

**For information
on 5 July 2004**

**Legislative Council
Panel on Financial Affairs**

Overall Review of the Companies Ordinance

PURPOSE

This paper informs Members of the progress of the overall review of the Companies Ordinance (CO), the objective of which is to make our company law more user-friendly and ensure that the CO continues to provide Hong Kong with the legal infrastructure commensurate with its status as a major international business and financial centre.

BACKGROUND

2. The CO is one of the largest and most complex pieces of legislation in Hong Kong. Since its last major review in 1984, continuous efforts have been made to update the CO to keep it attuned to business needs. The Standing Committee on Company Law Reform (SCCLR) was formed in 1984 to advise on necessary amendments to the Ordinance on a continuous basis.

NEED FOR THE REWRITE OF THE COMPANIES ORDINANCE

3. Many of the provisions in the CO are closely inter-linked and amendments to any specific section could have implications for numerous other provisions in the Ordinance. While the Ordinance has been amended regularly in the past two decades, we have now reached a stage where “piecemeal” amendments to the Ordinance are no longer desirable because –

- (a) We need a CO that can meet the needs of modern day users, particularly in the business community which often makes reference to international practices;
- (b) The SCCLR and Government have conducted several major

reviews (details at **Annex**) over the past few years which aimed to provide Hong Kong with modernized company legislation and upgrade its corporate governance regime to international standards. While every effort has been made to implement the recommendations in the reviews, several important recommendations necessitate a complete rewrite and restructuring of the Ordinance;

- (c) The “piecemeal” nature of the amendments to the CO in the past inevitably gives rise to the issue of harmonization between the new and old provisions as these amendments have not necessarily resulted from an in-depth and systematic examination of company law as a whole.

4. Given the above circumstances, we consider that it is timely to start rewriting the Ordinance rather than amending it in a “piecemeal” fashion. This view has also been echoed by members of the Bills Committees considering company amendment bills on several previous occasions and the SCCLR.

UK COMPANY LAW REFORM

5. The UK is currently engaged in a major review of its company law. In undertaking our rewrite of the CO, the Administration, in consultation with SCCLR, considers it desirable that due regard be given to the UK’s company law reform for the following reasons—

- (a) Hong Kong company law is essentially derived from UK company law. Consequently, if the UK is undertaking a major review of its company law, it is essential that Hong Kong gives due regard to the outcome of that exercise. This does not mean that Hong Kong and UK company laws have to be identical as there are cultural, social, economic and regulatory differences which have to be taken into account. However, given the large number of commonalties, it is only logical, wherever possible, to base the Hong Kong company law reform on the results of the UK exercise, rather than re-inventing the wheel;
- (b) Any changes to the wording of provisions in the UK Companies Act could have very significant implications on

the numerous case law decisions based on interpretations of the current wording of these provisions. The extent to which existing case law would continue to apply under revised statutory provisions is a very major issue which the UK Government is discussing with the legal profession. As Hong Kong is a common law jurisdiction, we cannot afford to neglect or gloss over this issue; and

- (c) With the exception of the USA (which has 50 different companies acts in 50 different states) the UK is, commercially speaking, the most important common law jurisdiction in the world. Given this and Hong Kong's own position as one of the world's leading commercial and financial centres, it is very important that we make reference to the developments in the UK as the basis for reform.

THE PROPOSED REWRITE EXERCISE

6. If the rewrite of the CO is to be both a quality job and completed within a reasonable timeframe, it is essential that a robust structure be established and adequate resources be allocated at the outset. The rewrite will be a very major exercise involving extensive legal research for the purpose of preparing drafting instructions, drafting and subsequently presenting the new Companies Bill to the Legislative Council. To ensure that the new CO is both user-friendly and attuned to the needs of modern commerce, it will also be necessary to involve relevant stakeholders and experts in the private sector in the exercise from the outset.

7. In parallel with the rewrite, we also propose to introduce a further companies amendment bill to cover the remaining recommendations of the Corporate Governance Review and those proposals on accounting and auditing already finalized by the Joint Government/Hong Kong Society of Accountants Working Group (details at Annex). We consider it necessary to adopt such an approach in order to ensure that our corporate governance regime is in line with international developments.

8. In view of the above considerations, we propose the following structure for undertaking the rewrite –

- (a) A Companies Bill Team (“CBT”) would be established in the Companies Registry (“CR”) to undertake the relevant research work, prepare all draft drafting instructions and a White Bill and steer the new Companies Bill through the Legislative Council. To ensure that the Bill is commensurate with the need of the business community, we will engage professionals in the private sector to participate in the CBT as appropriate;
- (b) Working Groups (WGs) would be established under the CBT comprising representatives nominated by the relevant professional bodies and company law academics from the universities. These WGs would consider and endorse all draft drafting instructions and the White Bill;
- (c) The White Bill would be issued for public consultation and revised in the light of public comments before the new Companies Bill is finalised for introduction into the Legislative Council.

9. Assuming the UK White Bill is available in early 2005, we envisage the following timeframe for the rewrite –

	<u>Activity</u>	<u>Timing</u>
(a)	Undertaking research and preparing draft drafting instructions and the White Bill	May 2005 – April 2007 (24 months)
(b)	Consultation on the White Bill	May 2007 – October 2007 (6 months)
(c)	Revising the White Bill	November 2007 – April 2008 (6 months)
(d)	Steering the New Companies Bill through the Legislative Council	October 2008 – March 2010 (18 months)

10. In the event that the outcome of the UK White Bill is not available and the rewrite exercise is to proceed independently, it would be necessary to undertake a far greater degree of research into the company law of other jurisdictions and a longer time would be required to finish Hong Kong's White Bill.

RESOURCE REQUIREMENTS

11. Members of SCCLR considered that it was critically important to recruit staff of the right calibre to join the CBT. The resource requirements for the team will be examined in the normal way.

CONSULTATION WITH SCCLR

12. SCCLR was consulted on 21 February and again on 26 June 2004. SCCLR endorsed the need for proceeding with the rewrite and noted the proposed work plan of setting up Working Groups to take forward various parts of the Ordinance. SCCLR remarked that it is crucial to recruit staff of the right calibre to make the exercise a success. The rewrite should not proceed if the right people could not be identified.

WAY FORWARD

13. We intend to commence the rewrite exercise in early 2005 to synchronize with the release of the UK Companies Bill. In the meantime, a working group has already been formed to map out the terms of reference and the detailed work schedule for the re-write exercise. Members will be invited to approve the additional staffing requirements, where necessary, some time towards the end of the year.

Financial Services Branch
Financial Services and the Treasury Bureau
June 2004

Major Reviews on Company Law

MAJOR REVIEWS

Report of the Standing Committee on Company Law Reform

In February 2000, the Standing Committee on Company Law Reform (SCCLR) published a report on the recommendations of a consultancy report of the review of the CO. The SCCLR Report contained recommendations on a wide range of legislative amendments including proposals to enhance shareholders' protection, update the requirements regarding directorships, simplify the requirements for registration of foreign companies and make structural changes to modernise the Ordinance.

2. On the basis of the recommendations in the SCCLR Report, we have identified a total of 62 items for legislative amendments or further study. These items are divided into the following four phases –

- (a) Phase I: The 18 items in this phase involve amendments to specific sections of the CO;
- (b) Phase II: The 19 items in this phase are related to corporate governance matters and require either further study or consultation. These items have been also examined in the context of either the Corporate Governance Review (CGR) (see paragraph 3 below) or the review of the accounting and auditing provisions (RAAP) of the CO by the Joint Government/Hong Kong Society of Accountants Working Group (see paragraph 4 below);
- (c) Phase III: The 8 items in this phase are not related to corporate governance and require either further study or consultation;

- (d) Phase IV: This 17 items in this phase involve restructuring and rewriting the Ordinance.

Corporate Governance Review (CGR)

3. In 2000, the SCCLR was tasked by the then Financial Secretary to conduct a comprehensive corporate governance review. The review covered virtually all the items categorised in Phase II of the SCCLR Report (as well as many other items) and was completed in early 2004.

Review of Accounting and Auditing Provisions

4. There are certain parts of the CO which have not been examined in the context of the SCCLR Report. One of them is the accounting and auditing provisions in Parts II, IIA and IV of the CO. The JWG was established in March 2002 to undertake a comprehensive review of the accounting and auditing provisions (RAAP).

PRESENT POSITION

5. We have undertaken a stock-taking exercise of all the recommendations in the SCCLR Report, CGR and RAAP. The present position can be summarized as follows –

- (a) All items in Phase I of the SCCLR Report have been included in the Companies (Amendment) Ordinance 2003 which was implemented on 13 February 2004;
- (b) Items in Phases II and III of the SCCLR Report regarding shareholders remedies and overseas companies have been included in the Companies (Amendment) Bill 2003 which is being scrutinised by the Legislative Council;
- (c) Several items in Phases II and III of the SCCLR Report have been included in a companies amendment bill being processed by the Securities and Futures Commission (SFC) to implement the recommendations of the Report of the Steering Committee on the Enhancement of the Financial Infrastructure, which covers scripless securities, dematerialization of shares etc;
- (d) Those remaining corporate governance related items in Phase II of the SCCLR Report and Phases I and II of the CGR requiring

legislative amendments are planned to be included in the next new companies amendment bill. The remaining items involving changes to, for example, best practice are being followed up by the relevant parties;

- (e) Those proposals of the JWG which have been already finalized can be included in the companies amendment bill mentioned in (d). The remainder will be processed in the context of the rewrite of the CO;
- (f) Remaining items in Phases III and IV of the SCCLR Report which include the inspection and offences provisions, capital maintenance provisions, and rewriting and restructuring of the CO will be taken forward in the context of the rewrite of the CO.