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New Companies Ordinance Expected to Take Effect in 2014

Quick Read

Rewriting the Companies Ordinance (**CO**), Hong Kong's primary corporate statute, was no doubt a long and arduous process. The work, which was started back in 2006, eventually began to bear fruit when the Companies Bill was finally passed by the Legislative Council on 12 July 2012 and gazetted on 10 August 2012, following at least five rounds of public consultation.

Major Initiatives

There were discussions on almost all aspects of the original CO during the rewriting process. Two of the more eye-catching conclusions of relevance to corporate finance practitioners are the replacement of the headcount test and the abolition of par values for shares.

REPLACEMENT OF THE HEADCOUNT TEST

Under the existing CO, where a scheme is proposed between a company and its members or creditors, the court may order a meeting of the members or creditors to be summoned. If a majority in number (**headcount test**), representing 75% in value (**share value test**) of the creditors or members present, votes at the meeting to agree to the proposed scheme, the scheme shall, if sanctioned by the court, be binding on all members or creditors, and on the company.

The current headcount test became a cause for concern during the high-profile PCCW case in 2009. In that case, the problem that emerged was that, while the existing law empowered the court not to sanction a scheme—even if the scheme had been approved under both the headcount test and share value test (e.g. if there were doubts about whether the process had been fairly administered; for instance, if approval under the headcount test was achieved by share splitting)—it did not empower the court to sanction a scheme where the headcount test had not been passed, even in cases where share splitting had increased the headcount of members opposing the scheme.

Following the 2009 PCCW case, the question of whether the headcount test should be abolished was much debated, with a number of diverse views being expressed. After numerous discussions, the new CO has finally settled the issue by introducing new provisions. For specified privatisation and takeover schemes, the headcount test is to be replaced with a new requirement: the number of votes cast against the resolution to approve a scheme of arrangement must not be more than 10% of the votes attached to all disinterested shares (**disinterested shares test**). The new requirement is aligned with the 10% objection rule in the Takeovers Code[1]. Accordingly, such schemes are subject to the share value test and disinterested shares test. For requirements of other scheme categories, please refer to the table below.

ABOLITION OF PAR VALUES FOR SHARES

In a public consultation commissioned by the Financial Services and the Treasury Bureau in 2003, a significant proportion of respondents commented that par value had caused various practical problems. The Standing Committee on Company Law Reform, which concurred with the views of the majority of respondents from the 2003 consultation, recommended the adoption of a mandatory no-par regime for companies. From then onwards, the issue became a hot subject for discussion. Further consultations were conducted in 2008 and 2009 respectively. In both consultations, the majority of respondents supported the mandatory no-par proposal. The new CO has finally settled this issue by introducing new provisions to adopt a mandatory no-par regime for companies. For more details, please refer to the table below.

SUMMARY OF VARIOUS MAJOR INITIATIVES

The major purposes of the new CO are to enhance corporate governance, ensure better regulations, facilitate business and modernise the law. The new CO consists of 921 sections and 11 schedules. In order to facilitate implementation of the new CO, more than ten regulations will have to be legislated in 2013-14. The new CO is expected to take effect in 2014.

There are many new initiatives contained in the new CO. For discussion purposes, we have selected some of the more relevant and interesting ones, and an overview of these provisions (not an exhaustive list) is presented in the following table:

MAJOR INITIATIVES	EXISTING CO PROVISIONS	NEW CO PROVISIONS
Voting of shareholders		
Replacing the Headcount Test	Where a scheme is proposed between a company and its members or creditors, the court may order a meeting of the members or creditors to be summoned. If both the headcount test and share value test have been passed, the scheme shall, if sanctioned by the court, be binding on all members or creditors and the company. The court has the discretion not to sanction a scheme even though it has met both the share value test and headcount test. Privatisation and takeover schemes proposed by listed companies are often conducted by way of members' schemes.	For specified privatisation and takeover schemes, the headcount test is to be replaced with the disinterested shares test. The new requirement is aligned with the 10% objection rule in the Takeovers Code. Accordingly, such schemes are subject to the share value test and disinterested shares test. For other categories of members' schemes, although the headcount test and share value test may still be applicable, the court is given a new discretion to dispense with the headcount test (in cases where it is retained). As for creditors' schemes, the headcount test and share value test are retained and there is no need to extend the court's discretionary power to dispense with the headcount test. As under the existing law, all schemes can only be implemented with the sanction of the court.
Reducing the threshold to demand a poll	One of the threshold requirements for members to demand a poll in general meetings is 10% of the total voting rights.	The threshold requirement for members to demand a poll is reduced from 10% to 5% of the total voting rights.

MAJOR INITIATIVES	EXISTING CO PROVISIONS	NEW CO PROVISIONS
Strengthening the enforcement regime and auditors' rights		
Strengthening the enforcement regime	A number of offence provisions punish not only a company but also officers of the company who are in default. The formulation of "officer who is in default" is defined as an officer or shadow director of a company who "knowingly and wilfully authorises or permits the default, refusal or contravention".	A new formulation of "responsible person" to replace "an officer who is in default" is adopted. A "responsible person" of a company is an officer or shadow director who "authorises or permits, or participates in, the contravention or failure".
Strengthening the rights of auditors	Only restricted rights are granted to auditors to obtain information.	Auditors are empowered to obtain information and explanations they may reasonably require for the performance of their duties from a wider range of persons, including: • a person holding or accountable for any accounting records of the company; • any officer or former officer of the company at a time to which the information and explanation relates; and • those persons in the company's Hong Kong and non-Hong Kong incorporated subsidiaries. Failure to comply with the requirement will be subject to criminal sanctions.
Directors and officers		
Clarifying directors' duty of care, skill and diligence	No statutory provision on directors' duty of care, skill and diligence.	Respective statutory objective and subjective standards are introduced. Those being that a director must exercise reasonable care, skill and diligence, at the standard that would be exercised by a reasonably diligent person with: • the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of the director in relation to the company (objective standard); and • the general knowledge, skill and experience that the director has (subjective standard).

MAJOR INITIATIVES	EXISTING CO PROVISIONS	NEW CO PROVISIONS
Directors and officers		
Restricting the appointment of corporate directors	Public companies and private companies that are members of a group of companies of which a listed company is a member are prohibited from appointing a body corporate as their director. There are no restrictions regarding other private companies.	Corporate directorship in other private companies is restricted by requiring them to have at least one director who is a natural person.
Better protection of personal data	Directors and company secretaries are required to provide their residential addresses and identification numbers (**ID numbers**) to the Companies Registry for incorporation and registration purposes. Such information is available on the Companies Register and can be inspected and copied by the public.	Access is to be restricted, on application, to the (a) residential addresses of directors and company secretaries (only correspondence addresses are to be made available for public inspection in such cases); and (b) full ID numbers of individuals.
Share Capital		
Abolishing par value for shares	Companies having a share capital are required to have a par value ascribed to their shares.	A mandatory system of no-par for all companies with a share capital is adopted. Accordingly, a company's shares will have no nominal value. Relevant concepts, such as share premium and requirement for authorised capital, are also abolished.
Providing a court-free procedure for reducing capital	A reduction of share capital is only allowed if it is approved by the shareholders via a special resolution and if the reduction is approved by the court. In determining whether to approve the reduction, the court considers various factors, including whether the reduction is equitable between shareholders and whether creditors' interests are safeguarded.	An alternative court-free procedure for reduction of capital is introduced, subject to a solvency test. Key features of the procedure include: • a solvency statement signed by all directors; • members' approval by a special resolution; • publication of a notice in the Gazette; • registration of the solvency statement with the Companies Registry; and • any creditor or non-approving member may, within five weeks after the resolution is passed, apply to the court for cancellation of the resolution.

MAJOR INITIATIVES	EXISTING CO PROVISIONS	NEW CO PROVISIONS
Share Capital		
Allowing purchase of own shares out of capital	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. There is an exception for private companies which may fund a buy-back by payment out of capital based on a solvency test.	Except for a listed company purchasing its own shares on a stock exchange, generally allowing companies (rather than just private companies) to purchase their own shares out of capital, subject to a solvency test. The requirements and procedures are similar to the new court-free procedure for reduction of capital as explained above.
Allowing provision of financial assistance to acquire shares	Subject to certain exceptions, a company and its subsidiaries are broadly prohibited from giving financial assistance for the purpose of acquiring shares in the company.	Previous restrictions are relaxed, and companies (whether listed or unlisted) are generally allowed to provide financial assistance to another party to acquire the company's own shares or the shares of its holding company, subject to a solvency test and the following conditions: • if the financial assistance, and all other financial assistance previously given and not repaid, is in aggregate not more than 5% of the paid up share capital and reserves; • if the financial assistance is approved by written resolution of all members of the company; or • if the financial assistance is approved by an ordinary resolution, shareholders holding at least 5% of the total voting rights or members representing at least 5% of the members of the company may apply to the court to restrain the giving of the assistance.
Other facilitating measures		
Introducing a court-free statutory amalgamation regime	Companies intending to amalgamate have to resort to the procedures which require court sanction.	A court-free statutory regime for amalgamations is introduced. The regime is confined to amalgamations of wholly-owned intra-group companies where minority shareholders' interest would normally not be an issue and is subject to a solvency test.
Relaxing the requirement on the use of a common seal	Every company shall have a common seal with the company name engraved in legible characters.	A company may have a common seal, thus making the keeping and using of a common seal optional so as to facilitate business and simplify the mode of execution of documents by companies.

Future Developments

As mentioned above, more than ten regulations in relation to the new CO will have to be legislated in the future. We will closely monitor the latest developments of the new CO and its related regulations from time to time and will issue updates as and when appropriate. In the meantime, please do not hesitate to contact us if you require any advice or further information.

A summary of the other major initiatives contained in the new CO can be downloaded via the link below:

http://www.cr.gov.hk/en/publications/docs/ec5-2012-annex-e.pdf

You may also download copies of the new CO via the link below:

http://www.cr.gov.hk/en/companies_ordinance/docs/full-e.pdf

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Endnote

1 Referring to Rule 2.10 (b) of the Takeovers Code which states that: "*Except with the consent of the Executive, where any person seeks to use a scheme of arrangement or capital reorganisation to acquire or privatise a company, the scheme or capital reorganisation may only be implemented if, in addition to satisfying any voting requirements imposed by law:- .... (b) the number of votes cast against the resolution to approve the scheme or the capital reorganisation at such meeting is not more than 10% of the votes attaching to all disinterested shares.*"