

# New Companies Ordinance: highlights of major changes (part two)

In the second part of this series, [Ada Chung](#) and [Karen Ho](#) set out the major changes introduced in the new legislation to enhance corporate governance and ensure better regulation

**T**his article is the second of two articles covering the new Companies Ordinance (Cap. 622). The first article, published in the last issue, set out the major changes introduced by the new ordinance to facilitate business and modernize the law. This article highlights the major changes introduced to achieve the objectives of enhancing corporate governance and ensuring better regulation.

## Enhancing corporate governance

The new ordinance introduces the following major initiatives with the aim of enhancing corporate governance:

### Strengthening the accountability of directors

There were provisions in the old ordinance prohibiting all public companies, as well as private companies that are members of a group of companies of which a listed company is a member, from appointing a body corporate as their director. There was no restriction for other private companies. The new ordinance requires, on top of these restrictions, that private companies must have at least one director who is a natural person.

There are no provisions on directors' duty of care, skill and diligence in the old ordinance and the common law position in Hong Kong in this respect is not entirely clear. The standard of the duty in old case law, which focuses on the knowledge and experience that a particular director possesses (the subjective test), is considered too lenient nowadays.

In light of developments overseas, the

new ordinance introduces a statutory statement to provide clear guidance to directors. The new provision stipulates that a director must exercise reasonable care, skill and diligence, and sets out a mixed objective and subjective test in the determination of the standard. The objective test looks at the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of the director in question.

### Enhancing shareholder engagement in the decision-making process

The old ordinance provided that anything that might be done by a company by resolution in a general meeting might be done by a written resolution signed by all members without convening a meeting. However, there were no statutory rules on proposing or passing a written resolution.

The new ordinance provides the procedures for proposing, passing and recording written resolutions. A company's articles may set out alternative procedures for passing a resolution without convening a meeting, provided that the resolution is agreed to by the members unanimously.

To enhance the right of shareholders, the expenses of circulating members' proposed resolutions for annual general meetings, and members' statements relating to the proposed resolution or other business to be dealt with at AGMs, will be borne by the company if the required threshold for requests are met and the requests to circulate such documents are received in time for sending with the notice of the relevant meeting.

Under the old ordinance, a poll would be called for if the demand is made by

not less than five members, members representing not less than 10 percent of the total voting rights, or members holding not less than 10 percent of the total paid-up share capital of the company carrying the right to vote at the meeting. The threshold for demanding a poll is lowered from 10 percent to 5 percent of the total voting rights under the new ordinance. The threshold of five members is retained but the threshold based on the total paid-up capital is removed.

### Improving the disclosure of corporate information

The new ordinance requires public companies and companies not qualified for simplified reporting (details of simplified reporting have been given in the first article) to prepare a more comprehensive directors' report, which includes an analytical and forward-looking "business review," while allowing private companies to opt out from the requirement by a special resolution.

The review should contain, for example, information relating to environmental and employee matters that have a significant impact on the company. The new requirement is in line with the international trend towards integrated reporting.

### Modifying the "headcount test"

The "headcount test," pursuant to which a majority in number of the members present and voting is required to pass a resolution to approve a scheme involving a takeover offer or general offer to buy back shares (including a privatization scheme), is replaced under the new ordinance by a new requirement that the



number of votes cast against a resolution to approve such a scheme must not be more than 10 percent of the votes attached to all disinterested shares. "Disinterested shares" basically means shares held by non-interested parties.

For other members' schemes, the headcount test is retained, with a new provision giving the courts a discretion to dispense with the test where appropriate. To address the concern that minority shareholders are reluctant to challenge a scheme in court because of the potentially substantial legal costs, it is provided that a dissenting member might be ordered to pay legal costs only if his or her opposition to the scheme is frivolous or vexatious.

#### **Fostering shareholder protection**

The scope of the unfair prejudice remedy is extended to cover proposed acts and omissions, so as to remove the uncertainty as to whether a member can bring an action for unfair prejudice where a course of action is only at the proposal stage, or where there is only a threat to do or not to do something. The remedies that may be granted by

a court are also extended to cover an order restraining the proposed act or requiring the doing of an act that the company has proposed not to do.

To avoid potential conflict of interests, the old law prohibited a company from entering into loans or other similar transactions with a director. For a listed company or a private company that is within the same group as a listed company, the reference to "director" was extended to cover persons or corporations closely associated with a director. The new ordinance expands the prohibition to cover a wider category of entities connected with a director.

In the case of a "specified company," i.e. a public company or a private company or company limited by guarantee that is a subsidiary of a public company, the prohibition also covers, among others, an adult child, a parent, a cohabitee, a minor child of the cohabitee who lives with the director and an associated body corporate.

To minimize the risk that a director may entrench himself in office, the new ordinance provides that the approval of members must be obtained for any

contracts under which the guaranteed term of employment of a director with the company exceeds or may exceed three years.

#### **Strengthening auditors' rights to information**

To ensure that an auditor will be in a position to perform his oversight functions in an effective manner, the new ordinance empowers auditors to require a wider range of persons, including persons holding or accountable for any of the accounting records of the company or its Hong Kong incorporated subsidiary, or any such persons at the time to which the information or explanation relates, to provide them with the information and explanation that they reasonably require for the performance of their duties.

In particular, the auditor of a holding company may also require the company to obtain information or explanation from the auditor of its subsidiary undertaking that is not a Hong Kong incorporated company and persons holding or accountable for any of the accounting records of such a subsidiary undertaking.

### Ensuring better regulation

To ensure that the new ordinance enhances regulation, measures have been introduced on various fronts.

#### Improving the enforcement regime

To improve enforcement, a new power of enquiry is given to the Registrar of Companies to obtain documents or information where there is reason to believe any conduct relating to an offence of providing false or misleading statement has taken place. The investigatory powers of inspectors appointed to investigate the affairs of companies are also enhanced.

To encourage compliance and to optimize the use of judicial resources, the new ordinance introduces a new power for the registrar to compound specified offences as set out in Schedule 7 to the new ordinance. Compoundable offences are generally confined to straightforward and minor regulatory offences committed by companies. In compounding an offence, the registrar will give a notice in writing to a company in breach to offer it an opportunity to rectify the default. If the company pays the compounding fee and complies with the terms of the notice, the registrar will not initiate a prosecution.

The threshold for breach of any provision of the new ordinance by an officer of the company has been lowered through the introduction of a new definition of "responsible person," which targets intentional and reckless conduct other than willful conduct as under the old law.

#### Companies limited by guarantee

Under the new ordinance, companies limited by guarantee come under a specified category of companies and they are required to comply with the following requirements:

- At least two directors are required;
- No corporate director is allowed; and
- The annual returns must be delivered together with certified copies of the financial statements, directors' reports and auditor's reports.

To encourage compliance with statutory filing requirements, an escalating scale of annual registration fees is introduced for the filing of annual returns by companies limited by guarantee. In the case of late filing, substantially higher registration fees are payable. The escalating fee scale is set out in the Companies (Fees) Regulation

(Cap. 622K) and is the same as that applicable to private companies.

#### Ensuring the accuracy of information on the Companies Register

To enhance the accuracy of information on the Companies Register, the new ordinance clarifies the powers of the registrar in relation to the following:

- Registration of documents – the registrar is expressly empowered to specify the requirements for the authentication of documents to be delivered to the Companies Registry and the manner of delivery, and withhold the registration of unsatisfactory documents pending further particulars; and
- Keeping of the register – the registrar may rectify typographical or clerical errors, make annotations and require a company to resolve any inconsistency or provide updated information.

The new ordinance provides a statutory basis for applications to court for removing information from the register that is inaccurate, forged or derived from anything invalid, ineffective or done without the authorization of the company.

A statement of capital is required to be delivered for registration whenever there is a change in a company's share capital, including an allotment of shares or a permitted alteration of share capital, to ensure the disclosure of up-to-date share capital information.

#### Introducing a new offence in relation to an inaccurate auditor's report

The old law required auditors to make two important statements in an auditor's report but there were no related offence provisions. Under the new ordinance, the statements have to be made by auditors where the financial statements are not in agreement with the accounting records of the relevant company in any material respect or where the auditor in question has failed to obtain all the necessary and material information or explanations for the purpose of the audit.

To enhance the reliability and integrity of financial statements and improve the regulatory regime, a new offence is introduced for the omission of the statements under section 408 of the new ordinance. The offence would be committed if the auditor in question knowingly or recklessly caused any of the two statements to

be omitted from the auditor's report.

To clarify the issues involved, the Companies Registry has issued an external circular on the subject. The Hong Kong Institute of CPAs has also issued guidance to members (see another article on AATB 4)

#### Improving the registration of charges

To improve transparency, the period for submitting charges for registration has been shortened from five weeks to one month. Further, a certified copy of the instrument documenting the charge will have to be filed and registered for public search. Third parties will be deemed to have constructive notice of the terms of the charge as registered.

#### Refining the scheme for deregistration of companies

To minimize any potential abuse of the deregistration procedure, the new ordinance enhances the regulation of voluntary deregistration by imposing additional conditions to be met, i.e., the applicant must confirm that the company is not a party to any legal proceedings and that neither the company nor its subsidiary has any immovable property in Hong Kong.

### A new era

The new ordinance, which is one of the longest and most complex pieces of legislation ever enacted in the history of Hong Kong, encapsulated the inputs and contributions of all those who are involved in the process, including members of the accounting profession. We believe that the changes brought about by the new ordinance will benefit all companies in Hong Kong, including their shareholders and directors, people doing businesses with or providing services to these companies, and reinforce Hong Kong's competitiveness as a place to do business.

Comprehensive information about the new ordinance, which includes briefing materials, highlights of major changes, answers to frequently asked questions and reference tables, are available at the "New Companies Ordinance" section on the Companies Registry's website at [www.cr.gov.hk](http://www.cr.gov.hk).



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