CU Review Winter 2012

The Commercial Unit, Civil Division
The Department of Justice

What's inside

Editorial

The Companies Bill 2011 was passed by LegCo on 12 July this year. It has become the new Companies Ordinance, No. 28 of 2012. The new Companies Ordinance was gazetted on 10 August 2012, but it has not yet come into operation. It is expected to come into operation in 2014.

Prior to the enactment of the new Companies Ordinance, the current Companies Ordinance was last substantially reviewed and amended in 1984. Over the past two decades or so, piecemeal amendments have been made to the Companies Ordinance from time to time. But this piecemeal approach has its limitations. A comprehensive rewrite of the Companies Ordinance was needed to modernise our company law, in particular where many major common law jurisdictions had reformed their company law over the past two decades. The current Companies Ordinance Rewrite Exercise began in 2006. It has taken us 6 years to produce the new Companies Ordinance. The new Companies Ordinance contains more than 900 sections and 11 Schedules. There are many differences between the new Companies Ordinance and the current Companies Ordinance. For example :

(i) removal of the concepts of authorised capital and par value of shares;

(ii) removal of the requirement of memorandum of association; and

(iii) the concept of "responsible persons", i.e. the persons who, in addition to the company, are liable for the company's default.

Given the importance and complexity of the new Companies Ordinance, we think it appropriate to devote the entire edition of the CU Review to an article summarising some of the major differences between the current Companies Ordinance and the new Companies Ordinance. We hope that you will find the article useful.

YUNG Lap-yan

Major Changes to the New Companies Ordinance

In mid-2006, a comprehensive exercise to rewrite the Companies Ordinance (Cap. 32) was launched. The Rewrite was considered in CU Review for Summer 2007, Spring 2008, Summer 2010 and Summer 2011. The finalized Companies Bill ("the blue Bill") was introduced into the Legislative Council ("LegCo") in January 2011. On 3 July 2012, the second reading debate of the Bill resumed and the Bill was passed on 12 July 2012. The new Companies Ordinance (No. 28 of 2012) ("the new CO") was gazetted on 10 August 2012. This article gives a summary of the major differences between the current Companies Ordinance ("the current CO") and the new CO.

Changes to the Registration System

Registrar's Power in relation to registration of documents

Under s. 348 of the current CO, the Registrar has power to refuse to register or accept for registration any document delivered, if it appears that the document is manifestly unlawful or ineffective, incomplete or altered. However, there is uncertainty whether the power is applicable if the document is internally inconsistent with the information already on the Companies Register[1]. Section 31 of the new CO sets out the circumstances where a document is unsatisfactory, and these include the situation where the document is internally inconsistent or inconsistent with the information already on the Companies Register. The Registrar may refuse to accept unsatisfactory documents for registration (s. 35). If the Registrar refuses to register the document, the Registrar is in certain situations required to send a notice of refusal and the reason for refusal to the presentor of the documents (s. 38). Also, a new provision is added to empower the Registrar to withhold the registration of an unsatisfactory document and request certain remedial actions to be taken within a specified time (s. 36). As to documents already registered on the Companies Register, there are new provisions which widen the Registrar's power to clarify inconsistencies or rectify errors (ss. 39 to 41).

Protection of Personal Data

Under the current CO, directors and company secretaries of companies incorporated in Hong Kong and registered non-Hong Kong companies are required to provide their residential addresses and identification numbers ("ID numbers") to the Companies Registry ("CR") for incorporation and registration purposes. The ID numbers of other persons may also be required to be provided to the CR for registration purposes (e.g. the ID number of a liquidator, receiver, manager etc.). Such information is available on the Companies Register and can be inspected and copied by the public. From the perspective of protection of personal privacy, there are concerns of possible misuse of such personal data. Under the new CO, there are provisions requiring the Registrar not to make available for public inspection a usual residential address or the full ID number of any person contained in documents delivered to the Registrar for registration (ss. 54-56). For residential addresses and full ID numbers shown on a document already registered on the Companies Register before the commencement of the new CO, there is no automatic protection. Directors, company secretaries etc. have to apply and pay a fee for substituting the usual residential address with a correspondence address and masking a full ID number (s. 49). Disclosure of withheld or protected personal data is permitted under specified circumstances only (ss. 51, 52, 58 and 59).

Formation of Companies & Abolition of Par Value

Under the current CO, eight types of companies are capable of being formed (ss. 4 and 29). Under the new CO, unlimited companies without share capital (whether private or non-private) are abolished and can no longer be formed. Companies limited by guarantee without share capital (whether private or non-private) become a separate category of companies.

[1] *Re Hang Lung Properties Ltd* [2008] 2 HKLRD 196

Moreover, non-private companies are renamed as "public companies". There are 5 types of companies capable of being formed under the new CO, namely, private and public companies limited by shares, private and public unlimited companies with a share capital and companies limited by guarantee without a share capital (ss. 9 and 66).

Under the current CO, a memorandum of association ("MA") is required to be registered for incorporation of companies (ss. 4(1), 12(1)(c)). Such requirement is abolished under the new CO. Under s. 67 of the new CO, person(s) may form a company by delivering to the Registrar for registration an incorporation form and a copy of the company's articles of association ("articles"). A company must have articles prescribing regulations for the company (s. 75). There must be five mandatory provisions in articles as set out in ss. 81 to 85 of the new CO. These cover: (a) Company Name (s. 81); (b) Company's objects (s. 82), which are mandatory for companies licensed to dispense with "Limited" etc. in their name, but otherwise optional; (c) Members' liabilities (s. 83), i.e., limited or unlimited; (d) Liabilities or contributions of members of limited company (s. 84); and (e) Capital and initial shareholdings (s. 85). Moreover, the concept of par value will be abolished under the new CO (s. 135). Under s. 5(4)(a) of the current CO, a company must (unless it is an unlimited company) state the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount. Such a requirement to have a capital clause in the MA will be abolished following the abolition of the MA and par value. Instead, the Capital and Initial Shareholding statement in the articles (s. 85) must state pursuant to s. 85(1) the information required to be stated under s. 68(2) in the incorporation form as set out in s. 8 of Schedule 2. Such information consists of: (a) the total amount of shares the company proposes to issue; (b) the total amount of share capital to be subscribed by the founder members; (c) the amount to be paid up or to be regarded as paid up, and the amount to remain unpaid or to be regarded as unpaid on the total number of shares that the company proposes to issue. If the share capital is to be divided into different classes of shares, similar information for each class of shares must be stated. Under s. 85(2), the articles of a company with a share capital may state the maximum number of shares that the company may issue.

Following the abolition of the MA, there is a new provision dealing with the status or the effect of making reference to the provisions of the MA of an existing company (s. 98). Regulations, which apply by default in the absence of modification or exclusion in the registered articles, will be contained in the model articles prescribed by the Financial Secretary instead of Table A in the current CO (ss. 78-80 of new CO).

Registration of Company Charges

The main new development in relation to registration of charges is the requirement for delivery of a certified copy of the charge (together with the particulars of charge, which is the existing requirement under s. 80 of the current CO) under ss. 335, 336, 338 and 339 of the new CO. There has been debate as to the extent to which registration constitutes notice of the terms of the charge[2]. As both the copy of the charge instrument and the particulars will be registrable and available for public inspection under the new CO, there will be constructive notice of all the terms (e.g. negative pledge clause, automatic crystalisation clause) of the charge. In particular, the provision of no constructive notice of matters disclosed in articles etc. (s. 120) will not apply.

Section 334 of the new CO adds two types of charge to the existing list in current CO s. 80(2), namely, (a) charges on instalments due, but not paid, on the issue price of shares; (b) charge on an aircraft or any share in an aircraft (s. 334(1)(f) and (1)(h)). On the other hand, a charge for securing any issue of debentures (currently in s. 80(2)(a) of the current CO) is removed from the list of registrable charges. The time allowed for registration is shortened from 5 weeks to one month.

Offences and enforcement

The formulation of "officer who is in default" under s. 351(2) of the current CO requires the prosecution to prove "knowingly and wilfully", which is a high evidential burden, as it has to be shown that the officer has knowledge or wilful intention (see *HKSAR v Tang Tze Hoo Anthony*[3], a case concerning failure to keep books of account contrary to s. 274(1) of the current CO). Under the new CO, the formulation is replaced by "responsible person" (s. 3). In the blue Bill, the original definition of "responsible person" was an officer or shadow director of the company

[2] *ABN Amro Bank NV v Chiyu Banking Corp Ltd* [2000] 3 HKC 381

[3] HCMA 775/2008, 5 February 2009

who authorizes or permits, participates in or fails to take all reasonable steps to prevent the contravention or failure. However, owing to the LegCo Bills Committee members' concern that the limb "fails to take all reasonable steps to prevent" would cover mere negligence, this limb was removed. The formulation adopted in s. 3 is therefore an officer or shadow director of the company who authorizes or permits, or participates in the contravention or failure. The policy intention is that the mens rea for the offence involving a responsible person will be actual knowledge, wilful blindness or recklessness, but not negligence. As compared with the current CO, the prosecution threshold for the formulation of "responsible person" in the new CO will be lower, as there is no need to prove "wilfulness".

Moreover, there will be a new power under s. 899 to allow the Registrar to compound offences. Where the offence is constituted by a failure to do an act or thing, 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 six offences which are compoundable are listed in Schedule 7 to the new CO and are mostly filing offences.

Company Administration and Procedure

Meetings and Resolutions

Under s. 116B of the current CO, the procedural formalities as to passing of a written resolution are not provided for in detail. Under the new CO it is provided that member(s) representing not less than the requisite percentage of the total voting rights of all the members entitled to vote (5% or a lower percentage as specified in the articles) have the power to propose a written resolution and to request the company to circulate the resolution (ss. 549, 551 and 552). The circulation may be effected by sending the copies in hard copy form or electronic form or by making the copies available on a website (ss. 552-553). Members may signify their agreement to a proposed written resolution and send it back to the company either in hard copy or electronic form (s. 556). A company's articles may also set out alternative procedures for passing a resolution without a meeting, provided that the resolution has been agreed by the members unanimously (s. 561).

In view of developments in information technology, there is also a new provision permitting a general meeting to be held at more than one location by using technology that enables the members of the company to exercise their right to listen, speak and vote at the meeting (s. 584). A company may set out rules and procedures for holding a dispersed meeting in the company's articles.

On voting at general meetings, the members' power to demand a poll is enhanced under the new CO. The threshold for members to demand a poll is reduced from 10% (s. 114D of current CO) to 5% (s. 591 of the new CO) of the total voting rights. The threshold based on one-tenth of the paid up capital is removed and the chairman is allowed to demand a poll. A chairman is bound to demand a poll if, before or on declaration of the result on a show of hands, the chairman knows from the proxies received that the result on a show of hands will be different from that on a poll (s. 592).

Turning to the requisite period for a general meeting for passing of a special resolution, 21 days' notice is required under ss. 114 and 116 of the current CO. Under the new CO, except in the case of AGM (where 21 days notice is still required), only 14 days' notice is required for a general meeting for passing a special resolution by a limited company (s. 571(1)(b)). For a resolution requiring special notice, the requirement for the company to give notice of the resolution is changed from 21 days' notice (s. 116C) to 14 days' notice (s. 578(3)).

There are also new provisions clarifying the rights and obligations of proxies in new CO ss. 596 to 605.

Circumstances where holding of AGM can be dispensed with

Under s. 111(6) of the current CO, a company is not required to hold an AGM if everything that is to be done at the meeting is done by a written resolution and a copy of each document required to be laid at the meeting is provided to each member in the manner prescribed. This exception from holding of the AGM is preserved in s. 612(1) of the new CO. In addition, s. 612 of the new CO provides that a company is not required to hold its AGM if it is a single-member company (s. 612(2)(a)) or if all members agree pursuant to s. 613 (s. 612(2)(b)). A company which has dispensed with the requirement for holding AGMs under s. 613 will no longer be required to hold any subsequent AGMs, unless requested by any member (s. 613(5)) or the resolution

dispensing with AGMs is revoked (s. 614).

Register, Company Records and Inspection

Under the current CO, a company is required to keep a register of debenture holders (s. 74A), register of charges (ss. 89 and 91), register of particulars of loans, quasi loans and credit transactions etc. (ss. 161BA and 161BB), register of members (s. 95) and register of directors and company secretaries (ss. 158 and 158A). Under the new CO, the obligation for a company to keep such registers is maintained (ss. 308, 352, 353, 384, 627, 641 and 648). The period for keeping records for past members will be reduced from 30 years (s. 95) to 10 years (s. 627(6)). The time limit (30 years under s. 102 of the current CO) for adducing evidence to challenge the accuracy of an entry in the register is removed (s. 635). Moreover, the particulars of directors and companies secretaries will be kept in separate registers rather than a single register. For the purpose of protection of personal data, there are new provisions allowing a company to withhold the usual residential address and full ID number contained in the register of directors, and the full ID numbers contained in the register of company secretaries, from a person who inspects it or requests a copy of it (ss. 644 and 651). There are modifications as to the required particulars to be kept in the register of directors and register of secretaries (ss. 643 and 650).

Under the new CO, a definition is given to the term "company record" in s. 654 (i.e. "any register, index, agreement, memorandum, minutes or other document required by this Ordinance to be kept by a company, but does not include accounting records"). The detailed provisions on inspection and provisions of copies of company records, as well as the prescribed place (other than the registered office) for keeping company records will be provided in the Company Records (Inspection and Provision of Copies) Regulation (ss. 356 and 657).

Electronic Communications

Under the current CO, Part IVAAA contains provisions (introduced by the Companies (Amendment) Ordinance 2010) in relation to communication by a company to another person in hard copy form, electronic form or by means of a website. These provisions are restated in Part 18 of the new CO. In addition, there are also new provisions governing communications to a company by natural persons. Section 828 provides that a document may be sent to a company by a natural person in electronic form if the company has so agreed, generally or specifically, or is regarded as having so agreed under a provision of the new CO.

Transactions in relation to Share Capital

A Uniform Solvency Test

Under Part II of the current CO, a solvency test is provided for in respect of:- (a) buy-backs of its own shares out of capital by a private company (requirements of the solvency test are set out in s. 49K(3), (4) and (5)); and (b) financial assistance by an unlisted company for the purpose of an acquisition of shares in the company or its holding company (requirements of the solvency test are set out in s. 47F(1)(d) and (2)). Under the new CO, a uniform solvency test is adopted for buy-backs, financial assistance and reduction of capital (under the new court-free procedure), which is based on the existing solvency test under s. 47F(1)(d).

Introducing a Court-free Procedure for Reduction of Share Capital

The current CO only allows a reduction of share capital if there is approval by the shareholders via a special resolution and if the reduction is approved by the court (ss. 58 to 63). Under the new CO, ss. 215 to 225 introduce a court-free procedure for reduction of share capital, subject to compliance with the solvency test. The procedural requirements, involving signing of a solvency statement by the directors, passing of special resolution by members and rights of any creditor or non-approving member to apply to the court for cancellation, are set out in ss. 220 to 223 of new CO.

Allowing all companies to Purchase Own Shares out of Capital

Under the current 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 (ss. 49A and 49B). There is an exception for private companies which may fund a buy-back by payment out of capital based on a solvency test (ss. 49I to 49N). Under the new CO, all companies are allowed to fund buy-backs out of capital, subject to a solvency requirement (ss. 257 to 266). The procedure is similar to the court-free procedure for reduction of capital as explained above. As far as listed companies are concerned, there is a restriction in s. 257(3) which prohibits payments out

of capital in respect of a buy-back of own shares on a recognized stock market or on an approved stock market.

Financial Assistance

Section 47A of the current CO prohibits a company and its subsidiaries from giving financial assistance for the purpose of acquiring shares in the company. The broad prohibition is subject to certain exceptions. Under ss. 274 to 289 of the new CO, the provisions allow all types of companies (listed or unlisted) to provide financial assistance, subject to satisfaction of the solvency test and one of the three new procedures: (a) assistance not exceeding 5% of the shareholder funds (s. 283); (b) with approval of all members by written resolution (s. 284); (c) by notice to members with solvency statement signed by a majority of directors and an ordinary resolution of the company (s. 285) and no application to the court or the court confirms the giving of financial assistance.

Directors and Shareholder Remedies

Corporate Directors

Under s. 154A of the current CO, a company is not allowed to have corporate directors except for private companies (other than a private company that is a member of a group companies of which a listed company is member). Under the new CO, such a private company may still have corporate directors under s. 456, however, it must have at least one director who is a natural person (s. 457).

Statutory duty of care, skill and diligence

Under the current CO, there is no provision on directors' duty of care, skill and diligence and the common law position in Hong Kong is not entirely clear. The standard in older case law which focused on the knowledge and experience which a particular director possessed (which is generally called the subjective test[4]), is considered to be no longer appropriate[5]. In most common law jurisdictions, there have been clear judicial statements in more modern cases applying an objective/subjective test[6].

Section 465(2) of the new CO now 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; and (b) the general knowledge, skill and experience that the director has. Paragraph (a) provides an objective test, whereas paragraph (b) a subjective test. Also, s. 466 preserves the existing civil consequences of breach (or threatened breach) of the said duty.

Directors' Power to Contract for Company and Third Party Protection

Under the new CO, it is optional for a company to have a common seal (s. 124). If the company has a common seal and executes documents under its common seal, the seal must be affixed in accordance with its articles (s. 127). Section 127(3) provides for a new alternative way that a company may execute a document: (a) if the company has only one director, by having the documents signed by the director on the company's behalf; (b) if the company has two or more directors, by signing on behalf of the company by two directors, or any of the directors and the company secretary. A document executed in accordance with s. 127(3) has the effect as if it had been executed under the company's seal in favour of a purchaser in good faith for valuable consideration (s. 127(5), (7)).

Under the common law, the rule in *Turquand's* case[7] provides that a third party dealing with a company in good faith is entitled to assume that acts within the company's constitution and powers have been properly and duly performed and is not bound to inquire whether any internal procedures contained in the constitution regulating the conferment of authority have been complied with. Under the new CO, s. 117 provides that in favour of a third party dealing with a company in good faith, the power of the company's directors to bind the company, or to authorize others to bind the company is free of any limitation under the articles (or other relevant documents), except where the party to the transaction is a director or his associates or where the company is an exempted company. Under s. 118, a transaction involving directors or their associates is voidable at the instance of the company. Section 119 further provides that s. 117 does not apply to an "exempted company" which has been granted a licence to dispense with "Ltd" in its name under s. 103 under the new CO and which is

4 *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407

5 *Law Wai Duen v Boldwin Construction Co Ltd* [2001] 3 HKLRD 430

6 England: *Re D'Jan of London* [1994] 1 BCLC 561; Australia: *Daniels v Anderson* (1995) 16 ACSR 607; Singapore: *Lim Wing Kee v PP* [2002] 4 SLR 327

7 *Royal British Bank v Turquand* (1856) 119 ER 886

exempted from tax under s. 88 of the Inland Revenue Ordinance (Cap 112).

Section 117 applies only if the third party deals with the company through the company's directors or a person authorised by the directors. The provision also only applies where the limitation on the power to bind the company is set out in the articles, or other relevant documents. Therefore, s. 117 has a narrower scope of operation than the rule in *Turquand's case* in this respect as the latter is not so confined. Moreover, s. 117(2)(b) provides for a presumption of good faith on the part of the person dealing with the company. Section 117(2)(c) also provides that a person dealing with a company is not to be regarded as acting in bad faith by reason only of the person's knowing that an act is beyond the directors' powers. Section 117 applies in addition to, or as an alternative to, the common law indoor management rule, which may still have application in some circumstances.

Under s. 157 of the current CO, the act of a director or manager is regarded as valid despite defects later discovered in his appointment or qualification. In *Morris v. Kanssen*[8], wording similar to s. 157 had been interpreted narrowly so as to apply only when there is a procedural defect in the appointment, not when there has been no appointment at all, nor where a director had vacated office but continued to act. Section 461 restates with modification s. 157 of the current CO and explicitly extends the provision to apply, inter alia, to acts of a person acting as director despite the fact that it is afterwards discovered that the person had ceased to hold office as director or to acts of an under-age director notwithstanding his appointment is void.

Ratification of conduct of directors by disinterested members' approval

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 the consequences of breach of their fiduciary duties. Under the current regime, conflicts of interest may arise where the majority shareholders are directors or are connected with the directors. Under the new CO, s. 473 provides that ratification by a company of conduct of a director involving negligence, default, breach of duty or breach of trust in relation to the company must be done by disinterested members' approval. Hence, every vote by a member who is a director in respect of whose conduct the ratification is sought, or who is an entity connected with that director (as defined in s. 486) or holder of any shares in the company in trust for that director or entity, is to be disregarded. The provision does not affect any ratification of conduct by unanimous consent of the members of the company or any power of the directors to agree not to sue, or to settle or release a claim made by them on behalf of the company (s. 473(6)(a)).

Fair Dealing by Directors

Sections 157H to 157J of the current CO prohibit a company from entering into loans or other similar transactions with a director or persons connected with the director. In respect of a listed company or a private company that is within the same group as a listed company, s. 157H(8) and (9) extends the references to "director" to a spouse, child and step-child (including illegitimate child) under the age of 18, and specified categories of trustees and partners; and s. 157H(2)(c), (3)(c) and (4)(c) extends the prohibitions to a company in which a director (or the above categories of persons) holds a controlling interest. Under ss. 500 to 504 of the new CO, the prohibitions are extended to cover loans or other similar transactions with connected entities of a director of the holding company, and a wider category of persons will fall within "connected entity" (ss. 486 to 488). Despite the prohibitions, under ss. 500 to 504 of the new CO there is a general exception applicable to all types of companies (rather than private companies only in s. 157HA(2)) where there is members' approval (s. 496). For a public company, or a private or guarantee company that is a subsidiary of a public company, disinterested members' approval is required (i.e. votes in favour of the resolution by the interested members are disregarded) (s. 496(2)(b)(ii), (5) and s. 515(1)(b)(ii), (4)).

Further, there are three new exemptions from prohibition (ss. 505, 507 and 508). Section 505 provides for a new exception where the aggregate of the value of a loan, quasi-loan, credit transaction, guarantee or security in question, and the value of any other relevant transaction or arrangement, does not exceed 5% of the company's net assets or called-up share capital. Sections 507 and 508 permit a company to fund a director's expenditure in defending certain criminal or civil proceedings or putting up a defence in certain investigations or regulatory action. Moreover, the existing criminal sanction for contravention under s. 157J under the current CO is

[8] [1946] 1 All ER 586

removed, as the consequence of violation only attracts civil sanction under ss. 513 to 515 of the new CO.

Under ss. 163 to 163D of the current CO, it is unlawful to make payments to directors or former directors of a company, as compensation for loss of office or as consideration for retirement from office, without the company's prior approval. Under the new CO, the loss of office provisions are extended by s. 516(3) to include: (a) payment to an entity connected with the director; and (b) payment to a person made at the direction of, or for the benefit of, the director or his connected entity. Further, s. 521(2) extends the prohibition to include payment by a company to a director or former director of its holding company. Section 522(2) extends the provisions to include the payment made in connection with a transfer of the undertaking or property of the company's subsidiary. By virtue of s. 516(1) (definition of "takeover offer") and s. 523(1), the prohibitions in connection with a share transfer are widened to include all transfers of shares in the company or in its subsidiary resulting from a takeover offer. Moreover, the requirement for disinterested members' approval is modified (s. 518(2)(b)(ii), (4), (5)), as it only applies to a public company, or a private or guarantee company that is a subsidiary of a public company.

Long Term Service Contract

Under the current CO, there is no requirement requiring members' approval for director's employment exceeding three years. Under s. 534 of the new CO, a company has to obtain members' approval before agreeing to such employment. For a public company, or a private or guarantee company that is a subsidiary of a public company, disinterested members' approval is required (s. 532(2)(b)(ii), (4)).

Disclosure of material interests

Under the new CO, the ambit of disclosure of material interests is widened to cover "transaction" and "arrangement", instead of just "contract" as in s. 162 of the current CO (s. 536(1)). For a public company, the ambit is further widened to include disclosure by a director of any material interest of entities connected with him (s. 536(2)). Moreover, the director is required to disclose both the "nature and extent" of his interest, instead of just "nature" of his interest as in s. 162 of the current CO (s. 536(1)). The disclosure requirement is also extended to shadow directors under s. 540 of the new CO.

Shareholder remedies

The unfair prejudice remedy under s. 168A of the current CO provides that a member of a company may petition the court if the affairs of the company are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members. There is some uncertainty whether, under the current provisions, a member can bring an action for unfair prejudice in relation to proposed acts or omissions, or where there is only a threat to do or not to do something. Under ss. 724(1)(b), (2)(b) and 725(2)(a)(i)(C) of the new CO, it is clarified that the remedy will cover proposed acts or omissions. Accordingly, the remedies that the court may order under s. 725(2) are extended to cover an order restraining the proposed act or requiring the doing of an act that the company has proposed to omit to do.

Investigation and Enquiries

Sections 142 to 151 of the current CO deal with investigations of a company's affairs by independent inspectors appointed by the Financial Secretary ("FS"). Under the new CO, the categories of companies that may be subject to investigation (under s. 840) is extended to include a "registered non-Hong Kong company" (s. 839). The powers of the inspector are also widened (ss. 846(1)(b), 848(2), 848(3), 863). Upon application by the inspector, the court may also order persons to comply with requirements imposed by inspectors (s. 864).

The power of the FS (or someone authorized by him) to inspect books and papers of a company under ss. 152A to 152F of the current CO is rephrased in the new CO as a power to "enquire into company's affairs" under ss. 867 to 872 of the new CO. Moreover, there will be a new investigation power under ss. 873 to 875 allowing the Registrar to obtain documents or information where she suspects conduct would constitute offences under s. 750 or s. 895.

Corporate Re-organisations

Arrangement and Compromises

Under s. 166 of the current CO, if a majority in number ("headcount test") representing three-fourths in value ("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. If the company is a listed company, it must also satisfy Rule 2.10(b) of the Takeovers Code (i.e. the number of votes cast against the scheme must not be more than 10% of the votes attaching to disinterested shares). The headcount test has been criticized as inconsistent with the "one share one vote" principle and as attracting vote manipulation by way of share splitting[9].

Under s. 674 of the new CO, the headcount test is retained in creditors' schemes (s. 674(1)(a), (1)(b)). For members' schemes, the headcount test is also retained (s. 674(1)(c), (1)(d)) but with the following exceptions. For members' schemes, s. 674(2)(a)(ii), (b)(ii) requires that an arrangement involving a general offer within the meaning of s. 707 or a takeover offer has to satisfy the test of at least 75% in value of members voting and the votes cast against the arrangement not exceeding 10% of the total voting rights attached to all disinterested shares in the company (as defined in s. 674(3)). Even in the situation where the headcount test is applicable to a members' scheme (arrangements that do not involve a general offer or a takeover offer), the court is given a discretion to "order otherwise" (s. 674(1)(c)(ii), (1)(d)(ii)), i.e. to allow the court to dispense with the headcount test. Moreover the general discretion in the court to sanction or not to sanction an arrangement is maintained in new s. 673(2) (i.e. The court may… sanction the arrangement or compromise). Under s. 676 of the new CO, a new provision is introduced dealing with the court's power to award costs to dissenting members if the member was acting in good faith and had reasonable grounds for opposing the application. It also provides that the court may only make an order about costs against the member if his opposition to the application is frivolous or vexatious.

Reconstruction or amalgamation

Apart from restating the procedure in ss. 166 to 167 of the current CO, the new CO also introduces a court-free regime for amalgamations of wholly-owned intra-group companies. Sections 678 to 686 provide that an amalgamation may either be vertical (i.e. between the holding company and one or more of its wholly-owned subsidiaries) or horizontal (i.e. between two or more subsidiaries of the same holding company). Under ss. 680 and 681, 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 or other securities (or that the secured creditors has consented to the amalgamation) and to verify the solvency of the amalgamating company as well as the amalgamated company. Details of the solvency statement are set out in s. 679. The amalgamation proposal must be approved by the members of each amalgamating company by special resolution.

Compulsory Acquisitions after Takeover or General Offer for Share Buy-backs

Under the current CO, s. 168 and the Ninth Schedule deals with the compulsory acquisition of shares following a takeover, while s. 168B and the Thirteenth Schedule deal with the compulsory acquisition of shares following a general offer for share buy-backs. The new CO contains new provisions, in particular in relation to squeeze-out and revision of the terms of offer (ss. 687 to 721).

Accounts and Audit

Contents of Financial Statements

Under the current CO, the contents of financial statements are governed by the Tenth and Eleventh Schedules, as well as the Hong Kong Financial Reporting Standards or the Financial Reporting Standard for Small and Medium-Sized Entities (ss. 123 and 126). Under the new CO, s. 380 and Schedule 4 provide for the contents of financial statements. The detailed contents requirements in the Tenth and Eleventh Schedules are not reproduced in the new CO. The requirement to give a "true and fair view" is reworded to require that the annual financial statements must give a true and fair view of the financial position of the company as at the end of the financial year and a true and fair view of the financial performance of the company for the financial year. Any financial statements for a financial year must also comply with the accounting standards applicable to the financial statements. The applicable accounting standards are the statements of standard accounting practice issued or specified by the Hong Kong Institute of Certified Public Accountants (c.f. Companies (Accounting Standard (Prescribed Body) Regulation).

Directors' Report

Under the current CO, s. 129D(1) and (3) provide for the duty to prepare a directors' report and set out the requirements relating to the contents of the directors' report. Under the new CO, the requirements as to

[9] *Re PCCW Ltd* [2009] 3 HKC 292 (CA)

contents of directors' report are set out in ss. 388 to 391 and Schedule 5. Schedule 5 of the new CO provides that all public companies, and private companies or guarantee companies not qualified for simplified reporting, should be required to prepare as part of the directors' report, a business review. The business review covers information which is more analytical and forward looking than the information currently required, the contents of which are listed in Schedule 5.

Simplified Reporting

A private company (other than a company which is a member of a corporate group and certain companies specifically excluded, such as insurance and stock-broking companies) 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 (current CO s. 141D). Hence, the exemption is not applicable to groups of companies or guarantee companies. Under ss. 359 to 366 and Schedule 3 of the new CO, the qualifying criteria for simplified reporting are relaxed. The following types of company will automatically qualify for simplified reporting (s. 359(1)(a), (2), (3)): (a) a "small private company", i.e. a private company that satisfies any two of the following conditions: (i) Total annual revenue of not more than HK$100 million; (ii) Total assets of not more than HK$100 million; (iii) No more than 100 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: (i) Aggregate total annual revenue of not more than HK$100 million net; (ii) Aggregate total assets of not more than HK$100 million net; (iii) No more than 100 employees; (c) "a small guarantee company" or a guarantee company that is the holding company of a "group of small guarantee companies" that satisfies the following: (i) total annual revenue must be not more than HK$25 million.

Moreover, s. 359(1)(c) and (2)(c) also allows private companies/groups of private companies meeting a higher threshold (namely, two out of the three criteria: HK$200 million assets, HK$200 million revenue and 100 employees) to prepare simplified reporting, if members of the company holding 75% of the voting rights so resolve and no member objects. The existing qualification for exemption by unanimous consent under s. 141D of the current CO is also preserved under s. 359(1)(b) of the new CO.

Auditors

Under the current CO, the auditor's rights to information as set out in ss. 133(1) and 141(5) are considered to be too restrictive. Under s. 412 of the new CO, a wider range of persons is required to provide information and explanations to the auditor. Section 414 further entitles an outgoing auditor to provide information to an incoming auditor without contravening any duty, provided that he does so in good faith and under a reasonable belief that such information is relevant. Where an auditor is removed from office, resigns or retires, he is also required to make a statement of circumstances under ss. 424 to 428 of the new CO.

Section 141(4) and (6) of the current CO sets out the duty of the auditors to carry out investigations to enable them to form an opinion as to whether proper books of account have been kept and whether the accounts are in agreement with the accounting records. If not, or if the auditors fail to obtain all necessary information and explanations, they must state the fact in the auditors' report. These provisions are restated in s. 407 of the new CO with modification in that materiality is added as a prerequisite to the requirement to state the auditor's opinion. Moreover, a new criminal offence is created in case of failure to comply with s. 407 (2)(b) or (3) by knowingly or recklessly causing a statement required to be contained in the auditor's report to be omitted. The offence will cover persons who are: (a) where the auditor is a natural person, the auditor and every employee and agent who is eligible for employment as an auditor; (b) where the auditor is a firm, every partner, employee or agent so eligible; and (c) where the auditor is a body corporate, every officer, member, employee or agent so eligible.

Summary Financial Reports

Under ss. 141CA to 141CH of the current CO, a listed company may send a summary financial report to its members and debenture holders in place of the accounts, directors' and auditor's reports required to be sent under s. 129G of the current CO, provided that it has obtained the agreement of those persons. Under ss. 441 and 442 of the new CO, all companies (other than those qualified for simplified reporting) will have a choice whether to send a copy of the summary financial report instead of a copy of the full reporting documents. Unlike the current CO, members' consent is not required before a company can send a copy of a summary financial report. Members receiving summary financial reports may

request a copy of the full reporting documents from the company (s. 445). Under s. 442, the company can at any time ascertain the wishes of its members or potential members through a "notification", which allows them to elect to receive a copy of the reporting documents, or a copy of the summary financial report in hard copy form, or electronic form, or from the company's website; or not to receive any copies of the documents.

Ted Tyler, Stefan Lo and Natalie Wong

Editor : Yung Lap Yan