

The New Companies Ordinance in Hong Kong—Key Issues for Real Estate Developers and Investors to Consider

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Real estate developers and investors should take note of Hong Kong's new Companies Ordinance, which has brought in a number of changes. The authors of this article provide answers to four frequently asked questions about the new Companies Ordinance.

Most real estate developers and investors in Hong Kong will own properties or their portfolios through a mixture of Hong Kong companies, BVI companies, and perhaps companies incorporated in other jurisdictions. Accordingly, it is important in the administration of company portfolios to take note of the new Companies Ordinance in Hong Kong, which commenced operation on March 3, 2014 ("new CO"). The new CO has brought in a number of changes. How does it affect your Hong Kong companies? What actions should you be addressing? Highlighted below are answers to four frequently asked questions.

Companies Ordinance Frequently Asked Questions

1. I wish to set up a Hong Kong private company as a special purpose/joint venture vehicle. How should I do it differently?

- Constitutional Documents**
 - The previous template Memorandum and Articles of Association should *no longer* be used. Under the new CO, only the Articles of Association are required (ss.75-77, new CO).
 - The new CO has prescribed a set of Model Articles that you can use, or, as in the past you can tailor make a set of Articles of Association for your Hong Kong companies (ss.78-80, new CO).
- Share Capital**
 - Under the new CO, the shares of a private company *do not* have any par value, i.e. there is no face value attached to the shares (s.135, new CO).
 - This means that Hong Kong companies are no longer restricted from issuing shares at a price lower than their par value.
- Director**
 - At least one director must be a natural person (s.457, new CO). Listed companies and their respective subsidiaries, as under the former law in Hong Kong, are not allowed to appoint corporate directors (s.456, new CO).
- Common Seal**
 - The keeping and use of a common seal is now optional (s.124, new CO). A deed can be executed without affixing the common seal.
 - The new CO provides that a Hong Kong company may execute a document as a deed by:

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(a) affixing its common seal (if adopted) in accordance with its Articles; or

(b) signing the document by any two directors or any one director plus the company secretary or if the company has only one director, by that director; or

(c) by a person appointed under a duly executed power of attorney (ss.128-129, new CO).

- The requirement that deeds (as opposed to simple contracts) required execution with a common seal often causes practical difficulties. We recommend that newly incorporated Hong Kong companies do not adopt a common seal, however this will mean that if there is more than one director then two directors will need to execute documents as a deed. This can be avoided by appointing one director under a power of attorney to execute documents as a deed by the company (however the power of attorney itself would need to be signed by two directors).

2. Do we need to take any action in respect of our existing Hong Kong private companies?

Immediate action may be required (if you have not already considered these issues). The following should be considered:

(a) Appointment of a Natural Person as a Director

If your Hong Kong private company has only one corporate director (i.e. a company entity is named as its sole director), you should appoint a natural person as a director. The grace period was six months and this has now passed (s.89 of Schedule 11, new CO).

(b) Memorandum and Articles of Association

It is *not* mandatory that you amend the Memorandum and Articles of Association because there are various *deeming provisions* in the new CO which deal with the necessary changes required to be

consistent with the new CO. For example:

- Any provision in the Memorandum of Association prior to the commencement of the new CO will be deemed to be a provision of the Articles of Association; and
- The amount of the authorised capital will be deemed to be deleted (s.98, new CO).

However, we do suggest that you consider amending the Articles as follows:

Dispensing with the Annual General Meetings (“AGMs”)

- The new CO gives an option to dispense with the AGMs simply by passing a shareholders resolution (s.613, new CO).
- However if your existing Articles contain express provisions on when and how the company should hold the AGMs, these provisions need to be amended/deleted before you can choose to dispense with the AGMs.

Common Seal & Execution of Documents

- If you wish to dispense with the common seal or set out any particular manner for execution of documents, you should make these changes in the Articles.

Other Procedural Matters

- The new CO also makes some changes to the procedures for proposing and passing members’ written resolutions, the notice period for general meetings (generally ss.548-616, new CO), etc. You may wish to amend the Articles to align with the new requirements to remove any doubt as to what procedures the company should follow and also ensure that the Articles do not mislead you into following incorrect procedures.

Best practice is to amend the Articles so that they are consistent with the new CO.

(c) Financial Statements and other Reporting Documents

The new CO may affect your reporting obligations. It brings in the following key changes:

Accounting Reference Period (“ARP”)

- ARP is a new concept which is relevant to the timing of AGMs, the laying /sending of financial reports and the filing of annual returns (generally ss.368-371, new CO).

- Simplified Reporting**
 - The new CO broadens the exemption on small private companies to prepare simplified accounts and financing reports based on the SME Financial Reporting Framework and Standard (generally ss.359-366, new CO).
 - Whether a company is qualified for this exemption will depend on its group's annual revenues, assets and number of employees.
- Business Review**
 - Public companies (listed or unlisted) and private companies (other than those qualified for simplified reporting or a wholly owned subsidiary of another company) are generally required to prepare an analytical business review as part of the annual directors' report. *Private companies* can however choose to opt out of this requirement by passing a special resolution within the prescribed timeframe (s.388, new CO).

(d) Review of Relevant Contracts & Internal Policies

You should consider whether the new CO affects any of your existing contracts or internal policies and procedures, especially any shareholders' agreement and policy on declaration of directors' interest (see Question 3 below).

3. I am a director of several Hong Kong companies. What should I watch out for under the new CO?

The new CO probably does not significantly change your daily management of the Hong Kong companies. However, you should be aware of the following:-

- Directors' Duties**
 - The standard of care a director must exercise has been codified under the new CO. In deciding whether a director has fulfilled his/her duties of care, skill and diligence, his/her conduct will be considered based on:
 - (a) his/her own general knowledge, skill and experience (a subjective test); and
 - (b) the general knowledge, skill and experience that a person in that position is expected to have (an objective test) (ss.465-466, new CO).

- The usual fiduciary duties of a director remain unchanged and are defined by case law.
- Declaration of Interest**

The scope of interest which a director must declare is technically widened. A director is required to disclose interested "transactions" and "arrangements" in addition to "contracts," and the "nature and extent" (rather than just the "nature") of his/her interest (ss.536-542, new CO).
- Loan to Directors**

The new CO has changed the rules on restrictions on Hong Kong companies to make loans to directors, both in respect of public and private companies. These new detailed provisions should be reviewed if a loan to a director (or persons connected to a director) is proposed (Part 11, Division 2, new CO).
- Service Contract**

The approval of the members in a prescribed manner is required for any guaranteed term of employment of a director for longer than three years (ss.530-535, new CO).
- Ratification of Conduct**

Any act or omission of a director amounting to negligence, default, breach of duty or breach of trust may only be ratified by an ordinary resolution of the disinterested members (s.473, new CO).

4. I have considered reducing the share capital of a Hong Kong company to allow for payment of dividends but have given up this idea because approval from Hong Kong courts is required under the existing law. Has the new CO changed this?

Yes. The new CO introduces an alternative process for capital reduction without the need to go through the Hong Kong court procedures (ss.215-225, new CO). The new process generally requires:

- a) signing of a solvency statement by the directors;
- b) passing of a members' special resolution;
- c) publication of notices in the Hong Kong Government Gazette and newspapers; and (d) filing of relevant forms with the Hong Kong Companies Registry.

Any creditor or non-approving member may apply to the Hong Kong courts for an order to cancel the special resolution within the prescribed time frame.

The new CO has brought in other changes such as the application of the solvency test

for giving financial assistance for acquisition of the company's own shares, and the concept of the "responsible person."