of the CO). There is an exception for private companies which may fund a buy-back by payment out of capital based on a solvency test (sections 49I to 49N of the CO). In the CB, all companies are allowed to fund buy-backs out of capital, subject to the solvency requirement. Clauses 253 to 261 retain most of the current CO requirements and procedures applicable to buy-backs by a private company out of capital, and extend them to all companies. The requirements and procedures are similar to the new court-free procedure for reduction of capital. Taking into account members' views on the need to ensure it is

feasible for companies to publish notice in the Gazette as required under clause 256(1), the Administration will move a CSA to the clause with the same effect as the one amending clause 213(1).

Allowing all types of companies (listed or unlisted) to provide financial assistance, subject to satisfaction of the solvency test and certain specified procedures (clauses 279 to 285)

128. Section 47A of the CO prohibits a company and its subsidiaries from giving financial assistance for the purpose of acquiring shares in the company subject to certain exceptions. The rules on financial assistance and the exemptions available have been reformed in the CB with retention of the current exceptions to the prohibition in section 47C of the CO and the special restrictions for listed companies in section 47D of the CO. The main change is to allow all types of companies (listed or unlisted) to provide financial assistance subject to the solvency test and the following conditions --

(a) If the assistance, and all other financial assistance previously given and not repaid, is in aggregate less than 5% of the shareholders' funds (clause 279).

(b) If the financial assistance is approved by written resolution of all members of the company (clause 280).

(c) If the financial assistance is approved by an ordinary resolution, shareholders holding at least 10% of the total voting rights or members representing at least 10% of the total members of the company may apply to the court to restrain the giving of the assistance (clauses 281 and 282).

129. The Bills Committee notes that relaxing rules for companies to provide financial assistance is in line with the position in other jurisdictions. Restriction against private companies providing financial assistance has been abolished under the UKCA 2006. In Australia, financial assistance is allowed if the giving of the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors. Members further note that many respondents to the Administration's consultations and deputations attended the meeting of the Bills Committee supported the proposal to abolish the restrictions on financial assistance for private companies. On the other hand, there are concerns over outright abolition for the protection of minority shareholders and creditors. On balance, the Administration considers it prudent to

retain some restrictions on financial assistance for private companies in the CB, pending study on provisions on the director's duty to prevent insolvent trading under the corporate insolvency law modernization exercise. Regarding the threshold for members to apply to the court for restraining the giving of financial assistance under clause 282, the Bills Committee notes that Association of Chartered Certified Accountants Hong Kong ("ACCA(HK)") has suggested lowering the threshold. After consideration, the Administration will move a CSA to lower the threshold to 5%. Members agree that a lower threshold would better protect interest of shareholders.

Rules on giving of financial assistance for the case of employee share schemes and loans to employees (clauses 276 and 277)

130. Section 47C(4)(b) of the CO provides that the prohibition on financial assistance does not apply to employee share schemes if the financial assistance is restricted to the provision of money for the purchase or subscription of fully paid shares. Clause 276 allows financial assistance for all types of employees share schemes if the assistance is given in good faith in the interest of the company for the purposes of an employee share scheme or the giving of the assistance is for the purposes of enabling or facilitating transactions to acquire the beneficial ownership of shares for the employees. Clause 277 restates the law in the CO, i.e. not to apply the general prohibition on financial assistance to the making of company's loans to its eligible employees for the purpose of enabling them to acquire fully paid shares in the company or its holding company. The term "eligible employees" excludes a director. Some members are concerned that a company may circumvent the prohibition by relegating a "director" to an "employee", and re-appoint the "employee" as a director after the acquisition of shares. There is also enquiry about whether the company would need to call back the loan from that director in case a loan was made to an eligible employee and that employee is subsequently appointed as director but the loan or part of it remains outstanding.

131. The Administration has advised that the term "eligible employees" under clause 277(2) means persons employed "in good faith" by the company. This would provide a safeguard against the potential avoidance arrangement as mentioned by members. 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. The Administration

considers it unnecessary to impose additional conditions for a person to be qualified as an "eligible employee" under the clause, such as an employee must not be a director of the company for a certain period before the provision of the loan, as this may create hardship to companies which genuinely make use of this exception to benefit its employees.

Group 6: Parts 6, 7, and 8

Part 6

132. Part 6 -- Distribution of Assets and Profits, contains provisions that deal with distribution of profits and assets of a company to members. There is no fundamental changes to the distribution provisions in the CO as the current rules have generally worked well and provided certainty. Existing provisions in the CO have been reorganized and some minor technical amendments have been made.

133. In Part 6, "distribution" means every description of distribution of a company's assets to its members whether in cash or otherwise, except distribution by way of bonus shares, redemption or buy-back of shares, reduction of capital, distribution in a winding up, and financial assistance given by the company to a member under clause 279, 280 or 281. Distribution can only be made out of profits available for the purpose. A company's profits available for distribution are its accumulated, realized profits (so far as previously not distributed or capitalised) less its accumulated, realized losses (so far as not previously written off in a reduction or reorganization of capital).

Justification of distribution by reference to financial statements (clause 298)

134. Members have enquired about the need to introduce provisions to address the situation where a distribution has been proposed or approved, but before it has actually been made, a certain event occurs that may change the opinion regarding the financial ability of the company, and the director's obligation when they are aware of the new situation. The Administration considers that should such a situation arise, a director is bound by his fiduciary duties to reconsider the distribution, and hence it is unnecessary to put in place provisions in this respect. There is well-established case law that the directors have fiduciary duty to act in good faith in the interests of the company which requires the directors to take into account the interests of creditors when the company is insolvent or nearing insolvency. A payment of dividends when the company is

insolvent or which puts the company into insolvency can amount to a breach of duty on the part of the directors, even if the dividends are paid out of profits.

Distribution in-specie

135. A distribution from a company can be made in specie, i.e. in the form of non-cash assets. Members note that the UKCA 2006 has provided for distribution in-specie and enquired the practice of distribution in-specie in Hong Kong. The Administration has studied section 845 in the UKCA 2006 and found that it has been put in place to address a specific concern in the UK relating to intra group transfers. On the practice for distribution in-specie in Hong Kong, the Administration has advised that HKICPA promulgated in December 2008 the interpretation on "Distributions of Non-cash Assets to Owners" which in general requires distributions of non-cash assets to be accounted for at the fair value of the assets. This will often result in a profit being recognized when the distribution is made. As there were no particularly strong views received from the business sector during the public consultations on the issue, the Administration is of the view that no such provisions are required under the CB.

Part 7

136. Part 7 -- Debentures, contains provisions that deal with matters concerning debentures, for example, keeping of the register of debenture holders, rights to inspect and make copies of the register, trust deeds and other documents and convening meetings of debenture holders.

Keeping of the register of debenture holders with similar provisions for register of members (clauses 304 to 312)

137. In the CB, the provisions relating to the register of debenture holders are aligned with and mirror those relating to the register of members (clauses 616 to 631 in Part 12), including removing the requirement to disclose the debenture holder's occupation (clause 304), providing for the right to inspect and request a copy of the register of debenture holders (clause 306), and adding the provisions for keeping of branch registers in respect of debenture holders (clauses 309 to 312).

138. In the UK, the keeping of the register of debenture holders is not obligatory and the particulars of the debenture holders are not specified. But the CB re-enacted the existing requirements in the CO for a company to enter a debenture holder's name and address in a register and allow the

register for public inspection. Members are concerned that privacy issues would be involved in allowing the register of debenture holders to be open for public inspection. The Administration has pointed out that keeping an up-to-date record of the names and addresses of the holders of debentures and allowing public inspection of the register would help protect the interest of debenture holders as a whole, such as facilitating communication among holders in organizing action in defence of their common interests, and contact by the company in case of appointment of liquidator for the company. In fulfilling the requirement to provide "name and address", the debenture holder is not required to provide a residential address, and may provide a correspondence address at which he can be contacted by the company or the other debenture holders. Similar requirements to enter the name and address of a debenture holder in the register of debenture holders for public inspection can also be found in Australia.

Debenture holders to apply to the Court to order a meeting to be held to give directions to the trustee and immunity of trustees for debenture holders (clauses 328 and 330)

139. Clause 328 is a new provision which provides that debenture holders with at least 10% of the value of the debentures in total may apply to the court to convene a meeting to give directions to the trustee. This right may be excluded or varied by the terms of the debenture or trust deed. Clause 330 clarifies that the trustee is not liable for anything done by it in accordance with a direction given by a meeting of debenture holders held under clause 328. Members have enquired about the rationale for clause 328 and queried the immunity provided to the trustees under clause 330. According to the Administration, clause 328 is based partly on provisions in the ACA, which provide that upon request of holders of 10% or more of the nominal value of the issued debentures, the trustee may call or the Court may order a meeting of the debenture holders. In the UK, meetings of debenture holders are governed by the terms of the covering trust deed and there is no statutory right to apply to court for a meeting to be held. As regards clause 330, having considered Members' views, the Administration agrees that trustees acting in accordance with directions given by debenture holders in meetings called under clause 328 should be treated in the same manner as those in meetings called in accordance with the provisions of the trust deed or debenture. The Administration will move a CSA to delete clause 330 accordingly.

Part 8

140. Part 8 -- Registration of Charges, contains provisions that deal with registration of charges by both Hong Kong and registered non-Hong Kong companies. It sets out the types of charges that require registration, registration procedures, consequences of non-compliance, and other related matters such as keeping and inspection of copies of charge instruments and registers of charges.

List of registrable charges (clause 333)

141. There are some difficulties with the categories of charges which are registrable under section 80(2) of the CO. Clause 333 seeks to remove the ambiguities and dispense with redundant items. For example, a charge on an aircraft or any share in an aircraft is registrable, charges for the purpose of securing any issue of debenture is removed, a shipowner's lien on subfreights does not constitute a charge on book debts or a floating charge and a charge over cash deposits is not regarded as a charge on book debts. Members have requested the Administration to reconsider including charges over cash deposits as registrable charges under clause 333(3)(b), as the exclusion of large amount of cash deposits has implications on a company's financial position. The Administration has advised that currently it is not clear whether charge over cash deposits could be registrable under the CO as a charge over book debts. As registration of charges over quickly moving transactions and short term assets will make registration too burdensome and may impede commercial activities, the Administration is of the view that there is a need to put the position beyond doubt that charges over cash deposits are not registrable. The public will not be misled by the non-registration of charges over cash deposits as bank accounts are generally confidential and the amount a company is in credit is usually not known to outside creditors. On the suggestion made by some deputations to allow registration of a charge over cash deposits in favour of a party other than a depository bank, the Administration considers it difficult to make a distinction, which would result in requiring a charge over cash deposits created in favour of, say, a stock broker or investment financier or over a margin deposit or any other financial products resembling a charge over cash deposits to be registrable as a charge over book debts. The Administration maintains the view that all charges on cash deposits should not be registrable.

Registration of charges and release of charges (clauses 334, 335, 337 to 339, 344 and 345)

142. The CO requires a charge instrument together with prescribed particulars of the charge to be submitted to the Registrar for registration within five weeks but only the particulars will be available in the Company Register for public search. In order to enhance transparency and provide more detailed information on the charge to those who search the register (usually the charge holder, i.e. chargee, such as banks and financiers), the CB provides that both a certified copy of the charge instrument and the prescribed particulars of the charge are registrable and available for public inspection. Moreover, the time limit for registration is shortened to one month under the CB. Under the CO, if a debt secured by a registered charge has been satisfied, the company will submit to the Companies Registry for registration a memorandum of satisfaction. Such applications have to be accompanied by evidence of the discharge. Only the memoranda of satisfaction but not the evidence of discharge is open for public inspection. The CB provides that a certified copy of the evidence of discharge has to be registered and made available for public inspection.

143. The Bills Committee has considered the need to put in place an early alert system to alert the public to the fact that there is a charge in respect of the company pending registration shortly after the charge is created. The Administration has advised that an early alert system is already in place. When a company creates a charge and a Form M1 ("Mortgage or Charge Details") is received by the Companies Registry, a new entry will appear at the top of the Document Index of that company to show that a Form M1 relating to a charge in respect of the company has been submitted. In this way, the public will be alerted to the existence of a charge document submitted to the Registrar pending registration.

144. Some members have considered whether the responsibility for delivering the charge for registration should be taken up by the chargee instead of the company since the former has stronger economic incentive because a failure to register may result in the charge being void. The Administration is of the view that the obligation to register charges should remain with the company as the company has the responsibility to maintain its records up-to-date. Given that the registration of charges is intended to protect third parties against false impression of the company's financial standing, it is appropriate to put the duty to register on the company. Although the primary obligation to register a charge will continue to be imposed on the company, where the charge will be void for want of due registration, a "person interested" in the charge, i.e. the chargee, is given an

option under the CB to register and to claim against the company for the fees incurred in so doing (for example, clauses 334(3) and (7), and 335(3) and (8)). The Administration considers it appropriate to maintain the status quo to require a company creating a charge to deliver it for registration. The same is adopted in the UK, Australia and Singapore.

Group 7: Parts 10 and 11

Part 10

145. Part 10 -- Directors and Company Secretaries, contains provisions relating to directors and company secretaries.

Restricting corporate directorship in private companies (clause 448)

146. Currently, the CO prohibits all public companies and private companies which are members of a group of companies of which a listed company is a member from appointing a body corporate as their director. There is no restriction for other private companies. The CB restricts corporate directorship in such other private companies by requiring them to have at least one director who is a natural person (clause 448). Companies would be given a grace period of six months from the commencement of that clause to comply with the requirement (clause 83 of Schedule 10).

147. The Bills Committee notes that there are different views among deputations on the issue. While HKIoD considers that corporate directorship should be abolished altogether in Hong Kong, deputations including The Hong Kong Chinese Importers' and Exporters' Association and Hong Kong Small and Medium Enterprises General Association are concerned that the requirement for private companies to appoint natural persons as directors will increase the cost of operating business, in particular for SMEs, and may drive businesses away from Hong Kong. There are suggestions of granting exemption to trust companies, dormant companies and small companies, extending the grace period to two years to allow companies to find and appoint individual directors, and imposing requirements on the individual director such as they must be an accountant, lawyer or company secretary, and must be a local resident.

148. The Administration stresses that the proposal has struck a balance between the need to enhance corporate governance and transparency and the legitimate commercial need for flexibility. It will also address to a large extent the anti-money laundering concern of the Financial Action

Task Force. Having considered the comments received, an exemption for existing dormant companies has been incorporated in the CB. However, granting exemption to trust companies and small companies would be against the principles laid down and the recommendations made by the Financial Action Task Force for combating money laundering. Moreover, granting exemptions to small companies would also lead to complexities in implementation as their status as small companies may change over time. Regarding the grace period, it is envisaged that the new CO will only come into force at least 18 months after the enactment of the CB. The grace period of six months will count from the commencement of the new CO. Hence, companies will have sufficient time to find and appoint individual directors. As for requirements on the individual director, the Administration considers it too rigid to require that the director must be a professional or must be a local resident, and this may adversely affect business operations in Hong Kong.

Directors' duty of care, skill and diligence (clauses 456 and 457)

149. There is no provision on directors' duty of care, skill and diligence in the current CO and the common law position in Hong Kong on the subject is not entirely clear. The standard in old case law, which focuses on the knowledge and experience which a particular director possesses (generally known as the subjective test), is considered too lenient nowadays. The Administration considers it appropriate to clarify the standard of directors' duty of care, skill and diligence by introducing a statutory statement in the CB to provide appropriate guidance to directors. Clause 456 provides that a director must exercise reasonable care, skill and diligence, at the standard that would be exercised by a reasonably diligent person with --

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (clause 456(2)(a), objective standard); and

(b) the general knowledge, skill and experience that the director has (clause 456(2)(b), subjective standard).

150. The standard is therefore both objective and subjective. Clause 456(4) further provides that the said duty has effect in place of the corresponding common law rules and equitable principles. Clause 456(5) provides that the duty applies to a shadow director. Clause 457 preserves the existing civil consequences of breach (or threatened breach) of the said

duty. The remedies for breach of the duty will be exactly the same as those that are currently available following a breach of the common law rules and equitable principles that the said duty replaces.

151. The Bills Committee has enquired about the development in other comparable jurisdictions in the adoption of the objective and subjective standard of care, skill and diligence expected of directors. Members have questioned the appropriateness to replace the common law rules and equitable principles in relation to director's duty of care, skill and diligence by clause 456(4), and asked whether it would be advisable to preserve the common law principles in this area and leave the matter to the courts.

152. According to the Administration, there is a judicial trend in other comparable jurisdictions towards the use of a dual objective and subjective standard of care, skill and diligence expected of directors. The adoption of the dual standard in overseas jurisdictions has come about through both the decisions of the courts on the common law and through confirmation of that standard under statute. While it is likely that Hong Kong courts would also adopt the dual standard in the light of overseas developments in the common law, uncertainty remains in the absence of a clear/authoritative ruling in Hong Kong on the standard of duty of care, skill and diligence. It is necessary to clarify the standard of duty by introducing a statutory statement in clause 456 to provide appropriate guidance to directors. The Administration has also advised that the general duties of directors (including fiduciary duties and duty of care, skill and diligence) have been comprehensively codified in the UKCA 2006. Clause 456 is modelled on section 174 of the UKCA 2006. The scope of clause 456 does not cover fiduciary duties and is only in respect of directors' duty of care, skill and diligence. Australia (section 180(1) of the ACA) and Singapore (section 157(1) of SCA) have both adopted the objective standard in the statute, which are judicially interpreted to incorporate subjective elements.

153. Members share deputations' concerns about the impact of the dual standard on directors. In particular whether the subjective part of the standard would raise the standard for those directors having special knowledge or experience, and whether the objective part would raise the current standard of directors' duty for non-executive directors requiring them to exercise the same care, skill and diligence of executive directors, and how the court would interpret the dual standard. There are also concerns about whether imposing the dual standard would reduce the incentive for professionals to take up directorship in Hong Kong, and difficulties encountered by directors of SMEs in meeting the standards.

154. The Administration has explained that the current formulation of clause 456 makes it clear that the court, when determining whether a particular director has exercised reasonable care, skill and diligence, must take into account the functions carried out by the relevant director in relation to the company. This means that what is required of the director will depend on the functions carried out by the director, so that there will be variations not only between executive and non-executive directors, but also between different types of executive directors (and equally of non-executives) and between different types and sizes of companies. Hence the objective element would not raise the standard expected of non-executive directors to that of executive directors. As to the concern that the subjective element in clause 456(2)(b) would raise the standard expected of directors who have special knowledge, skills or experience, it should be noted that this largely reflects the position under the common law.

155. As regards the protection for directors against liabilities, the Bills Committee notes that some deputations have suggested developing a "safe harbour" to define the circumstances under which the directors would be protected from liability, adopting a "business judgment rule" similar to that in jurisdictions like Australia to protect directors from liability for bona fide business decisions which subsequently turn out to be mistaken, and providing exemption for directors of SMEs from the dual standard. Members have asked the Administration to respond to theses concerns.

156. On the proposal to introduce a "safe harbour", the Administration considers that there is no obvious need to do so given that clauses 891 and 892 already provide that the court may relieve an officer of a company from liability for any misconduct if he has acted honestly and reasonably and ought fairly to be excused having regard to all the circumstances. For the proposed introduction of a statutory "business judgment rule", SCCLR has considered the proposal and is of the view that there is already similar protection under the common law, and that the existing common law position is sound. There is no need for a statutory formulation of the "business judgment rule".

Ratification of conduct of directors by disinterested members' approval (clause 464)

157. At present, the ratification of acts or omissions of directors is subject to common law rules, which generally require members' approval in a general meeting to release the directors from their fiduciary duties. Ratification would have the effect of barring the company from bringing

actions against the director for damages it suffered as a result of the ratified act or omission, but dissenting minorities may seek redress by pursuing unfair prejudice claims or statutory derivative claims. Under the current regime, conflict of interest may arise in situations where the majority shareholders are directors or are connected with the directors. It is therefore necessary to introduce a disinterested shareholders' approval requirement for ratification of directors' conduct. Clause 464 provides that any ratification by a company of the conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be approved by resolution of the members of the company disregarding the votes in favour of the resolution by the director, any entity connected with the director and any person holding shares of the company in trust for the director or for the connected entity.

158. The Bills Committee agrees that the proposal requiring disinterested members' approval in ratification of wrongdoings to the company by the director would enhance protection of minority shareholders' interests. Members have enquired whether the proposal would change the common law position and whether a breach of trust by a director could be ratified. They also note that there are concerns from deputations that certain breach of duties by the directors should not be ratifiable by the shareholders, and disinterested shareholders' approval requirement might be impractical in a family-owned company where all shareholders are connected entities.

159. The Administration has clarified that the common law principle relating to fiduciaries is that those to whom the duties are owed may release those who owe the duties from their legal obligations. This also applies to the duty of trust where a beneficiary can release a trustee from liabilities for breach of trust since the trustee's duties are owed to the beneficiary. In this regard, clause 464 does not alter the common law in relation to the types of breaches which can be ratified by the shareholders. Clause 464(7) preserves existing common law rules which restrict ratification, so there is no need to provide expressly that certain breaches are not ratifiable. As for the concern regarding family-owned business, clause 464(6) provides that nothing in clause 464 affects the validity of a decision taken by unanimous consent of the company's members, so the restrictions imposed by clause 464 will not apply when every member approves the ratification.

Part 11

160. Part 11 -- Fair Dealing by Directors, contains provisions relating to fair dealing by directors, particularly in situations in which a director is perceived to have a conflict of interest. It governs transactions involving

directors or their connected entities which require members' approval (namely loans and similar transactions, payments for loss of office and directors' long-term employment), and covers disclosure by directors of material interests in transactions, arrangements or contracts.

Prohibitions on loans and similar transactions to cover a wider category of persons connected with a director (clauses 477 to 479)

161. At present, to avoid potential conflict of interests between a company and its directors, section 157H of the CO prohibits a company from making loans to or entering into other similar transactions with a director or persons connected with the director. Such parties include spouse, child and step-child under the age of 18, specified categories of trustees and partners, and a company in which a director holds a controlling interest, etc. The CB has expanded the scope of entity connected with a director to cover all parties who are closely associated with the directors. Clauses 493 and 494 prohibit a specified company from making a loan, quasi-loan, etc. to, or entering into credit transaction etc. as creditor for an entity connected with a director without prescribed approval of members. Clauses 477 to 479 provided for the coverage of an entity connected with a director. It covers an adult child, an adult step-child, an adult illegitimate child or an adopted child of any age, a parent, a cohabitee, a cohabitee's minor child, minor step-child, minor illegitimate child and minor adopted child if such a child lives with the director, an associated body corporate, etc.

162. Members note that the formulation "a couple in an enduring family relationship" in clause 477(1)(b) may not accurately reflect "cohabitation relationship". Noting that the formulation of "as a couple in an intimate relationship" has been adopted in the definition of "cohabitation relationship" in the Domestic and Cohabitation Relationships Violence Ordinance (Cap. 189) after extensive deliberation, members agree to replace "a couple in an enduring family relationship" by "as a couple in an intimate relationship". The Administration will introduce a CSA to this effect.

Disinterested members' approval for various prohibited transactions (clauses 486, 506, 509 and 523)

163. The CB introduces the requirement for disinterested members' voting for connected transactions. The requirement will be applicable to public companies for various prohibited transactions, and to a private company or company limited by guarantee that is a subsidiary of a public

company for loans and similar transactions. The details are set out in various clauses in Divisions 2 to 4 of Part 11. If a company is subject to the disinterested members' approval requirement, the resolution at a general meeting of such a company is passed only if every vote in favour of the resolution by the interested members is disregarded.

164. The Bills Committee has considered whether the requirement for disinterested shareholders' approval should be extended to private companies to enhance protection of interests of shareholders of these companies. The Administration has pointed out that the voting rights of shareholders are proprietary rights and should only be restricted with sound justifications. The current proposal has struck a balance between corporate governance and shareholders' rights to vote. However, individual private companies may include the requirement for disinterested shareholders' approval in their articles of association if it is considered necessary.

165. Members have expressed concerns about the potential loopholes in the provisions under Subdivision 2 of Division 2 where directors may set up private companies to circumvent the prohibition for obtaining loans and in respect of loans, quasi-loan etc. to entities connected with a director of the holding company of a specified company. Having reviewed the provisions and considered members' views, the Administration will introduce CSAs to extend the prohibition from making a loan etc. to a director of the company under clause 491 to cover a body corporate controlled by the director, and extend the prohibition from making a loan, quasi-loan etc. to a director of the holding company of the specified company under clauses 491, 492, 494 and 495 to cover the connected entities of such a director.

166. Members have considered the exemption under clauses 491(3)(a), 492(3)(a), 494(3)(a) and 495(3)(a), for a holding company, subsidiary or body corporate (as the case may be) from the requirement for members' approval in respect of a transaction to be entered into if the holding company, subsidiary or body corporate is incorporated outside Hong Kong. The Administration has explained that these provisions are modelled on sections 198(6)(a) and 217(4) and similar provisions in the UKCA 2006. It should be noted that as the CB mainly governs companies incorporated in Hong Kong, the exemption under the above clauses are considered appropriate.

Disclosure by directors currently under section 162 of the CO (clauses 527 to 532)

167. Section 162 of the CO requires a director, who has a material interest, directly or indirectly, in a contract or proposed contract with the company which is of significance to the company's business, to disclose to the board of directors the nature of such interest at the earliest meeting of directors that is practicable. Division 5 (clauses 527 to 532) restates the provisions in the CO with modifications to widen the ambit and keep in line with the relevant provisions of other common law jurisdictions such as the UK. For instance, disclosure is widened to cover "transactions" and "arrangements" instead of just "contracts", and the disclosure requirements are extended to shadow directors.

168. Clause 529 prescribes the procedures for declaration of interests by directors. The provision provides that a director may declare his interest by making a general notice to the other directors and the notice is not effective unless it is given at a directors' meeting or the directors takes all reasonable steps to secure the notice is brought up and read at the next directors' meeting after it is given. Members have expressed concern that the requirement is onerous on the director. They consider that it is sufficient for the director to send the general notice to the company and the latter should be required to send the notice to other fellow directors. The Administration has agreed to introduce CSAs to clause 529 and a new clause 531A to this effect. Non-compliance of the company in sending the general notice will be an offence.

Group 8: Parts 13 and 14

Part 13

169. Part 13 -- Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back, contains provisions relating to schemes of arrangement or compromise with creditors or members, reconstructions or amalgamations of companies, and compulsory acquisitions of shares following a takeover offer or following a general offer for a share buy-back.

Headcount test for approving a scheme of compromise or arrangement (clauses 664)

Proposal in the CB

170. Section 166 of the CO provides that where a scheme is proposed between a company and its members or creditors or any class of them, the court may order a meeting of the members or creditors or a class of them to be summoned. The section also provides that if a majority in number ("headcount test") representing 75% value of the company ("share value test") of the creditors or members (or classes of creditors or members) present and voting at the meeting agree to the proposed scheme, the scheme shall, if sanctioned by the court, be binding on all members or creditors and the company. The court has the discretion not to sanction a scheme even though it has met both the share value test and the headcount test (for instance, where there is doubt that the process has been unfairly administered, such as where the approval under the headcount test was achieved by share splitting). Privatization and takeover schemes proposed by listed companies are often conducted by way of members' schemes.

171. It is the proposal under the CB to retain the headcount test for members' schemes, and give the court a new discretion to dispense with the test in special circumstances, such as where there is evidence that the result of the vote has been unfairly influenced by share splitting. As for creditors' schemes, the headcount test will also be retained. Given that the concern for vote manipulation is unlikely to happen, there is no need to extend the court's discretionary power to dispense with the headcount test in creditors' schemes.

Views of deputations

172. The Bills Committee has held in-depth discussion on whether the headcount test for members' schemes should be retained, including holding a meeting specifically with deputations to seek their views on the subject in March 2012. The deputations which the Bills Committee has met or received submissions from have expressed divergent views on the headcount test for members' schemes relating to listed companies. In general, business and professional bodies including Hong Kong General Chamber of Commerce, FHKI, The Chinese Manufacturers' Association of Hong Kong, The Chamber of Hong Kong Listed Companies, The Canadian Chamber of Commerce in Hong Kong, REDA, ES, LSHK, Hong Kong Bar Association, HKICPA, HKICS, HKIoD, as well as individual listed

companies and some academics and Mr David WEBB, support abolition of the headcount test. Their main arguments are --

(a) the headcount test is contrary to the "one share, one vote" principle and gives disproportionate control to a potentially very small number of shareholders who may have invested very little in the company;

(b) the headcount test creates a loophole for vote manipulation, such as share splitting, to unfairly influence the voting results by any shareholder groups, large and small shareholders alike;

(c) the headcount test is unnecessary since minority shareholders are adequately protected by other means, including the court's discretion not to approve a scheme and the requirement that the number of votes cast against the resolution shall not be more than 10% of the voting rights attached to all disinterested shares under Rule 2.10(b) of the Code on Takeovers and Mergers ("Takeovers Code") ("the 10% objection rule"). This rule in essence provides that a resolution to approve a members' scheme can be defeated if the number of votes cast against it is more than 10% of the votes attaching to all disinterested shares;

(d) for listed companies, the headcount test fails to reflect the decisions of the beneficial owners of the overwhelming majority of listed shares in Central Clearing and Settlement System ("CCASS"). Even when a scripless market is introduced, most shareholders may still prefer to hold shares in the names of their nominees and custodians for ease of trading and to save costs;

(e) the existence of the headcount test, and the uncertainty that it introduces, acts as a deterrent to schemes of arrangement. As schemes typically provide an exit for minority shareholders at higher than current market prices, and very often in cases where trading in the shares is illiquid, having a deterrent to putting schemes forward is not in the interests of minority shareholders; and

(f) other jurisdictions are moving towards abolishing the headcount test. Jurisdictions quoted included Cayman Islands and New Zealand. The specialist government advisory committees in the UK and Australia have recommended that the

headcount test be abolished. In addition, in many jurisdictions where the headcount test is still in force, like the UK and Australia, there is no such provision as Rule 2.10(b) of the Takeovers Code.

173. On the other hand, members note that the major supporters for retaining the headcount test include minority shareholders groups, SFC, SMEs associations, Hong Kong Securities Association, HKAB and some accountants associations. The major arguments include --

(a) the headcount test serves as a potentially important check to counterbalance the value test for the interests of minority shareholders in the context of privatizations or takeovers since schemes, once sanctioned, will bind dissenting shareholders and permit the compulsory acquisition of their shares;

(b) any perceived imbalance in the current headcount test in section 166 of the CO appears to have been addressed by the inclusion of clause 664 of the CB providing a new discretion for the court to dispense with the headcount test;

(c) the implementation of scripless securities could help address the problem caused by nominee holdings in the CCASS;

(d) there is no credible evidence to support the argument that headcount test attracts vote manipulation or that reasonable privatisation schemes are blocked by the headcount test;

(e) the proportion of individual investors is higher in Hong Kong than in overseas jurisdictions. If the headcount test is abolished, the major shareholders can easily control the voting result and the interests of minority shareholders could be affected; and

(f) retaining the headcount test places Hong Kong in line with other common law jurisdictions, such as Singapore, the UK and Australia.

Revised proposal from the Administration

174. Members hold different views on the retention of the headcount test in respect of members' schemes. Some members, including Hon Jeffrey LAM, Hon Abraham SHEK, and Dr Hon Philip WONG

echoed the views of deputations about the importance to uphold the "one share, one vote" principle and that retaining the headcount test is contrary to the majority views received by the Administration during previous public consultations. Other members, including Hon James TO and Hon Starry LEE have stressed the need to safeguard the interests of minority shareholders and urged the Administration to act prudently on the matter. The Bills Committee has requested the Administration to update the situations on the headcount test in overseas jurisdictions and urged it to explore other possible options to protect minority shareholders' interests if the headcount test is to be replaced. In this regard, the Bills Committee notes that SFC, while reiterates the need for retention of the headcount test, has suggested that there is merit in exploring whether minority shareholders' protection might be more effectively achieved by aligning the test in the CO with the 10% objection rule in the Takeovers Code. Moreover, there is a suggestion from some deputations that in addition to abolishing the headcount test, the 10% objection rule should be included in the CB.

175. The Administration has stressed that in making the decision to retain the headcount test in the CB, it has considered the market concern that abolition of the test may undermine the protection of the interests of minority shareholders. For public and listed companies, while the Takeovers Code offers some protection for minority shareholders, it is intended to supplement rather than to substitute the statutory protection in the CO. As a scheme will bind all members and permit the compulsory acquisition of the shares of dissenting shareholders, it would be important to ensure that the interests of minority shareholders are sufficiently safeguarded.

176. On the positions in overseas jurisdictions, the Administration has advised that while there have been recommendations for the abolition of the headcount test in the UK and Australia, no concrete plan has been put forward. Singapore still retains the test. For Cayman Islands, the headcount test is abolished in respect of mergers and consolidations but not in relation to arrangements and reconstructions. However, it should be pointed out that the abovementioned jurisdictions do not have rules similar to the 10% objection rule of the Takeovers Code. Hence, the headcount test is an important safeguard to project minority shareholders. As for New Zealand, the headcount test has been abolished.

177. The Administration has considered the views of deputations and members. It believes that the 10% objection rule, if suitably adapted to fit into the CB context, would be a balanced, sensible alternative to address

concerns raised by deputations supporting and opposing the abolition of the headcount test. First, it upholds the "one share, one vote" principle whilst at the same time provides an added safeguard to protect minority shareholders' interest. Secondly, as compared to the headcount test, which does not differentiate between interested and disinterested shareholders in the counting of votes, the 10% objection rule clearly puts the veto power in the hands of the disinterested shareholders only. Thirdly, it avoids the inherent deficiencies of the headcount test as pointed out by many commentators. Fourthly, it provides a more certain and predictable framework for the proposer of a scheme to assess whether or not to put forward a scheme. Hence the Administration has proposed to replace the headcount test in clause 664 with a new requirement to the effect that the number of votes cast against the resolution to approve a scheme of arrangement is not more than 10% of the votes attached to all disinterested shares. The new requirement would apply to the following two types of schemes of arrangement --

(a) takeover offer as defined in clause 678, with suitable modifications; and

(b) general offer for share buy-back as defined in clause 696.

178. The Administration has consulted SFC in the cause of developing the proposal and the CSA. The SFC has examined the proposal and considers it is broadly consistent with Rule 2.10(b) of the Takeovers Code, which was introduced for the protection of minority shareholders. The SFC believes that embedding the principle underlying Rule 2.10(b) in the CB is in the interests of minority shareholders and addresses its main concerns about the abolition of the headcount test.

179. As under the existing law, a scheme can only be implemented with the sanction of the court. For other types of schemes such as creditors' schemes, the headcount test would be retained on the ground that the major objections relating to the test do not concern these schemes and the concept of "disinterested members" is not applicable.

180. Members consider that the arguments put forth by deputations supporting or opposing the abolition of the headcount test are valid. The "one share, one vote" principle is an important core value in the business sector and should be upheld, and inherent problems of CCASS holding listed shares in the names of nominees and custodians and vote manipulation through share splitting are difficult to address. On the other hand, the binding nature of members' schemes warrant adequate safeguard

to protect the interest of the minority shareholders. Against such background, members including Hon Andrew LEUNG, Hon Abraham SHEK and Hon Jeffrey LAM consider that the Administration's revised proposal acceptable and has struck a balance in protecting the interest of minority shareholders and addressing the concerns about the abolition of the headcount test.

181. Some members, including Hon Albert HO, Hon Audrey EU, Hon Starry LEE and Hon Ronny TONG are concerned that minority shareholders, who together holding less than 10% of the voting rights attached to all disinterested shares and with a good reason to oppose a scheme, might be reluctant to challenge the scheme in court because of the potential huge legal costs. The Administration has explained that the court has a wide discretion to award costs and precedent cases show that the court does not make a costs order against shareholders objecting to a scheme when their objections are not frivolous and have been of assistance to the court. Hon Albert HO and Hon Audrey EU remain concerned and consider it necessary to provide in the CB some safeguard to address minority shareholders' concern about legal costs. Hon Audrey EU has suggested incorporating a provision in the CB to exempt a member challenging a scheme in court from being required to pay the other parties' legal costs so long as the challenge is not frivolous or vexatious. Hon Albert HO has proposed to add a provision requiring the company to pay the legal costs incurred in a challenge to a members' scheme in court.

182. Hon Starry LEE has urged the Administration to seriously consider establishing a litigation fund to support small investors in pursuing legal actions against companies proposing unfair schemes affecting the interests of minority shareholders. Recognizing that the matter falls beyond the scope of the CO and it would take time for the Administration to consider her proposal, she has requested the Administration to make an undertaking in this respect during the second reading debate on the CB.

183. The Administration has re-iterated that there are established precedents that are favourable to shareholders objecting to a scheme of arrangement. To address members' concerns, it has proposed to add a new clause 665A in relation to the costs of legal action for shareholders of a company to challenge a scheme of arrangement that applies the new requirement. The new clause provides that, inter alia --

(a) the court may only make an order about costs in favour of the shareholder if it is satisfied that the shareholder was acting in

good faith in, and had reasonable grounds for, opposing the application for sanctioning a scheme of arrangement; and

(b) the court may only make an order as to costs against the shareholder if the shareholder's objection to a scheme of arrangement is frivolous or vexatious.

Members in general find the above proposal acceptable.

184. Noting that the concept of "disinterested members" under the Administration's revised proposal does not exclude parties "acting in concert" under the Takeovers Code, Hon Albert HO has expressed concern that the revised proposal would not offer the same level of protection to minority shareholders as that headcount test. The Administration has explained that the 10% objection rule would not alter the current procedures for sanctioning a scheme. It is worth noting that while SFO, the Takeovers Code and other SFC guidelines regulate listed companies, the new CO would be applicable to all companies, public or private. It would be inappropriate to adopt the same concept and rules used in the Takeovers Code in the CB. Besides, the test should have internal consistency with the concepts and definitions adopted in other provisions of Part 13 of the CB which differentiate between "interested" and "disinterested" members when dealing with changes in ownership of a company.

Court-free statutory amalgamation procedure (clauses 667 to 675)

185. Currently, companies intending to amalgamate have to resort to the procedures under sections 166 to 167 of the CO which require court sanction and usually involve high cost. The CB introduces a court-free regime for amalgamation which is confined to amalgamations of wholly-owned intra-group companies to minimize the risk of abuse. The board of each amalgamating company must make a statement to confirm that the assets of the amalgamating company is not subject to any floating charge and to verify the solvency of the amalgamating company as well as the amalgamated company. Details of the solvency statement are set out in clause 668. The amalgamation proposal must be approved by the members of each amalgamating company by special resolution. The court may disallow or modify the amalgamation proposal or give any directions before the effective date of the amalgamation proposal (clause 675) which is to protect the interests of the minority shareholders and creditors in the course of the amalgamating process.

186. Members have enquired about the reasons for confining the court-free regime to intra-group amalgamations and the situations in other jurisdictions. The Administration has advised that during the public consultation in 2008, while a majority of the respondents supported a court-free statutory amalgamation procedure, some of them expressed the view that the procedure should only apply to intra-group amalgamations as such cases were less complicated. There were views stressing the importance of adequate protection for shareholders and creditors in the procedure to prevent possible abuses by the management which might easily happen in amalgamation involving companies not within the same group, and such amalgamations should continue to be subject to judicial scrutiny to ensure fairness to minority shareholders and creditors. Considering the public views received, the Administration has decided to confine the new court-free procedure to intra-group amalgamations. The Administration has pointed out that the proposal is generally in line with the situations in Singapore, and New Zealand.

187. Members note that the requirement under clauses 669 and 670 require the companies to meet the cash-flow test, and the amalgamating company is not subject to any floating charge. They opine that there should be relaxation in the requirement so that companies meeting the balance sheet test only can still make use of the procedure, and a company with floating charge can be allowed to use the procedure if the relevant creditors have given consent to the company. On the solvency requirement for amalgamation, the Administration considers it prudent to maintain the original requirement as reliance on the balance sheet test alone may be too risky. A balance sheet is a snapshot report of the affairs of the company at a particular date. It does not consider the quality of a company's assets and liabilities and their linkage over time and fails to reflect the assets coming into the company and project any expected deterioration of revenues. Off balance sheet liabilities, such as contingent liabilities, and other risks need to be properly assessed in the amalgamation process. Other comparable jurisdictions, including the UK, Singapore, the United States and New Zealand, also do not adopt a pure balance sheet solvency test for amalgamation. As regards the no-floating charge requirement on the amalgamating company, it would address problem relating to priority of competing floating charges of the amalgamated companies after amalgamation. However, the Administration agrees that removing the requirement would facilitate greater use of the non-court procedure. After considering members' views, the Administration will propose CASs to clauses 668, 669 and 670 to require the consent of all the holders of the floating charges as a condition for allowing the amalgamation, so as to ensure that the holders of the floating charges can

act to protect their own interests. Likewise, a company with other security would also be allowed to use the procedure provided that all holders of the other security have consented to the amalgamation proposal.

Part 14

188. Part 14 -- Remedies for Protection of Companies' or Members' Interests, contains provisions relating to the remedies available for protection of companies' or members' interests. These include the unfair prejudice remedy, the statutory injunction order restraining conduct that constitutes contravention of the new CO, the statutory derivative action, and the right to seek a court order for inspection of company records.

189. Shareholder remedies provisions were substantially revised by the Companies (Amendment) Ordinance 2004 with a view to enhancing legal remedies available to members of a company. The amendments include providing for a statutory derivative action that may be taken on behalf of a company by a member of the company (subsequently extended to cover multiple derivative action through Companies (Amendment) Ordinance 2010); facilitating members to exercise their rights to obtain access to company records; empowering the court, on application by an affected person or the FS, to grant an injunction restraining any person from engaging in conduct which constitutes contravention of the CO or a breach of his fiduciary or other duties owed to a company; and improving the unfair prejudice remedy in section 168A of the CO to provide the court with a power to award damages to the members of a company where it was found that their interests had been unfairly prejudiced and to award such interest on the damages as the court thinks fit. Part 14 of the CB mainly restates the existing provisions with improved drafting with new initiatives to extend the scope of the unfair prejudice remedy to cover proposed acts and omissions (clause 713), and enhance the court's discretion in granting relief in cases of unfair prejudice (clause 714).

<u>Remedies for unfair prejudice to members' interests (Division 2) and remedies for others' conduct in relation to companies etc. (Division 3)</u>

190. The Bills Committee notes that the procedures provided in Division 2 and Division 3 in Part 14 are both related to remedies which the court may order for prejudice of members' interests, and asked if the procedures for application under the two divisions should be aligned for consistency. The Administration has consulted LSHK on the subject. Given that the scope of protection under clauses 713 and 714 is much wider than that under clauses 717 and 718, LSHK considers it advisable to retain the status

quo to provide potential claimants with more options when faced with a situation where their rights as members of a company are being infringed.

191. Members have considered the need to include a clause similar to clause 716 in Division 3 so as to empower the Chief Justice ("CJ") to make rules for actions under that Division. The Administration has pointed out that unlike actions for unfair prejudice remedies, procedures for applications for injunctive relief are relatively straight forward because they are not usually associated with winding-up proceedings. The practice and procedures set out in the Rules of the High Court (Cap 4A), in particular Orders 28 and 29, are applicable to such actions. Therefore there is no need for separate rules to be made.

Court may order inspection of records (clause 729)

192. Clause 729 reinstates sections 125FA and 152FB of the CO to provide for the court's power to make an order for inspection of company records on the application by members of the company. Members note that the meaning of "records" in clause 729 is very general, and would include all documents owned or possessed by the company. They are concerned about the wide scope of the term "record" and the burden on the company. The Administration has explained that the inspection must be for a proper purpose and the application must be made in good faith (clause 729(2)). Previous court cases have demonstrated the need to strike a balance between the right of members and the duty of company to provide records. In a court case, the records that were disclosed in relation to the specified transaction included contracts or agreements, monthly management accounts, correspondence and communications between the company and its accountants, and reports prepared by the accountants for the company.

Group 9: Parts 15 and 19

Part 15

193. Part 15 -- Dissolution by Striking Off or Deregistration, contains provisions on striking off and deregistration of defunct companies, restoration of companies that have been struck off the Companies Register or deregistered by the Registrar, and related matters, including treatment of the properties of dissolved companies.

Voluntary deregistration procedure for companies (clause 737, 738 to 739)

194. At present, only a private company may make application to the Registrar for deregistration under the CO. This is a voluntary deregistration procedure which allows dissolution of a company without going through the winding-up process. To avoid prejudicing the public interest, non-private companies and certain categories of businesses are not allowed to apply for voluntary deregistration. The CB extends the voluntary deregistration procedure to guarantee companies (clause 737), which are often social or community organizations, so that they can dissolve their companies at lower cost. To prevent any potential abuse of the deregistration procedure, in addition to the existing conditions for deregistration including, the company has not commenced operation or business, or has not been in operation or carried on business for three months, it has no outstanding liabilities, all the members agree to the deregistration; two new conditions are added: (a) the applicant must confirm that the company is not a party to any legal proceedings; and (b) that it has no immovable property in Hong Kong (clause 738(2)(d) and (e)).

195. On the condition that a company's assets must not consist of any immovable property situated in Hong Kong in order to qualify for using the voluntary deregistration procedure, members are concerned that the current formulation of clause 738(2)(e) may not be able to cover the situation where the company held immovable property indirectly, for example by holding shares in another company which held the immovable property. Noting members' view, the Administration will introduce a CSA to clause 738 to exclude a holding company of another body corporate with assets consisting of immovable property situated in Hong Kong from the application of the deregistration provisions.

196. Clause 744 provides that notwithstanding the dissolution of the company, the liabilities of directors, managers and members continue and may be enforced. Members are concerned about the scope of "liabilities". The Administration has pointed out that the liability envisaged under clause 744 covers both criminal and civil liabilities (including those liabilities owed to the company before dissolution and to other third parties) which were incurred by a director, manager and member before dissolution of a company. They should not be allowed to avoid such liabilities after dissolution of the company. Similar provision can be found in the UKCA 2006 and the SCA.

197. Clause 746 requires that a director of a company immediately before its dissolution must ensure that the books and papers of the company

are kept for at least six years, otherwise he commits an offence. Members have suggested adding a defence for the director who had reasonable excuses for not being able to keep the company's books and papers after the dissolution of the company. The Administration will move a CSA to clause 746 to provide the defence that the director had reasonable ground to believe a competent person is charged with the duty to comply with the record keeping requirements under clause 746(1).

Part 19

198. Part 19 -- Investigations and Enquiries, contains provisions that deal with investigations and enquiries into a company's affairs. This Part mainly reorganizes the existing provisions of the CO relating to the appointment of an inspector by the FS to investigate the affairs of a company, and the power of the FS (or someone authorized by him) to inspect books and papers of a company, which has been rephrased in the CB as a power to "enquire into company's affairs". Reference has been made to similar provisions on investigations under SFO and FRCO, which are more up-to-date. New powers are provided to the inspectors, for example to require a person to preserve records or documents before production to the inspector (clause 834(1)(b)), and to require a person to verify by statutory declaration any answer or explanation given to the inspector (clause 836(2)). Also the Registrar is provided with a new power to require production of records or documents, and to require information or explanations in respect of the records or documents (clause 861). There are criminal sanctions on non-compliance with requests of the inspectors and the Registrar.

199. Noting that the FS has not appointed inspectors for undertaking investigations on companies after 1999 and has never invoked the enquiry power, members have questioned the need to retain the powers in the CB. Members have enquired about the considerations the FS would take into account in deciding whether to appoint inspectors, and whether such considerations should be put down in the provisions. Moreover, there is concern about the new powers provided to inspectors and the Registrar being too excessive and a suggestion for putting in place proper check and balance to prevent abuse.

200. The Administration has explained that the absence of investigation by inspectors after 1999 is mainly due to the commencement of SFO in 2003, which empowered SFC with greater authority to investigate into market misconduct involving listed companies; and the establishment of the Financial Reporting Council ("FRC") in 2006, which conducts

independent investigations of possible auditing and reporting irregularities in relation to listed companies. However, the Administration is of the view that the possibility of the FS using the investigatory and enquiry powers in future cases cannot be ruled out. It is appropriate to retain the provisions in the CB as "reserve" or "last resort" powers as a supplement to the powers contained in other Ordinances, including SFO and FRCO. As to how the FS would exercise his discretion to appoint inspectors, the Administration has stressed that the FS would only exercise the discretion if significant or great public interest is involved. The FS will consider a number of factors, against the facts of individual cases, in deciding whether a case involves significant or great public interest, including the scale and scope of the alleged complaints, the expected difficulties, costs and benefits involved in pursuing the investigation, and the availability of alternative remedies, etc. Putting down these details in the law would reduce the flexibility in exercising the discretionary power.

201. As regards the concern about excessive powers of the inspector and the Registrar, the Administration has advised that the new powers are necessary and incidental to the proper conduct of an investigation. Nonetheless, to address concerns by members about the conducting of fishing expeditions, the Administration agrees with the Bills Committee's suggestion that more information should be provided in the application for court warrant to enter premises for search of papers and records (clause 865). The information to be specified in the application will include the nature of the record or document that the applicant requires, and the relevant provisions (in Division 2 or Division 3 of Part 19) under which the applicant is empowered to require. The Administration will move CSAs to effect the proposal. As for the enquiry power of the Registrar, the Administration has explained that he may only invoke the power if he has reason to believe, and certifies such in writing, that an offence has been committed; the record, document, information or explanation is relevant to the enquiry; and the person is in possession of the record or document (clause 861(2)). The new power is therefore, clearly defined and confined.

Group 10: Parts 20 and 21

Part 20

202. Part 20 -- Miscellaneous, contains miscellaneous provisions that mainly re-enact provisions in the CO that relate to miscellaneous offences, miscellaneous provisions relating to investigation or enforcement measures, provide a new power for the Registrar to compound specified offences

under the CB, and miscellaneous provisions relating to misconduct by an officer or auditor of a company.

Empowering the Registrar to compound specified offences (clause 887)

203. Clause 887 provides the Registrar with a new power to compound, at his discretion, specified offences. In compounding an offence, the Registrar will give a notice to a person in breach to offer him an opportunity to rectify the default by paying an amount to the Registrar as a compounding fee and remedying the breach constituting the offence within a specified period. If that person accepts and complies with the terms of the notice, no prosecution will be initiated against him for that offence. The offences that are compoundable are specified in Schedule 7. Clause 899(1) provides that the FS may amend the Schedule by notice published in the Gazette. While there is no similar power to compound under the UKCA 2006, administrative penalties are provided for two offences in addition to criminal penalties. The ACA provides for a penalty notice procedure for less serious breaches of the Act. In Singapore, the Registrar may allow a person to pay a sum of money for offences, which is punishable only by a fine or a fine and a default penalty, in lieu of prosecution in court.

204. The Bills Committee notes that SMEs associations welcome the proposal. Members including Hon Andrew LEUNG, Hon WONG Ting-kwong and Hon Jeffrey LAM support the proposal as it would reduce burden on SMEs, encourage compliance with the CO filing obligations, and optimize the use of judicial resources. They consider that the list of compoundable offences should be expanded to include more minor offences under the CB. Members have also enquired about the criteria used for determining whether an offence should be included in Schedule 7.

205. According to the Administration, the general principles for determining whether an offence should be compoundable were developed by one of the Advisory Groups in the CO Rewrite and agreed by SCCLR. The principles are: (a) the compoundable offences should be limited to non-compliance of obligations that are not of a serious nature, which are punishable only by a fine or a fine and a daily default fine (i.e. not imprisonment) and triable summarily (i.e. not on indictment); and (b) it is inappropriate to compound offences that are intermediate offences that would form part of a more serious offence, that involve proof of reasonableness on the part of the person in breach, and where compounding may be detrimental to members of a company. In accordance with these

principles, the compounding regime under the CB will be confined to straightforward, minor regulatory offences committed by companies that are easily detectable by the Registrar from objective reliable evidence.

206. Currently, the five offences included in Schedule 7 are related to failure to engrave name on a company's common seal, improper use of the common seal, failure to file annual returns and failure to deliver accounts. After review, the Administration agrees that the offence under clause 69(2) for failure to deliver the written consent to act as directors, which is straightforward and minor in nature, can be compoundable. The Administration will introduce a CSA to Schedule 7 to include the offence. Some other minor regulatory offences which have yet to be created by subsidiary legislation would also be included in Schedule 7 in due course, including offences for failure to paint or affix the company's name, failure to disclose the company's name, etc. in its documents. On the future development of the compounding regime, the Administration assures members that it would keep in view enforcement of the regime after implementation and consider if the list of compoundable offences would warrant expansion. In considering the question, the Administration would be mindful of the need to strike a reasonable balance between encouraging compliance and not undermining the criminal sanctions.

Part 21

207. Part 21 -- Consequential Amendments, and Transitional and Saving Provisions, contains technical provisions that deal with transitional and saving arrangements required for the commencement of the CB, as well as some consequential amendments to the CO that are necessary for the operation of the CB (included in Schedule 9).

Consequential amendments

208. For the bulk of the consequential amendments to the CO and other Ordinances, the Administration's original plan when introducing the CB into LegCo in January 2011 was to submit a separate Bill to deal with them. To enable the scrutiny of these consequential amendments by the same bills committee with a view to achieving consistency with the CB, the Bills Committee agreed at the meeting on 14 March 2011 that all consequential amendments pursuant to the enactment of the CB would be dealt with simultaneously with the Bill and become part of the Bill through CSAs. To implement this plan, the Administration will move the following CSAs --

(a) a CSA to replace the current Schedule 9 (which only contains a small number of consequential amendments that are necessary because of the transitional and saving provisions in the Bill) with a revised Schedule 9 involving around 340 consequential amendments to the existing CO and its subsidiary legislation; and

(b) a CSA to add a new Schedule 9A involving around 880 consequential amendments to other ordinances and pieces of subsidiary legislation in the Laws of Hong Kong.

209. Draft versions of Schedule 9 and Schedule 9A, together with a marked-up version of the amendments illustrating the proposed changes to the ordinances were circulated to members for consideration in February 2012. The Administration further briefed members on the consequential amendments at two meetings in May 2012. Members note that consequential amendments set out in the two Schedules are mostly technical in nature and consequential to the enactment of the CB. They can be broadly grouped into five board categories, as follows --

(a) Category I: Changes in reference to "Companies Ordinance (Cap. 32)" or its provision(s);

(b) Category II: Amendments due to changes in concepts, terminologies and definitions in CB;

(c) Category III: Amendments arising from the repeal of existing provisions in CO in whole or in part;

(d) Category IV: Amendments due to effect of the provision being spent or redundant; and

(e) Category V: Drafting changes.

Apart from the above categories, there are other miscellaneous consequential amendments in Schedules 9 and 9A dealing with various matters.

210. To facilitate members' deliberation, the Administration has produced examples in each category to illustrate how the consequential amendments operate. The Bills Committee notes that the legal advisers to the Bills Committee have studied the amendments and discussed with the Administration on technical and drafting matters. Members did not raise

any objection to the amendments included in the proposed Schedules 9 and 9A.

Alignment of the penalties for offences under the Companies Bill

Present situation under the Companies Ordinance

211. At present, the Twelfth Schedule to the CO sets out the penalties for all offences under the CO. It specifies the nature of the offence (summary or indictable), the penalties (the maximum level of fine and/or the maximum length of imprisonment)[8] and, where applicable, the level of daily default fine for each offence[9]. The Administration has pointed out that currently there is inconsistent treatment of similar offences under the CO, where penalties prescribed for offences of a similar nature may vary and offences punishable by the same level of fine may be subject to different daily default fines.

Review on the penalty levels

212. To ensure that offences of similar nature under the CB would be punishable with similar penalties and that the penalties involved reflect the relative seriousness of the offences, and to align the penalties for offences committed by Hong Kong companies and those by non-Hong Kong companies, the Administration has undertaken an exercise to align and rationalize the penalty levels for all offences under the CB. The major changes are as follows --

(a) Maximum penalties for the breach of regulatory filing obligations to vary according to the category, nature and importance of documents involved and the severity of the consequences of the breach for the protection of members, creditors or the public. The maximum penalties imposed for the most part will range from Level 3 with a daily default fine of $300, to Level 5 with a daily default fine of $1,000.

(b) Maximum penalties for regulatory (non-filing) offences relating to maintenance and disclosure of company books etc., such as

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[8] In respect of the maximum level of fine, section 113B of, and Schedule 8 to, the Criminal Procedure Ordinance (Cap. 221) prescribe the actual amount represented by the different levels of fines, i.e. from Level 1 to Level 6 with maximum fines from $2,000 to $100,000.

[9] It is a fine for each day on which the default or contravention continues. The amount of daily default fine specified in the Twelfth Schedule represents the maximum which the court can impose for the particular offence and in most cases the actual amount imposed by the court will be lower and will depend upon the circumstances of the case.

breach of obligations relating to the different kinds of registers that are required to be kept, including the failure to keep the registers or refusal of inspection of the registers, are aligned at the same level, namely a fine at Level 4.

(c) The penalty of imprisonment is removed for certain offences where it is considered that the seriousness of the offence does not justify imprisonment as penalty. For example, the responsible person of a company or a registered non-Hong Kong company will not be liable for imprisonment for failing to comply with a direction issued by the Registrar to change a company's name under clause 103(5) or clause 769(2) as seriousness of this breach does not warrant imprisonment.

(d) The maximum penalty level for certain offences has been lowered in the alignment exercise on the basis that the level under the CO is too high. For example, the penalty for a company failing to deliver to the Registrar for registration of a return of allotments is lowered from Level 5 to Level 4 to align with penalties appropriate to offences relating to the register of members.

(e) The maximum penalty level for certain offences is raised in view of the seriousness of the offence. For example, under clause 202 (director making a solvency statement without having reasonable grounds for the opinion expressed), the maximum fine level is raised from Level 5 to Level 6 on summary prosecution as it is considered that making a false or misleading solvency statement can seriously endanger the interests of creditors.

(f) To ensure consistency in the imposition of daily default fines in the CB, each applicable level of fine will carry one corresponding amount of daily default fine where an offence calls for a daily default fine. The maximum daily default fine is set as a fixed percentage (ranging from 2%-3%) of the corresponding fine level. A comparison of the daily default fines for offences in the CO and the CB is set out in the table below --

Level of fine	Maximum amount of fine	Daily default fine in the CO	Proposed daily default fine in the CB
Level 1	$2,000	N/A	N/A
Level 2	$5,000	N/A	N/A
Level 3	$10,000	$200 to $700	$300 (3%)
Level 4	$25,000	$250 to $700	$700 (2.8%)
Level 5	$50,000	$300 to $1,500	$1,000 (2%)
Level 6	$100,000	$300 to $700	$2,000 (2%)

Aligning the penalties for offences

213. Members have enquired about the general rationale for setting different levels of fines for different offences in the alignment exercise. The Administration has reiterated that the general guiding principles are that penalty should reflect the relative seriousness of the offences and offences of similar nature or seriousness should be punishable with similar penalties. To illustrate the different level of fine applicable to various types of offences, the Administration has provided supplementary information set out below.

Level 3

214. Offences which are punishable by a Level 3 fine include regulatory offences where the consequences of non-filing are less serious. These include failure to deliver to the Registrar for registration a notice of change made to the articles of association (clauses 89(3), 90(3), 91(4), 664(9) and 665(7)).

Level 4

215. The Level 4 fine includes more serious filing offences, for example where non-filing may impact upon members and creditors of the company (clauses 166(5), 178(2), 186(2) and 305(5)). It also covers non-filing regulatory offences. For example, offence relating to the maintenance and disclosure of company books, such as breach of obligations relating to the

different kinds of registers which are required to be kept (clauses 304 to 306).

Level 5

216. The Level 5 fine is generally applicable to offences relating to failure to deliver to the Registrar for registration important documents such as annual returns (clauses 653(6), 776 and 777) and solvency statements (clauses 213(5) and 256(5)). It also covers offence relating to failure to keep important documents available for inspection, for example solvency statements and special resolutions for a proposed reduction of share capital (clauses 214(3)), accounting records (clause 371(6)), and resolutions and minutes of meetings and decisions of members (clauses 608 to 610).

Level 6

217. The Level 6 fine is generally applicable to very serious offences. For instance, failure to comply with a direction by the Registrar to change a company name (clauses 103(5), 104(5) and 759(4)), and failure of directors or shadow directors to comply with requirements in relation to disclosure of material interest in a significant transaction with the company (clause 532(1)).

Maximum amount of fine exceeding $100,000 and imprisonment

218. Offences under this category mainly involve provisions in Parts 5, 9 and 19. These offences can seriously endanger members' or creditors' interests and may involve elements of dishonesty on the part of the offenders. Examples are companies reducing capital (clause 207(1)), acquiring its own shares (clause 262(3)), or providing financial assistance for acquisition of its own shares or for reducing or discharging liability for such acquisition (clause 271(4)).

Daily default fines

219. Regarding the proposal on the daily default fine for offences, while members note that the fine for offences attracting a Level 3 fine is equivalent to 3% of the corresponding maximum fine level, the fine for offences attracting a Level 5 or a Level 6 fine is set at only 2% of the corresponding maximum fine level. Members have enquired about the reasons for the general trend of a decreasing daily default fine as the fine level increases. The Administration has explained that in arriving at the appropriate daily default fines in the CB, reference has been made to the

offences under the CO. Given that it is most common for the CO offences to carry a maximum fine at Level 3 or Level 4, it is appropriate to adopt 3% of the maximum fine levels as the general basis in prescribing the daily default fines for offences punishable by Level 3 or Level 4 fines.

220. Some members including Hon Andrew LEUNG, Hon WONG Ting-kwong and Hon Jeffery LAM have expressed concern that imposition of a daily default fine of $300 for Level 3 fine offences would impose undue burden on some SMEs especially if a company is not aware of the breach while the daily default fine incessantly accumulates, and that a daily default fine of $300 is not proportionate to the severity of the Level 3 fine offences which are mostly minor regulatory offences. They have urged the Administration to remove the daily default fine for minor offences with a Level 3 fine level, in particular those where the consequences are not serious and do not involve public interest. However, Hon Audrey EU and Hon Ronny TONG consider that the imposition of daily default fine an important mechanism to ensure quick remedial actions by offenders and discontinuation of the offences. Removal of the daily default fine in some cases would leave the Registrar powerless to deal with continuing default. In particular, they consider it inappropriate to remove the daily default fine for existing offences under the CO and there is no operational problem with the enforcement of the offence provisions under the CO. They are of the view that the daily default fine for offences applicable to listed companies should be retained as greater public interest is involved in such offences. Moreover, as listed companies are better resourced and assisted by company secretaries and professionals, they should not have difficulties in complying with the statutory requirements. The Bills Committee has requested the Administration to review the daily default fine for offences with a Level 3 fine level with reference to criteria including offences applicable to listed companies only, offences applicable to single-shareholder companies only, offences set for protection of the interest of minority shareholders, and existing or new offences.

221. As advised by the Administration, there are 27 non-filing offences in the CB which attract a maximum penalty at Level 3 and a daily default fine. Having considered members' views, the Administration has conducted a further review on the proposal. It agrees that the daily default fine for 19 non-filing offences with a Level 3 fine level could be removed on grounds that few parties will be affected by the non-timely compliance of the offence (e.g. there may be grounds for removing the daily default fines for relatively minor offences which relate only to sole director companies or sole member companies and are unlikely to affect the public interest at large); the continuing default has limited effect on other parties

(e.g. the interests of a member who already has access to a company document in electronic form should not be seriously affected by the company failing to provide him with the same document in hard copy within a prescribed time); and/or lower need to impose a daily default fine if prosecution on the offence is likely to be targeted at a specific breach on a specific date rather than over a continuous period.

222. For offences involving filing obligations, the Administration considers that the imposition of daily default fine justifiable as timely compliance allows for timely disclosure of company information to the general public, which is essential to protect the interests of those dealing with a company and the integrity of the Companies Register. Offences in respect of such filing obligations include a company's failure to file a notice relating to a company's change of status (clause 89(3)), and failure to file an office copy of Court order to confirm or cancel a proposed reduction of share capital (clause 218(2)).

223. The list of 19 offences punishable by a Level 3 fine which will have their daily default fines removed is in **Appendix IV**. The Bills Committee has examined the list and agreed with the principle enshrined in the proposal, i.e. relieving the burden on SMEs relating to minor offences without undermining the interest of third parties. It has also noted that the Administration's intention in removing the daily default fines for the 19 non-filing offences was to reduce the amount of fine that would be imposed, and there was no intention to change the nature of the offence such that it is no longer an offence of a continuing nature or to restrict the ability of the Registrar to prosecute a breach which continues after a successful prosecution.. The Administration will introduce CSAs to effect the proposed changes.

Prosecution of offences under the new Companies Ordinance

224. Members also consider it important for the Companies Registry to formulate clear polices for prosecuting offences under the CB in order to enhance consistency and transparency in the exercise of the power. For minor filing offences, Hon Andrew LEUNG has suggested the Registrar to issue a notice/warning to companies where non-filings are discovered and if the offenders have taken immediate remedial actions within a specified time, the Registrar should not proceed with prosecution. The Administration has advised that the Registrar has been delegated with authority to prosecute summary offences under the CO in the Magistrates' Courts. In deciding whether to prosecute, the Registrar acts in accordance with the "Prosecution Code for Prosecutors" as set out in "The Statement of

Prosecution Policy and Practice" published by the Department of Justice ("DoJ") which is available at DoJ's website. The issues to be considered in deciding whether to prosecute are whether or not there is sufficient evidence to secure a conviction, and if so, whether or not it is in the public interest to pursue a prosecution.

The use of "notes" in the Companies Bill

225. One of the purposes of the CO Rewrite is to modernize the company law. Members note that the main measures directed to this purpose include improvement to the structure of the provisions through re-arrangement in the sequence of some of the provisions, improvement in section headings making them more informative and concise, adopting modern terminology and simplified wordings in drafting, and provision of readers' aids, such as notes.

226. On the provision of notes in the CB, while members agree that there are merits in using notes in providing more information on the relevant provisions in the bill and illustrating the meaning, thus making the law more readable, comprehensible and user-friendly, they have expressed concern about the legal effect of notes. As some of the notes also include examples, members including Hon Audrey EU, Hon Ronny TONG and Hon Albert HO are also concerned about the possible impact of notes and examples on the interpretation of the provisions, in particular the use of examples may create confusion as they are non-exhaustive and different interpretations of examples can be applied in explaining the provisions.

227. The Administration has explained that the use of examples and notes in legislation is not new in Hong Kong legislation[10]. The purpose of providing examples in a provision is to explain the situations in which the provision applies or to illustrate how it will work in practice. As examples shall be construed together with the provision to which they are attached and be given legal effect accordingly, it is not necessary to expressly provide for the legal effect of examples in legislation. An example of a provision enacted as part of the law forms part of the context in which the provision must be interpreted. In other words, "example" will be given their ordinary meaning and corresponding status as an example. While examples are usually given in the body of a provision, they may be set out at the foot of a provision which has the merit of improving the readability of the provision concerned. The location of an

[10] Examples are provided in section 52 of the Evidence Ordinance (Cap. 8), and The Schedule to the Widows and Orphans Pension Ordinance (Cap. 94). Notes are found in section 15 of the Legislative Council Ordinance (Cap. 542) and section 2(1) of the Food Safety Ordinance (Cap. 612).

example does not affect its legal status. On the question about whether examples set out in a provision are exhaustive, the Administration has pointed out that previous court cases have confirmed that examples provided in legislation are not exhaustive. Hence, an example provided in a provision is merely an example and the provision will prevail if the example is inconsistent with that provision.

228. As regards the legal effect of notes (including notes containing examples) provided in the CB, the Administration has explained that clause 2(6) of the CB provides that "A note located in the text of this Ordinance is provided for information only and has no legislative effect." By stating that a note "is provided for information only", the legislative purpose of the note is made abundantly clear, i.e. it is provided only for the information of the reader and serves no other purpose, and is not intended to have any other effect, whether legal or otherwise. The CB contains 37 notes located at the foot of various provisions. These notes are classified into three broad categories --

(a) 25 notes for drawing readers' attention to other relevant provisions of the CB;

(b) 5 notes for providing readers with factual information which is available elsewhere; and

(c) 7 notes for providing examples of the situations in which the relevant provision applies or to illustrate how it will work in practice.

229. While the notes under category (c) above have included examples, the Administration has clarified that by virtue of clause 2(6), the examples provided in these notes have no legal effect. After review, the Administration considers it appropriate to amend some notes containing examples (hence without legislative effect) to "examples" (hence with legislative effect) with some modification to make them clearer and more concise.

230. Given that the provision of readers' aids in legislation concerns policy on drafting of legislation, the Bills Committee has referred the matter for consideration by the Panel on Administration of Justice and Legal Services which discussed issues relating to the use of notes and examples in legislation at its meeting on 22 May 2011. While members of the Panel expressed no particular concern on the use of notes in legislation and were not opposed to the use of examples in legislation in principle,

they cautioned against extensive reliance on examples in legislation. On the use of examples in the CB, Bills Committee members consider that the Administration should exercise greater restraint in this respect to avoid unintended legal effect and possible disputes regarding their interpretations. Hon Ronny TONG is of the view that provision of examples in the CB should depend on actual needs and whether such examples will benefit readers in enhancing their understanding of the provisions concerned. As for the use of notes, Bills Committee members agree with the Administration's view that given the voluminous contents of the CB and the wide spectrum of prospective readers, there are benefits to provide notes to assist readers in navigating through the provisions and understanding more complex provisions.

231. Having considered the views of members and the legal advisers to the Bills Committee and upon a further review, the Administration will introduce CSAs to effect the following amendments to the notes provided in the CB --

(a) For the 7 notes including examples -- to amend 3 notes (in clauses 175, 183 and 205) to "examples" with some modification to make them clearer and more concise, and delete 4 notes (in clauses 155, 207, 346 and section 27 of Schedule 10) that are no longer required;

(b) For the rest of 30 notes -- to delete 20 notes (e.g. in clauses198, 218, 225, 231, 237, 253, 261, 266, 272, 279, 280, 281, 285, 420, 534, 710 and sections 15, 39, 45 and 46 of Schedule 10) and retain 10 notes with amendments to some of them to make them more helpful (e.g. in clauses 2, 130, 133, 162, 165, 166, 169, 219, 220 and section 34 of Schedule 10);

(c) To add 7 new notes in some provisions to draw readers' attention to other relevant provisions in the Bill (e.g. in clauses 391, 394, 410, 453, 529, 738 and 883); and

(d) To add 2 new examples to assist readers in understanding the operation of the provisions concerned (in clauses 213 and 256).

Subsidiary legislation to be made under the Companies Bill after its enactment

232. As currently provide under the CO, the Chief Executive in Council ("CE in Council"), the FS and the CJ are empowered to make subsidiary

legislation on matters mainly to deal with administrative, technical or procedural matters relating to companies, with the majority of them subject to the negative vetting procedures of LegCo. The Bills Committee notes that the CB has adopted the same approach of prescribing technical requirements, operational details and fees items in subsidiary legislation so as to facilitate future updates. Members have enquired about the nature and contents of the subsidiary legislation to be made under the CB, as well as the timing for introducing the subsidiary legislation. The Administration has advised that 14 sets of subsidiary legislation (the details are set out in **Appendix V**) are required to be made for the operation of the CB, and its plan to introduce the legislation in batches in late 2012 or early 2013. Subject to LegCo's scrutiny, the subsidiary legislation will commence operation together with the CB. The Bills Committee further notes other provisions in the CB including clauses 32, 194, 203 and 269 also provide power for the CE in Council, the FS and the CJ to make rules and regulations. These rules and regulations are subject to the approval of LegCo. According to the Administration, such rules and regulations are not required for the commencement of the CB. The Administration has provided information on the scope of such rules and regulations (the details are set out in **Appendix VI**). Moreover, clause 897 provides the FS with the general power to make regulations for any matters required or permitted to be prescribed under the CB.

COMMITTEE STAGE AMENDMENTS

233. The major CSAs proposed by the Administration specific to the relevant Parts of the CB have been highlighted in the above paragraphs. The Administration will also introduce general CSAs which are applicable to various Parts of the CB as appropriate. More important ones are --

(a) Change "14 days" to "15 days" for delivery of documents to the Registrar -- This type of CSAs is introduced in response to members' concern that the 14-day period may be insufficient for companies to deliver certain documents to the Registrar for registration or notification, as the delivery period for some of the documents is 15 days in the CO; and

(b) Deletion of the relevant provisions to effect abolition of capital duty -- The FS announced in his 2012-2013 Budget Speech to abolish capital duty levied on local companies. This type of CSAs will effect the proposal under the CB.

234. Taking into account views from members, the legal advisers to the Bills Committee, and deputations, the Administration will also introduce a number of CSAs to various clauses which are technical or textual in nature with the purposes to clarify the intention of the provisions and facilitate their operation, as well as improve and maintain consistency in drafting throughout the CB.

235. To facilitate the Bills Committee in scrutinizing its proposed CSAs, the Administration has provided the CSAs in marked-up versions against the Blue Bill, with papers explaining the various amendments. Details of these papers with their hyperlinks to the relevant documents on the LegCo website are provided in Appendix III.

236. The Bills Committee agrees to the draft CSAs proposed by the Administration and will not move any CSAs in its name.

237. The Administration has also provided a full set of draft CSAs to be moved. Due to the huge volume (over 500 pages) of the document, the hard copy is not attached to this report. The soft copy is available on the LegCo web site (http://www.legco.gov.hk/yr10-11/english/bc/bc03/reports/bc03-dcsa-e.pdf).

RECOMMENDATION

238. The Bills Committee supports the Administration's proposal to resume the Second Reading debate on the Bill on 27 June 2012.

ADVICE SOUGHT

239. At the House Committee meeting on 8 June 2012, the Deputy Chairman made a verbal report on the deliberations of the Bills Committee. Members are invited to note the deliberations of the Bills Committee.

Council Business Division 1
Legislative Council Secretariat
12 June 2012

Appendix I

Membership list

Chairman	Hon Paul CHAN Mo-po, MH, JP
Deputy Chairman	Hon Starry LEE Wai-king, JP
Members	Hon Albert HO Chun-yan Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP Hon James TO Kun-sun Hon CHAN Kam-lam, SBS, JP (up to 25 May 2011) Dr Hon Philip WONG Yu-hong, GBS Hon Miriam LAU Kin-yee, GBS, JP Hon Abraham SHEK Lai-him, SBS, JP Hon Audrey EU Yuet-mee, SC, JP Hon Jeffrey LAM Kin-fung, GBS, JP Hon Andrew LEUNG Kwan-yuen, GBS, JP Hon WONG Ting-kwong, BBS, JP Hon Ronny TONG Ka-wah, SC Hon CHIM Pui-chung (up to 14 March 2011) Prof Hon Patrick LAU Sau-shing, SBS, JP (Total: 14 members)
Clerk	Ms Connie SZETO
Legal Advisers	Mr KAU Kin-wah Mr Timothy TSO

Appendix II

Bills Committee on Companies Bill

List of organizations and individuals who have given views to the Bills Committee
(as at 11 June 2012)

Organizations

1. Allen & Overy
2. Asian Citrus Victims Alliance
3. Asian Transnational Corporation Monitoring Network
4. Association of Chartered Certified Accountants Hong Kong
5. Baker & McKenzie
6. Baker Tilly Hong Kong Limited
7. Cheung Kong (Holdings) Limited
8. College of Business, City University of Hong Kong
9. Computershare Hong Kong Investor Services Limited
10. Crowe Horwath (HK) CPA Limited
11. Democratic Accountants
12. Economic Synergy
13. Ernst & Young
14. Federation of Hong Kong Industries
15. Hong Kong Bar Association
16. Hong Kong General Chamber of Commerce
17. Hong Kong Institute of Certified Public Accountants
18. Hong Kong Securities Association
19. Hong Kong Small and Medium Enterprises Association

20. Hong Kong Small and Medium Enterprises Development Association
21. Hong Kong Small and Medium Enterprises General Association
22. Hsin Chong Construction Group Limited
23. Hutchison Whampoa Limited
24. International Chamber of Commerce -- Hong Kong, China
25. Investor Interest Concern Group
26. KPMG
27. Mayer Brown JSM
28. MAZARS CPA Limited
29. Minority Shareholder's Interest Concern Group
30. PCCW Minority Share Holder Alliance
31. 1189 Rosedale Hotel (Former Wing On Travel) Minority Shareholder Alliance
32. Securities and Futures Commission
33. Seanew Media Company Limited
34. The British Chamber of Commerce in Hong Kong
35. The Canadian Chamber of Commerce in Hong Kong
36. The Chamber of Hong Kong Listed Companies
37. The Chinese Manufacturers' Association of Hong Kong
38. The DTC Association (The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)
39. The Hongkong and Shanghai Banking Corporation Limited
40. The Hong Kong Association of Banks
41. The Hong Kong Chinese Importers' & Exporters' Association
42. The Hong Kong Electronic Industries Association
43. The Hong Kong General Chamber of Small and Medium Business Limited

44. The Hong Kong Institute of Chartered Secretaries

45. The Hong Kong Institute of Directors

46. The Institute of Certified Management Accountants -- Hong Kong Office

47. The Investors Protection Association

48. The Law Society of Hong Kong

49. The Real Estate Developers Association of Hong Kong

50. The Society of Chinese Accountants and Auditors

51. The Society of Trust and Estate Practitioners (HK) Limited

52. Peter K H TONG & Co

53. Woo Kwan Lee & Lo

54. 公司條例草案關注組

Individuals

1. Dr Surya DEVA, Associate Professor, School of Law, City University of Hong Kong

2. J C

3. Mr Daniel LAM, Lecturer of School of Accounting and Finance, Hong Kong Polytechnic University

4. Mr LEUNG Kwok-keung

5. Dr Brian LO

6. Dr LU Hai-tian, Assistant Professor, School of Accounting and Finance, Hong Kong Polytechnic University

7. Ms Alice TAM Yuk-kuen

8. Mr David WEBB

9. Professor Mark WILLIAMS, Associate Head and Professor of School of Accounting and Finance, Hong Kong Polytechnic University

10. Dr Davy WU, Senior Lecturer, Department of Accountancy & Law, Hong Kong Baptist University

11. Mr YEUNG Wai-sing, Eastern District Council member

Appendix III

Bills Committee on Companies Bill

Administration's papers on major proposals, comparison tables of the clauses with provisions of the Companies Ordinance and relevant provisions in overseas jurisdictions, and draft Committee Stage amendments presented to the Bills Committee for discussion

	LC Paper No.		
Part/Schedule of the Bill	**Major proposals and policy issues**	**Comparison table for clause-by-clause examination**	**Draft Committee Stage amendments in marked-up versions**
Overall Policies	CB(1)1522/10-11(02)	--	--
Part 1	CB(1)1671/10-11(03)	CB(1)1052/11-12(04)	CB(1)1591/11-12(01) CB(1)1979/11-12(03) CB(1)2019/11-12(03)
Part 2	CB(1)1879/10-11(03)	CB(1)2756/10-11(03)	CB(1)1866/11-12(03)
Part 3	CB(1)1671/10-11(03)	CB(1)2948/10-11(01)	CB(1)1821/11-12(01) CB(1)1979/11-12(03)
Part 4	CB(1)2066/10-11(01)	CB(1)34/11-12(05)	CB(1)1591/11-12(02) CB(1)2019/11-12(03)
Part 5	CB(1)2066/10-11(01)	CB(1)225/11-12(02)	CB(1)1591/11-12(03) CB(1)2019/11-12(03)
Part 6	CB(1)2175/10-11(01)	CB(1)278/11-12(01)	CB(1)1612/11-12(01)

	LC Paper No.		
Part/Schedule of the Bill	**Major proposals and policy issues**	**Comparison table for clause-by-clause examination**	**Draft Committee Stage amendments in marked-up versions**
Part 7	CB(1)2175/10-11(01)	CB(1)278/11-12(02)	CB(1)1747/11-12(01) CB(1)2019/11-12(03)
Part 8	CB(1)2175/10-11(01)	CB(1)278/11-12(03)	CB(1)1747/11-12(02)
Part 9	CB(1)1879/10-11(04)	CB(1)331/11-12(01)	CB(1)1979/11-12(01) CB(1)1979/11-12(02) CB(1)2019/11-12(01) CB(1)2019/11-12(03) CB(1)2091/11-12(02)
Part 10	CB(1)2280/10-11(01)	CB(1)404/11-12(01)	CB(1)1747/11-12(03)
Part 11	CB(1)2280/10-11(01)	CB(1)461/11-12(01)	CB(1)1821/11-12(02) CB(1)1979/11-12(03)
Part 12	CB(1)1879/10-11(03)	CB(1)530/11-12(01)	CB(1)1940/11-12(01) CB(1)1979/11-12(03)
Part 13	CB(1)2389/10-11(01)	CB(1)744/11-12(04)	CB(1)1747/11-12(04) CB(1)2019/11-12(02) CB(1)2091/11-12(01) CB(1)2115/11-12(01)
Part 14	CB(1)2389/10-11(01)	CB(1)807/11-12(01)	CB(1)1591/11-12(04)

	LC Paper No.		
Part/Schedule of the Bill	**Major proposals and policy issues**	**Comparison table for clause-by-clause examination**	**Draft Committee Stage amendments in marked-up versions**
Part 15	CB(1)2439/10-11(06)	CB(1)807/11-12(02)	CB(1)1591/11-12(05)
Part 16	CB(1)1671/10-11(04)	CB(1)943/11-12(01)	CB(1)1763/11-12(01)
Part 17	CB(1)1671/10-11(03)	CB(1)1003/11-12(01)	CB(1)1591/11-12(06)
Part 18	CB(1)1671/10-11(04)	CB(1)1003/11-12(02)	CB(1)1747/11-12(05)
Part 19	CB(1)2439/10-11(06)	CB(1)1003/11-12(03)	CB(1)1763/11-12(02) CB(1)2019/11-12(03)
Part 20	CB(1)2636/10-11(03)	CB(1)1052/11-12(01)	CB(1)1591/11-12(07) CB(1)2019/11-12(03)
Part 21	CB(1)2636/10-11(03)	CB(1)1052/11-12(03)	CB(1)1612/11-12(02) CB(1)2019/11-12(03)
Schedule 1	CB(1)1671/10-11(03)	CB(1)1052/11-12(04)	CB(1)1591/11-12(01)
Schedule 2	CB(1)1671/10-11(03)	CB(1)2948/10-11(01)	CB(1)1821/11-12(01)
Schedule 3	CB(1)1879/10-11(04)	CB(1)331/11-12(01)	CB(1)2019/11-12(01) CB(1)2091/11-12(02)
Schedule 4	CB(1)1879/10-11(04)	CB(1)331/11-12(01)	--
Schedule 5	CB(1)1879/10-11(04)	CB(1)331/11-12(01)	--
Schedule 6	CB(1)1879/10-11(03)	CB(1)530/11-12(01)	--

	LC Paper No.		
Part/Schedule of the Bill	**Major proposals and policy issues**	**Comparison table for clause-by-clause examination**	**Draft Committee Stage amendments in marked-up versions**
Schedule 7	CB(1)2636/10-11(03)	CB(1)1052/11-12(01)	CB(1)1591/11-12(07)
Schedule 8	CB(1)2636/10-11(03)	CB(1)1052/11-12(01)	CB(1)2019/11-12(03)
Schedule 9	CB(1)2636/10-11(03)	--	CB(1)2059/11-12(01)
Schedule 9A	CB(1)2636/10-11(03)	--	CB(1)2059/11-12(01)
Schedule 10	CB(1)2636/10-11(03)	CB(1)2756/10-11(03) CB(1)2948/10-11(01) CB(1)331/11-12(01) CB(1)404/11-12(01) CB(1)461/11-12(01) CB(1)530/11-12(01) CB(1)744/11-12(04) CB(1)807/11-12(01) CB(1)807/11-12(02) CB(1)943/11-12(01) CB(1)1003/11-12(01) CB(1)1003/11-12(03) CB(1)1052/11-12(01)	CB(1)2059/11-12(02)

Appendix IV

Proposed deletion of daily default fines

List of non-filing offences punishable by a Level 3 fine and daily default fine of $300 under the Companies Bill

Offence provision in CB	General description of the offence	Justifications
Clause 213(3) (in respect of clause 213(1))	• Company failing to publish a notice about the particulars of a proposed reduction of share capital in the Gazette within the prescribed time.	• These offences relate to failure to publish the requisite notice within a prescribed time in relation to a proposed reduction of share capital or a proposed payment out of capital. Since these proposed transactions would need to be approved by a special resolution of the company, members of the company should already be aware of the proposals. Members of the public will also have access to information on these transactions as the solvency statement and the special resolutions supporting these transactions would need to be filed with the Registrar (with late filing being penalized by a daily default fine). Moreover, prosecution would focus on the actual breach as at a specific date and not a continuous period. Therefore, we consider the daily default fines for these provisions can be removed.
Clause 213(3) (in respect of clause 213(2))	• Company failing to comply with the requirement either to publish a notice about the particulars of a proposed reduction of share capital in newspapers or give written notice to that effect to creditors within the prescribed time.	
Clause 256(3) (in respect of clause 256(1))	• Company failing to publish a notice about the particulars of a proposed payment out of capital in the Gazette within the prescribed time.	

Offence provision in CB	General description of the offence	Justifications
Clause 256(3) (in respect of clause 256(2))	• Company failing to comply with the requirement either to publish a notice about the particulars of a proposed payment out of capital in newspapers or give written notice to that effect to creditors within the prescribed time.	
Clause 372(5) (in respect of clause 372(3))	• Company failing to reproduce in hard copy form the accounting records that are kept in electronic form.	• These provisions relate to the form of information provided or record kept by the companies. Provided there is an electronic version of the information, the interests of members are protected. Therefore, we consider that the daily default fines can be removed in respect of these clauses.
Clause 646(5) (in respect of clause 646(3))	• Company failing to ensure that the company records that are kept in electronic form are capable of being reproduced in hard copy form.	
Clause 825(3)	• Company failing to provide a document or information in hard copy form as requested by its member or debenture holders within the prescribed time.	
Clause 372(5) (in respect of clause 372(4))	• Company failing to take adequate precaution and steps to guard against, and facilitate the discovery of, falsification of accounting records.	• These offences relate to a company taking adequate precautions to guard against falsification of accounting and company records if such records are kept otherwise than by making entries in a bound book. These offences

Offence provision in CB	General description of the offence	Justifications
Clause 647(2)	• Company failing to take adequate precaution and steps to guard against, and facilitate the discovery of, falsification of company records.	are mainly about having a proper system or mechanism in place. It is considered that prosecution would focus on the actual breach as at a specific date and not a continuous period. Therefore, the daily default fines could be removed. • Further, there are other provisions and penalties for non-compliance in the Companies Bill ("CB") dealing with the keeping of the various individual registers etc. to protect the interests of members.
Clause 462(5) (in respect of clause 462(2))	• Company failing to keep available for members' inspection copy of permitted indemnity provision or memorandum thereof at the prescribed places.	• These offences relate to failure to keep copies of permitted indemnity provision or memorandum thereof made for a director of a company at a prescribed place and for at least one year after termination or expiry of indemnity. • The daily default fine can be removed as prosecution would focus on the actual breach as at a specific date and not a continuous period.
Clause 462(5) (in respect of clause 462(3))	• Company failing to retain and keep copy of permitted indemnity provision or memorandum thereof for at least one year after the date of termination or expiry of the permitted indemnity provision.	
Clause 474(6) (in respect of clause 474(4))	• Sole director of a company failing to provide the company with a written record of any of his decision that may	• Clause 474(6) relates to a sole director providing a written record of a decision taken in a director's meeting to the company within 7 days. This is likely to apply to small

Offence provision in CB	General description of the offence	Justifications
	be taken in a directors' meeting and has effect as if agreed in such meeting.	one person companies and non-timely compliance would be unlikely to affect the interests of the public or indeed other members. Prosecution of the breach should be sufficient to ensure compliance. Therefore, the daily default fine can be removed. • Clauses 535(3) and 607(3) both relate to sole member companies and for the same reason, the daily default can also be removed from these offences.
Clause 535(3)	• Company failing to ensure that the terms of a contract with its sole member who is also a director are set out in a written memorandum and the memorandum be kept at the prescribed place.	
Clause 607(3)	• Sole member failing to provide the company with a written record of any decision made by him within the prescribed time.	
Clause 533(6) (in respect of clause 533(3))	• Company failing to keep at a prescribed place a copy of the management contract; or a written memorandum setting out the terms of the contract if the contract is not in writing.	• These offences relate to the keeping of management contracts with directors, or in which they have an interest, or keeping them for a period of at least one year after termination or expiry of the contract. • The daily default fines can be removed as prosecution would focus on the actual breach as at a specific date and not a continuous period.
Clause 533(6) (in respect of clause 533(4))	• Company failing to retain and keep available for members' inspection copy of a contract by which a person	

Offence provision in CB	General description of the offence	Justifications
	undertakes the management and administration of the whole or any substantial part of any of the company's business or memorandum thereof for at least one year after the date of termination or expiry of the contract.	
Clause 584(2)	• Company failing to record in the minutes of proceedings of a general meeting the prescribed results of each resolution decided on a poll.	• This offence relates to a company failing to record in the minutes of proceedings of a general meeting the prescribed results of each resolution decided on a poll. • As the members of the company should be aware of the result of the poll at the general meeting, their interests will not be affected by the late recording of the information provided the general meeting if the poll is properly conducted. Therefore, the daily default fine can be removed.
Clause 651	• Company failing to disclose company name etc. in accordance with the requirements prescribed by the Financial Secretary in regulations.	• These offences will be included in Schedule 7 to CB as offences which can be compounded by the Registrar. When CB is implemented, it is anticipated that such breaches will be dealt with by compounding.

Offence provision in CB	General description of the offence	Justifications
Clause 780(8) (in respect of clause 780(2))	• Non-Hong Kong company failing to exhibit its names and place of incorporation on every place it carries on business in Hong Kong and (if applicable) conspicuously exhibit a notice of the fact that the liability of its members is limited.	

Appendix V

Subsidiary legislation to be made under the Companies Bill before its commencement

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
1	Clause 25	Section 304 and the Eighth Schedule	• The Financial Secretary may make regulations pursuant to clause 25(1) to require payment to the Registrar of fees in respect of -- (a) the performance of any of the Registrar's functions; or (b) the provision of services or facilities connected with the performance of functions. • The regulations may -- (a) provide for the amount of the fees to be fixed by or determined under the regulations; (b) provide for different fees to be payable in respect of the same matter in different circumstances; and (c) specify when and how fees are to be paid.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			• The fees payable would include those in relation to the registration of documents, inspection of documents, granting of licences and other miscellaneous fees.
2	Clauses 47, 53, 648 and new provisions to be introduced through Committee Stage Amendments ("CSAs")[1]	N/A	• The Financial Secretary may make regulations to prescribe -- (a) the information to be contained in an application under clause 47(1) for withholding a residential address or a full identification number, as well as the documents and fees to accompany such an application; and (b) the entities to whom the protected or withheld residential addresses and full identification numbers may be disclosed under clause 53(4) and the new provisions to be introduced through CSAs, the conditions for the disclosure and the fees payable. It is envisaged that the entities would at least include -- (i) the individual to whom the information relates and other persons authorised by him;

[1] CSAs will be introduced to add new provisions to provide for disclosure of the information withheld pursuant to clause 47 similar to the provisions under clauses 53 and 54.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			(ii) the members of the relevant company; (iii) relevant government bureau and departments, as well as other relevant regulators; and (iv) a liquidator or a provisional liquidator. • The regulations would also prescribe the manner in which residential addresses and full identification numbers should be withheld for companies intending to withhold the information contained in its registers of directors and company secretaries from inspection pursuant to clauses 635 and 642.
3	Clause 73	Tables A , C, D and E of the First Schedule	• The Financial Secretary may prescribe model articles for companies. It is envisaged that there will be model articles for public companies limited by shares, private companies limited by shares and companies limited by guarantee. A company may adopt as its articles any or all of the provisions of the model articles. On the incorporation of a limited company, the model articles that are prescribed for the type of company to which the company belongs, so far as applicable, form part of the company's articles if the company's articles do not exclude or modify the model articles.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			• It is envisaged that the model articles for public companies limited by shares would be similar in scope to the current Table A and there would be suitable modifications, including those for clearer layout and drafting. The model articles for private companies limited by shares would be considerably simpler, reflecting how small companies operate. • Unlike the current Tables C and D which only provide the forms of the memorandum and articles of association of a company limited by guarantee, the model articles would be comprehensive in scope. However, they will be simple and concise taking into account the fact that most of the companies limited by guarantee in Hong Kong are small to medium in size.
4	Clause 96	Section 22B and the Companies (Specification of Names) Order (Cap. 32E)	The Financial Secretary may specify any word or expression, to the effect that a company must not be registered by a name containing those words or expressions without prior approval of the Registrar of Companies. This subsidiary legislation would serve the same function as the current Companies (Specification of Names) Order.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
5	Clause 355	N/A	• The Financial Secretary may make regulations -- (a) prescribing places at which copies of instruments creating charges and a register of charges are to be kept by a registered non-Hong Kong company under clauses 350 and 352. It is envisaged that a registered non-Hong Kong company may keep those copies and the register at its principal place of business in Hong Kong or another place in Hong Kong; (b) providing for the obligations of a registered non-Hong Kong company to keep the copies and the register available for inspection under clause 354(2). The regulations would prescribe the notice required from the person who would like to inspect the records. Given the required notice, a registered non-Hong Kong company would be required to allow for the person to inspect and make copies of the records; and (c) prescribing the fees payable by persons who are not members of the company for inspection of the copies and the register under clause 354. • This subsidiary legislation would mirror the one relating to company records for Hong Kong companies to be made under Part 12 (see item 11 below).

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
6	Clause 441	Section 141E and Companies (Revision of Accounts and Reports) Regulation (Cap. 32N)	• The Financial Secretary may make regulations providing for the application of the CB in relation to the financial statements, summary financial report or directors' report ("the reports") that has been revised under clause 440. The regulations may, among others, -- (a) make different provisions depending on how the reports have been revised; (b) provide for the functions of the auditors in relation to the revised reports; and (c) require the company to take certain steps if the reports have been laid before the company in general meeting or sent to members before the revision. • It is envisaged that the regulations would be derived from the current requirements under the Companies (Revision of Accounts and Reports) Regulation (Cap. 32N) with suitable modifications. Among others, the regulations would require -- (a) that the revised reports must contain statements on the revision in a prominent position;

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			(b) that the auditor has to make a report on the revised financial statements; and (c) that the revised reports and audit reports must be laid at a general meeting and/ or sent to members, and forwarded to the Registrar of Companies within a prescribed period after the revision.
7	Clause 443	Section 129D	• The Financial Secretary may make regulations -- (a) prescribing information that is required to be contained in a directors' report under clause 380(1) and (2); and (b) prescribing other requirements for a directors' report. • It is envisaged that the regulations would be derived from the current requirements under section 129D of the CO with suitable modifications. Among others, the directors' report in respect of a financial year would be required to include -- (a) a statement explaining the effect of the arrangements to which the company or other relevant companies are parties the object of which is to enable directors of the company to acquire benefits by means of the acquisition of shares in the company or any other body corporate;

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			(b) the amount of donations of not less than $10,000 made for charitable or other purposes by the company and its subsidiaries (companies falling within the reporting exemption under Part 9 would be exempted from this requirement); (c) the details of shares issued by the company and equity linked arrangements entered into by the company; (d) the amount of dividend (companies falling within the reporting exemption under Part 9 would be exempted from this requirement); and (e) if any director has resigned on grounds of his disagreement with the management of the company, the reasons he has given to the company (companies falling within the reporting exemption under Part 9 would be exempted from this requirement).
8	Clause 443	Section 161(1), 161B(1) to (7), (11) & (17), 161BB(1), and 161C(1), (2A) & (3)	• The Financial Secretary may make regulations -- (a) prescribing information that is required to be contained in the notes to any financial statements under section 378(1); and (b) prescribing other requirements for notes to any financial statements.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			• It is envisaged that the regulations would focus on information in relation to the benefits of directors and would be derived from the current requirements under sections 161, 161A, 161B and 161BB of the CO with suitable modifications. Among others, the notes to the financial statements of a company would be required to include information on -- (a) directors' emoluments; (b) for listed companies, benefits in respect of share options or shares; (c) retirement benefits in excess of the directors' entitlements; (d) payment for loss of office ; and (e) transactions entered into by the company and its subsidiaries which are restricted under Part 11 (including loans, quasi-loans, credit transactions, etc. in favour of the directors and their connected entities) or similar transactions in which the directors or their connected entities have material interest.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
9	Clause 443	Sections 141CB, 141CF and Companies (Summary Financial Reports for Listed Companies) Regulation (Cap. 32M)	• The Financial Secretary may make regulations -- (a) prescribing information that is required to be contained in a summary financial report under clause 430(2); (b) prescribing other requirements for a summary financial report; and (c) providing for the form and contents of notifications given by the company to members under clause 433(2) and the notice of intent given by members to the company in relation to summary financial report. • It is envisaged that the regulations would be derived from the current requirements under the Companies (Summary Financial Reports of Listed Companies) Regulation (Cap. 32M) of the CO with suitable modifications. Among others, the summary financial reports must be derived from the reporting documents of the company to which it relates and must contain the following information in relation to the company -- (a) the information and particulars included in the company's statement of financial position and statement of comprehensive income; (b) the information required to be contained in the directors' report;

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			(c) relevant auditor's statements and opinion (e.g. the statement that the financial statements have not been properly prepared, that the financial statements are not consistent with the directors' report, etc.); (d) important events which occur after the end of the financial year that may affect the company ; and (e) any other information necessary to ensure that the report is consistent with the reporting documents for the financial year in question. • It is also envisaged that the regulations would set out the technical requirements on the form and contents of notifications given by the company to members and potential members under clause 433(2) in relation to summary financial report. For example, the regulations would require that the notification must make it clear that the members may request the company to send them the full reporting documents or, instead, the summary financial reports. The notice of intent has to be postage prepaid if sent to an address in Hong Kong.
10	Clause 443	N/A	• The Financial Secretary may make regulations prescribing a body for the purposes of section 376(8)(a). The reference to "accounting standards" in the CB means the statements of standard accounting practice issued by that

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
			body. It is envisaged that the body would be the Hong Kong Institute of Certified Public Accountants.
11	Clause 648	N/A	• The Financial Secretary may make regulations to provide for the obligations of a company that is required by the CB to keep, make available for inspection and provide copies of any company records. The regulations may -- (a) prescribe places for the keeping of company records. It is envisaged that a company may keep the records at its registered office or a place in Hong Kong; (b) make provision as to the inspection and copying of the company records. The regulations would prescribe the notice required from the person who would like to inspect the records. Given the required notice, a company would be required to allow the person to inspect and make hard or electronic copies of the records; and (c) prescribe the fees payable for inspection of company records by persons who are not members of the company and for making copies of the records.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
12	Clauses 650 and 651	Section 93	• The Financial Secretary may make regulations to require companies -- (a) to display prescribed information in prescribed locations. Among others, a company has to display its name outside of its registered office and other places of business; (b) to state prescribed information in prescribed descriptions of documents or communications. Among others, a company has to display its name on its website and also its registration number in its business letters and official publications. For companies with limited liability, "Limited" should be added to its name (unless exempted); and (c) to provide prescribed information on request to those they deal with in the course of their business. The information would include the addresses of the registered office and places where company records are kept, and the types of records kept.
13	Clause 716	Sections 168A, 296 and Companies (Winding-up) Rules (Cap. 32H)	The Chief Justice may make rules for regulating unfair prejudice proceedings. It is envisaged that the rules may -- (a) prescribe the form, contents and manner of the presentation, service and return of petition as well as the advertisement of the order; and (b) prescribe fees or empower the Court to fix fees.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Brief description of the subsidiary legislation to be made
14	Clauses 792 and 793	Sections 333, 333B, 334, 335, 336, 359A(1) and Companies (Revision of Accounts and Reports) Regulation (Cap. 32N)	• The Financial Secretary may make regulations in relation to the revision of accounts by a registered non-Hong Kong company. It is envisaged that the regulations would be derived from the requirements under section 20 and 21 of the Companies (Revision of Accounts and Reports) Regulation (Cap. 32N). • The Financial Secretary may also make regulations prescribing the particular and accompanying documents in an application, notification and return under Part 16. It is envisaged that the regulations would be derived from the requirements under sections 333, 333B, 334, 335 and 336 of the CO with suitable modifications. • The Financial Secretary may also make regulations providing that an application under section 764(2) or (3), or a return under section 766(2), may contain a certified translation of a domestic name of the non-Hong Kong company; and providing for the procedures and requirements for the purpose. It is envisaged that the requirements will be derived from the current practice and procedure as set out in Companies Registry External circular No.1/2001.

Appendix VI

Rules and Regulations which can be made under the Companies Bill but will not be made before its commencement

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Remarks
1	Clause 32	N/A	The Financial Secretary may make regulations requiring any document required or authorized to be delivered to the Registrar under an Ordinance to be delivered by electronic means.
2	Clause194	Section 48F	The Financial Secretary may make regulations for restricting or otherwise modifying the relief provided by Subdivision 1 of Division 8 of Part 4 in relation to share capital requirements.
3	Clause 203	Section 49Q(1)(d) and (4)	The Chief Executive in Council may make regulations -- (a) modifying the solvency test or its application to any transaction or class of transactions; or (b) modifying the matters that a director is required to take into account in forming an opinion for the purpose of making a solvency statement.

No.	Empowering provisions in the Companies Bill ("CB")	Relevant provisions in the Companies Ordinance ("CO")	Remarks
4	Clause 269	Section 49Q(1)(a) to (c) and 49Q(4)	The Chief Executive in Council may make regulations modifying any of the provisions of Division 4 of Part 5 with respect to -- (a) the authorization required for a company to buy back its own shares; (b) the authorization required for the release by a company of its rights under a contract for the buyback of its own shares, including a contingent buyback contract; and (c) the information to be included in a return by a company to the Registrar in relation to a share redemption or buy-back.
5	Clause 716(1)(b)	Sections 168A(6) and 296	The Chief Justice may make rules for prescribing fees payable in respect of proceedings under Division 2 of Part 14 (unfair prejudice proceedings).
6	Clause 897	Section 359A(1)	The Financial Secretary may make regulations for any matter required or permitted to be prescribed under the CB.