

▶ Key changes under the 2014 Hong Kong Companies Ordinance



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Introduction – Key Changes under the NCO

- ▶ The New Companies Ordinance (Cap. 622) (**NCO**) came into force on 3 March.
- ▶ The previous Companies Ordinance (Cap. 32) (**OCO**) has been retitled as the “Companies (Winding Up and Miscellaneous Provisions) Ordinance”.
- ▶ Following the commencement of the NCO,
 - the provisions relating to winding-up and insolvency of companies and prospectuses have been preserved in the Companies (Winding Up and Miscellaneous Provisions) Ordinance);
 - all other provisions under the OCO have been repealed.

Introduction – Key Changes Affecting Directors (Cont'd)

Part	Key areas
1	Changes affecting directors of HK companies
2	Changes concerning share capital, transactions involving share capital and registration of share transfers
3	Company administration, procedure and operations
4	Registration of charges
5	Financial reporting
6	Schemes of arrangement, amalgamations and compulsory share acquisitions
7	Abolition of memorandum of association and matters relating to the articles of association
8	Listing Rule amendments and FAQs following the implementation of the NCO

► **Part 1 - Changes affecting directors of HK companies**



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Standard of Directors' Duty of Care, Skill and Diligence

NCO references: s465– 466

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ No specific provisions on directors' duty of care, skill and diligence.▶ General common law and fiduciary duties of directors apply.	<p>A director must exercise reasonable care, skill and diligence i.e. the care, skill and diligence that would be exercised by a reasonably diligent person with:</p> <ul style="list-style-type: none">▶ Objective Test: the general knowledge, skill and experience that may be reasonably expected of a person carrying out the functions carried out by the director; AND▶ Subjective Test: the general knowledge, skill and experience that the director has. <p>(s465(2)(a) & (b) NCO)</p>

Standard of Directors' Duty of Care, Skill and Diligence

(Cont'd)

NCO references: s465– 466 (Cont'd)

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ No specific provisions on directors' duty of care, skill and diligence.▶ General common law and fiduciary duties of directors apply.	<ul style="list-style-type: none">▶ The statutory duty applies equally to a shadow director of a company.▶ Shadow director is defined as a person in accordance with whose directions the directors, or a majority of directors, are accustomed to act. <i>(s465(5) NCO)</i>▶ The existing common law or equitable civil consequences of breach of the duty is retained. <i>(s466 NCO)</i>

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Standard of Directors' Duty of Care, Skill and Diligence

(Cont'd)

Practical considerations and recommended steps:

- ▶ Therefore, if a director has special knowledge, skill or experience, then such director will be subject to a higher standard of care (**Subjective Test**).
- ▶ Conversely, a director will be expected to meet an objective reasonable standard of care, even if the director is in fact under-qualified for the role (**Objective Test**).
- ▶ Fiduciary duties of a director will remain subject to case law, which include:
 - the duty to act in good faith in the interests of the company;
 - the duty to exercise powers for their proper purpose;
 - the duty to avoid conflicts of interest
- ▶ A director may have additional duties under:
 - a company's articles;
 - the director's individual terms of engagement;
 - Listing Rules
- ▶ The Companies Registry's Guide on Directors' Duties has been revised to reflect the new statutory duty.

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Standard of Directors' Duty of Care, Skill and Diligence

(Cont'd)

Application to HK listed companies

- ▶ While section 465 of the NCO does not apply directly to the directors of non-Hong Kong companies (i.e. companies incorporated outside Hong Kong), the directors of a non-Hong Kong company which is listed on the Hong Kong Stock Exchange must comply with it since they are required by Listing Rule 3.08 to exercise duties of skill, care and diligence to the standard set by Hong Kong law.
- ▶ It should also be noted that the Exchange's Guidance Letter HKEx-GL62-13 was recently revised to state that listed company directors are expected to comply with the Companies Registry's Guide on Directors' Duties and that failure to do so may constitute a breach of the Listing Rules (at paragraph 2.8).

Concept of “Responsible Person”

- ▶ A number of offences under the OCO applied both to the company and officers who are in default. In the NCO, the concept of “responsible person” has replaced that of “officer in default” under the OCO.
- ▶ Effect is to lower the threshold for breach or contravention of relevant provisions.
- ▶ “Officer in default” under the OCO was:
 - a) any officer or any shadow director of the company;
 - b) who knowingly and willfully authorises or permits the default, refusal or contravention of the relevant provisions.
- ▶ s3(2) NCO defines a “responsible person” of a company or non-Hong Kong company as an officer (i.e. a director, manager or company secretary) or shadow director of the company or non-Hong Kong company who “authorises or permits, **or participates in**, the contravention or failure”.
- ▶ s3(3) NCO extends the scope of a “responsible person” to cover an officer or shadow director of a body corporate that is an officer or shadow director of a company or non-Hong Kong company.

Concept of “Responsible Person” (Cont’d)

3 main differences between the definitions of “officer in default” and “responsible person”

- ▶ the definition of "responsible person" is wider so that if the officer or shadow director is a body corporate (which includes both Hong Kong and non-Hong Kong companies), the officers and shadow directors of that body corporate are also responsible persons;
- ▶ the scope of the offence has been expanded to include “participation” in the contravention, such that omissions or assistance to others in committing offences by officers and shadow directors are also included;
- ▶ the definition of “responsible person” removes the mental element of "knowingly and willfully" so that reckless acts and omissions by officers will also be covered.

Concept of “Responsible Person” (Cont’d)

Examples of offences under NCO for which every responsible person of the company is punishable upon conviction:

- ▶ failure to provide information to the Companies Registrar;
- ▶ failure to notify or register with the Companies Registrar in respect of alteration of the company’s articles, change of the company’s name, return of allotment, alteration of share capital etc.;
- ▶ reduction of share capital;
- ▶ acquisition of own shares;
- ▶ financial assistance by the company or its subsidiaries for the purchase of its own shares;
- ▶ breach of requirements in relation to financial statements and reporting documents;
- ▶ breach of requirements in relation to company’s auditors.

Ratification of Directors' Conduct

NCO references: s473

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ No specific provisions on shareholder ratification of director's conduct.▶ Under common law, shareholders can ratify breaches by directors of their fiduciary duties	<ul style="list-style-type: none">▶ Any ratification of a director's (including a shadow director's) conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company must be approved by a resolution of disinterested shareholders.▶ For the purpose of ratification, votes in favour of the resolution of the following are to be disregarded:<ul style="list-style-type: none">○ A director of the company whose conduct is to be ratified;○ An entity connected with that director; or○ A holder of any shares in the company in trust for that director or connected entity▶ If none of the shareholders are disinterested, then approval must be by unanimous consent of all shareholders. <p><i>(s473 NCO)</i></p>

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Ratification of Directors' Conduct (Cont'd)

Practical considerations and recommended steps:

- ▶ The independent ratification requirement under NCO should provide a more preventative protection for minority shareholders than statutory derivative or unfair prejudice remedies.
- ▶ This is because statutory derivative or unfair prejudice remedies would normally be taken by a dissenting minority shareholder after a breach has already occurred.
- ▶ The new rule should not impact significantly on small companies that normally take shareholder decisions by way of unanimous written consent.

Liability and Indemnification of Directors

Position under the NCO

Exempting directors from liability to the company

- ▶ Any provision which purports to exempt a director from liability owed to the company where there has been negligence, default, breach of duty or breach of trust by the director in relation to the company is void.

(s468(1) & (2) NCO)

Liability and Indemnification of Directors (Cont'd)

Position under the NCO

Indemnifying directors against liability to the company / an associated company

- ▶ Any provision which indemnifies a director of the company or of an associated company of the company, against liability owed to the company or an associated company where there has been negligence, default, breach of duty or breach of trust by the director in relation to the company or associated company is void.
- ▶ “Associated company” in the NCO has the same meaning as “related company” in the OCO, which means a company’s subsidiaries, holding companies and subsidiaries of such holding companies.

(s468(3) NCO)

Liability and Indemnification of Directors (Cont'd)

Position under the OCO	Position under the NCO
<p data-bbox="277 459 981 549"><u>Indemnifying directors against liability to third parties</u></p> <ul data-bbox="277 612 1055 1059" style="list-style-type: none"><li data-bbox="277 612 1055 804">▶ No specific provisions in the OCO regulating a director's right to be indemnified against liabilities to third parties.<li data-bbox="277 868 1055 1059">▶ Under common law, the scope of the right of directors to be indemnified against liabilities to third parties was not clear.	<p data-bbox="1093 459 1886 549"><u>Indemnifying directors against liability to third parties</u></p> <ul data-bbox="1093 560 1982 1225" style="list-style-type: none"><li data-bbox="1093 560 1982 644">▶ A company can indemnify a director against liability incurred by the director to a 3rd party.<li data-bbox="1093 692 1982 1043">▶ However, the following liabilities cannot be covered by the indemnity:<ul data-bbox="1151 788 1982 1043" style="list-style-type: none"><li data-bbox="1151 788 1429 820">○ Criminal fines;<li data-bbox="1151 831 1532 863">○ Regulatory penalties;<li data-bbox="1151 874 1982 1043">○ Defence costs of criminal proceedings in which the dir is convicted OR civil proceedings brought by the company and in which judgement is given against the dir<li data-bbox="1093 1098 1982 1225">▶ Common law continues to govern any potential indemnities that fall outside the statutory prohibitions and exclusions described above.

Liability and Indemnification of Directors (Cont'd)

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ N/A	<ul style="list-style-type: none">▶ The company must disclose the indemnity provision in the dir report.▶ It must keep a copy of any permitted indemnity at its registered office until 1 year after its expiry and make it available for inspection by members on request.▶ Failure to retain the copies is an offence for which the company and its responsible persons may be fined. <p><i>(s470 to 472 NCO)</i></p>

Liability and Indemnification of Directors (Cont'd)

Purchase of directors' insurance

- ▶ The NCO does not prohibit a company from purchasing insurance for directors and the Model Articles envisage that directors can be insured against liability in certain situations.
- ▶ Article 32 of the Model Articles (Article 36 for public companies) provides that a company may, at the expense of the company, purchase insurance for a director against:
 - **primary liability**: a director's liability to any person in connection with any negligence, default, breach of duty or breach of trust (except for fraud) in relation to the company or an associated company;
 - **costs of proceedings**: a director's liability in defending any proceedings (civil or criminal) for any negligence, default, breach of duty or breach of trust (including fraud) in relation to the company or an associated company.
- ▶ For listed companies, paragraph A.1.8 of Appendix 14 (Corporate Governance Code and Corporate Governance Report) of the Listing Rules requires a listed company to arrange appropriate insurance cover in respect of legal action against its directors. Compliance with this code provision is not mandatory, but a listed company would need to explain the reasons for any non-compliance in its annual report.

Liability and Indemnification of Directors (Cont'd)

Practical considerations and recommended steps:

- ▶ Companies and their directors should review the scope of any indemnities granted to directors to see if these should now be extended to cover indemnification against 3rd party liabilities.
- ▶ The NCO does not prohibit a company from taking out insurance for directors against liabilities for negligence, default, breach of duty or breach of trust (except fraud).
- ▶ Any existing directors' and officers' (D&O) insurance policies should be reviewed to see if coverage should be extended.

Liability and Indemnification of Directors (Cont'd)

Practical considerations and recommended steps (Cont'd):

- ▶ Permitted exemptions from liability, indemnities for liability to a third party and any undertaking to take out D&O insurance should be clearly set out in a director's service contract, even if the articles already include the same.
- ▶ The articles are a contract between the company and the shareholders, so a director would have difficulty enforcing an exemption, indemnity or undertaking contained only in the articles.
- ▶ Hong Kong courts have also been reluctant to imply provisions from a company's articles into the terms of appointment of a director.
- ▶ The scope of any director indemnity should also be considered, in particular whether it covers only liabilities arising from the performance of the director qua director, or in other capacities (for example, as chief financial officer) or in a personal capacity.

Liability and Indemnification of Directors (Cont'd)

Practical considerations and recommended steps (Cont'd):

- ▶ Copies of permitted indemnity provisions to directors must be kept at the company's registered office and made available free of charge upon request by a member of the company.

Loans to Directors and Similar Transactions

NCO references: s484 to 490, 491 to 515

- ▶ s500 NCO prohibits a HK company from making a loan to, or giving a guarantee or providing security in connection with a loan made by any person to:
 - its directors;
 - directors of its holding company (“**Holdco Directors**”); or
 - companies (whether incorporated in HK or not) controlled by the company’s directors or Holdco Directors
- ▶ The NCO is more stringent than the OCO in that the prohibitions under the OCO did not extend to non-HK incorporated companies controlled by the directors.

Loans to Directors and Similar Transactions (Cont'd)

Specified Companies

More stringent provisions apply to “specified companies” which are Hong Kong public companies and their subsidiaries (including private companies and companies limited by guarantee). Specified companies are additionally prohibited from:

- ▶ making quasi-loans to, and entering into credit transactions as creditors for, directors of the company or its holding company (or providing security for or guaranteeing such quasi-loans or credit transactions); and
- ▶ making loans or quasi-loans to, and entering into credit transactions as creditors for, certain categories of persons connected with directors of the company or its holding company (or providing security for or guaranteeing such quasi-loans or credit transactions).

Loans to Directors and Similar Transactions (Cont'd)

The prohibitions under the NCO are wider than under the OCO in that:

- ▶ Under the OCO, the prohibitions on quasi-loans and credit transactions only applied to private companies and companies limited by guarantee that are members of a listed group. Under the NCO, the prohibitions apply to subsidiaries of all Hong Kong public companies; and
- ▶ The NCO extends the categories of persons connected with company or Holdco directors which are covered by the prohibitions.

Loans to Directors and Similar Transactions (Cont'd)

Prohibition on Quasi-loans

Specified companies are prohibited from:

- ▶ making a quasi-loan to a director of the company or its holding company, or giving a guarantee or providing security in connection with a quasi-loan made by any person to such a director (ss.501(1) and (2)); or
- ▶ making a loan or quasi-loan to an entity connected with a director of the company or its holding company (a “connected entity”), or giving a guarantee or providing security in connection with a loan or quasi-loan made by any person to a connected entity (s.502(1) and (2)).

Loans to Directors and Similar Transactions (Cont'd)

A company makes a “quasi-loan” to a director or a connected entity if it:

- a) pays or agrees to pay a sum for the director or connected entity:
 - i. on terms that the director or connected entity (or another person on their behalf) will reimburse the company;
 - ii. in circumstances giving rise to a liability on the director or connected entity to reimburse the company; or
- b) reimburses or agrees to reimburse expenditure incurred by another person for the director or connected entity:
 - i. on terms that the director or connected entity (or another person on their behalf) will reimburse the company; or
 - ii. in circumstances giving rise to a liability on the director or connected entity to reimburse the company (section 493(1))

Loans to Directors and Similar Transactions (Cont'd)

“**Connected entity**” is defined in section 486 of the New CO as:

▶ a spouse	▶ a child, step-child, illegitimate child or adopted child of any age
▶ a parent	▶ a cohabitee
▶ a minor child, minor step-child, minor illegitimate child or minor adopted child of the cohabitee who lives with the director	▶ a trustee of a trust the beneficiaries of which include the director, his spouse, his minor children (other than employee share schemes or pension schemes)(“connected trustee”)
▶ an associated company, meaning a company in which the director and/or his spouse, minor children or connected trustee control more than 30% of the voting power of the company	▶ a business partner of the director or his spouse, minor children or connected trustee

Loans to Directors and Similar Transactions (Cont'd)

Prohibition on Credit transactions

Specified companies are prohibited by section 503 from:

- a) Entering into a credit transaction as creditor for:
 - i. A director of the company or its holding company; or
 - ii. A connected entity of a director of the company or its holding company; or
- b) Giving a guarantee or providing security in connection with a credit transaction entered into by the company as creditor for:
 - i. A director of the company or its holding company; or
 - ii. A connected entity of a director of the company or its holding company

“Credit transaction” is defined under section 494 of the New CO as:

- ▶ the supply of goods under a hire-purchase agreement;
- ▶ the sale of goods or land under a conditional sale agreement;
- ▶ the lease or hire of goods or lease of land to a director or his connected entity in return for periodical payments; and
- ▶ the supply of goods or services or disposal of land to a director or his connected entity on the understanding that payment is to be deferred.

Loans to Directors and Similar Transactions (Cont'd)

Prohibition on Arrangements seeking to circumvent sections 500 to 503 (s.504)

The New CO retains the previous prohibitions on a company seeking to circumvent the prohibitions under sections 500 to 503.

Section 504 prohibits a Hong Kong incorporated company from:

- a) taking part in any arrangement under which a third party enters into a transaction with a director of the company or its holding company, a company controlled by such a director or a connected entity of such a director which, if entered into by the company, would be prohibited under sections 500 to 503 (a “**questionable transaction**”) where the third party will obtain a benefit from the company or its associated company; or
- b) arranging for an assignment to it, or the assumption by it, of any rights, obligations or liabilities under a questionable transaction entered into by a third party with a director of the company or its holding company, a company controlled by such a director or a connected entity of such a director.

Loans to Directors and Similar Transactions (Cont'd)

Exemptions – Shareholder approval

The OCO exempted private companies which are not part of a listed group from the prohibition on loans provided that shareholder approval was obtained. The NCO has extended the exemption so that all companies, including public companies, are exempt from the prohibitions on loans, quasi-loans and credit transactions if **prior shareholder approval** is obtained in accordance with **section 496** of the NCO.

Arrangements and assignments in respect of questionable transactions are also exempt from the prohibitions under Section 504 if prior shareholder approval is obtained.

Loans to Directors and Similar Transactions (Cont'd)

Exemptions – Shareholder approval (Cont'd)

Section 496 requires that:

- a) the approval must be obtained before the transaction is entered into;
- b) a memorandum setting out the following matters must be sent to all shareholders together with the notice of general meeting, or if the resolution is to be passed as a written resolution, before or at the same time as the resolution is sent to them:
 - i. in the case of a loan or quasi-loan:
 - o the nature of the transaction to be approved by the resolution;
 - o the amount of the loan or quasi-loan;
 - o the purpose for which the loan or quasi-loan is required; and
 - o the extent of the company's liability under any transaction connected with the loan or quasi-loan;

Loans to Directors and Similar Transactions (Cont'd)

Exemptions – Shareholder approval (Cont'd)

- ii. in the case of a credit transaction:
 - the nature of the transaction to be approved by the resolution;
 - the amount and value of the credit transaction;
 - the purpose for which the goods, land or services supplied, sold, leased, hired or disposed of under the credit transaction are required; and
 - the extent of the company's liability under any transaction connected with credit transaction; and

- iii. in the case of a resolution for the purposes of section 504:
 - the matters that would have to be disclosed if the company were seeking approval of the transaction to which the arrangement relates;
 - the nature of the arrangement to be approved by the resolution; and
 - the extent of the company's liability under the arrangement.

Loans to Directors and Similar Transactions (Cont'd)

Exemptions – Shareholder approval (Cont'd)

- c) in the case of specified companies (i.e. public companies and their subsidiaries) disinterested shareholder approval is required.

The vote of the following members in favour of the transaction will be disregarded:

i.	the director of the company or its holding company to whom the loan or quasi-loan is made;c
ii.	a company controlled by a director of the company or its holding company to whom the loan or quasi-loan is made;
iii.	a person holding shares in the company on trust for a director or controlled company referred to in (i) or (ii) above;
iv.	a connected entity to whom the loan or quasi-loan is made;
v.	a director connected with a connected entity in (iv) above;
vi.	a person holding shares in the company on trust for a connected entity or director in (v) above;
vii.	the director or connected entity for whom a credit transaction is entered into;
viii.	the director connected with the connected entity in (vii) above

Loans to Directors and Similar Transactions (Cont'd)

Exemptions – Shareholder approval (Cont'd)

- c) in the case of specified companies (i.e. public companies and their subsidiaries) disinterested shareholder approval is required.

The vote of the following members in favour of the transaction will be disregarded:

ix.	a person holding shares in the company on trust for a connected entity or director in (vii) or (viii) above;
x.	a company controlled by, or a connected entity of, a director of the company or its holding company for whom the arrangement is entered into;
xi.	a director: <ul style="list-style-type: none">• who controls the controlled company or is connected with the connected entity referred to in (x) above; or• for whom the arrangement is entered into; and
xii.	a person holding shares in the company on trust for a controlled company in (x) above or a director in (xi) above

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions

Two **new** exemptions under ss505 - 512:

- i. transactions with a value below 5% of the net assets of the company or 5% of the called-up share capital; and
- ii. expenditure in connection with defending proceedings, investigations or regulatory actions for misconduct (provided the director repays the company if he is found guilty or to have committed the misconduct)

Exemptions are available for the following:

- a) **Loans, quasi-loans and credit transactions with a value not exceeding 5% of net assets or called-up share capital (s.505)(New)**

A loan, quasi-loan or credit transaction, or the provision of a guarantee or security for any of the foregoing is exempt if the aggregate of the value of the transaction in question, and the value of any other relevant transaction or arrangement, does not exceed 5% of the company's net assets or called-up share capital.

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions (Cont'd)

Exemptions are available for the following (Cont'd):

b) Expenditure on company business (s.506)

A transaction is exempt from the prohibitions under sections 500 to 503 if it is entered into for the purposes of providing the director, a company controlled by the director or a connected entity with funds to meet expenditure (or avoid expenditure) incurred for the purposes of the company or to enable the director, controlled company or connected entity to perform duties as an officer of the company.

c) Expenditure on defending proceedings (s.507)(New)

A transaction is exempt from the prohibitions under sections 500 to 503 if it provides a director with funds to meet expenditure incurred in defending any criminal or civil proceedings in connection with any alleged negligence, default, breach of duty or breach of trust by the director in relation to the company or an associated company of the company or to avoid incurring such expenditure.

The exemption applies subject to the condition that the funds must be repaid (or any liability to the company must be discharged) if the director is convicted or judgment is given against him.

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions (Cont'd)

Exemptions are available for the following (Cont'd):

d) Expenditure in connection with investigation or regulatory action (s.508)(New)

A transaction is exempt if it provides a director with funds to put up a defence in an investigation, or against any action taken or proposed to be taken, by a regulatory authority in connection with any alleged misconduct by the director in relation to the company or an associated company. The exemption is subject to the condition that the funds must be repaid (or any liability to the company must be discharged) if the director is found to have committed the misconduct.

e) Home loan (s.509)

A transaction is exempt if it is entered into for the purposes of:

- i. the purchase of any residential premises for use as the only or main residence of a director of the company; an employee of the company who is a holdco director or an employee of the company who is a connected entity of a company or holdco director;
- ii. improving any residential premises so used; or
- iii. substituting any transaction entered into by any other person for a purpose in (i) or (ii) above.

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions (Cont'd)

Exemptions are available for the following (Cont'd):

e) Home loan (s.509)

The following conditions apply:

- i. at the time the transaction is entered into, it must not exceed 10% of the value of the company's net assets as determined by reference to the company's relevant financial statements or, if no relevant financial statements have been prepared, 10% of the amount of the company's called-up share capital;
- ii. the company must ordinarily enter into transactions for the above purposes on terms no less favourable than those on which the transaction in question is entered into;
- iii. a valuation report on the residential premises must be made and signed by a professionally qualified valuation surveyor within 3 months before the date of the transaction; and
- iv. the transaction in question must be secured by a legal mortgage on the residential premises.

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions (Cont'd)

Exemptions are available for the following (Cont'd):

f) Leasing goods and land (s.510)

Leasing or hiring goods or leasing land to a director, a company controlled by a director or a connected entity of a director is exempt if:

- i. the transaction does not exceed 10% of the company's net assets as determined by reference to the company's relevant financial statements or, if no relevant financial statements have been prepared, 10% of the amount of the company's called-up share capital; and
- ii. the terms of the transaction are not more favourable than what is reasonable to expect the company to have offered on the open market to a person unconnected with the company.

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions (Cont'd)

Exemptions are available for the following (Cont'd):

g) Transaction entered into in ordinary course of business (s.511)

A loan or quasi-loan, or giving a guarantee or providing security for a loan or quasi-loan, is exempt if:

- i. it is made, given or provided by the company in the ordinary course of its business; and
- ii. its amount is not greater than, and its terms are not more favourable than, what it is reasonable to expect the company to have offered to a person of the same financial standing but unconnected with the company (s.511(1)).

A credit transaction loan, or giving a guarantee or providing security for a credit transaction, is exempt if:

- iii. it is entered into in the ordinary course of the company's business; and
- iv. its amount is not greater than, and its terms are not more favourable, than what it is reasonable to expect the company to have offered to a person of the same financial standing but unconnected with the company (s.511(2)).

Loans to Directors and Similar Transactions (Cont'd)

Other exemptions (Cont'd)

Exemptions are available for the following (Cont'd):

h) Intra-group transaction (s.512)

Transactions between members of a group of companies are exempt from the prohibitions under sections 500 to 503.

Loans to Directors and Similar Transactions (Cont'd)

Civil consequences of contravention (s.513)

Under the NCO, criminal sanctions no longer apply to breaches of the prohibitions in sections 500 to 504.

If a company enters into a transaction in contravention of these prohibitions, the transaction is voidable at the company's instance unless:

- a) restitution is no longer possible;
- b) the company has been indemnified for loss resulting from the transaction or arrangement;
- c) a third party (other than the director, his controlled body corporates or connected entities) has in good faith acquired rights for value and without actual notice of the contravention, and those rights would be affected by the avoidance; or
- d) the transaction is affirmed by the shareholders of the company and / or the holding company (as applicable) within a reasonable period after it is entered into in accordance with section 514 of the NCO

Loans to Directors and Similar Transactions (Cont'd)

Civil consequences of contravention (s.513)

Whether or not the transaction has been avoided, the following persons will be liable to account to the company for any gain made and to indemnify the company for any loss resulting from the transaction or arrangement:

- ▶ a director of the company, or of a holding company of the company, for whom the company entered into the transaction or arrangement;
- ▶ a body corporate controlled by such a director, or a connected entity of such a director, for whom the company entered into the transaction or arrangement;
- ▶ the director of the company who controls such a body corporate or with whom such an entity is connected;
- ▶ the director of a holding company of the company who controls such a body corporate or with whom such an entity is connected; and
- ▶ any other director of the company who authorised the transaction or arrangement.

Loans to Directors and Similar Transactions (Cont'd)

Defences

The NCO creates the following defences:

a) For a controlled body corporate or connected entity of a director

It is a defence if it establishes that, at the time the transaction or arrangement was entered into, it was not aware of the circumstances constituting the contravention (s513(4)(a)).

b) For the director of the company (and its holding company) who controls the body corporate or with whom the entity is connected

It is a defence if the director establishes that he took all reasonable steps to secure the company's compliance with the relevant provisions (s513(4)(b)).

c) For any other director of the company who authorised the transaction or arrangement

It is a defence if the director establishes that, at the time the transaction or arrangement was entered into, he was not aware of the circumstances constituting the contravention (s513(4)(c)).

Loans to Directors and Similar Transactions (Cont'd)

Summary table

Transaction	Private companies	Public companies and its subsidiaries
Loans to dirs of HK company or body corporates controlled by those dirs	Prohibited unless approved by shareholders, or other exemption applies.	Prohibited unless approved by disinterested shareholders, or other exemption applies.
Loans to holdco dirs or body corporates controlled by those holdco dirs	Prohibited unless approved by shareholders and holdco shareholders, or other exemption applies.	Prohibited unless approved by disinterested shareholders, and holdco's disinterested shareholders, or other exemption applies.
Loans to connected entities of directors	Not prohibited	Prohibited unless approved by disinterested shareholders, or other exemption applies.

Loans to Directors and Similar Transactions (Cont'd)

Summary table (Cont'd)

Transaction	Private companies	Public companies and its subsidiaries
Loans to connected entities of holdco directors	Not prohibited	Prohibited unless approved by disinterested shareholders and holdco's disinterested shareholders, or other exemption applies
Quasi-loans to directors		Prohibited unless approved by disinterested shareholders, or other exemption applies
Quasi-loans to holdco directors		Prohibited unless approved by disinterested shareholders and the holdco's disinterested shareholders, or other exemption applies

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Loans to Directors and Similar Transactions (Cont'd)

Summary table (Cont'd)

Transaction	Private companies	Public companies and its subsidiaries
Quasi-loans to connected entities of directors	Not prohibited	Prohibited unless approved by disinterested shareholders, or other exemption applies
Quasi-loans to connected entities of holdco directors		Prohibited unless approved by disinterested shareholders and holdco's disinterested shareholders, or other exemption applies

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Loans to Directors and Similar Transactions (Cont'd)

Summary table (Cont'd)

Transaction	Private companies	Public companies and its subsidiaries
Credit transactions for directors	Not prohibited	Prohibited unless approved by disinterested shareholders, or other exemption applies
Credit transactions for holdco directors		Prohibited unless approved by disinterested shareholders and holdco's disinterested shareholders, or other exemption applies

Loans to Directors and Similar Transactions (Cont'd)

Summary table (Cont'd)

Transaction	Private companies	Public companies and its subsidiaries
Credit transactions for connected entities of directors	Not prohibited	Prohibited unless approved by disinterested shareholders, or other exemption applies
Credit transactions for connected entities of holdco directors		Prohibited unless approved by disinterested shareholders and holdco's disinterested shareholders, or other exemption applies

- ▶ *Only holdco disinterested shareholder approval required if company is a wholly-owned subsidiary and holdco is a Hong Kong company*

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Liability and Indemnification of Directors (Cont'd)

Practical considerations and recommended steps:

- ▶ Companies should amend their existing policies and internal controls in respect of loans and similar transactions with directors to ensure that they cover the additional categories of entities.
- ▶ Some of the new changes are likely to facilitate business for Hong Kong companies, in particular the introduction of new exemptions, and the extension of the shareholder approval exemption to all companies.
- ▶ Where a company is seeking shareholder approval for a particular transaction, it must send shareholders a memorandum containing information on the nature of the transaction, the amount of the loan, quasi-loan or credit transaction, its purpose and the extent of the company's liability.

Directors' Service Contracts

NCO references: s530 to s535

- ▶ The NCO requires a company to obtain shareholder approval before entering into any contract under which the guaranteed term of employment of a director (including a shadow director) with the company exceeds or may exceed **three** years (whether under the original contract or under a new contract entered into pursuant to it).
- ▶ Where a company enters into a further service contract (not pursuant to a term of the original contract) more than 6 months before the end of the guaranteed term of a director's contract, the guaranteed term of employment under the further contract is taken to include the unexpired period of the guaranteed term under the original contract.

Directors' Service Contracts (Cont'd)

NCO references: s530 to s535

- ▶ If the company is a public company, approval of the company's disinterested shareholders is required. Accordingly, votes in favour of approving a relevant contract of the following categories of shareholders are to be disregarded:
 - a) the director with whom the service contract is proposed to be entered into; and
 - b) any person holding shares in the company on trust for that director.
- ▶ In order for the shareholders' approval to be valid:
 - a) it must be given before the company agrees to the relevant provision; and
 - b) a memorandum setting out the proposed service contract (including the provision in question) must be sent to shareholders with the notice convening the general meeting, or if the resolution is to be passed as a written resolution, either at or before the time at which the proposed resolution is sent to shareholders.

Directors' Service Contracts (Cont'd)

Consequences of breach (s.535)

If a service contract is entered into in breach of these requirements, the provision granting long-term employment will be void and the contract is regarded as containing a term entitling the company to terminate it at any time on reasonable notice. The restrictions also apply to service contracts which relate to services to be provided by a director to a company's subsidiary.

Payment for Loss of Office

NCO references: s516 to s529

- ▶ Section 521(1) of the NCO prohibits a HK company from making any payment by way of compensation for loss of office or as consideration for retirement from office to a director or former director of the company unless the payment has been approved by the company's shareholders in the manner prescribed in section 518.
- ▶ Section 521(2) of the NCO additionally prohibits a HK company from making any payment by way of compensation for loss of office or as consideration for retirement from office to a director or former director of its **holding company** unless the payment has been approved by the company's shareholders and the holding company's shareholders in the manner prescribed in section 518.
- ▶ However, if a company's holding company is incorporated outside HK, the payment need only be approved by the company's shareholders (s.521(3)(a)).

Payment for Loss of Office (Cont'd)

NCO references: s516 to s529

The NCO extends the prohibition on payments for loss of office to include:

- ▶ a payment to a connected entity (as defined in s486) of a director or former director; and
- ▶ a payment to a person made at the direction, or for the benefit, of a director or former director or a connected entity of such a director (s.516(3)); and
- ▶ payments made in connection with a transfer of the undertaking or property of the company or of its subsidiary (s.522); and
- ▶ payments made in connection with a transfer of shares in the company, or in a subsidiary of the company, resulting from a takeover offer (s.523).

Payment for Loss of Office (Cont'd)

NCO references: s516 to s529

Shareholder Approval

Where shareholder approval is to be obtained, it must be obtained before the payment for loss of office is made and a memorandum setting out particulars of the payment must be sent to shareholders either:

- a) together with the notice of general meeting at which the resolution will be passed; or
- b) if the resolution is to be passed as a written resolution, before or at the same time as the resolution is sent to shareholders.

Where the payment is made by a public company, disinterested shareholder approval is required

Payment for Loss of Office (Cont'd)

NCO references: s516 to s529

Exemption

The prohibitions are subject to the following exemptions:

a) Exemption for payments in discharge of a legal obligation

The following payments are exempt:

- i. payments in discharge of an existing legal obligation;
- ii. payments by way of damages for breach of an existing legal obligation;
- iii. payments by way of settlement or compromise of any claim arising in connection with the termination of a person's office or employment; and
- iv. payments by way of pension for past services; and

b) Exemption for small payment

Payments not exceeding \$100,000 when aggregated with all other payments for loss of office made by the company or a subsidiary to the director or former director in connection with the same event are exempt

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Payment for Loss of Office (Cont'd)

NCO references: s516 to s529

Consequences of Breach

- ▶ The recipient of a payment for loss of office that breaches section 521 will hold the relevant amount on trust for the company, and any director who authorised the payment will be liable to indemnify the company for any loss resulting from the payment.

Disclosure of Interests

NCO references: s536 to s542

Interests to be disclosed

The NCO, like the OCO, requires a director who has a material interest in a contract or proposed contract with the company that is of significance to the company's business, to disclose to the board of directors the nature of such interest at the earliest meeting of directors that is practicable.

The scope of disclosure under the NCO is widened to cover “**transactions**” and “**arrangements**” as well as “**contracts**”, and directors must disclose the “**extent**” as well as the “**nature**” of the interest (s536(1)).

Directors of public companies are additionally required to disclose material interests of their **connected entities** (but only if they are aware, or ought reasonably to be aware, of the interest or the relevant transaction, arrangement or contract). Section 540 of the NCO also extends the disclosure requirements to shadow directors and sets out the procedures for a shadow director to provide general notice of his interests.

Directors are not however required to declare their interest in the terms of their service contracts which are to be considered by the board. If a declaration proves subsequently to be, or becomes, inaccurate or incomplete, the director must make a further declaration.

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Disclosure of Interests (Cont'd)

Procedure for declaration of directors' interests

Timing

Where a director has an interest in a transaction, arrangement or contract that has already been entered into, his declaration of interest must be made as soon as reasonably practicable. A director's interest in a proposed transaction, arrangement or contract must be declared before the company enters into the relevant transaction, arrangement or contract.

Method

A declaration of interest must be made:

- a) at a directors' meeting;
- b) by notice in writing sent to the other directors; or
- c) by general notice

Where a declaration of interest is to be made by notice in writing to the directors:

- a) it must be sent:
 - i. in hard copy form by hand or post; or
 - ii. in electronic form if the recipient has agreed to receive it by electronic means; and
- b) the making of the declaration will be regarded as forming part of the proceedings at the next directors' meeting after the notice is given.

Disclosure of Interests (Cont'd)

Procedure for declaration of directors' interests

A general notice is a notice to the effect that the director:

- a) has an interest in a body corporate or firm specified in the notice and is to be regarded as interested in any transaction, arrangement or contract that is entered into with that body corporate or firm; or
- b) is connected with an individual specified in the notice and is to be regarded as interested in any transaction, arrangement or contract that is entered into with that individual.

A general notice must state:

- a) the nature and extent of the director's interest in the specified body corporate or firm; or
- b) the nature of the director's connection with the specified individual

A general notice given at a directors' meeting takes effect on the date of the meeting. A general notice may also be given in writing sent to the company in which case it will take effect 21 days after it is sent to the company. The company must send a copy of a director's written general notice to the other directors of the company within 15 days after it receives the notice (s.541).

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Disclosure of Interests (Cont'd)

Consequences of contravention

A director or shadow director who fails to disclose a material interest commits an offence and may be liable to a fine of \$100,000.

Practical considerations and recommended steps:

- ▶ Directors and shadow directors should be made aware of the new disclosure requirements.
- ▶ In many cases, directors disclose their interests in particular businesses by way of general notice (to avoid the need for repeated declarations).
- ▶ Directors should consider updating any general disclosures in order to ensure that their disclosures comply with the wider disclosure obligations under the NCO.

Restricting Corporate Directorships in Private Companies

NCO references: s456 to s457

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Public companies and private companies within the same group as a listed company were prohibited from appointing a body corporate as their director.▶ However, the prohibition did not apply to other private companies.	<ul style="list-style-type: none">▶ The prohibition in relation to listed companies is retained.▶ Other private companies (except those within the same group as a listed company) are now required to have at least 1 director who is a natural person.

Restricting Corporate Directorships in Private Companies (Cont'd)

Practical considerations and recommended steps:

- ▶ Hong Kong private companies that are engaging corporate secretarial service providers to provide nominee corporate directors need to ensure that at least one natural person is appointed as a director.

Part 2 – Changes concerning share capital, transactions involving share capital and registration of share transfers



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Abolition of Par Value of Shares

NCO references: s135 & 170; part 4, division 2 of Sch 11

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Hong Kong companies having a share capital were required to have a par value ascribed to their shares.▶ Generally, par value was the minimum price at which shares could be issued.	<ul style="list-style-type: none">▶ The NCO adopts a mandatory system of no-par for all Hong Kong companies with a share capital and abolishes the concept of par (or nominal) value of shares.▶ This applies to all shares, including shares issued before 3 March 2014.▶ Concepts such as par value, share premium and the requirement for authorised capital have been abolished.▶ The amount of authorised capital set out in an existing company's constitutional documents is deemed to be deleted.

Abolition of Par Value of Shares (Cont'd)

NCO references: s135 & 170; part 4, division 2 of Sch 11

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Hong Kong companies having a share capital are required to have a par value ascribed to their shares.▶ Generally, par value is the minimum price at which shares can be issued.	<p>Transitional arrangements and deeming provisions (Sch 11):</p> <ul style="list-style-type: none">▶ For contracts, resolutions, trust deeds and other documents executed before the commencement date of the NCO, any express or implied reference to par or nominal value will be deemed to be a reference to nominal value immediately before the commencement date of the NCO.

Abolition of Par Value of Shares (Cont'd)

NCO references: s135 & 170; part 4, division 2 of Sch 11

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Hong Kong companies having a share capital were required to have a par value ascribed to their shares.▶ Generally, par value was the minimum price at which shares can be issued.	<p>Transitional arrangements and deeming provisions (Sch 11) (Cont'd):</p> <ul style="list-style-type: none">▶ From the commencement date, any amount in the share premium account and any amount in the capital redemption reserve will become part of the company's share capital.▶ The previously permitted uses of share premium will be preserved for any such amounts in the share premium account immediately before the commencement date.

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Abolition of Par Value of Shares (Cont'd)

NCO references: s135 & 170; part 4, division 2 of Sch 11

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Hong Kong companies having a share capital were required to have a par value ascribed to their shares.▶ Generally, par value was the minimum price at which shares can be issued.	<p>Transitional arrangements and deeming provisions (Sch 11) (Cont'd):</p> <ul style="list-style-type: none">▶ The liability of a shareholder for calls on partly paid shares issued before the commencement date (whether the amounts due are in respect of nominal value or premium) will not be affected.

Abolition of Par Value of Shares (Cont'd)

Practical considerations and recommended steps:

- ▶ The migration to no-par should benefit companies by giving them greater flexibility in structuring their share capital.
- ▶ The nature of a share is the same whether or not it has a par value, in that a share still represents a fraction of ownership in a company.
- ▶ The concepts of paid up capital, issued capital and partly paid shares are still relevant.

Alteration of Share Capital

NCO references: s170

- ▶ A Company must submit notice of any alteration of share capital to the Registrar of Companies in Hong Kong within one month (s171).
- ▶ The notice must include a statement of capital setting out the number of shares in issue, the amount of the share capital and the amount of the increase in the company's issued share capital (if any).
- ▶ If the company alters its share capital by allotting new shares, it is not required to file notice of alteration of capital under s171 but must file a return of allotment to the Registrar under section 142.
- ▶ A company can alter its share capital (other than by redemption or repurchase of shares) by:
 - Issuing new shares,
 - Capitalising profits,
 - Issuing bonus shares;
 - Effecting a share split; and
 - Effecting a share consolidation

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Alteration of Share Capital (Cont'd)

NCO references: s170

Issuing new shares for consideration

- ▶ If a company issues new shares for consideration, then the full proceeds will be credited to the share capital account.

Changes after the NCO

- ▶ There is now no minimum price at which shares must be issued, or any statutory control over the issue price of shares.
- ▶ Directors still have an overriding fiduciary duty to set the price in good faith.
- ▶ It may also be necessary to obtain shareholders' approval before issuing new shares, if the shares are not allotted on a pro rata basis.

Maximum number of shares that may be issued

- ▶ As the concept of authorised share capital has been abolished, there is no limit on the number of shares that the directors can issue.
- ▶ Shareholders can amend the articles by way of special resolution to specify a maximum number of shares that may be issued.
- ▶ The maximum number of shares can be changed by way of ordinary resolution

Alteration of Share Capital (Cont'd)

NCO references: s170

Issuing bonus shares

- ▶ When a company issues bonus shares under the “no-par” regime, the company is no longer required to transfer an amount to share capital if it issues shares for no consideration.
- ▶ It can elect to transfer an amount to share capital by capitalising profits.
- ▶ Therefore, a company may allot and issue bonus shares either with or without increasing its share capital.
- ▶ Shareholder approval would not be required for a bonus issue provided that the issue is on a pro rata basis.

Consolidation and subdivision of shares

- ▶ Companies continue to be able to consolidate and subdivide shares.
- ▶ It can be effected by increasing or reducing the number of shares with no visible effect on the share capital.

Alteration of Share Capital (Cont'd)

Practical considerations and recommended steps

Amendments to constitutional documents and contracts

- ▶ Companies may wish to review their particular situation to determine if they need to introduce specific changes to company documents.
- ▶ While the transitional arrangements provide legal safeguards in respect of contracts that reference par value (and related concepts) under HK law, they may not necessarily be applied by courts outside Hong Kong, especially for contracts governed by non-HK law.
- ▶ Such contracts may need to be reviewed to determine whether clarifying amendments should be requested.
- ▶ An example would be a preferential dividend or liquidation preference payable to a holder of preferred shares up to the amount of **the nominal value** of each share.

Shareholder Consent for Grants of Options and Other Equity Linked Securities

NCO references: s140 and 141

Requirement for shareholder approval

Sections 140 and 141 of the NCO provide that directors may only allot new shares or grant rights to subscribe for, or to convert any securities into, shares with prior approval of the company in general meeting.

This is more prohibitive than the OCO which only required shareholders' approval for allotments of new shares. The OCO did not require shareholders' approval for the grant of an option to subscribe for shares or a right to convert any securities into shares. Only the subsequent exercise of the option or the right of conversion that would result in an allotment required shareholders' approval.

Shareholders' approval is not however required for :

- a) allotments of shares or grants of rights under a pro rata offer to shareholders;
- b) allotments of shares, or grants of rights on a pro rata bonus issue of shares;
- c) allotments to a founder member of a company of shares that the member, by signing the company's articles, has agreed to take; and
- d) an allotment of shares made in accordance with a grant of a right to subscribe for, or to convert any security into, shares.

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Shareholder Consent for Grants of Options and Other Equity Linked Securities (Cont'd)

NCO references: s140 and 141

Approval may be given for a particular exercise of the power or for its exercise generally, and may be unconditional or subject to conditions. An approval may also be revoked or varied at any time by ordinary resolution of the company. An approval expires:

- a) if the company is required to hold an annual general meeting (**AGM**) on the earlier of:
 - i. the conclusion of the next AGM held after the approval is given; or
 - ii. the expiry of the period within which the next AGM after the approval is given is required to be held;
- b) if the company is not required to hold an AGM because of section 612(1), on the date on which the requirements of that section are satisfied; or
- c) if the company is not required to hold an AGM for any other reason, on the date specified in the approval which must not be more than 12 months after the approval.

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Shareholder Consent for Grants of Options and Other Equity Linked Securities (Cont'd)

NCO references: s140 and 141

Consequences of Contravention

A director who knowingly contravenes, or authorises or permits a contravention of section 140 commits an offence and is liable to a fine of \$50,000 and up to 6 months' imprisonment. The contravention will not however affect the validity of an allotment or grant of rights.

Return of allotment (s.142)

A limited company must file a return of allotment with the Registrar within one month after an allotment of shares setting out the information required under section 142(2).

Shareholder Consent for Grants of Options and Other Equity Linked Securities (Cont'd)

Practical considerations and recommended steps:

- ▶ It will be useful for both companies and rights holders to deal upfront with shareholder approval for the granting of rights, rather than dealing with the issue subsequently when the rights are exercised, at a time when the shareholding structure may have changed and / or shareholder approval may not be forthcoming.

Uniform Solvency Test For Share Capital Transactions

NCO references: s204 to 206

The NCO establishes a uniform solvency test for share buy-backs, financial assistance and reductions of capital. Under section 205 of the NCO, a company satisfies the solvency test in relation to a particular transaction if:

- ▶ immediately after the transaction there will be no ground on which the company could be found to be unable to pay its debts; and
- ▶ either:
 - if it is intended to commence the winding up of the company within 12 months after the date of the transaction, the company will be able to pay its debts in full within 12 months after the commencement of the winding up; or
 - in any other case, the company will be able to pay its debts as they become due during the period of 12 months immediately following the date of the transaction.

Uniform Solvency Test For Share Capital Transactions

(Cont'd)

NCO references: s204 to 206

- ▶ Section 206 further requires the directors of a company to make a “solvency statement” to the effect that the directors have formed the opinion that the company satisfies the solvency test in relation to a particular transaction.
- ▶ In forming his or her opinion, a director must inquire into the company’s state of affairs and prospects and take into account all liabilities (including contingent and prospective liabilities) of the company.
- ▶ A solvency statement must be in the specified form unless it relates to the giving of financial assistance. It must be made and signed by all directors for buy-backs and reductions of capital, and made and signed by the directors who vote in favour of giving the financial assistance.
- ▶ Under the NCO, there is no longer any requirement to attach an auditors’ report to the solvency statement.

Financial Assistance

NCO references: s274 to 289

The Prohibition (s.275)

The NCO, like the OCO, prohibits a company and its subsidiaries from giving financial assistance directly or indirectly to any person for the purpose of acquiring shares in the company, subject to certain exceptions. The prohibition extends both to financial assistance given before or at the same time as the acquisition takes place, and to financial assistance given to reduce or discharge the liability incurred by any person to finance an acquisition which has already occurred.

Non-Hong Kong holding companies

Section 275(3) of the NCO clarifies that a company is not prohibited from giving financial assistance for the purpose of an acquisition of shares in its holding company, if the holding company is incorporated outside Hong Kong.

However, there is no clarification that the giving of financial assistance by a non-Hong Kong subsidiary for the purpose of an acquisition of shares in its Hong Kong holding company is not prohibited. As the definition of “subsidiary” in the NCO is not limited to companies formed and registered under the NCO (referring instead to “body corporates”), the prudent view would be that non-Hong Kong subsidiaries are caught by the prohibition.

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Financial Assistance (Cont'd)

Definition of financial assistance(s.274(1))

The definition of “financial assistance” in the New CO is broadly unchanged. “Financial assistance” can be by way of:

- a) Gift;
- b) Guarantee, security or indemnity;
- c) Release or waiver;
- d) Loan or any other similar agreements;
- e) The novation of, or the assignment of rights arising under, a loan or other similar agreements;
- f) Any other financial assistance given by a company if;
 - i. The net assets of the company are reduced to a material extent by the giving of the assistance; or
 - ii. The company has no net assets

Financial Assistance (Cont'd)

Exceptions to the prohibition

The NCO substantially retains the exceptions to the prohibition as in the OCO.

a) General exceptions (s.277)

The NCO does not prohibit any of the following transactions:

- i. Distribution of a company's assets by way of dividend or in the course of winding up;
- ii. Allotment of bonus shares;
- iii. Reduction of a company's share capital;
- iv. Redemption or buy-back of a company's own shares;
- v. Anything done pursuant to a court order for reorganisation of a company's share capital (Division 2 of Part 13 of the NCO);
- vi. Anything done under an arrangement under section 237 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (power of liquidator to accept shares, etc. as consideration for sale of property of a company on winding up; and
- vii. Anything done under an arrangement made between a company and its creditors that is binding on the creditors by virtue of section 254 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

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Financial Assistance (Cont'd)

Exceptions to the prohibition

The NCO substantially retains the exceptions to the prohibition as in the OCO.

b) Principal purpose exception (s.278)

A company is not prohibited from giving financial assistance for the purpose of the acquisition of a share in the company or its holding company or for the purpose of reducing or discharging a liability incurred for such an acquisition if:

i. Either:

- o the principal purpose in giving the assistance is not the acquisition of a share in the company or its holding company or reducing or discharging a liability incurred for such an acquisition; or
- o the giving of the assistance is only an incidental part of some larger purpose of the company; and

ii. the assistance is given in good faith in the interests of the company.

c) Exception for money lending businesses (s.279)

If the lending of money is part of the ordinary business of the company, it is not prohibited from lending money in the ordinary course of such business.

For listed companies, the exception only applies if the company has net assets that are not reduced by the giving of the financial assistance or, to the extent that the assets are reduced, the assistance is provided by a payment out of distributable profits (s.282).

Financial Assistance (Cont'd)

Exceptions to the prohibition

d) Exception for employee share schemes (s.280)

The exception applies to the company giving financial assistance:

- i. in good faith in the interests of the company for the purposes of an employee share scheme. Employee share scheme is defined as a scheme for encouraging or facilitating the holding of shares in a company by or for the benefit of employees and former employees of the company or another company in the same group of companies or the spouses, widows, widowers and minor children of such employees: or
- ii. for the purposes of enabling or facilitating the acquisition of beneficial ownership of shares in the company or its holding company by employees and former employees of the company or another company in the same group of companies or the spouses, widows, widowers and minor children of such employees.

Financial Assistance (Cont'd)

Exceptions to the prohibition

d) Exception for employee share schemes (s.280)

The NCO has relaxed the rules on giving financial assistance for the purposes of employee share schemes. While the OCO only allowed financial assistance for the purchase or subscription of fully paid shares, section 280 of the NCO allows financial assistance for all types of employee share schemes if the assistance is given in good faith in the interests of the company for the purposes of an employee share scheme.

For listed companies, the exception only applies where the company has net assets that are not reduced by the giving of the financial assistance or, to the extent that the assets are reduced, the assistance is provided by a payment out of distributable profits.

Financial Assistance (Cont'd)

Exceptions to the prohibition

d) Exception for loans to employees (s.281)

Companies are not prohibited from making of loans to their “eligible employees” for the purpose of enabling them to acquire fully paid shares in the company or its holding company. Eligible employees do not include:

- i. a director of the company;
- ii. a director’s spouse;
- iii. a director’s minor child’
- iv. a trustee of a trust (other than an employee share scheme):
 - o the beneficiaries of which include a person referred to in (i) to (iii) above; or
 - o the terms of which may be exercised for the benefit of a person referred to in (i) to (iii) above; or
- v. a partner of a person referred to in (i) to (iii) above or of a trustee referred to in (iv) above.

For listed companies, the exception only applies where the company has net assets that are not reduced by the giving of the financial assistance or, to the extent that the assets are reduced, the assistance is provided by a payment out of distributable profits.

Financial Assistance (Cont'd)

New authorisation procedures for financial assistance (s.283 to 285)

- ▶ The main change in relation to financial assistance under the NCO is to allow all types of companies (listed or unlisted) to provide financial assistance for the acquisition of shares in the company or its holding company or to reduce or discharge a liability incurred for such acquisition, subject to satisfaction of the solvency test and one of three authorisation procedures.
- ▶ These replace the complicated whitewash exemption under the OCO.
- ▶ Each of the three authorisation procedures requires:
 - i. a prior board resolution to the effect that:
 - the company should give the assistance;
 - giving the assistance is in the company's best interests; and
 - the terms and conditions of the assistance are fair and reasonable to the company.

The board resolution must set out in full the board's conclusions on the above matters.

Financial Assistance (Cont'd)

- ▶ Each of the three authorisation procedures requires (Cont'd) :
 - ii. A solvency statement made on the same day as the board resolution and not more than **12 months** before the giving of the assistance. For financial assistance, there is no specified form which must be used (s.206(4)). The solvency statement need only be signed by the directors who vote in favour of giving the financial assistance.

Financial Assistance (Cont'd)

The new authorisation procedures allow:

- ▶ financial assistance which together with all other financial assistance previously given and not repaid, is less than 5% of the paid up share capital and reserves of the company (s.283);
- ▶ financial assistance approved by prior written resolution of all members of the company (s.284); and
- ▶ financial assistance approved by an ordinary resolution of shareholders. The following additional requirements apply if approval is by ordinary resolution:
 - i. at least 14 days before the date of the proposed resolution, the company must send shareholders:
 - a copy of the solvency statement; and
 - a notice setting out:
 - the nature and terms of the assistance and the name of the person to whom it will be given;
 - if it will be given to a nominee for another person, the name of the other person;
 - the text of the board resolution; and
 - any further information necessary to explain the nature of the assistance and the implications of giving it for the company and the shareholders; and
 - ii. the assistance must not be given less than 28 days after the date of the ordinary resolution.

Financial Assistance (Cont'd)

Where financial assistance is approved by ordinary resolution, shareholders holding at least 5% of the total voting rights or, in the case of a company which is not limited by shares, members representing at least 5% of the total members of the company, may apply to the Court for an order restraining the giving of financial assistance (s.286).

The application for a restraining order must be made within 28 days of the shareholders' resolution approving the financial assistance and may only be made on the ground that:

- i. the giving of the assistance is neither in the best interests of the company nor of benefit to those shareholders of the company not receiving the assistance; or
- ii. the terms and conditions under which the assistance is to be given are not fair and reasonable to the company and those members not receiving the assistance.

A shareholder who voted in favour of the financial assistance cannot apply for a restraining order.

Financial Assistance (Cont'd)

Consequence of breach of the prohibition on financial assistance

Where financial assistance is given in contravention of the NCO, the financial assistance and contracts connected to that financial assistance remain valid (s276).

Contravention of the prohibition on financial assistance is an offence for which the company and every responsible person of the company are each liable to a fine of HK\$150,000 and to imprisonment for a maximum period of 12 months.

Financial Assistance (Cont'd)

Practical considerations and recommended steps:

- ▶ NCO facilitates transactions involving financial assistance by abolishing the previous complicated whitewash exemption procedure and replacing it with a choice of three approval mechanisms that can be used by both listed and non-listed companies.
- ▶ Directors do not need to obtain an auditors' report or rely on audited accounts when making a solvency statement to support financial assistance in a particular case.
- ▶ However, directors are still expected to have reasonable grounds in forming their opinion as to the company's solvency.
- ▶ Therefore, directors must make due enquiries as to the company's state of affairs and prospects before signing the solvency statement.
- ▶ In some cases, directors may decide that professional assistance (for example, from auditors or financial advisers) is needed.

Financial Assistance (Cont'd)

Practical considerations and recommended steps (Cont'd):

- ▶ However, the additional expenses and delays in engaging third party advisers may not be appropriate in all cases.
- ▶ Third party advisers may not be in a better position than the directors in ascertaining the company's solvency, which involves forward-looking business judgments.
- ▶ In the resolutions approving the financial assistance, the board should clearly set out its bases for forming the opinion that the company satisfies the solvency test in relation to the particular transaction.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test

NCO references: s215 to 225

Position under the OCO

A reduction of share capital was allowed only if:

- ▶ it was approved by way of shareholders' special resolution; and
- ▶ a court approved the reduction (although court approval was not required if the sole purpose of the reduction was to re-designate the nominal value of shares to a lower amount).

Court-free procedure for capital reductions under the NCO

While retaining a court-sanctioned procedure for capital reductions, the NCO introduces an alternative court-free procedure based on a solvency test.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Court-free procedure for capital reductions: Requirements

Solvency statement

All the directors need to sign the solvency statement in support of the proposed reduction.

Shareholders' special resolution

The company needs to obtain shareholders' approval by way of special resolution (75%) within 15 days after the date of the solvency statement.

If the resolution is to be passed as a written special resolution, any shareholder holding shares to which the resolution relates is not eligible to sign the special resolution. If the special resolution is proposed at a meeting, the resolution will not be effective if a shareholder holding shares to which the resolution relates exercises the voting rights carried by those shares and the resolution would not otherwise have been passed.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Court-free procedure for capital reductions: Requirements (Cont'd)

Public notice of reduction of share capital (s.218)

If a special resolution for reduction of share capital is passed, the company must:

- a) publish a notice in the Gazette:
 - i. stating that the company has approved a reduction of share capital;
 - ii. specifying the amount of share capital to be reduced and the date of the special resolution;
 - iii. stating where the special resolution and solvency statement are available for inspection; and
 - iv. stating that a shareholder who did not vote in favour of the special resolution or a creditor of the company may apply to the Court under section 220 within 5 weeks after the date of the special resolution for its cancellation.

The notice must be published no later than the last working day of the week following the passing of the special resolution (or, if that is less than 4 clear business days after the date of the special resolution, no later than the last working day of the week after that);

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Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Court-free procedure for capital reductions: Requirements (Cont'd)

Public notice of reduction of share capital (s.218)

If a special resolution for reduction of share capital is passed, the company must:

- b) before the end of the week following the passing of the special resolution:
 - publish a notice to the same effect as the notice under paragraph (a) above in at least one specified English newspaper and one specified Chinese newspaper; or
 - give written notice to that effect to each of the company's creditors.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Court-free procedure for capital reductions: Requirements (Cont'd)

Registration and inspection of solvency statement

The company must deliver a copy of the solvency statement to the Registrar no later than the day on which the company publishes notice in the Gazette, or if earlier, the day on which it publishes notice in specified newspapers or gives notice to the company's creditors.

It must also ensure that the special resolution and the solvency statement are available for inspection by any shareholder or creditor at its registered office or any place prescribed by regulations made under section 657:

- ▶ from the date of publication of notice in the Gazette or, if earlier, the date of publication of notice in specified newspapers or the date on which written notice was given to the company's creditors
- ▶ until 5 weeks after the date of the special resolution.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Court-free procedure for capital reductions: Requirements (Cont'd)

Power of Court to confirm or cancel special resolution

Any creditor or non-approving shareholder may, within five weeks after the special resolution is passed, apply to the court for cancellation of the resolution under section 220. If an application is made, the applicant must serve the application on the company and give notice of the application to the Registrar within 7 days of serving the application on the company.

The Court must make an order either confirming or cancelling the special resolution.

The Court order may also:

- a) provide for the company to buy back the shares of any of its members and for the reduction accordingly of the company's share capital;
- b) provide for the protection of the interests of shareholders or creditors of the company;
- c) make any alteration to the company's articles that may be required as a consequence;
- d) require the company not to alter its articles.

The company must deliver a copy of the Court order to the Registrar within 15 days.

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Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Court-free procedure for capital reductions: Requirements (Cont'd)

Registration of return of reduction of share capital

If no application to Court is made for cancellation of the special resolution, the company must deliver a return setting out particulars of the reduction of share capital and the share capital of the company to the Registrar no earlier than 5 weeks and no later than 7 weeks after the date of the special resolution.

If application to Court is made and the Court confirms the special resolution or the proceedings terminate without determination by the Court, the company must deliver the return to the Registrar within 15 days after the making of the Court order or after termination of the proceedings.

The special resolution and the reduction of share capital take effect when the return is registered by the Registrar.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

NCO references: s215 to 225

Position under the OCO	Position under the NCO
<p><u>Treatment of reserves</u></p> <ul style="list-style-type: none">▶ It was unclear under the OCO whether reserves created arising from a reduction of share capital could be regarded as distributable reserves.	<p><u>Treatment of reserves</u></p> <ul style="list-style-type: none">▶ s214 of the NCO clarifies that reserves arising from a reduction of share capital may be regarded as realised profits.

Alternative Court-free Procedure for Reduction of Capital based on Solvency Test (Cont'd)

Practical considerations and recommended steps:

- ▶ The directors are expected to have reasonable grounds in forming their opinion as to the company's solvency.
- ▶ Therefore, directors must make due enquiries as to the company's state of affairs and prospects before signing the solvency statement.
- ▶ In some cases, directors may decide that professional assistance (for example, from auditors or financial advisers) is needed.

Allowing All Companies to Buy Back Shares out of Capital, subject to Solvency Test

NCO references: s257 to 266

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A company could generally only buy back its shares using distributable profits or using the proceeds of a fresh issue of shares.▶ There was an exception for private companies, which could fund a buy-back by payment out of capital based on a solvency test.	<ul style="list-style-type: none">▶ All HK companies are allowed to fund buy-backs out of capital, subject to a solvency requirement.▶ Listed Hong Kong companies are however prohibited from funding an on-market share buy back out of capital (s. 257(3)).▶ Most of the OCO requirements and procedures applicable to buy-backs out of capital are retained and extended to all companies.

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Allowing All Companies to Buy Back Shares out of Capital, subject to Solvency Test (Cont'd)

NCO references: s257 to 266

The requirements and procedures are similar to the new court-free procedure for reduction of capital as set out above and include the following key features:

a) Solvency statement

All the directors need to sign a solvency statement in support of the proposed payment out of capital (s.259).

b) Special resolution of shareholders

The company needs to obtain shareholders' approval by a special resolution passed within 15 days after the date of the solvency statement.

If the resolution is to be passed as a written special resolution, any shareholder holding shares to which the resolution relates is not eligible to sign the special resolution. If the special resolution is proposed at a meeting, the resolution will not be effective if a shareholder holding shares to which the resolution relates exercises the voting rights carried by those shares and the resolution would not otherwise have been passed.

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Allowing All Companies to Buy Back Shares out of Capital, subject to Solvency Test (Cont'd)

NCO references: s257 to 266

The requirements and procedures are similar to the new court-free procedure for reduction of capital as set out above and include the following key features:

c) Publication of notices

The company must publish notices in the Gazette and in a specified English and Chinese newspaper and must register the solvency statement with the Registrar.

d) Application to Court to cancel special resolution

Any creditor or non-approving shareholder may, within five weeks after the special resolution is passed, apply to the court for cancellation of the resolution.

e) Time Limit

The payment out of capital and the buy-back must be made no earlier than five weeks and no later than seven weeks after the special resolution is passed (subject to any court application by a creditor or dissenting shareholder).

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Allowing All Companies to Buy Back Shares out of Capital, subject to Solvency Test (Cont'd)

Practical considerations and recommended steps:

- ▶ The NCO removes the requirement for an auditors' report to be prepared when funding a buy-back out of capital.
- ▶ However, the directors are still expected to have reasonable grounds in forming their opinion as to the company's solvency.
- ▶ Therefore, directors must make due enquiries as to the company's state of affairs and prospects before signing the solvency statement.
- ▶ In some cases, directors may decide that professional assistance (for example, from auditors or financial advisers) is needed.

Refusal to Register Transfers of Shares or Debentures

NCO references: s151(3) and (4)

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A company which refused to register transfer of shares or debentures was required to send a notice of such refusal to the transferor and transferee within 2 months after the transfer was lodged with the company.▶ There was no requirement for the notice to be accompanied by the reasons for the refusal.	<ul style="list-style-type: none">▶ Companies are required to give reasons explaining their refusal to register a transfer of shares upon request and within 28 days after receiving the request.

Refusal to Register Transfers of Shares or Debentures

(Cont'd)

Practical considerations and recommended steps:

- ▶ The NCO (s152) retains the provisions of the OCO that allow a transferee, where a company refuses to register a transfer of shares, to apply to the court to have the transfer registered by the company.
- ▶ A court may, if it is satisfied that the application is well founded, disallow the refusal and order that the transfer be registered forthwith by the company.
- ▶ However, courts have been reluctant to intervene in the exercise of directors' discretion without clear evidence of bad faith or an improper motive.
- ▶ The requirement to provide reasons for refusing to register a share transfer under the NCO will enhance transparency and help to ensure that directors only exercise their powers for proper purposes.

Refusal to Register Transfers of Shares or Debentures

(Cont'd)

Practical considerations and recommended steps (Cont'd):

- ▶ One area where a refusal to register a transfer of shares may be a significant issue is in the case of an equitable charge over shares, where the charged shares are not registered in the name of the security holder.
- ▶ Following enforcement, the board may refuse to register the transfer of shares into the name of the security holder or a third party purchaser.
- ▶ In such case, the requirement to explain the refusal under the NCO may assist the security holder (if it can be shown the refusal is motivated by bad faith).
- ▶ As an extra precaution, the security holder may insist at the outset that the articles of association are amended so as to remove the directors' discretion to refuse to register a transfer of shares following enforcement of the charge.

Part 3 – Company administration, procedure and operations



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Annual General Meeting (AGM)

NCO references: s430(3), 609 to 614

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Every company was required to hold an AGM in each year, with not more than 15 months between the date of one AGM and the next.▶ There were no rules on shorter accounting periods.▶ There was no provision to regulate the first accounting period, except that the first AGM has to be held within 18 months of incorporation.	<p><u>Time for holding AGM</u></p> <ul style="list-style-type: none">▶ Unless exempted, companies are required to hold an AGM:<ul style="list-style-type: none">○ Within 6 months (for public companies); or○ Within 9 months (for private companies or companies limited by guarantee) <p>after the end of their accounting reference period.</p>

Annual General Meeting (AGM) (Cont'd)

NCO references: s430(3), 609 to 614

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A company can dispense with holding AGMs if:<ul style="list-style-type: none">○ everything that is required or intended to be done at the meeting is done by written resolutions, and○ a copy of each of the documents (including any accounts or records) which would be required to be laid before the meeting is provided to each member of the company.	<p><u>Resolution to dispense with requirement to hold AGM</u></p> <ul style="list-style-type: none">▶ A company is allowed to dispense with the requirement for holding of AGMs by passing a written resolution or a resolution at a general meeting by all members (<i>s613 NCO</i>).▶ After passing the resolution, the company will not be required to hold any AGMs for the financial year or for subsequent financial years to which the resolution relates.▶ The financial statements and reports originally required to be laid before an AGM still need to be sent to the members (<i>s430(3) NCO</i>).

Annual General Meeting (AGM) (Cont'd)

NCO references: s430(3), 609 to 614

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A company can dispense with holding AGMs if:<ul style="list-style-type: none">○ everything that is required or intended to be done at the meeting is done by written resolutions, and○ a copy of each of the documents (including any accounts or records) which would be required to be laid before the meeting is provided to each member of the company.	<p><u>Resolution to dispense with requirement to hold AGM (Cont'd)</u></p> <ul style="list-style-type: none">▶ Any member may request the company to convene an AGM for a particular year (s613(5) NCO).▶ Such notice must be given no later than 3 months prior to the last day that the company would otherwise be required to hold an AGM for the relevant financial year.▶ The company may also revoke the resolution dispensing with AGMs by passing an ordinary resolution to that effect.

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Annual General Meeting (AGM) (Cont'd)

NCO references: s430(3), 609 to 614

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A company can dispense with holding AGMs if:<ul style="list-style-type: none">○ everything that is required or intended to be done at the meeting is done by written resolutions, and○ a copy of each of the documents (including any accounts or records) which would be required to be laid before the meeting is provided to each member of the company.	<p><u>Single member companies</u></p> <ul style="list-style-type: none">▶ Single member companies are not required to hold AGMs (<i>s612(2)(a) NCO</i>).▶ A single member company is still required to send financial statements and reports to its member under (<i>s430(3) NCO</i>). <p><u>Written resolution procedure</u></p> <ul style="list-style-type: none">▶ The written resolution procedure is retained for any company (including a public company or a company limited by guarantee) wishing to dispense with an AGM on a specific occasion by a written resolution (<i>s612(1) NCO</i>).

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Annual General Meeting (AGM) (Cont'd)

NCO references: s430(3), 609 to 614

Position under the OCO	Position under the NCO
<p><u>Dormant companies</u></p> <ul style="list-style-type: none">▶ Dormant companies were exempt from the requirement to hold AGMs.▶ Dormant companies were also exempt from the requirements to prepare financial statements and reports.	<p><u>Dormant companies</u></p> <ul style="list-style-type: none">▶ The exemptions are retained in the NCO.

Annual Return

NCO references: s662, sch 6

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Except where the company is a private company having a share capital, the annual return is required to be filed within 42 days after the AGM for the year.▶ Except where the company is a private company, the annual return shall include certified copies of the company's balance sheet and reports laid before the company in general meeting to which the return relates.	<p><u>Public companies and guarantee companies</u></p> <ul style="list-style-type: none">▶ The annual return must to be filed within 42 days after the company's return date being:<ul style="list-style-type: none">○ 6 months for public companies, or○ 9 months for companies limited by guaranteeafter the end of the company's accounting reference period. <p><u>Private companies</u></p> <ul style="list-style-type: none">▶ Private companies are still required to file their annual returns within 42 days after the anniversary of their incorporation.

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Annual Return (Cont'd)

NCO references: s662, sch 6

Information to be included in, and documents to accompany, annual return

- ▶ Schedule 6 of the NCO sets out the information to be included in an annual return and the documents required to accompany it.
- ▶ The requirement for listed companies to file the details of all members in their annual returns has been relaxed.
- ▶ Section 2 of schedule 6 requires listed companies to include particulars only of members who held 5% or more of the issued shares in any class of the company's shares as at the date of the annual return.

Written Resolutions

NCO references: s547 to 561

Written resolutions

Anything which may be done by a company by resolution in a general meeting may be done, without a meeting and without any previous notice, by a resolution signed by all shareholders of a company.

Procedures for proposing, passing and recording written resolutions of HK companies

- ▶ Section 549 provides that the directors or a shareholder of a company may propose a resolution as a written resolution.
- ▶ A shareholder of the company who proposes the resolution may request the company to circulate with the resolution a statement of not more than 1,000 words on the subject matter of the resolution (section 551).

Written Resolutions (Cont'd)

NCO references: s547 to 561

Written resolutions

Procedures for proposing, passing and recording written resolutions of HK companies

The company must circulate a written resolution to every shareholder within 21 days after it receives the proposal if:

- a) the resolution is proposed by a director of the company; or
- b) it has been requested to do so by shareholders representing not less than 5% of the total voting rights (or a lower percentage if specified in the company's articles) (section 552).

The company must send shareholders together with the proposed resolution guidance as to:

- a) how to signify agreement to the resolution; and
- b) the date by which the resolution must be passed if it is not to lapse.

Circulation may be effected by sending copies of the resolution in hard copy form or electronic form or by making the copies available on a website (section 553).

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Written Resolutions (Cont'd)

NCO references: s547 to 561

Written resolutions

Procedures for proposing, passing and recording written resolutions of HK companies

- ▶ The company must also send the proposed resolution and any statement which a shareholder has requested to be circulated with the resolution to the company's auditor on or before the date of circulation of the resolution to shareholders (section 555).
- ▶ Copies may be sent to auditors either in hard copy or electronic form (section 555(2)).
- ▶ A company or any other person who claims to be aggrieved by a statement which a shareholder has requested by circulated with a proposed written resolution may apply to Court for an order that the company is not required to circulate the statement (section 554).
- ▶ The court will make such an order if it is satisfied that the rights given by section 551(2) are:
 - a) being abused; or
 - b) being used to secure needless publicity for defamatory matter.
- ▶ The court may also order the shareholders requesting the circulation to pay all or part of the company's costs.

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Written Resolutions (Cont'd)

NCO references: s547 to 561

Written resolutions

Procedures for proposing, passing and recording written resolutions of HK companies

- ▶ The period for agreeing to the proposed written resolution is 28 days or such other period as specified in the company's articles (section 558).
- ▶ The proposed written resolution will lapse if not passed within 28 days after the circulation date (or such other period as provided for in the articles).
- ▶ Members may signify their agreement to a proposed written resolution and send it back to the company either in hard copy form or electronic form (section 556).
- ▶ A written resolution requires agreement in writing by all eligible shareholders of a company (section 556(1)).
- ▶ If a resolution is passed as a written resolution, the company must send a notice of that fact to every shareholder and the auditor of the company within 15 days (section 559).
- ▶ Non-compliance with the requirements on circulation of proposed written resolution or notification of the passing of a written resolution is an offence for which the company and every responsible person of the company may be liable to a fine of \$10,000.

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Written Resolutions (Cont'd)

NCO references: s547 to 561

Written resolutions

- ▶ The new procedures do not replace the common law doctrine of unanimous consent to the effect that, if all the members of a company actually agree on a particular decision which can be made at a general meeting, the decision is binding and effective without a meeting (section 547(3)).
- ▶ A company's articles may also set out alternative procedures for passing a resolution without a meeting, provided that the resolution has been agreed by the members unanimously (section 561).

General Meetings

Notice Requirements

- ▶ Under the NCO, the notice period for an AGM is at least 21 days. In any other case the notice period is at least 14 days for a limited company (irrespective of whether an ordinary or special resolution will be considered), and at least 7 days for an unlimited company (section 571(1)).
- ▶ If the Articles require a longer period of notice, the meeting must be called by notice of that longer period (section 571(2)).
- ▶ As previously, for resolutions requiring special notice, such as the removal of a director or auditor, notice of the intention to move the resolution must be given to the company at least 28 days before the meeting (section 578).

General Meetings Permitted to be held in 2 or more places

NCO reference: s584 NCO

- ▶ Section 584 of the NCO permits a company to hold a general meeting at two or more places using any technology that enables the shareholders of the company who are not together at the same place to listen, speak and vote at the meeting. A company may set out rules and procedures for holding a dispersed meeting in its articles.

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Execution of Documents

NCO references: s124 to 125, 127 to 129

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Every HK company had to have a common seal.▶ A company had to be authorised by its articles of association to have an official seal for use outside Hong Kong, and have objects which required the transaction of business outside Hong Kong.▶ In addition, an attorney could only bind a company in respect of deeds executed by him on its behalf outside Hong Kong.	<ul style="list-style-type: none">▶ The keeping and use of a common seal is optional (<i>s124 NCO</i>).▶ Where a company has a common seal it must be a metallic seal with the company's name engraved on it.▶ A company with a common seal is allowed to have an official seal for use outside HK (<i>s125 NCO</i>). <p><u>Execution of documents (<i>s127 NCO</i>)</u> A company may execute a document:</p> <ol style="list-style-type: none">1) under its common seal in accordance with its articles; AND2) A) in the case of a company with only one director, by having the document signed by the director; OR B) in the case of a company having two or more directors, by having the document signed by any two directors or by any director and the company secretary. <p>(<i>s127(3)(a) & (b) NCO</i>)</p>

Execution of Documents (Cont'd)

NCO references: s124 to 125, 127 to 129

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Every HK company must have a common seal.▶ A company must be authorised by its articles of association to have an official seal for use outside Hong Kong, and have objects which require the transaction of business outside Hong Kong.▶ In addition, an attorney could only bind a company in respect of deeds executed by him on its behalf outside Hong Kong.	<p><u>Execution of documents (s127 NCO) (Cont'd)</u></p> <ul style="list-style-type: none">▶ In favour of a good faith purchaser for value, a document is to be regarded as having been executed by a company if the document purports to have been signed in accordance with s127(3)(a) or (b) NCO (as described above).▶ A document signed in accordance with section 127(3)(a) or (b) NCO and expressed to be executed by the company has effect as if the document had been executed under the company's common seal (s127(5) NCO)

Execution of Documents (Cont'd)

NCO references: s124 to 125, 127 to 129

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Every HK company must have a common seal.▶ A company must be authorised by its articles of association to have an official seal for use outside Hong Kong, and have objects which require the transaction of business outside Hong Kong.▶ In addition, an attorney could only bind a company in respect of deeds executed by him on its behalf outside Hong Kong.	<p><u>Execution of deeds (s128 NCO)</u></p> <p>A company may execute a deed by:</p> <ul style="list-style-type: none">▶ Executing it in accordance with s127 NCO;▶ Having it expressed to be executed by the company as a deed; and▶ Delivering it as a deed <p><u>Execution of documents by attorney (s129 NCO)</u></p> <ul style="list-style-type: none">▶ A company is allowed to authorise any person as its attorney to execute a deed or any other document on its behalf in Hong Kong or elsewhere.▶ The authorisation must be given by an instrument executed as a deed.

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Execution of Documents (Cont'd)

Practical considerations and recommended steps:

- ▶ Although a company may continue to employ other methods to execute documents (e.g. passing a board resolution to appoint authorised signatories), the deeming provisions in favour of good faith purchasers for value will only apply to documents executed in accordance with s127 NCO.
- ▶ In order to take full advantage of the new flexibility in executing documents (including deeds), a company should review its articles of association and remove any “legacy” limitations regarding use of the seal or execution.
- ▶ The NCO is silent on the valid mode(s) of execution of a Hong Kong law deed by a foreign company.
- ▶ Therefore, foreign companies should continue to execute deeds in the same way as under existing practice.

Statutory Protection for Persons Dealing with Companies

NCO references: s117 to 118, 120

Indoor management rule

- ▶ Sections 117 and 118 of the NCO provide statutory protection for persons dealing with a company in addition to the common law “indoor management rule”.
- ▶ The “indoor management rule” provides that a third party dealing in good faith with a company is not bound to inquire whether acts of internal management have been regular and is entitled to presume that acts within the company’s constitution and powers have been properly and duly performed.
- ▶ In favour of a person dealing with a company in good faith, the power of the directors to bind the company will be deemed to be free of any limitation under the articles of association, any resolutions of the company or any agreement between the members of the company.
- ▶ Good faith will be presumed (unless the contrary is proved).
- ▶ A person will not be regarded as acting in bad faith by reason only of the person’s knowing that an act is beyond the directors’ powers.
- ▶ Third parties are not required to inquire as to any limitations on the directors’ power, and will not be regarded as having constructive notice of any matters publicly disclosed in the articles or any return or resolution kept by the Companies Registrar.

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Statutory Protection for Persons Dealing with Companies (Cont'd)

NCO references: s117 to 118, 120

Indoor management rule (Cont'd)

- ▶ Section 118 provides that the protection afforded to a person by section 117 will not apply where the party to a transaction with a company is an “insider” (for example, a director of the company or of a holding company of the company; or an entity connected with such a director).

Part 4 – Registration of charges



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Registrable Charges

NCO references: s334

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ It was not clear whether the following categories of charges were registrable under the OCO:<ul style="list-style-type: none">○ mortgages over aircrafts (as bills of sale);○ instalments due, but not paid, on the issue price of shares;○ liens on subfreights (either as a charge on book debts or a floating charge);○ a charge over cash deposits (as a charge over book debts)	<ul style="list-style-type: none">▶ A charge on an aircraft or any share in an aircraft is expressly made registrable.▶ A charge on instalments due, but not paid, on the issue price of shares is also expressly made registrable.▶ A shipowner's lien on subfreights shall not be regarded as a charge on book debts or as a floating charge and is therefore not registrable.▶ If a company maintains a deposit of money with another person, a charge on the company's right to repayment is not a charge on book debts of the company.

Registrable Charges (Cont'd)

NCO references: s334

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Registration of charges was required for the purpose of securing any issue of debentures, which overlapped with other categories of registrable charges.▶ Typically, issues of debentures are supported by a floating charge, or a fixed charge that is registrable under other categories of registrable charges.	<ul style="list-style-type: none">▶ Charges for securing any issue of debentures are no longer registrable.

Registrable Charges (Cont'd)

Practical considerations and recommended steps:

- ▶ The exclusion of a charge on a company's right to repayment (where that company maintains a deposit of money with another person), will exclude any bank account charge from the requirement to register, whether or not such charge is given to secure the obligations of the account holder itself or the obligations of a third party.
- ▶ This means that lenders looking to take security over bank accounts will no longer be able to rely on a company search to determine whether there are any existing charges affecting the relevant bank account.

Acceleration of Repayment Obligation

NCO references: s337(6)

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Where a charge became void for not being registered with the Company Registry within the specified time limit, the money secured by such charge automatically became immediately payable.	<ul style="list-style-type: none">▶ s337(6) of the NCO replaces the “automatic” acceleration provision with a “discretionary” acceleration provision, giving a choice to the lender as to whether the secured amount is to become immediately payable.

Acceleration of Repayment Obligation (Cont'd)

Practical considerations and recommended steps:

- ▶ *Hong Kong security documents often include a post-signing undertaking on the part of the grantor to register the security, although often the grantee will carry out the registration itself (or through its lawyers).*
- ▶ *In any event, under the terms of the security document, breach of an undertaking to register will typically constitute an event of default triggering immediate repayment of the secured liabilities (as well as enforcement of the relevant security).*

Certified Copy of Charge to be Made Available for Public Inspection

NCO references: s333, 335, 336, 338 to 340

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ An original of a charge instrument (if any) together with the prescribed particulars of the charge in a specified form were required to be delivered to the Registrar for registration.▶ Only the prescribed particulars were made available for public inspection.▶ The charge instrument itself was not available for public search (and was returned by the Company Registry).	<ul style="list-style-type: none">▶ Both a certified copy of the charge instrument (if any) and the prescribed particulars of the charge are registrable and available for public inspection.

Certified Copy of Charge to be Made Available for Public Inspection (Cont'd)

Practical considerations and recommended steps:

- ▶ As the contents of the charge will be publicly available, parties should consider if and how commercially sensitive information (for example, details of bank accounts) may be excluded from the charge instrument.
- ▶ The availability for public inspection of a copy of the charge instrument will give rise to constructive notice of all the terms in the charge instrument, including negative pledge clauses, to those who may reasonably be expected to search the register, such as banks, financiers and relevant professionals.
- ▶ The particulars of a charge required for registration under the NCO are required to be contained in a specified form of “Statement of Particulars of Charge”, which contains fewer details than required under the OCO.
- ▶ The copy of the charge may be certified by a director, company secretary or other authorised person (s333(4) of the NCO).

Shortening Period for Delivery of Charge and Particulars from 5 Weeks to 1 Month

NCO references: s335, 336, 338 to 340

- ▶ Under the NCO, the period for delivery of the charge instrument and prescribed particulars to the Registrar for registration has been reduced to **one month** (from five weeks).

Practical considerations and recommended steps:

Where a registrable charge created by the company is not registered in time, the charge will be void as against the liquidator and creditors (s337(4) of the NCO).

Evidence of Debt Satisfaction or Release of Charge to be Made Available for Public Inspection

NCO references: s345

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ If a debt secured by a registered charge has been satisfied, or property or undertaking has been released from a registered charge, an application may be made to the Registrar for entering on the register a memorandum of satisfaction or release, accompanied by evidence of discharge (for example, a deed of release or discharge).▶ Only the memoranda of satisfaction or release are open for public inspection, but the evidence of discharge is neither registered nor available for public inspection.	<ul style="list-style-type: none">▶ A certified copy of the evidence of discharge or release also has to be registered and made available for public inspection (<i>s345(4) NCO</i>)

Part 5 – Financial reporting



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Simplified Financial Reporting for SMEs

NCO references: s359 to 366, Sch 3

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A private company could, with the written agreement of all its shareholders, prepare simplified accounts and simplified directors' reports (s141D exception).▶ A company which is a member of a corporate group and certain companies such as insurance and stock-broking companies were not allowed to enjoy s141D exception.	<p><u>Full financial statements</u></p> <ul style="list-style-type: none">▶ True and fair view required;▶ Compliance with HKFRS issued by HKICPA required;▶ Compliance with CO disclosure requirements;▶ For listed companies, compliance with Listing Rules

Simplified Financial Reporting for SMEs (Cont'd)

NCO references: s359 to 366, Sch 3

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A private company could, with the written agreement of all its shareholders, prepare simplified accounts and simplified directors' reports (s141D exception).▶ A company which is a member of a corporate group and certain companies such as insurance and stock-broking companies were not allowed to enjoy s141D exception.	<p><u><i>Simplified financial statements</i></u></p> <ul style="list-style-type: none">▶ Directors' report required;▶ Audit of financial statements required (except for dormant companies);▶ No need to give a true and fair view;▶ Prepared under the HKICPA's SME-Financial Reporting Framework (SME-FRF), instead of HKFRS;▶ Prepared on a simplified historical cost basis;▶ Do not include any assets or liabilities at fair value, or deferred tax;▶ Disclosure notes contain less info on the company's affairs

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Simplified Financial Reporting for SMEs (Cont'd)

NCO references: s359 to 366, Sch 3

Position under the OCO	Position under the NCO
<ul style="list-style-type: none"> ▶ A private company could, with the written agreement of all its shareholders, prepare simplified accounts and simplified directors' reports (s141D exception). ▶ A company which is a member of a corporate group and certain companies such as insurance and stock-broking companies were not allowed to enjoy s141D exception. 	<p><i><u>Other benefits of simplified financial reporting</u></i></p> <ul style="list-style-type: none"> ▶ No requirement on auditor to express a "true and fair view" opinion; ▶ Disclosure of auditor's remuneration not required; ▶ Subsidiary undertakings may be excluded from consolidated financial statements; ▶ Business review in the directors' report not required; ▶ Exemption from certain disclosures in the directors' report, e.g.: <ul style="list-style-type: none"> ○ Dir share/debenture arrangements; ○ Charitable or other donations; ○ Reasons for dir resignation; ○ Reasons for dir not seeking re-election

Simplified Financial Reporting for SMEs (Cont'd)

Eligibility for simplified reporting – NCO references: s359 to 366, Sch 3

	Small private company or group *	Small guarantee company or group	Eligible private company or group*	s141D private company
Annual revenue	HK\$100m or less	HK\$25m or less	HK\$200m or less	No max
Total assets	HK\$100m or less	No max	HK\$200m or less	No max
Number of employees	100 or less	No max	100 or less	No max
Shareholder approval	Not required	Not required	75% approval with no objections	100% approval

* Must satisfy two out of the three tests for annual revenue, total assets and employees

** Banking or deposit-taking companies, corporations licensed under the SFO, or insurance companies are not eligible

Simplified Financial Reporting for SMEs (Cont'd)

Practical considerations and recommended steps:

Timing

- ▶ The first full year statements that will be effected will be those falling in 2015.
- ▶ For example, for companies whose financial year ends on 31 December, the NCO will first impact on financial statements for the year ending 31 December 2015.

Shareholder approval requirements

- ▶ In the case of a group of eligible private companies, all the companies individually must obtain the requisite shareholder approval – 75% of the total voting rights with none objecting, except for subsidiaries that qualify as “small private companies” (section 360(2) of the NCO).

Simplified Financial Reporting for SMEs (Cont'd)

Practical considerations and recommended steps (Cont'd):

Deciding whether to adopt simplified reporting

- ▶ Simplified financial reporting will appeal to many companies looking to cut down on compliance costs.
- ▶ However, management should carefully consider all pros and cons of switching to simplified reporting.
- ▶ For example, contractual obligations to third parties, such as banks or investors, may require a company to prepare full financial statements.
- ▶ If the company is part of a listed group that has to prepare consolidated full financial statements, it may increase time and costs to consolidate simplified financial statements.
- ▶ If the company (or group) is borderline with respect to the annual revenue or asset tests, so that there is a risk that it will exceed the thresholds at some point in the near future, then the company may not consider it worthwhile to switch for a short period to simplified reporting.

Business Review in Directors' Report

NCO references: s388, 390 and 448, Sch 5

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO sets out the information required to be included in the directors' report, which had to be approved by the board of directors and sent to every shareholder and debenture holder of the company together with a copy of the accounts and auditors' report.	<ul style="list-style-type: none">▶ Except those qualified for simplified reporting, all companies are required to prepare a "<u>business review</u>" as part of the directors' report.▶ Private companies may opt out by special resolution.▶ Wholly-owned subsidiary companies are exempt from the requirement → their holding company will prepare the business review

Business Review in Directors' Report (Cont'd)

NCO references: s388, 390 and 448, Sch 5

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO sets out the information required to be included in the directors' report, which must be approved by the board of directors and sent to every member and debenture holder of the company together with a copy of the accounts and auditors' report.	<p>The business review consists of a fair review of the company's business including:</p> <ul style="list-style-type: none">▶ a description of the principal risks and uncertainties facing the company;▶ particulars of important events affecting the company that have occurred since the end of the financial year;▶ an indication of likely future development in the company's business;

Business Review in Directors' Report (Cont'd)

NCO references: s388, 390 and 448, Sch 5

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO sets out the information required to be included in the directors' report, which must be approved by the board of directors and sent to every member and debenture holder of the company together with a copy of the accounts and auditors' report.	<p>The business review consists of a fair review of the company's business including (Cont'd):</p> <ul style="list-style-type: none">▶ if necessary for an understanding of the development, performance or position of the company's business,<ul style="list-style-type: none">○ an analysis using financial key performance indicators;○ a discussion on the company's environmental policies and performance and the company's compliance with relevant laws and regulations that have a significant impact on the company; and○ an account of the company's key relationships with its employees, customers and suppliers and others that have a significant impact on the company or on which the company's success depends.

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Business Review in Directors' Report (Cont'd)

NCO references: s388, 390 and 448, Sch 5

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO set out the information required to be included in the directors' report, which must be approved by the board of directors and sent to every member and debenture holder of the company together with a copy of the accounts and auditors' report.	<p><u>Director liability for directors' reports</u></p> <ul style="list-style-type: none">▶ Directors are only liable if they knew, or were reckless as to whether, a statement was untrue or misleading, or an omission was dishonest concealment of a material fact.▶ Directors are liable to the company only in respect of loss suffered by the company.▶ Directors are not subject to any liability to another person other than the company resulting from reliance on any information contained in the report, unless such person is entitled to be granted a civil remedy or to rescind or repudiate an agreement. <p><i>("Safe harbour" in s448 NCO)</i></p>

Business Review in Directors' Report (Cont'd)

Practical considerations and recommended steps:

- ▶ Guidance on contents: Smaller companies looking for guidance on the contents of the new business review can review annual reports of listed companies in the same sector or industry which are required to include a MD&A.
- ▶ Excluding business review: A company that qualifies for simplified reporting can elect to exclude the business review from its business report, even if it otherwise decides to prepare full financial statements (for example, because a lender requires full financial statements).
- ▶ Shareholder approval requirement for business review exclusion: The requirement is less strict than that for eligible private companies to switch to simplified reporting. The business review exclusion only needs to be approved by a 75% majority vote in a general meeting, even if there is objection from shareholders.

Business Review in Directors' Report (Cont'd)

Practical considerations and recommended steps (Cont'd):

- ▶ *Impending developments and negotiations:* A company is not required to disclose any information about impending developments or matters in the course of negotiation, if such disclosure would, in the directors' opinion, be seriously prejudicial to the company's interests (para 3 Sch 5 to NCO)
- ▶ *Impact on listed companies:* Listed companies are required to include in their annual reports a MD&A of the group's performance during the financial year and the material factors underlying its results and financial position.
- ▶ There will be substantial overlap between the contents of the business review and the minimum contents of the MD&A as specified in paragraph 32 of appendix 16 to the Listing Rules, and the "recommended additional disclosures" in paragraph 52 of the appendix 16. However listed companies should ensure the scope of their MD&A covers the requirements of schedule 5 of the NCO.

Financial Year

NCO references: s367 to 371

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Accounts are required every year and to be laid before the company at AGM.▶ Those accounts must be made up to a date falling not more than a specified number of months before the date of the AGM.▶ The financial year is defined as the period in respect of which such accounts are made up.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ The financial year of a company is the same as the accounting reference period.▶ Alteration of the accounting reference period is allowed.▶ Accounting reference period:<ul style="list-style-type: none">○ For companies under OCO, the date immediately following the date to which its previous accounts were made up and ending on the anniversary of that date.○ For companies under NCO, the date of incorporation and end on a date specified by the directors or, failing that, the anniversary of the company's incorporation

Financial Year (Cont'd)

NCO references: s367 to 371

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Accounts are required every year and to be laid before the company at AGM.▶ Those accounts must be made up to a date falling not more than a specified number of months before the date of the AGM.▶ The financial year is defined as the period in respect of which such accounts are made up.	<ul style="list-style-type: none">▶ The accounting reference period can be altered by a resolution of the directors.▶ For public companies and companies limited by guarantee, any change in the accounting reference date must be notified to the Registrar of Companies.

New Criminal Offence For Auditors

NCO references: s407 to 408

Auditor's opinion

Section 407 provides that an auditor must state in the auditor's report if:

- ▶ it is of the opinion that the company's financial statements are not in agreement with its accounting records in a material respect (s407(2)(b) NCO); or
- ▶ the auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit (s407(3) NCO)

The OCO had similar requirements in section 141, but did not provide any sanction for breach of the requirement.

New Criminal Offence For Auditors (Cont'd)

NCO references: s407 to 408

Position under the OCO	Position under the NCO
No provisions as to sanctions.	<p><u>Sanctions</u></p> <ul style="list-style-type: none"> ▶ Criminal offence for an auditor who knowingly or recklessly causes a statement required under s407(2)(b) or s407(3) NCO to be omitted from an auditor's report. ▶ The following persons may be liable: <ul style="list-style-type: none"> ○ if the auditor is a natural person, the auditor and every employee and agent of the auditor who is eligible for appointment as auditor of the company; ○ if the auditor is a firm, every partner, employee and agent of the auditor who is eligible for appointment as auditor of the company; ○ if the auditor is a body corporate, every officer, member, employee and agent of the auditor who is eligible for appointment as auditor of the company <p>(s408(2) NCO)</p>

New Criminal Offence For Auditors (Cont'd)

NCO references: s407 to 408

Position under the OCO	Position under the NCO
No provisions as to sanctions.	<p><u>Eligibility to act as a company's auditor</u> Only a practice unit is eligible:</p> <ul style="list-style-type: none"> ▶ a firm of certified public accountants practising accountancy pursuant to the Professional Accountants Ordinance (Cap 50) ("PAO"); ▶ a certified public accountant practising accountancy on his own account pursuant to the PAO; or ▶ a corporate practice registered under the PAO. <p><i>(s393(1) NCO)</i></p> <p><u>Sanction</u></p> <ul style="list-style-type: none"> ▶ The sanction for the offence under s408(1) NCO is a max fine of HK\$150,000 ▶ Guidance on whether an offence under section 408 should be prosecuted → see CR external circular No.10/2014

Auditors' Rights of Information

NCO references: s412

Position under the OCO	Position under the NCO
<p>Auditors have the following rights:</p> <ul style="list-style-type: none">▶ Right of access → right of access to the books and accounts of a company;▶ Right of information → right to require officers of the company to provide information and explanations necessary for the performance of the auditor's duties;▶ Under the NCO, these rights also extend to HK incorporated subsidiaries and their auditors	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ Right of information → auditors have a wider right to request information or explanation from the following persons:<ul style="list-style-type: none">○ Persons holding or accountable for accounting records;○ An officer of the company;○ A HK subsidiary of the company;○ An officer or auditor of such a subsidiary; and○ A person holding or accountable for any of the accounting records of the company or such a subsidiary (whether HK or non-HK incorporated) <p>(s412 NCO)</p>

Auditors' Rights of Information (Cont'd)

NCO references: s412

Position under the OCO	Position under the NCO
<p>Auditors have the following rights:</p> <ul style="list-style-type: none">▶ Right of access → right of access to the books and accounts of a company;▶ Right of information → right to require officers of the company to provide information and explanations necessary for the performance of the auditor's duties;▶ The rights also extend to HK incorporated subsidiaries and their auditors	<p><u>Offences</u></p> <ul style="list-style-type: none">▶ Failure to provide any information or explanation required by the auditors constitutes an offence.▶ The person is liable to a max fine of HK\$25,000; in case of a continuing offence, a max daily fine of HK\$700.▶ It is a defence to establish that it was not reasonably practicable for the person to provide the information or explanation. <p><i>(s413(1) NCO)</i></p>

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Auditors' Rights of Information (Cont'd)

NCO references: s412

Position under the OCO	Position under the NCO
<p>Auditors have the following rights:</p> <ul style="list-style-type: none"> ▶ Right of access → right of access to the books and accounts of a company; ▶ Right of information → right to require officers of the company to provide information and explanations necessary for the performance of the auditor's duties; ▶ The rights also extend to HK incorporated subsidiaries and their auditors. 	<p><u>Offences (Cont'd)</u></p> <ul style="list-style-type: none"> ▶ If a company fails to take reasonable steps to obtain the required information or explanation in respect of its non-HK subsidiary, the company and its responsible persons commit an offence. ▶ Each is liable to a max fine of HK\$25,000; in case of a continuing offence, a daily fine not exceeding HK\$700. ▶ It is a defence for the holding company if it would be an offence under the law of the relevant jurisdiction for the subsidiary to provide the information or explanation. <p>(s413(5) NCO)</p>

Auditors' Rights of Information (Cont'd)

NCO references: s412

Position under the OCO	Position under the NCO
<p>Auditors have the following rights:</p> <ul style="list-style-type: none">▶ Right of access → right of access to the books and accounts of a company;▶ Right of information → right to require officers of the company to provide information and explanations necessary for the performance of the auditor's duties;▶ The rights also extend to HK incorporated subsidiaries and their auditors.	<p><u>Offences (Cont'd)</u></p> <ul style="list-style-type: none">▶ If in response to an auditor's request for information or an explanation, a person provides information which is misleading, false or deceptive in a material particular, and the person knows that, or is reckless, as to whether that is the case, the person commits an offence.▶ The offence is punishable on conviction on indictment by a fine of HK\$150,000 and 2 years' imprisonment, and on summary conviction to a fine of HK\$50,000 and 6 months' imprisonment.

Voluntary Revision of Financial Statements

NCO references: s449 and the Companies (Revision of Financial Statements and Reports) Regulation

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Directors were allowed to revise the accounts and make necessary consequential revisions to the summary financial report or directors' report after the accounts have been provided to the members.	<ul style="list-style-type: none">▶ Similar provision is retained in the NCO (s449 NCO).
<ul style="list-style-type: none">▶ Revisions were allowed only to aspects of the accounts which did not comply with the OCO and necessary consequential revisions.	<ul style="list-style-type: none">▶ Similar provision is retained in the NCO (s449 NCO).
<ul style="list-style-type: none">▶ The detailed requirements applicable to revision of accounts were set out in the Companies (Revision of Accounts and Reports) Regulation (Cap.32N) ("Cap. 32N").	

Voluntary Revision of Financial Statements (Cont'd)

NCO references: s449 and the Companies (Revision of Financial Statements and Reports) Regulation

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The detailed requirements applicable to revision of accounts are set out in the Companies (Revision of Accounts and Reports) Regulation (Cap.32N).	<ul style="list-style-type: none">▶ The detailed requirements are now set out in the Companies (Revision of Financial Statements and Reports) Regulation (the “Regulation”).

Major changes to the old Cap. 32N:

- ▶ alignment of accounting terminology with the NCO – i.e. the term “accounts” is replaced by “financial statements” and “balance sheet” by “statement of financial position”;
- ▶ alignment of requirements prescribed in respect of the signing and distribution of the revised statements and reports with those under the NCO; and
- ▶ alignment of provisions on the auditor’s report on revised financial statements and auditor’s rights and privileges with the relevant provisions under the NCO, including the provisions relating to the auditor’s opinion as to whether the revised financial statements give a true and fair view. It also includes the offences relating to the contents of an auditor’s report in sections 407 and 408 of the NCO.

Auditor's Statement On Termination Of Appointment

NCO references: s410, 424 to 427

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A resigning auditor must make a statement in the notice of resignation as to whether there are any circumstances connected with his resignation that he considers should be brought to the notice of the members or creditors of the company.▶ If there are, the auditor must make a statement of such circumstances.▶ However, an auditor whose office has ceased owing to other reasons, for example, removal or not being re-appointed after retirement, is not required to make such a statement.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ An outgoing auditor's duty to make a statement of circumstances is <u>extended</u> to:<ul style="list-style-type: none">○ An auditor who has been removed; and○ A retiring auditor who has not been reappointed

Auditor's Statement On Termination Of Appointment (Cont'd)

NCO references: s410, 424 to 427

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A resigning auditor must make a statement in the notice of resignation as to whether there are any circumstances connected with his resignation that he considers should be brought to the notice of the members or creditors of the company.▶ If there are, the auditor must make a statement of such circumstances.▶ However, an auditor whose office has ceased owing to other reasons, for example, removal or not being re-appointed after retirement, is not required to make such a statement.	<ul style="list-style-type: none">▶ A company is required to send a copy of the auditor's statement to its shareholders within 14 days of receipt, unless it is applying to court for an order that the statement not be sent on the grounds that the outgoing auditor has abused the use of the statement, or is using it to secure needless publicity for defamatory matter.▶ If the outgoing auditor has not received notice of such court application within 21 days of the company's receipt (or the court does not grant the application), the auditor must send a copy of the statement to the Registrar for registration within a further 7 days (<i>s426(5) & 427(5) NCO</i>)

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Auditor's Statement On Termination Of Appointment (Cont'd)

NCO references: s410, 424 to 427

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A resigning auditor must make a statement in the notice of resignation as to whether there are any circumstances connected with his resignation that he considers should be brought to the notice of the members or creditors of the company.▶ If there are, the auditor must make a statement of such circumstances.▶ However, an auditor whose office has ceased owing to other reasons, for example, removal or not being re-appointed after retirement, is not required to make such a statement.	<p><u>Privilege for statements</u></p> <ul style="list-style-type: none">▶ s410 of the NCO gives an auditor qualified privilege for statements made in the course of performing duties as auditor of a company.▶ In particular, in the absence of malice, an auditor is not liable for defamation in respect of any statement given by the auditor connected with its cessation of office.

Summary Financial Reports

NCO references: s437 to 446

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A listed company was allowed to send a summary financial report to its members and debenture holders in place of the accounts, directors' and auditors' reports normally required to be sent, provided it has obtained the agreement of such members and debenture holders.▶ There was no exemption for non-listed companies incorporated in HK not to send out accounts and reports or summary financial reports.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ The summary financial report provisions in the NCO are applicable to all companies (other than those qualified for simplified reporting).▶ Members' consent is not required before a company can send a summary financial report to its members.▶ Companies (other than those qualifying for simplified reporting) have the choice of sending a copy of the summary financial report instead of a copy of the full "reporting documents" (i.e. the financial statements, directors' report and auditors' reports) to their members. (s441 NCO)

Summary Financial Reports (Cont'd)

NCO references: s437 to 446

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A listed company was allowed to send a summary financial report to its members and debenture holders in place of the accounts, directors' and auditors' reports normally required to be sent, provided it has obtained the agreement of such members and debenture holders.▶ There was no exemption for non-listed companies incorporated in HK not to send out accounts and reports or summary financial reports.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ Members receiving summary financial reports may request a copy of the full reporting documents from the company (s445 NCO).▶ The company may at any time require its members or potential members to make an election whether to receive a copy of the reporting documents or the summary financial report (or neither), and whether or not to receive such documents in hard copy form, or electronic form, or by the making them available on a website (s442 NCO)

Statutory Backing For Accounting Standards

NCO references: s380(4)(b), Sch 4

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ There was no specific requirement in the OCO that a company's accounts must follow the standards of HKFRS.▶ The OCO also provided for certain disclosure requirements as to the contents of the accounts in the 11th Schedule (for companies that apply section 141D) and the 10th Schedule (for other companies), which overlap with the disclosure requirements in the SME-FRS and HKFRS respectively.▶ There were certain inconsistencies between the accounting requirements under the OCO and the applicable accounting standards.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ Financial statements must comply with the applicable accounting standards issued by a body prescribed by the Companies (Accounting Standards (Prescribed Body)) Regulation (ASPBR). The body prescribed is the HKICPA (<i>s380(4)(b) NCO</i>).▶ It is further required that a statement should be made in the financial statements as to whether they have been prepared in accordance with the applicable accounting standards, and to give the particulars of, and the reasons for, any material departure from those standards (<i>s4 of Part 1 of Sch 4 NCO</i>)

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Statutory Backing For Accounting Standards (Cont'd)

NCO references: s380(4)(b), Sch 4

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ There was no specific requirement in the OCO that a company's accounts must follow the standards of HKFRS.▶ The OCO also provided for certain disclosure requirements as to the contents of the accounts in the 11th Schedule (for companies that apply section 141D) and the 10th Schedule (for other companies), which overlap with the disclosure requirements in the SME-FRS and HKFRS respectively.▶ There were certain inconsistencies between the accounting requirements under the OCO and the applicable accounting standards.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ Only a small number of public interest disclosure requirements not covered by the HKFRS or SME-FRS are retained in sch 4 of the NCO, namely:<ul style="list-style-type: none">○ the aggregate amount of any outstanding loans to directors and employees to acquire shares in the company;○ information regarding a company's ultimate parent undertaking; and○ auditor's remuneration (applicable to companies not qualified for simplified reporting).

Statutory Backing For Accounting Standards (Cont'd)

NCO references: s380(4)(b), Sch 4

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ There was no specific requirement in the OCO that a company's accounts must follow the standards of HKFRS.▶ The OCO also provided for certain disclosure requirements as to the contents of the accounts in the 11th Schedule (for companies that apply section 141D) and the 10th Schedule (for other companies), which overlap with the disclosure requirements in the SME-FRS and HKFRS respectively.▶ There were certain inconsistencies between the accounting requirements under the OCO and the applicable accounting standards.	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ Amendments have also been made to the accounting terminology used in the NCO to align with terminology in the HKFRS.▶ Accordingly, "financial statement" replaces "accounts" and "consolidated financial statement" replaces "group accounts". "Statement of financial position" and "statement of comprehensive income" replace "balance sheet" and "profit and loss account", respectively.

Statutory Backing For Accounting Standards (Cont'd)

Practical considerations and recommended steps:

- ▶ Most of the information to be included in a Hong Kong company's financial statements relating to financial performance and position will now be determined in accordance with HKFRS (as well as the Listing Rules, in the case of listed companies).
- ▶ Companies will remain free to disclose more than the prescribed minimum content, meaning it will not be necessary to review the financial statements in order to delete disclosures that are no longer required. It is likely that some legacy disclosures will continue to be included in Hong Kong financial statements.
- ▶ At the same time, companies will now have the opportunity to streamline disclosures with HKFRS requirements.

Part 6 – Schemes of arrangement, amalgamations and compulsory share acquisitions



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Schemes of Arrangement: Headcount Test & 10% Objection Test

- ▶ The New CO, like the Old CO, sets out the procedures to be followed where a company proposes to enter a scheme of arrangement (i.e. a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into different classes) or a compromise with creditors which normally involves the creditors agreeing to accept less than the amount they are owed.
- ▶ As under the Old CO, the procedure is largely court driven and the company must apply to Court for an order to convene meetings of shareholders and/or creditors. Once the scheme of arrangement or compromise has been approved, a Sanction Hearing is held at which the Court will give its final approval to, or not approve, the scheme or compromise.
- ▶ The key change in the New CO is that different procedures apply according to the type of scheme to be entered into.

Schemes of Arrangement: Headcount Test & 10% Objection Test (Cont'd)

Members' schemes not involving a takeover offer or general offer

As under the Old CO, members' schemes not involving a takeover offer or general offer must be approved:

- ▶ by members representing at least **75%** of the voting rights of the members present and voting; and
- ▶ unless the court orders otherwise, by a **majority in number** of the members present and voting (**headcount test**)(Section 674(1)).

The New CO has introduced a new discretion for the Court to dispense with the headcount test in a particular case (e.g. if there is evidence that the result of the vote has been unfairly influenced by share splitting). The court's discretion can be exercised regardless of whether the arrangement has been approved or rejected under the headcount test.

Schemes of Arrangement: Headcount Test & 10% Objection Test (Cont'd)

Takeover and privatisation schemes

- ▶ For arrangements involving a general offer or a takeover offer, the headcount test has been replaced with a **new 10% objection test**. Accordingly, a members' scheme involving a takeover or general offer (i.e. a share buy-back) must:
 - be approved by members representing at least **75%** of the voting rights of the members present and voting; and
 - the number of votes cast against the arrangement must not be more than **10%** of the votes attached to **all disinterested shares** (the **10% objection test**)(Section 674(2)).

Schemes of Arrangement: Headcount Test & 10% Objection Test (Cont'd)

Takeover and privatisation schemes (Cont'd)

“Disinterested shares” under 10% objection test

- ▶ “Interested parties” include:
 - in the case of a general offer, the company which makes the buy-back offer and a non-tendering member, plus their associates and nominees;
 - in the case of a takeover offer, the offeror and his associates and nominees.
- ▶ “Associate” is defined in section 667 to include:
 - various family members of an individual offeror / member;
 - companies in which an offeror / member is “substantially interested” (e.g. by controlling more than 30% of the voting power);
 - if the offeror / member is a body corporate, companies within the same group of companies as the offeror / member;
 - a person (or its nominee) who is a party to an acquisition agreement with the offeror / member to acquire shares or interests in shares to which the offer relates.

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Schemes of Arrangement: Headcount Test & 10% Objection Test (Cont'd)

Takeover and privatisation schemes (Cont'd)

- ▶ New CO contains provisions dealing with the costs position of a dissenting member who applies to court to challenge a scheme involving a takeover offer or a general offer.
- ▶ The Court may only order such member to pay legal costs if his opposition to the scheme is frivolous or vexatious (section 676(5)).
- ▶ The court may require the company to indemnify a dissenting member against its legal costs if satisfied that the member is opposing the application in good faith (section 676(4)).

Schemes of Arrangement: Headcount Test & 10% Objection Test (Cont'd)

Takeover and privatisation schemes (Cont'd)

Implications under the Takeovers Code

- ▶ The 10% objection test under the NCO is broadly in line with the requirements for approving takeovers and privatisations under the Takeovers Code.
- ▶ The definition of "disinterested shares" under the NCO will overlap with the Code definition to a large extent, but the two definitions are not identical.
- ▶ An offeror must ensure that the 10% objection test has been satisfied both under the NCO and the Takeovers Code.
- ▶ The rules on schemes of arrangement under the NCO will apply only to Hong Kong incorporated companies.
- ▶ Listed companies incorporated in other jurisdictions will be subject to the Takeovers Code as well the statutory requirements for schemes of arrangement under the laws of their respective jurisdictions of incorporation.

Schemes of Arrangement: Headcount Test & 10% Objection Test (Cont'd)

Creditors' Schemes

- ▶ An arrangement or compromise with creditors must be approved:
 - by members representing at least **75%** of the voting rights of the creditors present and voting; and
 - by a **majority in number** of the creditors present and voting (**headcount test**)(Section 674(1)).
- ▶ The Court will **not** have discretion to dispense with the headcount test in the case of creditors' schemes.

Amalgamations: Court-free Statutory Amalgamation Procedure

- ▶ The Old CO required Court sanction for an amalgamation. The procedure was rarely used as it was expensive and time consuming.
- ▶ New CO provides for a court-free regime for amalgamations.
- ▶ **Conditions for court-free amalgamation**
 - Eligibility
 - each amalgamating company must be a Hong Kong incorporated company limited by shares; and
 - the amalgamation must be of wholly-owned companies in same group.
 - Types of amalgamation
 - vertical - between a holding company and one or more of its wholly-owned subsidiaries; or
 - horizontal - between two or more wholly- owned subsidiaries of the same holding company.

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ Conditions for court-free amalgamation (Cont'd)

○ Solvency statement

The directors of each amalgamating company must make a statement:

- i. to confirm the solvency of the amalgamating company as well as the amalgamated company. This requires a statement that in the opinion of the directors:
 - as at the date of the statement, there is no ground on which the amalgamating company could be found to be unable to pay its debts; and
 - after taking into account all liabilities (including contingent and prospective liabilities), the amalgamated company will be able to pay its debts as they fall due for the 12 months following the amalgamation; and
- ii. to confirm that the assets of the amalgamating company are not subject to any floating charge, or if a floating charge exists, that the chargee has consented to the amalgamation proposal.

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ Conditions for court-free amalgamation (Cont'd)

○ Directors' certificates

- Each director of an amalgamating company who votes in favour of making a solvency statement must issue a certificate as to the matters required to be confirmed;
- A director commits an offence if he votes in favour of making a solvency statement without having reasonable grounds for making it. The offence carries maximum penalties of 2 years' imprisonment and a fine of \$150,000.

○ Shareholder approval by special resolution

- Amalgamation proposal must be approved by the members of each amalgamating company by special resolution;
- For **vertical** amalgamations:
 - special resolution of amalgamating holding co's shareholders must be passed on a poll at general meeting (not by a written resolution); and
 - special resolution of amalgamating subsidiaries can be passed on a poll at general meeting or by written resolution.
- For **horizontal** amalgamations, the special resolution of shareholders of each amalgamating subsidiary can be passed on a poll at general meeting or by written resolution.

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Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ Conditions for court-free amalgamation (Cont'd)

- Directors of amalgamated company

The resolution approving the amalgamation must name the persons who will be directors of the amalgamated company.

- Notification of secured creditors

Directors of each amalgamating company must notify the company's secured creditors of the proposed amalgamation and publish notice of it in an English and Chinese newspaper in Hong Kong at least **21 days** before the date of the general meeting to approve the amalgamation, or if it will be approved by written resolution, before the written resolution is sent to shareholders (section 682).

- Registration of amalgamation

The approved amalgamation proposal and other documents must be delivered to the Registrar within 15 days after approval.

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

- ▶ **Court's power to disallow or modify amalgamation proposal**
 - Before the effective date of the amalgamation proposal, the Court can disallow or modify the proposal, or give directions, if satisfied that it would unfairly prejudice a member or creditor of an amalgamating company or a person to whom an amalgamating company is under an obligation, on application by a member or creditor of an amalgamating company or such a person (s686).

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ **Effect of vertical amalgamation**

- the shares of the amalgamating subsidiary will be cancelled (without payment or other consideration); and
- the articles of the amalgamated company will be the same as the articles of the amalgamating holding company.

▶ **Effect of horizontal amalgamation**

- the shares of all but one of the amalgamating subsidiaries will be cancelled (without payment or other consideration); and
- the articles of the amalgamated company will be the same as the articles of the amalgamating company whose share are not cancelled.

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ **Effect of amalgamation generally**

- each amalgamating company ceases to exist as an entity separate from each amalgamated company;
- the amalgamated company succeeds to all the property, rights and privileges, and all the liabilities and obligations, of each amalgamating company;
- any proceedings pending by or against an amalgamating company may be continued by or against the amalgamated company;
- any conviction, ruling, order or judgment in favour of or against an amalgamating company may be enforced by or against the amalgamated company; and
- any agreement entered into by an amalgamating company may be enforced by or against the amalgamated company unless otherwise provided in the agreement.

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ **Tax consequences of amalgamation**

No amendments have yet been proposed to the Inland Revenue Ordinance to reflect the new court-free amalgamation procedures.

Certain potential tax consequences may be of particular concern (in the absence of clarification):

- certain assets could be regarded as disposed of by the amalgamating companies on the effective date of the amalgamation. As the amalgamated company will not have incurred any costs in acquiring such assets, there may be no cost basis against which to claim depreciation allowances or deductible cost on sale of the relevant assets;
- tax losses may not be carried over from the amalgamating company to the amalgamated company (although the fact that the amalgamated company assumes all liabilities of each amalgamating company suggests that tax losses arising in one of the amalgamating companies could be offset against the amalgamated pool of taxable profits).

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ Tax consequences of amalgamation (Cont'd)

Relevant companies should also consider any overseas tax issues, e.g.:

- whether tax losses or profits will crystallise on amalgamation pursuant to the tax laws of the relevant jurisdiction; or
- whether a transfer of assets will be deemed to have occurred.

Stamp duty

- Any deemed transfer of HK real estate and shares from the amalgamating companies to the amalgamated company is likely to qualify for stamp duty group relief under section 45 of the Stamp Duty Ordinance.

▶ Contracts

- Important contracts (such as loan agreements, joint venture agreements and franchise agreements) should be reviewed to determine whether an amalgamation will constitute a breach or event of default under such documents.

Amalgamations: Court-free Statutory Amalgamation Procedure (Cont'd)

▶ **Foreign law issues**

- A court-free amalgamation under the NCO may not be recognised under foreign law. The relevant parties should consider obtaining foreign counsel advice in jurisdictions where key assets are located, or in respect of important contracts governed by foreign law.

▶ **Floating charges**

- As the effect of amalgamation is that the amalgamated company takes the benefits and is subject to the liabilities of the amalgamating companies, this creates an issue when amalgamating companies have floating charges over their respective assets in favour of different security holders.
- There will be a question of priorities between the competing security holders over the assets of the amalgamated company.
- The written consents of the holders of floating charges to a proposed amalgamation are required (s680(2)(d)(ii) and 681(2)(d)(ii) NCO).

Amalgamations: Revising the Definitions of “Property” and “Liabilities”

NCO references: s675

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The court had power to make provisions to facilitate reconstructions and amalgamations of companies, including by ordering the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company.▶ “Property” was defined as including “property, rights and powers of every description” and “liabilities” as including “duties”. Based on decided cases, contracts of employment were not transferable	<p><u>Key changes</u></p> <ul style="list-style-type: none">▶ Personal rights and duties may now be transferred or assigned, the consent of the parties concerned is not required.▶ “Property” is defined as including rights and powers of a personal character and incapable of being assigned or performed vicariously under the law; and rights and powers of any other description▶ “Liabilities” is defined as including duties of a personal character and incapable of being assigned or performed vicariously under the law; and duties of any other description. <p>(s675 NCO)</p>

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Compulsory Share Acquisitions: Meanings

NCO references: s689, 691, 707 and 709

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO included provisions for compulsory acquisition of shares following a takeover, applicable, inter alia, where a company makes an offer to acquire all the shares not already held by it in another company on terms which are the same in relation to all the shares to which the offer relates.▶ There were no clear definitions of what constituted “shares already held by an offeror” and “shares to which the offer relates”	<p><u>“Shares already held by an offeror”</u></p> <ul style="list-style-type: none">▶ include shares that the offeror has contracted, unconditionally or conditionally to acquire;▶ exclude shares that are subject to a contract with a shareholder which is intended to secure that such shareholder will accept the offer when it is made and entered into for no consideration and by deed, for consideration of negligible value, or for consideration consisting of a promise by the offeror to make the offer (for example, “irrevocable undertakings” often given by supportive shareholders in a takeover offer) (s689(3) NCO)

Compulsory Share Acquisitions: Meanings (Cont'd)

NCO references: s689, 691, 707 and 709

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO included provisions for compulsory acquisition of shares following a takeover, applicable, inter alia, where a company makes an offer to acquire all the shares not already held by it in another company on terms which are the same in relation to all the shares to which the offer relates.▶ There were no clear definitions of what constitutes “shares already held by an offeror” and “shares to which the offer relates”	<p><u>“Shares to which the offer relates” include:</u></p> <ul style="list-style-type: none">▶ shares that are allotted after the date of the offer but before a date specified in the offer (s689(6) NCO);▶ shares which the offeror acquires or contracted to acquire other than by virtue of acceptances of the offer during the offer period unless the acquisition consideration exceeds the consideration specified in the terms of the offer (s691(2) NCO); and▶ shares which a nominee or an associate of the offeror has contracted to acquire after a takeover offer is made but before the end of the offer period, unless the acquisition consideration exceeds the consideration specified in the offer (s691(4) NCO) <p>ss707(1), 707(3) and 709 contain similar provisions re. compulsory acquisition powers following a share buy-back offer.</p>

Compulsory Share Acquisitions: Revised Offers

NCO references: s692 and 710

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The OCO did not have any provision on revised offers, so that an offeror who wished to revise his offer had to make a new takeover or share buy-back offer, and address the acceptances received under the old offer.	<p>A revision of the terms of a takeover offer is not regarded as the making of a fresh offer if:</p> <ul style="list-style-type: none">▶ the terms of the original offer provide for:<ul style="list-style-type: none">○ the revision; and○ acceptances on the previous terms to be regarded as acceptances on the revised terms; and▶ the revision is made in accordance with that provision. (s692 NCO) <p>Section 710 contains a similar provision in the case of a share buy-back offer.</p>

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Compulsory Share Acquisitions: Untraceable Shareholders

NCO references: s693(3) to (7), and 712(4) to (8)

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ There was no mechanism for an offeror to apply for a court order authorising the giving of squeeze out notices in respect of takeover or buy-back offers which failed to achieve the applicable 90% squeeze out threshold because of untraceable shareholders.	<ul style="list-style-type: none">▶ An offeror is allowed to apply to the court for authorisation to give squeeze out notices where the failure to achieve the 90% threshold is because the offeror is unable to trace one or more shareholders after reasonable enquiry, and provided the consideration offered is fair and reasonable.▶ The court may not make an order unless it considers that it is just and equitable to do so having regard, in particular, to the number of shareholders who have been traced but have not accepted the offer. <p>Sections 712(4) to (8) provide for a similar mechanism in the case of a share buy-back offer.</p>

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▶ **Part 7 – Abolition of memorandum of association and matters relating to the articles of association**



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Abolition of the Memorandum of Association

NCO references: s67 and 98

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ The constitutional documents of a company formed in Hong Kong were the memorandum of association (“Memorandum”) and the articles of association (“Articles”).▶ As all the information provided on incorporation apart from the objects clause and the authorised capital (which has been removed following the migration to no par under the NCO) is contained in the Articles and the incorporation form, the need to retain the Memorandum as a separate constitutional document has reduced.	<ul style="list-style-type: none">▶ The NCO abolishes the requirement for a company to have a Memorandum. A company incorporated in Hong Kong has only one constitutional document – the Articles (s675 NCO)▶ For an existing company, provisions set out in its memorandum are deemed to be provisions of its Articles (s98 NCO).▶ However, any such provisions relating to authorised share capital and par value are regarded as deleted (s98(4)), to reflect the migration to no par.

Abolition of the Memorandum of Association (Cont'd)

Practical considerations and recommended steps

- ▶ It will not be necessary for an existing company established under the OCO to make changes to its constitutional documents as a result of the abolition of the Memorandum.
- ▶ However, companies may take the opportunity to review and amend their existing constitutional documents, in particular to take advantage of some of the new initiatives under the NCO and to ensure the Articles comply with the provisions of the NCO.
- ▶ For ease of reference, a company may wish to expressly restate in its Articles any provisions of the Memorandum that are deemed carried over to the Articles.

Removal of provisions formerly contained in the Memorandum

- ▶ If a company wishes to remove any provision of the Memorandum which does not constitute a mandatory provision, it may do so by way of special resolution. For example, a company may consider removing its object clause.

Abolition of the Memorandum of Association (Cont'd)

Practical considerations and recommended steps (Cont'd)

Objects clause

- ▶ Since 1997, the objects clause has been optional.
- ▶ Where a company does not state its objects, it has the capacity and the rights, powers and privileges of a natural person (s115 NCO), but may not exercise its powers in a manner contrary to its constitutional documents.
- ▶ Older companies that retain an objects clause may delete the objects clause, thereby giving them greater flexibility in their operations and dealings.
- ▶ Some companies may wish to retain specific object clauses e.g. charitable companies, joint venture companies.
- ▶ If the objects clause is not deleted, a counterparty enquiring as to a company's capacity to enter into a particular transaction (for example, to borrow or provide security) should review any objects clause in the former Memorandum (now deemed to be in the Articles).
- ▶ However, note that s117 of the NCO provides that in favour of a person dealing with a company in good faith, the power of the directors to bind the company will be deemed to be free of any limitation under the Articles, any resolutions of the company or any agreement between the members of the company.

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Mandatory Provisions in Articles

NCO references: s81, 83 to 85

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ Existing companies established under the OCO will comply with the requirements to have the mandatory articles by virtue of the deeming provision in section 98 of the NCO (see above)	<p>New companies incorporated under the NCO should have Articles dealing with the following matters:</p> <ul style="list-style-type: none">▶ the name of the company (s81);▶ the objects of the company (if the company has been granted a licence to dispense with the use of the word “Limited” in its name under s103) (s82);▶ details of members’ liabilities (s83);▶ details of liabilities or contribution of members (s84); and▶ details of initial capital and initial shareholding (s85).

Model Articles

NCO references: s78 – 80, Companies (Model Articles) Notice

Position under the OCO	Position under the NCO
<ul style="list-style-type: none">▶ A company limited by shares may register customised Articles upon incorporation.▶ If no Articles were registered, or if Articles were registered, in so far as they did not exclude or modify the regulations set out in Table A of the First Schedule to the OCO (the “Table A Articles”), the regulations set out in Table A would be the Articles of the company.	<ul style="list-style-type: none">▶ The NCO empowers the Financial Secretary to prescribe different model articles (“Model Articles”) for different types of companies.▶ A company may adopt as its articles all or any of the provisions of the Model Articles prescribed for the type of company to which it belongs.▶ Therefore, if a company established under the NCO does not register any additional articles upon incorporation, the Model Articles prescribed for that type of company will apply.▶ The Companies (Model Articles) Notice prescribes Model Articles for <i>public companies limited by shares, private companies limited by shares and companies limited by guarantee</i>.

Model Articles (Cont'd)

Major changes under the Model Articles compared to Table A Articles

Directors

- ▶ *Public companies:* new articles have been added to provide detailed procedures for written resolutions;
- ▶ *Private companies and guarantee companies:* a new article dealing with unanimous decisions of directors is added;
- ▶ Articles dealing with the appointment and removal of alternate directors have been added;
- ▶ Articles on voting at directors' meetings where there is a conflict of interests have been updated to take into account changes regarding disclosures of directors' interests and voting requirements in respect of connected transactions under the NCO;
- ▶ Articles on directors' meetings have also been revised to cater for dispersed meetings, i.e. where directors meet via telecommunication or video conferences, or with the aid of other communication technology;

Model Articles (Cont'd)

Major changes under the Model Articles compared to Table A Articles (Cont'd)

Proceedings at general meetings

- ▶ An article has been added on the rights of directors and anyone who is not a member of the company to attend and speak at a general meeting;
- ▶ Articles relating to the effect, validity and the delivery of relevant notices for proxies have been set out in greater detail;
- ▶ Articles on the contents and timeframe for notices of meetings have also been revised to align with those provided for in the NCO;

Share capital

- ▶ *Public companies:* the articles relating to forfeiture of partly-paid shares are set out in greater detail (default position for private companies ☐ shares must be fully paid up on issue);
- ▶ *Public companies:* an article has been added to deal with surrender of shares in lieu of enforcement of a call for payment;
- ▶ Amendments have also been made to reflect provisions in the NCO, providing for greater flexibility resulting from migration to no-par regime.

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Model Articles (Cont'd)

Practical considerations and recommended steps

- ▶ The Model Articles will have no impact on existing companies incorporated under the OCO.
- ▶ However, an existing company can amend its articles to follow the Model Articles if it so chooses.

Model Articles (Cont'd)

Recommended amendments to Articles

Abolition of Memorandum

- ▶ Restate provisions from Memorandum: For ease of reference, a company may wish to expressly restate any provisions formerly contained in the Memorandum (now abolished).
- ▶ Deletion of objects clause: A company may consider deleting its object clause for greater flexibility.

Model Articles (Cont'd)

Recommended amendments to Articles (Cont'd)

Share capital

- ▶ *References to par value:* The NCO abolishes the concept of par (or nominal) value of shares for both existing companies and new companies. Companies may wish to amend their Articles to reflect the no par regime, notwithstanding transitional measures and deeming provisions contained in the NCO.
- ▶ *Maximum number of shares:* The NCO provides that the amount of authorised share capital set out in an existing company's constitutional documents is deemed to be deleted. If shareholders so wish, they can amend the Articles to specify a maximum number of shares that may be issued. The maximum number of shares that a company may issue can subsequently be changed by way of ordinary resolution.
- ▶ *Reduction of share capital, financial assistance, share buy backs:* The Articles should be reviewed to identify and delete provisions that may impair a company's ability to take advantage of the more flexible procedures for reducing share capital, financial assistance and share buy backs under the NCO.

Model Articles (Cont'd)

Recommended amendments to Articles (Cont'd)

Meetings

Notice periods

- ▶ Under the NCO, the notice period for an AGM is at least 21 days. In any other case the notice period is at least 14 days for a limited company (irrespective of whether an ordinary or special resolution will be considered), and at least 7 days for an unlimited company (section 571(1)).
- ▶ If the Articles require a longer period of notice the meeting must be called by notice of that longer period (section 571(2)).
- ▶ As previously, for resolutions requiring special notice, such as the removal of a director or auditor, notice of the intention to move the resolution must be given to the company at least 28 days before the meeting (section 578).
- ▶ A company may wish to amend its Articles to reduce its notice periods to the new statutory minimum.

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Model Articles (Cont'd)

Recommended amendments to Articles (Cont'd)

Meetings (Cont'd)

Proxies

- ▶ The NCO provides that a proxy may exercise all or any of the member's rights to attend and to speak and vote at a general meeting (including voting on a show of hands, except in the case of multiple proxies) (section 596(1) and 591(3)).
- ▶ A company may wish to amend its Articles to include an express right for a proxy to vote on a show of hands.
- ▶ The Articles may also give more extensive rights to its members or proxies than are provided in the NCO (section 608).

Model Articles (Cont'd)

Recommended amendments to Articles (Cont'd)

Meetings (Cont'd)

Polls

- ▶ Under the NCO the threshold requirement for members to demand a poll has been reduced from 10% to 5% of the total voting rights. A provision to the contrary in the Articles will be void (section 591).

Meetings in two or more places

- ▶ Under section 584 of the NCO, a company may hold a general meeting at two or more places using any technology that enables the members who are not together at the same place to listen, speak and vote at the meeting, subject to any provision of its articles.
- ▶ A company may wish to ensure that there is no conflicting provision in the Articles.

Model Articles (Cont'd)

Recommended amendments to Articles (Cont'd)

Written resolutions

Circulation

- ▶ Under the NCO a company must circulate a proposed written resolution to all members who are entitled to vote if it has received requests from members representing not less than 5% of the total voting rights or a lower percentage specified for the purpose in the Articles (section 552).
- ▶ A company may wish to specify a lower threshold for circulation of written resolutions.

Deadline for agreement

- ▶ The period for agreeing to a proposed written resolution is 28 days, or such period as is specified in the Articles (section 558).
- ▶ If a company wants a longer or shorter deadline for agreeing a written resolution, this should be set out in the Articles.

Model Articles (Cont'd)

Recommended amendments to Articles (Cont'd)

Written resolutions (Cont'd)

Alternative procedures

- ▶ The Articles may also set out alternative procedures for passing a resolution without a meeting, provided that the resolution has been agreed to by all the members entitled to vote (section 561).

Execution of documents

- ▶ In order to take full advantage of the new flexibility in executing documents including deeds (in particular as regards optional use of a common seal), a company should amend its Articles to remove any prescriptive provisions regarding use of the seal or execution.

Directors' interests

- ▶ Provisions in the Articles on voting at directors' meetings where there is a conflict of interest should be updated to take into account the changes as regards disclosures of directors' interests and voting requirements in respect of connected transactions under the NCO.

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Part 8 – Listing Rule amendments following the implementation of the NCO



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Listing Rule Amendments

New templates of the Next Day Disclosure Return Forms

- ▶ The Exchange has published new templates of the Next Day Disclosure Return forms for Main Board and GEM issuers which are forms FF304M and FF304G, respectively.

Market Consultations

The Exchange has indicated that market consultations will be conducted on amendments to the Listing Rules in relation to:

- ▶ Notice periods for general meetings;
- ▶ Disclosure of financial information;
- ▶ Updating cross-references to the OCO so that they align with the NCO.

Frequently-Asked-Questions

In connection with the NCO, the Exchange published “FAQs relating to the NCO and its impact on issuers (Series 26)” to:

- ▶ provide explanation of the operation of the amended Listing Rules on annual listing fees;
- ▶ address the impact of the abolition of nominal (par) value on other areas of the Listing Rules; and
- ▶ provide guidance on those Listing Rules that may be affected by other provisions of the NCO.

Frequently-Asked-Questions (Cont'd)

Disclosure requirements for financial statements

FAQs	Relevant Listing Rules
<p>The FAQ state that all issuers (whether incorporated in Hong Kong or not) should include disclosures by reference to the provisions under the NCO in complying with Appendix 16 to MB Rules (financial statements disclosure requirements) which are equivalent to those under the OCO. To the extent that the new provisions increase the disclosure requirements beyond those under the OCO, non-Hong Kong-incorporated issuers are encouraged to comply with the requirements under the NCO (FAQ No. 11)</p> <p>The Exchange proposes to consult the market on amendments to the financial statements disclosure requirements.</p>	<p><i>MB Appendix 16 (paras 28 and 52); GEM Rules 18.28 (directors' remuneration only), 18.83, 24.20 (for overseas issuers) and 25.32 (for PRC issuers)</i></p>

Frequently-Asked-Questions (Cont'd)

General meetings

FAQs	Relevant Listing Rules
<p>The FAQs stipulate that Hong Kong-incorporated issuers may shorten the notice period for a general meeting at which a special resolution is to be proposed provided that the 14 day notice period requirement of the NCO is complied with.</p> <p>In the case of issuers incorporated in Bermuda or the Cayman Islands, the requirements that 21 days' notice must be given of an extraordinary general meeting at which a special resolution will be proposed, continue to apply.</p>	<p><i>MB Appendix 13(a) (para 3) and Appendix 13(b) (para 3(1)); GEM Appendix 11(a) (para 3) and Appendix 11(b) (para 3(1))</i></p>



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