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By Fax No. 25283345

26 March 1999

Mr. T K Yeung
Assistant Secretary (Companies) 1
Financial Services Bureau
18/F Tower 1 Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Mr. Yeung,

Companies (Amendment) Bill 1999

I am scrutinizing the legal and drafting aspects of the above Bill with a view to advising Members. I shall be grateful if you can clarify the following points:

1. Clause 3

In section 13(1) and (2) of the Companies Ordinance (Cap. 32), it is provided that a company may by special resolution alter or add to its articles. In the proposed new section 13(3) and (4), a company is only required to deliver document to the Registrar if its articles are altered. Does it mean that a company is not required to deliver its articles to the Registrar if there is an addition and not alteration to the articles?

2. Clause 4

Why is the original section 48B(3)(c) deleted? Have any other relevant provisions been consequentially amended?

3. Clause 5

In section 48F(3), it is stated that -
"Where there is any conflict between any of the provisions of sections 48B to 48E and any of the provisions of regulations made under this section, the second-mentioned provision shall prevail over the first-mentioned provisions."

/P.2....

Does it mean that the provision of regulation is to prevail over the Ordinance? Would this section be in contravention of section 28(1)(b) of the Interpretation and General Clauses Ordinance (Cap. 1) where it is stated that "no subsidiary legislation shall be inconsistent with the provisions of any Ordinance"? Has similar provision appeared elsewhere in the Laws of Hong Kong or in the U.K. Act?

4. Clauses 11, 12 and 28

Directors' and Secretaries' nationalities are no longer required to be reported. Would relevant forms be amended?

Your early reply in both English and Chinese is most appreciated.

Yours sincerely,

(Anita Ho)
Assistant Legal Adviser

c.c. Dept. of Justice (Attn: Mr. Fox Geoffrey A, Senior Asst Law Draftsman)
Dept. of Justice (Attn: Miss Shandy Liu, Senior Govt Counsel)
LA, (Fax No. 2868 2813)

香港特別行政區政府財經事務局的信頭

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27 March 1999

Miss Anita Ho
Assistant Legal Adviser
Legislative Council Secretariat
Legal Service Division
8 Jackson Road
Central
Hong Kong

Dear Miss Ho,

Companies (Amendment) Bill 1999

Thank you for your letter of March 26. Our reply to the points raised in your letter is as follows -

(1) Clause 3

This is a matter of semantics. In new section 13(3) & (4), the word “alteration” is used as its meaning would embrace any addition, deletion or amendment to the articles.

(2) Clause 4

This is to rectify an omission in the Companies (Amendment) Ordinance 1991. Section 48B(3)(c) should have been repealed in 1991 when section 49A(1)(b) was introduced. In this connection, you may wish to see the attached article from Professor Philip Smart pointing out the inconsistency between sections 48B(3)(c) and 49A(1)(b). Clause 42 of Bill aims to put beyond doubt the validity of distribution/redemption of shares issued after 1 September 1991 pursuant to section 48B(3).

(3) Clause 5

We are consulting the Department of Justice and will revert to you as soon as possible.

(4) Clauses 11, 12 and 28

Forms in the Companies Registry have been deregulated since February 1997. The Registrar of Companies will amend the forms accordingly if the proposal to delete the requirement to report nationality is approved.

Yours sincerely,

(YEUNG Tak-keung)
for Secretary for Financial Services

c.c. Department of Justice (Attn: Mr Geoffrey Fox, Miss Shandy Liu)
Registrar of Companies (Attn: Mr E T O'Connell)

FORUM

FOCUS

Conflicting Provisions in the Companies Ordinance

Section 48B(3)(c) of the Companies Ordinance should have been repealed in 1991, argues Philip Smart

There exists in Hong Kong, a practical problem (hitherto unrecognised) concerning a company's use of its share premium account when redeeming redeemable preference shares.

At first blush it might appear that there should be no problem at all, because s 48B(3)(c) of the *Companies Ordinance* seems expressly to allow a company to use its share premium account in providing for the premium payable on the redemption of redeemable preference shares. However, it is submitted that when, in 1991, the reforming provisions on capital and shares (including redeemable shares) were introduced by the *Companies (Amendment) Ordinance* 1991, the old section s 48B(3)(c) should have been repealed. The failure to delete s 48B(3)(c) means that there is today a direct conflict between ss 48B(3)(c) and 49A(1)(b). The latter section, introduced in 1991, requires 'any premium' payable upon a redemption of shares to be paid out of distributable profits or, in certain circumstances (see s 49A(2)), the proceeds of a fresh issue of shares.

It can only be that the failure to amend s 48B(3)(c) was a mistake. Section 48B(3) is a replica of what was s 56(2) of the UK *Companies Act* 1948, and that provision was repealed when the UK company law on redeemable shares (as well as capital and distributions) was reformed in the early 1980s (see s 130(2) of the UK *Companies Act* 1985). Those reforms were reproduced in the Hong Kong *Companies (Amendment) Ordinance* 1991, but it would appear that the draftsman forgot to copy the consequential amendment in respect of the share premium account (ie s 48B(3)(c)).

The net result is that s 48B(3)(c) is quite inconsistent with s 49A(1)(b) as well as certain other provisions, discussed below, introduced in 1991. In accordance with basic principles of statutory interpretation, s 48B(3)(c) must be taken to have been repealed by s 49A(1)(b). (A similar irregularity occurred in 1991 when consequential amendments to Table A were left out of the *Companies (Amendment) Ordinance* 1991: the amendments were speedily introduced in 1993 after the mistake had been pointed out by this commentator.)

Section 48B(3) of the Companies Ordinance

Section 48B(3) provides that the share premium account may, notwithstanding anything in subsection (1), be applied by the company:

(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

(b) in writing off:

(i) the preliminary expenses of the company; or

(ii) the expenses of, or the commission paid or discount allowed on, any issue of shares of the company; or

(c) in providing for the premium payable on redemption of any redeemable preference shares of the company.

Figure 1

Extract from (22) in LM (112) in Hong Kong Lawyer January 1997

The Statutory Framework

Where shares are issued for an amount in excess of their par value, that excess is said to be share 'premium' (rather than share capital). Section 48B(1) of the *Companies Ordinance* requires that where shares are issued at a premium, the issuing company must create in its books of account a 'share premium account' and transfer the aggregate amount or value of the premium to that account. The share premium account is, pursuant to s 48B(1) of the Ordinance, treated as if it were paid up capital, subject to s 48B(3) (see figure 1).

Section 48B(3) was introduced into the *Companies Ordinance* in 1974 as a replica of s 56(2) of the UK *Companies Act* 1948.

In the early 1980s, UK law concerning redeemable shares was reformed, specifically so as to allow redeemable ordinary shares as well as redeemable preference shares (see UK *Companies Act* 1985, ss 159–181). Moreover, very detailed provision was made for the financing of any redemption of shares including (in appropriate cases and subject to specific safeguards) a redemption out of capital by a private company. The UK legislation accordingly repealed s 56(2) of the 1948 Act; and the current provision (s 130(2) of the 1985 Act: 'application of share premium') now contains no reference to using share premium in relation to the premium payable on the redemption of redeemable preference shares.

However, the UK legislation does contain a saving provision (ss 180(1) and (2) of the 1985 Act) which in relation to preference shares issued prior to the reforms coming into operation, allows any premium payable on redemption still to be paid out of the share premium account. (For full details see *Gower's Principles of Modern Company Law*, Gower, LCB, 5th ed, 1992 at p 225.)

The 1991 Amendments

In Hong Kong, the scheme of UK legislation, as well as most of its detail, was directly copied in the *Companies (Amendment) Ordinance* 1991. Thus, currently in Hong Kong (just as in the UK):

It would appear that the draftsman forgot to copy the consequential amendment

- A company may issue redeemable ordinary shares as well as redeemable preference shares.
- Redeemable shares may (subject to s 49I) only be redeemed out of distributable profits or the proceeds of a fresh issue (see s 49A(1)(b)).
- Any premium payable on redemption must normally only be paid out of distributable profits (see s 49A(1)(b)) – this is subject to s 49A(2) which in limited circumstances allows any premium payable on redemption to be paid out of the proceeds of a fresh issue of shares.
- There is a saving provision contained in ss 49R(1) and (2) which allows, in relation to preference shares issued before the commencement of the *Companies (Amendment) Ordinance* 1991 (ie 1 September 1991), any premium payable on redemption to be paid out of the share premium account instead of out of profits, 'notwithstanding the repeal by the *Companies (Amendment) Ordinance* 1991 ... of any provision of this Ordinance'.

In short, there is a clear conflict between ss 48B(3)(c) and 49A(1)(b). The intention must have been to repeal s 48B(3)(c) – otherwise the saving provision in ss 49R(1) and (2) obviously would not have been required. In other words, the UK legislation was precisely copied, except that the draftsman overlooked the need to copy the consequential amendment to the equivalent of s 48B(3)(c).

This conclusion is further supported by reference to ss 79A and 79B. Section 79B(1) prohibits any 'distribution' except out of 'profits available for the purpose' (which expression is defined as a company's accumulated realised profits less its accumulated realised losses). A 'distribution' is defined in s 79A as meaning 'every description of distribution of a company's assets to its members except (b) the redemption ... of any of the company's own shares out of capital or out of unrealised profits *in accordance with ss 49 to 49S*' [emphasis added]. But the use by a company of the share premium account relying upon s 48B(3)(c) would not be 'in accordance with ss 49 to 49S', and would by definition amount to an unlawful distribution (not being out of profits available for the purpose).

Conclusion

Section 48B(3)(c) should have been amended or repealed in 1991. It is directly contrary to s 49A(1)(b) and quite inconsistent with the saving provision (s 49R(1) and (2)) as well as ss 79A and 79B. In accordance with general principles (*leges posteriores priores contrarias abrogant*) s 48B(3)(c) must be taken to have been impliedly repealed by the *Companies (Amendment) Ordinance* 1991 (see Bennion, *Statutory Interpretation*, 2nd ed. 1992, p 204).

The current position is therefore that a premium payable on redemption of redeemable preference shares may only be paid out of the share premium account (instead of out of profits) where the preference shares in question were issued prior to 1 September 1991. In respect of shares issued after that date, purported reliance upon s 48B(3)(c) will result in an unlawful distribution. Further legislative intervention is clearly required, not least to validate any mistaken reliance upon s 48B(3)(c) in relation to shares issued after 1 September 1991.

Philip Smart
Associate Professor
University of Hong Kong

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14 April 1999

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Legal Service Division
Legislative Council Secretariat
8 Jackson Road
Hong Kong

Dear Miss Ho,

Companies (Amendments) Bill 1999

Further to my letter dated 27 March 1999, our legal advisers have studied the questions you raised on Clause 5 of the Bill. Their reply is in the following paragraphs.

2. Section 48F(2) empowers the Financial Secretary (FS) to make different provisions to relieve companies of their statutory obligations under section 48B and also to restrict or otherwise modify the relief given in respect of those requirements. As a consequent and to make it abundantly clear, if there is a conflict between any of the regulations and sections 48B to 48E, then the regulations shall prevail. It gives the FS additional flexibility in any given merger scenario and will be welcomed by the business community. Section 48F is based on section 134 of the 1985 UK Companies Act.

3. According to section 34 of Cap. 1, the regulations made under new section 48F of Cap. 32 will be laid on the Legislative Council's table

after gazetting. They are, therefore, subject to the Council's scrutiny and disallowance. It is possible for the Council to expressly empower an executive authority to make regulations that will restrict or modify the effects of certain provisions in a principal ordinance, but at the same time retain control through negative vetting procedure. As for section 28(1)(b) of Cap. 1, it does not apply if "the contrary intention appears" from the context of the ordinance in question (Cap.1, s.2(1)).

4. Please let me know if you need any further information.

Yours sincerely,

(L W TING)
for Secretary for Financial Services

c.c. Department of Justice (Attn: Miss Shandy Liu)
Registrar of Companies (Attn: Mr E T O'Connell)

Section 134 of the 1985 U.K. Companies Act

134 Provision for extending or restricting relief from s 130

(1) The Secretary of State may by regulations in a statutory instrument make such provision as appears to him to be appropriate—

(a) for relieving companies from the requirements of section 130 in relation to premiums other than cash premiums, or

(b) for restricting or otherwise modifying any relief from those requirements provided by this Chapter.

(2) Regulations under this section may make different provision for different cases or classes of case and may contain such incidental and supplementary provisions as the Secretary of State thinks fit.

(3) No such regulations shall be made unless a draft of the instrument containing them has been laid before Parliament and approved by a resolution of each House.

NOTES

Secretary of State. See the note to s 107 ante.

By the Data Protection (Regulation of Financial Services etc) (Subject Access Exemption) Order 1987, SI 1987/1905, made under the Data Protection Act 1984, s 30(2), Vol 6, title Civil Rights and Liberties, personal data held for the purpose of discharging the functions of the Secretary of State under this section, and any functions of making available information for the purposes of or otherwise in connection with any functions specified in Sch 1 to that Order in relation to this Act are exempt from the "subject access provisions" of the 1984 Act, as defined in s 26(2) of that Act, in any case which the application of those provisions to the data would be likely to prejudice the proper discharge of those functions.

Statutory instrument; laid before Parliament. See the notes to s 118 ante.

Companies. For meaning, see s 735(1) post.

This Chapter. Ie Chapter III (ss 130–134) of Pt V of this Act.

Regulations under this section. Up to 1 October no regulations had been made under this section and none made under the corresponding provisions of the earlier legislation have effect as if so made by virtue of the Companies Consolidation (Consequential Provisions) Act 1985, s 31(2) post and the Interpretation Act 1978, s 17(2)(b), Vol 41, title Statutes, as read with s 31(11) of the 1985 Act.

Regulations made under this section may relate also to the Companies Consolidation (Consequential Provisions) Act 1985, s 12; see s 12(6) of that Act post.
