

Twenty five essential things to know about the New Companies Ordinance

Introduction

On 12 July 2012, the Legislative Council in Hong Kong passed the new Companies Ordinance (the “New Ordinance”). This is a significant milestone for the development of company law in Hong Kong. The last major overhaul of the existing Companies Ordinance (the “Old Ordinance”) was almost 20 years ago in 1984. The New Ordinance is one of the largest pieces of legislation in Hong Kong.

The Companies Ordinance provides the legal framework which enables the business community to form and operate companies in Hong Kong (including, in some cases, overseas companies). The changes to be introduced by the New Ordinance are extensive and many of them will affect the interests of those parties who have dealings with companies, such as members and creditors.

The New Ordinance was published in the Government Gazette in August 2012. It will become effective on a day to be appointed and published in the Gazette (“Commencement Date”), which is expected to be in 2014. From the Commencement Date, all the provisions in the Old Ordinance concerning existing companies will be repealed.

The New Ordinance covers all the areas regulated under the Old Ordinance, except the prospectus regime and the winding-up and insolvency provisions. These two areas will remain under the Old Ordinance which will be renamed the Companies (Winding Up and Miscellaneous Provisions) Ordinance. The Securities and Futures Commission has indicated that it will lead the review of the prospectus regime and it plans to move the provisions relevant to the prospectus regime into the Securities and Futures Ordinance. Separately, the Hong Kong Government has said the provisions relevant to winding-up and insolvency of a Hong Kong company will be dealt with under a separate corporate solvency and recovery law review exercise.

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We set out below a summary of twenty five essential points to know about in the New Ordinance.

Constitution and capacity

1. *Removal of requirement for memorandum of association*

The constitutional documents for a company are its memorandum and articles of association. The memorandum contains basic information about the company's objects and its authorised capital, whereas the regulations governing the company are set out in the articles. With the diminishing importance of the memorandum because of the abolition of the doctrine of *ultra vires* in relation to corporate capacity, and the removal of the concept of authorised capital (see points 2 and 3 below), the requirement to have both a memorandum and articles will be removed.

Under the New Ordinance, a company will have a single constitutional document, being the articles. For an existing company, the provisions of its memorandum, such as the objects clause and limited liability status, will be regarded as provisions of its articles. However, a company can take steps to remove such provisions completely from its articles (see point 2 below).

2. *Objects clause and power of company*

Unless the articles of a company specifically restrict the objects and power of the company, its objects and power will be unrestricted. The New Ordinance does not require a company to amend its articles to remove the objects clause and it can continue to refer to them. Some companies such as trustee companies or special purpose vehicles may choose to, and charitable and other "exempted" companies must, retain specific objects.

- If a company chooses to remove its objects clause from the articles, it can do so by the members passing a special resolution. If the objects clause is removed, the capacity of a company vis-a-vis a person dealing with it in good faith is unfettered.
- If a company chooses to keep its objects clause in the articles, any restrictions in it will act as a constraint on the directors' powers and they may be liable to the company (on the basis of a claim brought by the company or a derivative claim brought by members) if they execute a transaction in breach of those restrictions. However, the restrictions will not affect the validity of acts of the company vis-a-vis a person dealing with the company in good faith.

Share capital

3. *Authorised capital*

The concept of authorised capital, as distinct from issued share capital, will no longer apply to a company formed on or after the Commencement Date. Any provisions in a company's constitution which stated the amount of the company's authorised capital will be regarded to have been deleted from the constitutional documents of the company.

4. *No-par value*

The concept of the nominal value (*also known as par value*) of shares of a company will be abolished. From the Commencement Date, the par value, together with the amounts standing in the credit to the share premium account and the capital redemption reserve will form the share capital.

5. *Issue of shares*

The rules on members having to give authority to directors to allot shares will be extended. In addition to members' approval to allot and issue shares, directors will need approval from the members to grant rights to subscribe for, or to convert securities into, shares, such as warrants, share options or bonds. If members have given their approval when such rights are granted the directors do not need to seek further approval for the allotment of shares on conversion or exercise of the warrant, option or bond.

Maintenance of capital and share capital transactions

6. *Solvency test*

The New Ordinance modifies the maintenance of capital rules by introducing a solvency test for the following types of share capital transactions:

- i. reductions of share capital (applicable only to the court-free procedure);
- ii. redemptions and repurchases of shares; and
- iii. the giving of financial assistance by a company for the acquisition of its own shares.

The solvency test is a two-limb test:

- i. immediately after the transaction there will be no ground on which the company could be found to be unable to pay its debts; and

- ii. the company will be able to pay its debts as they become due during the 12 months immediately following the transaction provided that if it is intended that the company will be wound-up within 12 months from the date of the transaction the test would be whether the company will be able to pay its debts within 12 months after the commencement of the winding-up.

7. *Financial assistance for purchase of own shares*

The Government has decided to retain the financial assistance prohibition applicable to private and public companies. The restrictions, however, have been streamlined and relaxed. Both private and public companies will continue to be prohibited from providing financial assistance for the purchase of their shares unless the transaction falls under one of the current permitted exceptions such as the “principal purpose” exception and loans to employees to acquire shares.

The New Ordinance introduces new exceptions which allow all companies (both private and public) to give financial assistance for the purchase of their shares subject to the satisfaction of the solvency test and the obtaining of the relevant approvals in the following three scenarios:

- i. approval of the board of directors where the aggregate amount of financial assistance does not exceed 5% of the company’s paid-up share capital and reserves;
- ii. approval of the board of directors together with approval of all of the members by written resolution; or
- iii. approval of the board of directors together with approval of the members by ordinary resolution, subject to the right of members holding at least 5% voting rights of the company to petition to the court for a restraining order.

The effect of these provisions is that, provided the company obtains the requisite board and/or shareholders approval and satisfies the solvency test, it may provide financial assistance for the purchase of its own shares.

8. *Redemption and repurchases of shares*

All companies (including public companies) wanting to redeem or repurchase shares can, in addition to using the company’s distributable profits or the proceeds of a fresh issue of shares to fund the transaction, redeem or repurchase shares out of capital, subject to the solvency test. The requirements and procedures are similar to the new procedure for reduction of capital (see point 9 below). However, a listed company is not permitted to repurchase shares on-market using its capital.

9. *Reduction of capital*

The New Ordinance introduces an alternative procedure for a company wanting to reduce its share capital without the need for court approval. The new procedure requires the company to seek approval of disinterested members by special resolution together with the satisfaction of the solvency test and publication of notices in the Government Gazette and newspapers. Any creditor or non-approving member can petition to the court for a cancellation order. This new court-free procedure is likely to be faster and cheaper than the existing procedure (which requires court approval) and can be used by all companies (including public companies).

Debentures

10. All the provisions relating to debentures in the Old Ordinance are put in one place in the New Ordinance. These provisions have been separated from, and aligned with, many of the equivalent provisions in respect of shares.

There are also several new provisions in the New Ordinance such as those relating to keeping a branch register for overseas debenture holders and new administrative procedures in relation to the allotment of debentures similar to those for shares. Examples include filing a return of allotment and registration in the register of debenture holders. Also, notably, debenture holders can now apply to the court to order a meeting to be convened giving directions to the trustee for the protection of debenture holders. This right may be excluded by the debentures or trust deed.

Company administration

11. *Written resolutions*

The Old Ordinance allowed all matters that require approval by a members' resolution in general meeting (except removal of directors and auditors) to be approved, without a meeting, by a written resolution but there were no statutory rules regarding the necessary procedures. The New Ordinance now contains rules for proposing, passing and recording a written resolution. A written resolution requires agreement in writing by all eligible members of a company. Directors and any member may propose a resolution to be passed as a written resolution.

12. *General meetings*

- The notice period for all general meetings is 14 clear days (regardless of whether an ordinary or a special resolution is proposed for consideration), except the notice period for an annual general meeting is 21 clear days and a meeting to

consider any resolution relating to the removal of a director or an auditor before the end of his term of office requires 28 clear days' notice.

- The New Ordinance provides for a meeting to be held at two or more venues using electronic technology to link up the venues, subject to the provisions of the company's articles.
- The New Ordinance permits (a) a single-member company; or (b) a company, whose members have passed a unanimous resolution to that effect, to dispense with the requirement to hold annual general meetings. Such a unanimous resolution will have continuous effect until its revocation.

13. *Execution of documents*

The adoption and use of a common seal will become optional. This should simplify the manner in which companies may execute documents. A company may sign a deed under its common seal or, alternatively, under hand. It may do so by having its sole director sign the document if it is a "single-director company". If a company has two or more directors, any two directors or any director and the company secretary can sign the deed. If a company chooses to have a common seal for executing documents, the seal must be used in accordance with the requirements in the articles.

14. *Responsible person*

The New Ordinance has preserved many of the offences under the Old Ordinance that impose liability on an "officer" for failure to comply with various administrative requirements. Examples include failure to file returns and documents on time with the Companies Registry or carry out certain acts as directed by the Registrar of Companies. The threshold for committing an offence under the New Ordinance has been lowered.

Under the Old Ordinance, an officer is liable for an offence only if he "*knowingly and wilfully authorizes or permitted the default ...*". The burden of proving "*knowingly and wilfully*" is very high. The New Ordinance introduces a new formulation of a "responsible person" and he will be liable if he "*authorizes or permits, or participates in, the contravention or failure*". The lowered threshold does not catch negligence but it catches actual knowledge, "wilful blindness" and recklessness of a responsible person. A responsible person includes an officer or a shadow director of the company as well as an officer or a shadow director of a corporate officer of the company. It applies to both Hong Kong and non-Hong Kong companies.

Directors

15. *Directors' duties*

Certain directors' duties have been codified. Whereas previously the duties of a director to exercise reasonable care, skill and diligence ("Duties") were found mainly in case law, now these Duties have been codified in the New Ordinance. Directors' fiduciary duties, however, remain defined by case law and uncodified. The New Ordinance provides that in performing the Duties, a director must bring to bear his own skills and experience (a subjective test) as well as those that any director in that position would be presumed to have (an objective test). These standards replace the existing common law rules and equitable principles in relation to the Duties (found in case law). However, the civil consequences for breach (or threatened breach) of the Duties under common law and equity are preserved. The Duties apply equally to shadow directors as they do to directors.

16. *Ratification of director's conduct*

The ability of a company to ratify an act or omission of a director which amounts to negligence, default, breach of duty or breach of trust ("Conduct") was previously subject to common law rules. The New Ordinance codifies the common law requirements and introduces a disinterested members' approval requirement whereby a company may ratify a Conduct by the disinterested members passing an ordinary resolution. If none of the members is disinterested, Conduct can be approved by a unanimous resolution of all the members of the company.

17. *Personal data privacy*

A director or secretary will be able to state the company's registered office (or another correspondence address) as his personal address in the register held by the Companies Registry or the company, rather than his home address. His personal identity card or passport number will be redacted in public records. Access to the redacted data will be restricted to specified public authorities or other specified persons. Existing records will not be expunged. However, a company can pay a fee to withdraw the information from public inspection.

18. *Loans to directors*

The restriction on companies making loans to directors has generally been tightened, but there is a relaxation of the restriction for public companies and their subsidiaries. The restriction now covers a wider category of entities and individuals connected with a director but a public company and its subsidiaries can provide loans to its directors, and entities

and individuals connected with them, subject to disinterested members' approval. The New Ordinance reinstates existing, and introduces new, exceptions to the restriction. New exceptions include (i) a *de minimis* threshold of 5% of the net assets of the company before a transaction is subject to the restriction and (ii) expenditure in connection with defending any proceeding or investigation or regulatory action for misconduct provided that the director has to repay the company if he is found guilty or to have committed the misconduct.

19. *Declaration of interest*

The scope of interests which a director must declare to the company has been widened. Under the New Ordinance, a director will have to disclose any "transaction" or "arrangement" (rather than just "contracts" under the Old Ordinance) which he has entered into or proposed to enter into with the company which is of significance to the company's business.

Simplified financial reporting and directors' report

20. *Simplified financial reporting*

The New Ordinance widens the exemption on private companies to prepare simplified accounts based on the SME-Financial Reporting Standard in the following three scenarios: -

- i. a small private company or a small private group which satisfies two of the three conditions set out in note 1 automatically qualifies;
- ii. a large private company or a large private group which satisfies two of the three conditions set out in note 2 and with approval of members holding at least 75% of the voting rights and no objecting member; or
- iii. a single private company (not being a member of a corporate group) with all of its members' agreement in writing.

¹ A small company or a group of small companies is a private company or a group of private companies which satisfies two of the three conditions set out below:

- a. total annual revenue of not more than HK\$100 million;
- b. total assets of not more than HK\$100 million net; and
- c. no more than 100 employees

² A large company or a group of large companies is a private company or a group of large companies which meets two of the three conditions as set out below: -

- a. total annual revenue of not more than HK\$200 million;
- b. total assets of not more than HK\$200 million; and
- c. no more than 100 employees.

Banking or deposit-taking companies, corporations licensed under the Securities and Futures Ordinance, or insurance companies cannot benefit from this exemption.

21. *Directors' report*

The New Ordinance introduces a requirement on a public company (listed or unlisted) or a private company which does not qualify for simplified financial reporting to prepare an analytical and forward-looking business review of the company. The business review should include information regarding the risks and uncertainties the company faces, the future development of the company's business, environmental, employee, customers and suppliers matters that have a significant impact on the company and an analysis using financial key performance indicators.

Auditors' liabilities

22. The certified public accountants who prepare the auditors' report face criminal liabilities (only fines but not imprisonment) if, in the event of accounting fraud, they knowingly or recklessly failed to include in their report a declaration that the financial statements were materially different from the company's accounting records or that they could not obtain all the information or explanations needed for the audit.

Takeovers and amalgamation

23. *Removal of headcount test*

To take-private a Hong Kong-incorporated company by way of a scheme of arrangement, it is no longer necessary to satisfy the "headcount" test. A take-private transaction can be approved by members holding at least 75% of the voting rights of the company present and vote in favour of the scheme so long as the votes cast against the transaction do not exceed 10% of the total voting rights attached to all disinterested shares in the company. Even though both the Old Ordinance and the New Ordinance do not stipulate that only disinterested members can vote at a general meeting to consider a scheme to take-private a company, this is a requirement under the Code on Takeovers and Mergers.

24. *Court-free amalgamation procedure*

The New Ordinance introduces a new short form amalgamation procedure for wholly-owned entities within the same corporate group. The new procedure removes the need to apply to the Court subject to satisfaction of various

requirements such as the assets of the amalgamating companies not being subject to any floating charge, the solvency test and the approval of the members of each amalgamating company by special resolution.

After this process the resulting amalgamated company will take on the benefits and liabilities of all original amalgamating companies.

Change to the registration of charges regime

25. The New Ordinance updates the list of registrable charges to specifically state that:

- charges over an aircraft (or any share in an aircraft) and charges on instalments on the issue price of shares which are due, but not paid, will be registrable; and
- charges over bank accounts, charges for the purpose of securing an issue of debentures and a shipowner's lien on subfreights will not be registrable.

In addition to the current requirement to register particulars of a charge and its release, a certified copy of the charge document (and its release document) must be registered with the Registrar of Companies. This means that the charge document and any release document will be available for public inspection.

The time period for registration of a charge has been shortened from 5 weeks to one month. If a charge is not registered within the required timeframe, the New Ordinance removes the automatic acceleration of the charge as a consequence of such a failure to register. Instead, the lender will determine whether the loan becomes immediately due and payable.

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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