THE POLITICS OF LAW REFORM: THE MAKING OF NEW COMPANIES LAW IN HONG KONG

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INTRODUCTION

It has been a time of high politics in Hong Kong. Dramatic changes have occurred and are afoot. The reform of the Hong Kong *Companies Ordinance* (Cap. 32) has been caught in the middle, straddling the transition in political sovereignty. The following paper will look to the major considerations that determined the direction of *The Consultancy Report on the Review of the Hong Kong Companies Ordinance*, its substantive recommendations, the process which produced it and the political influences at work.

A. A New Model for Hong Kong Companies Law

1. Hong Kong Companies Law: An Orphan in Asia.

Until quite recently, Hong Kong, like many other Commonwealth jurisdictions, looked exclusively to the United Kingdom in structuring its public institutions and formulating its legislation for a variety of obvious reasons. Other small jurisdictions as different as Singapore and New Zealand have done the same, essentially importing legislation developed elsewhere, and relying on the judicial and other resources of that jurisdiction to "maintain" the local legislation. Professor Walter Woon, formerly of the National University of Singapore and others have spoken of "legislation by Xerox". In Hong Kong, the process was an even more natural and integral one, Hong Kong being an extension of British territory.

There is still much merit in aligning Hong Kong legislation with that of another jurisdiction. In this particular area of the law, the United Kingdom no longer provides a model that is easily emulated. As long ago as 1973, the last major review of Hong Kong companies law noted that it would no longer be possible to look as a matter of course to U.K. law as a model for Hong Kong companies law.[1] Since then the difficulties of following a U.K. model were exacerbated by successive waves of complex and marginally successful companies legislation in the United Kingdom. Hong Kong companies law was orphaned.

In fact, Hong Kong companies law had been looking elsewhere for direction for quite some time, as had, to a greater or lesser degree, other

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1 Hong Kong, *Second Report of the Companies Law Revision Committee — Company Law* (12 April 1973).

common law jurisdictions including South Africa, Singapore, New Zealand, Australia and Canada. Recent initiatives to abolish the noisome doctrine of *ultra vires* in Hong Kong looked to the *Business Corporations Act (Ontario)*.[2] This initiative, however, also serves to illustrate the potential pitfalls of incorporating isolated provisions taken from foreign legislation which proceeds from different assumptions and underlying concepts. The Ontario legislation is specialised business corporations legislation, by its terms not applicable to the broad range of different entities, such as not-for-profit enterprises, which may be created under the current Hong Kong *Companies Ordinance*. The Ontario provisions, assuming as they did, applicability exclusively to commercial entities, could not be dropped, unaltered, into the Hong Kong legislation.

2. A New Model.

It is primarily for this reason that the *Consultancy Report* recommended a shift to a new, coherent model rather than cobbling bits and pieces of foreign legislation together with the current legislation. The piecemeal approach to legislative change in this area has been criticised both in the United Kingdom and in Hong Kong.[3] A new model would provide a coherent legislative framework for commercial entities in Hong Kong, internally consistent, conceptually clear and well articulated. What was proposed is not the old "legislation by Xerox". The use of model legislation, as it has been developed of necessity in federal jurisdictions such as the United States and Canada, is much subtler and more flexible.

The model provides the basic principles and structure of the legislation which can then be adapted in detail to local circumstances. With its fifty state jurisdictions, the United States has been a consummate master in developing this technique. Model laws, such as the *Model Business Corporation Act* ("*MBCA*"),[4] are developed by bodies like the American Bar Association, drawing on the vast resources available to them among practioners and academics. A detailed official commentary is provided section by section explaining the origins, purpose and intended operation of the model legislation. The legislation is then adopted voluntarily on a state by state basis, being tailored and adapted as each state wishes. Over time, the model itself is revised and updated.

In this way, the costs of developing and maintaining sophisticated and responsive legislation are spread across many states. Individual states are free to adapt the model legislation as they wish, but the basic principles of the model continue to inform local legislation. Reference can continue to be made to developments and evolution in both the model and judicial decisions in other jurisdictions using the model. This process has also been taking place, informally, among Commonwealth jurisdictions which share common roots; legislators and the judiciary in Commonwealth countries look increasingly to each other rather than back to the United Kingdom. Of course, given its wealth of sophisticated commercial legislation, everyone looks to the United States, if not to follow, then as a benchmark against which to act.

2 *Ontario Business Corporations Act*, R.S.O. 1990, c. B.16, as amended.
3 Standing Committee on Company Law Reform, Hong Kong; the *Comparative Survey*, Part 2 at 6.
4 American Bar Association, Committee on Corporate Laws, *Revised Model Business Corporations Act*, 1984. The Revised Model Business Corporations Act replaced the 1969 *Model Business Corporations Act*; the "revised" was recently dropped.

The recommendations in the *Consultancy Report* were drawn primarily from four interrelated sources: the U.S. *MBCA* (1984) (revised annually since then), the *ALI Principles of Corporate Governance* (1994),[5] the *Canada Business Corporations Act* ("*CBCA*")[6] (and its provincial variants) and the *New Zealand Companies Act 1993*.[7] The *MBCA* and the *ALI Principles of Corporate Governance* represent the expression of modern and sophisticated thinking in companies law. The *MBCA* provides the structural and conceptual framework upon which to build new legislation, as it did for the Canadian and New Zealand legislation. These U.S. sources also provide the ample annotation and rich body of commentary to inform the legislation and guide practitioners and the judiciary alike.

The Canadian and New Zealand legislation impart Commonwealth sensibilities to the U.S. model; they share the same U.K. roots. In particular, the prevalence in both New Zealand and Canada of majority held, publicly-traded companies and family controlled businesses (characteristics shared with Hong Kong) argues for a different balancing of shareholder/management powers than in the United States. As well, unlike the United States, the Commonwealth jurisdictions tend to be considerably more litigation averse in commercial matters. Mediation and other alternative dispute resolution mechanisms should be highly appropriate to Hong Kong business and are now becoming firmly established in Canada in commercial matters.[8] The New Zealand and Canadian legislation also provide the additional benefit of working legislative models; this is legislation which is operating in the real world, in the case of the Canadian legislation for over 20 years. In addition to an established body of case law and practice which can be drawn upon by the judiciary and practitioners, recourse can be had to administrative practices that make the legislation work.

Finally, the use of internationally recognisable models for companies law serves to enhance Hong Kong's role as a centre for international and regional business. The form of legislation proposed meets modern international expectations and would promote the use of Hong Kong incorporated entities for international business in the region. In addition, by developing modern companies legislation adapted to the Asian environment, the Hong Kong legislation itself could become the model and the benchmark for the region.

B. The International, Regional and Local Context of Hong Kong Companies Law

1. Hong Kong Companies Law in the International Arena.

Hong Kong is a major international centre for trade and finance, out of all proportion to its size. A recent study of the competitiveness of the Hong Kong economy by Professor Michael Enright identified Hong Kong's "unique set of strengths":

> Hong Kong's strong economic performance has been due to its location, its people and a distinct economic system. This system is characterized by unique balance and interaction

5 American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, vols. 1-2 (St. Paul, Minnesota, USA: American Law Institute Publishers, 1994).
6 Canada Business Corporations Act, R.S.C. 1985,c. C-44, as amended.
7 1993, No. 105.
8 See, e.g., J. McFarland, "Companies Move Away from Courtroom Battles" *The [Toronto] Globe and Mail* (22 November 1996) B-19.

between government and business, between local and overseas firms, between strategies of hustle and commitment, and between management and entrepreneurship. These combinations have allowed Hong Kong to emerge as an economic powerhouse with an influence in the global economy that goes far beyond what would be expected given its size. Hong Kong is far more than a passive bridge, gateway, or entrepot. Instead, Hong Kong and its firms are active packagers and integrators of activities for the local, regional, and global economy, matching demand and supply on an international basis.
Hong Kong is home to a unique mix of thousands of local firms with transnational operations or sales and over eighteen hundred overseas firms with offices or operations in Hong Kong. The combination of entrepreneurial companies and managerial companies found in Hong Kong is distinctive in the Asian context. Hong Kong also has a unique mix of firms employing "commitment strategies" based on large scale investments in industries with relatively stable cash flows such as transportation, infrastructure, property, and utilities, and firms employing "hustle strategies" based on flexibility, rapid response, competitive pricing in industries such as garments, toys, electronics, and trading. It is the interaction of the components of each combination, rather than the presence of any one component, that has created advantage for Hong Kong.[9]

Hong Kong's place at the centre of rapid internationalisation of trade and finance has several important implications for its commercial law.

At the highest level, the existence of an internationally recognised body of commercial law in Hong Kong has undoubtedly been one of the attractions for international businesses basing their regional activities in Hong Kong. However, this has meant that Hong Kong legislation, in important commercial areas such as securities, companies, insolvency, finance, does not exist in isolation. It operates in the international arena and is held up to international scrutiny.

Usually, company law serves primarily local interests, Delaware and the multitude of small offshore incorporation jurisdictions being the notable exceptions. Company law tends to have a local face. There are not the same international pressures towards uniform international standards which have manifested themselves, for example, in banking or financial markets regulation.

Nonetheless, there are identifiable trends in the structure of and regimes applicable to commercial entities in major trading jurisdictions which have produced international expectations, if not international standards. Based as it now is on a 1948 U.K. statute, Hong Kong companies legislation does not meet international expectations. Foreign interests doing business in Hong Kong are often surprised at some of the more archaic aspects of Hong Kong companies legislation, for example, the requirement that a company have two shareholders.

The internationalisation of commerce is also sparking heightened competition among jurisdictions. Singapore, Shanghai, Taiwan, Sydney are all positioned as rivals to Hong Kong as regional centres for business in Asia. The Enright study notes that competitors are improving and trying to duplicate or surpass Hong Kong's strengths. Although he concludes that competitors are unlikely to "out Hong Kong" Hong Kong anytime soon they are narrowing the gap or the perceived gap.[10] Commercial infrastructure is identified as one of Hong Kong's advantages; commercial law is an important if intangible component of the commercial infrastructure. Enright exhorts Hong Kong to stay "ahead of the curve in infrastructure, education and training for the economy of the future".[11]

9 M. Enright et al., *The Hong Kong Advantage. A Study of the Competitiveness of the Hong Kong Economy* (Hong Kong: Vision 2047, 1996) (Enright), Executive Summary at 1-2.
10 Enright, *supra*, at 4-5.
11 Enright, *supra*, at 10.

A recent study by the Hong Kong Society of Accountants sounded a similar note.[12] Prevailing corporate governance practices in Hong Kong taken as a whole were "respectable by international standards and high by regional standards." The study goes on to flag the increasing competition in the region and the importance of continuous improvement in the business environment: "However, to maintain and enhance Hong Kong's image as an international financial and commercial centre amidst increasing competition, particularly those from the region, Hong Kong needs to continually improve its business environment, including its method of corporate governance to ensure investor confidence".[13]

In terms of "staying ahead of the curve" in the legal infrastructure, the lead is coming from the financial markets in Hong Kong. This is an area of rapid specialisation, considerable technicality and a very high degree of international integration and interdependence. It is a major Hong Kong industry and one that is regulated with great finesse. The Stock Exchange of Hong Kong ("SEHK") and the Securities and Futures Commission ("SFC"), as well as the Hong Kong Monetary Authority and the Futures Exchange, are all very much plugged into the international financial community and its regulatory structures. Regulation and commercial practices are responsive to and driven by international standards.

The emergence of Hong Kong as a major international financial centre has only served to highlight the inadequacies of outdated companies legislation. Old-fashioned Hong Kong companies legislation is out of step with the modern regulation and oversight of capital markets of which it is an essential part. The financial regulators are all too aware of the inadequacies:

> I see the need for a fundamental review as urgent. The total costs to the business community of poorly drafted legislation — in terms of management time, professional fees, and general uncertainty — are very great. Conversely, clear and simple business legislation is a major "national" asset.
> The proposal to unbundle the Companies Ordinance into a core company law and various pieces of specialist legislation seems a good one. If this effort is successful, Hong Kong's business statutes could overleap the burdensome process of modernisation in which the UK and other advanced countries are floundering and reach a "post-modern" era in one bound.[14]

Any new companies law regime must be contemporary and compatible with the directions taken in financial markets regulation.

2. Hong Kong Companies Law in the Asia Pacific Region.

Hong Kong is very much a regional business centre as well as an international one. Enright has stated:

> Hong Kong also is uniquely situated at the most important economic crossroads in the world today, between East and West, between East and East (intra-Asian trade and investment), between North and South, between industrialized and developing nations, between capitalist and reforming economies, and between China and everywhere else. Hong Kong is well situated in the center, both literally and figuratively, of the most dynamic economic region in the world today.
> Hong Kong also has emerged as the de facto capital of the overseas Chinese business community which is playing a powerful role in the growth of the economies of east and

12 Hong Kong Society of Accountants, *Second Report of the Corporate Governance Working Group*, January 1997, at 3.
13 *Ibid* at 3.
14 Letter of Matthew Harrison (Director, Research and Planning - SEHK) to Ermanno Pascutto (14 November 1995).

southeast Asia. This has increased Hong Kong's importance as a conduit between overseas Chinese and opportunities on the Mainland and elsewhere in Asia. It has enhanced Hong Kong's position as Asia's leading headquarters location for overseas firms and one of the world's principal sources of foreign direct investment.[15]

As such, Hong Kong's companies legislation operates primarily in the Asia Pacific region.

History has made the Asia Pacific a region of great diversity – politically, economically and legally. As documented by Gordon Redding[16] and others, a unifying thread in the commercial activities of the region has been the phenomenon of the overseas Chinese business empires, large and small. The overseas Chinese business community provides the common denominator for business structures and practices throughout the region. Although overseas Chinese comprise only six percent of the population of ASEAN nations, they exercise economic influence out of all proportion to their numbers. Notable characteristics of overseas Chinese businesses include an emphasis on informal networking, networking along ethnic/ linguistic lines, and aversions to litigation and debt.

The most notable characteristic is the use of the family controlled company by businesses both big and small.[17] The Second Corporate Governance Study of the HKSA confirmed the "widespread view that the extent of control by one shareholder or one family group of shareholders in the shareholding of listed companies in Hong Kong is significant".[18] Almost 90 percent of all Hong Kong listed companies have one shareholder or one family group of shareholders owning 25 percent or more of their entire issued capital; 77 percent show one shareholder or family group owning 35 percent or more of the entire issued capital, and more than half have one shareholder or family group owning 50 percent or more.

In terms of legal regimes, however, the source of greatest diversity in companies law throughout Asia is the mix of the two major Western legal traditions, the civil law and the common law, which overlay local and perhaps religious law which predate them. Each legal tradition takes a distinctive approach to business enterprise law, using different structural techniques and balancing different interests. Although some jurisdictions have successfully implanted elements from the different traditions into their business enterprise law, indiscriminately mixing and matching legal regimes can produce undesirable results. Malaysia, Singapore, Australia, New Zealand and Hong Kong originally aligned their legal regimes with the U.K. version of the common law tradition, whereas much of the rest of Asia has looked first to European civil law. This traditional alignment is breaking down, as North American influences make themselves felt in the commercial law area.

Adding to the diversity of approach to business enterprise law in the Asia Pacific region is the interaction of developed market economies, such as Hong Kong's and emerging market economies such as those of the PRC and Vietnam. Much of Hong Kong's phenomenal rise to prominence has been attributed to a wide open approach to doing business, free of government intervention. The emerging market economies around it are,

15 Enright, *supra,* at 3-4.
16 G. Redding, *The Spirit of Chinese Capitalism* (Berlin: Walter de Gruyter, 1990) Hereinafter, Redding.
17 The Review of the Hong Kong Companies Ordinance, *Family-Controlled Companies Background Memorandum*, at 1-3.
18 *Supra*, note 13 at 4.

on the contrary, subject to highly interventionist policies and only at the very beginning of a long process of creating the legal infrastructure to support a significant level of market economy activity. The business enterprise legislation required to promote their objectives may need to be structured quite differently from that of a developed market.

It is for these reasons that companies law in Hong Kong will likely continue upon a different path of development from that in the People's Republic of China. Throughout the course of preparation of the *Consultancy Report* the question was asked as to the degree to which Hong Kong companies law should be aligned with that of the PRC. The answer is that Hong Kong companies law proceeds from a different starting point and will continue to be distinct from that of the PRC for the foreseeable future.

First of all, it is so stipulated in the *Basic Law*,[19] which is now Hong Kong's constitution. Article 8 of the *Basic Law* maintains the existing common law legal system (that has been operative in Hong Kong for over 150 years) for the next 50 years. The Western legal tradition being gradually reintroduced in the PRC after a hiatus of several decades is primarily European civil law inspired (German law, by way of Japan and Taiwan). Although the PRC has been quite eclectic in its use of foreign models for its 1994 *Companies Law*,[20] the predominant influence of the German model is quite discernible. Structural concepts, such as dual boards and worker participation in management, have been astutely turned to socialist market economy purposes but would appear quite alien to the Hong Kong business community.

Secondly, the primary purpose of the new PRC *Companies Law* is "corporatisation" of state-owned enterprises in furtherance of the transition to a market economy. The PRC legislation is a first step, and a good one, towards creation of a more comprehensive companies law. It is essentially transitional in nature and somewhat incomplete pending the further development, among other things, of mature capital markets on the mainland. Hong Kong is a freewheeling market economy with developed capital markets. Over 98 percent of the companies in Hong Kong are private and virtually 100 percent are owned by the private sector (as opposed to the state).

The PRC has looked to sophisticated commercial legislation from many sources and it is quite possible it will also look to Hong Kong. As Hong Kong has taken a lead in the region in the development of its financial markets regulation, companies legislation setting the standard in the region would be a natural complement.

3. Hong Kong Companies Law in the Local Commercial Context.

(i) General commercial dealings.

Companies are the prime actors in local business dealings and so considerations respecting third parties are pertinent to companies law reform. Much of the credit for the phenomenal economic success of Hong Kong has been attributed to the non interventionist, free market policies of the Hong Kong Government. Balanced against the desirability of these policies, however, are concerns of fair dealing in the marketplace. These

19 *The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China*, adopted at the Third Session of the Seventh National People's Congress on 4 April 1990.
20 Company Law of the People's Republic of China, 1994.

concerns have been acute with respect to the public capital markets with both the SEHK and the SFC determined to promote integrity in the market and the containment of commercial fraud. The SFC has spoken of the creation of a "culture of compliance".[21]

Concerns with commercial fraud are not confined to Hong Kong. The United Kingdom's introduction of the Serious Fraud Office, to combat financial fraud, is one example. However, with the prospect of the transition to a Special Administrative Region of the PRC, concern was expressed with respect to the possibility of an increase in commercial fraud.[22]

There are measures related to companies law which promote a business environment of fair commercial dealing, primarily in the interests of third party trade and consumer creditors. Easily accessible public information with respect to company solvency and creditworthiness is the most important. In a comment letter from the Consumer Council, for example, more public information with respect to undischarged judgment debts was requested. The Consumer Council was also concerned that short of an action for fraudulent trading (which, like all allegations of fraud, is hard to prove), there was very little redress for consumer creditors with a grievance.

Very much related to issues of creditworthiness and solvency is the question of a comprehensive regime dealing with personal property security interests. Two separate issues are involved; implementing a modern regime for the systematic creation of security interests in a whole spectrum of personal property by any person or entity and providing for easy public access to such information. Part III of the Hong Kong *Companies Ordinance*, Charges, is inadequate for dealing with the complexity of modern commerce. Modern, sophisticated working models for personal property security interest regimes exist elsewhere. Ideally, intelligent use of information technology provides centralised access to the information most significant to trade and consumer creditors.

(ii) Proliferation of overseas incorporation by Hong Kong businesses.

A curious anomaly in some respects, given that Hong Kong has rapidly risen to prominence as a major international business centre, is the equally rapid rise of foreign incorporation of Hong Kong business. In some respects, this is a phenomenon sparked by the conjuncture of political, fiscal and commercial forces unique to Hong Kong. Although there has been abundant speculation as to the implications of political risk for Hong Kong businesses, strictly financial and commercial factors emerged as primarily responsible for the wave of offshore private company incorporations.

The British Virgin Islands (BVI) appears to be the jurisdiction of choice for private foreign incorporations of Hong Kong businesses. Although 1121 BVI companies were registered under Part XI of the Ordinance as of December 31 1996,[23] the vast majority are not registered and their actual presence in Hong Kong is estimated to be over 100,000. Professional advisors appear to be the driving force behind the proliferation of these offshore incorporations. The speed and ease of incorporation and reduced costs of operation were cited. BVI incorporation has been found to be

21 SFC, Annual Report 95/96: A Strategic Outlook for the Future at 15.

22 See e.g., P. Stein and P.W. Tam, "Hong Kong Market Reform Isn't Fast Enough for Some" *Asian Wall Street Journal* (9 September 1996) at 1.

23 According to statistics provided by the Companies Registry, the number of incorporations registered under Part XI of the Ordinance from the British Virgin Islands increased by almost 1 percent from 1121 at December 31, 1996 to 1131 at January 31, 1997.

suitable for both small flat owning companies and as a building block in major commercial conglomerates. The enabling nature of BVI companies law, as well as the absence of stamp and capital duty, ongoing reporting formalities, and the mandatory audit ranked high in the decision to incorporate in the BVI.

As for listed company offshore incorporations, political considerations appear to have given way to competitive forces; Bermuda and the Cayman Islands, having been recognised as acceptable jurisdictions of incorporation for listing purposes in Hong Kong, compete in a variety of ways to attract such incorporations. This does not constitute a "race to the bottom" since both jurisdictions must remain reputable for listing purposes in Hong Kong. In this way, the SEHK and the SFC continue to monitor the standards of corporate governance of these companies by serving as the gatekeepers to their entry into the public markets in Hong Kong. Both Bermuda and the Cayman Islands promote their responsive legislation and fine professional and back office services as primary attractions.

The recommendations in the *Consultancy Report* are geared primarily to structural features either common to public and private companies or exclusively related to private companies. Public and listed companies will, by definition, be of a sufficient size and economic significance to engage sophisticated professional advisors to structure their affairs; such structuring may point to offshore incorporation. Given that oversight of their financial market activities in Hong Kong should be subject to the SFC and, in the case of listed companies, the SEHK as well, there are few compelling reasons to dictate local incorporation in Hong Kong.

With respect to private companies on the other hand, there are much stronger arguments for actively promoting local Hong Kong incorporations, shareholder protection and the maintenance of respectable standards of commercial dealing being among them. Small businesses should prefer Hong Kong incorporation; it should be in their best interest. The remarkably high incidence of foreign incorporation of private companies by Hong Kong businesses is very much at odds with the usual bias of such businesses in favour of the convenience and predictability of local incorporation.

C. The Guiding Principles

1. The Basic Building Block

The first objective of a modern companies law in a developed economy should be to provide a simple, efficient and cost effective method of incorporation and ongoing corporate maintenance. The pace and complexity of modern commercial dealings has far outstripped the nineteenth century company law forms and procedures, the vestiges of a more leisurely and localised business environment. The modern corporation has become a basic building block of commercial activity. It should be possible to incorporate quickly and cheaply. The costs and complexity of incorporation and maintenance of a Hong Kong company were cited frequently as the underlying cause for recourse to BVI incorporations. Hong Kong based businesses have a local alternative which is competitive with foreign incorporations of convenience.

With the emergence of specialised regulatory regimes in other areas such as insolvency and securities regulation, companies law can be freed

of a heavy regulatory burden. Companies law can become, as it has in other jurisdictions, permissive, facilitative and enabling.

Rather than relying upon externally imposed administrative and criminal sanctions, company law can be structured so as to be primarily self-enforcing. This is a corollary of a permissive, facilitative and enabling regime; there are few mandatory provisions and little to prohibit. The Hong Kong *Companies Ordinance* contains a multitude of offences,[24] compliance is spotty and enforcement necessarily ineffectual. In the proposed regime, greater reliance would be placed upon civil and contractual remedies. The burden of enforcement would be shifted to those most directly aggrieved and, to the extent possible, the participants themselves would be encouraged to fashion their own dispute resolution mechanisms in advance. Recourse to court order would be exceptional and the use of alternative dispute resolution such as commercial arbitration and mediation would be recommended.

2. Simplification and Rationalization

In terms of simplifying and rationalising legislation,[25] form is as important as content. Much of Hong Kong legislation reflects 19th century drafting which tends to be prolix to no good end. Much of the language in older U.K.-style statutes is at odds with modern drafting techniques to say nothing of modern English usage. The language itself was often drawn straight from the 19th century case law. The clarity and economy of modern drafting techniques can be applied to commercial legislation to good effect.

In Hong Kong, a change in drafting style is imperative, the necessity arising out of the translation of all English legislation into Chinese. The Legal Department is considering "a systematic programme to rewrite laws in both languages to make them clearer".[26] In the same article, Bar Association chairman Gladys Li Chi-hei is quoted as saying "Let us strive to do what we can to simplify and inform, rather than to transform what is impenetrable in English into impenetrable Chinese".[27] The experience has been similar in other jurisdictions (such as Canada) in the move to a bilingual legislative system; the discipline of the translation process has instilled a belief in the virtues of simplicity and clarity.

3. Core Company Law

The overall approach recommended by the *Consultancy Report* is one characteristic of North American corporate law regimes, a "core company law". It is the approach recently followed in New Zealand in its *Companies Act 1993*. Several substantive areas are identified as more appropriately dealt with in separate legislation: capital market activities of public and listed companies, charges, insolvency, regulation of financial institutions, and not-for-profit enterprises. With the increasing complexity of commercial dealings and the development of areas of specialised regulatory focus, company law would no longer serve as a general repository for all statutory commercial law.

24 See Laws of Hong Kong, Cap.32, *Companies Ordinance*, Sch.12 which lists 25 pages of offences, section by section.
25 Schedule A - Terms of Reference.
26 "Plan to rewrite century-old laws in modern language", *South China Morning Post* (13 Nov 1996) at 3.
27 *Ibid.*

4. Mainstream Models

Obscurity does little to promote continuity, stability and certainty in commercial dealing. The recommendations attempted to build on the company law institutions and concepts familiar to the common law world but place them in a more coherent and rational framework. Where older constructs no longer served a purpose they were replaced with newer working formulations. There was very little in the recommendations that was cut from whole cloth; in the interests of continuity, stability and certainty, the recommendations were drawn from existing legislative models for which a body of judicial interpretation and commentary exists. Most importantly, in addition to clearing out the legislative accretions of decades, the recommendations strived to obviate the convolutions of the old case law which only add to the cost of doing business.

5. Ideological Stance

The recommendations do not purport to be ideologically neutral; they were made very much with the Hong Kong policy of minimum government intervention in the market in mind (as is expressly required by the Terms of Reference).[28] The goals were quite modest, the creation of a basic building block for commercial activity. Viewed as such, a company law regime can remain relatively stable for long periods of time. Other areas of the law are subject to much greater and more frequent shifts in underlying policy. Tax policy can be notoriously changeable, for example. It became evident at several points that the primary purpose served by some Hong Kong *Companies Ordinance* provisions was related to Inland Revenue considerations. Such a purpose was not viewed as a compelling reason to retain a provision which did not otherwise serve core company law ends.

6. International Outlook

Finally, as attuned to local circumstances as it may be, companies law in Hong Kong cannot afford to be parochial. Hong Kong is an international commercial and financial centre the importance of which is disproportionate to its size. Both international and Hong Kong businesses are nimble and well aware of the alternatives available to them. To continue to compete effectively, companies law in Hong Kong must take into account and meet international expectations with respect to the incorporation, operation and administration of modern companies.

D. The Process and its Implications

1. Description of the Process

The Review was commissioned in late November 1994; a two year mandate was given beginning in January 1995 and ending December 31, 1996. A former regulator with the SFC was appointed as the formal lead of the Review and the author was engaged on a full-time basis to implement the Review and research and prepare the Report. A series of research assistants, students from the Faculty of Law at McGill University, provided research support.

In accordance with the terms of the mandate, an Inception Report outlining the objectives and scope of the Review, the proposed methodology

28 Schedule A.

for conducting the Review, the areas of substantive investigation and a tentative timeline, was submitted to the Financial Services Branch (FSB) in February 1995. In the Inception Report it was proposed that the Review begin with the preparation of two background reports, one an overview of the Ordinance, its legislative history and a brief analysis, and the other a comparative survey of companies law in a number of jurisdictions (the United Kingdom, Australia, New Zealand, Canada, South Africa, France, Germany, the European Union, the United States, Singapore, the People's Republic of China and later expanded to include Bermuda).

As proposed in the Inception Report, the issues raised in the Terms of Reference were grouped into five broad areas or modules to be addressed sequentially. This approach was adopted primarily in order to discuss and determine the acceptability of the overall direction upon which much of the consideration of the substantive issues that ensued would depend. It was also hoped, in vain as it turned out, that this approach would accelerate the process of consideration and coordinated legislative action. Finally, regrouping the substantive areas of investigation in this manner permitted a more focused approach to the working party consultations and a better allocation of consultative resources. The five modules were:

Module 1: Identification of Core Company Law

Module 2: Corporate Formalities

Module 3: Shareholders' Rights, Remedies and Communications

Module 4: Directors' Duties; Corporate Governance Issues

Module 5: Foreign/International Business Corporations.

To this end, working parties were formed to advise on a module by module basis, drawing on various specialised expertise and ensuring channels of communication with the professional and business communities having the greatest interest in the *Ordinance*.

Members of various working parties included solicitors (qualified in several jurisdictions in addition to Hong Kong), barristers, in-house counsel, accountants, company secretaries, business people, academics, as well as the Registrar of Companies (and other representatives from the Companies Registry), the Official Receiver, representatives from the Attorney General's Chambers, the SFC, the Monetary Authority, and the SEHK. Several working party members were also members of the Standing Committee on Company Law Reform which had been created in 1984 after the last round of major revisions to the legislation. The presence on all working parties of a representative from the Attorney General's Chambers and from the Companies Registry ensured continuity from one working party to another.

Each working party met a number of times for a total of 23 meetings. Background information in the form of issue lists, briefing papers and background memoranda was supplied to each working party. A comparative and analytical approach was adopted; legislative responses in several jurisdictions were canvassed on particular issues accompanied by an assessment of strengths and weaknesses. The primary jurisdictions considered were the United Kingdom, the United States, Canada, Australia and New Zealand. As there was great interest in the legislative treatment of private companies, an additional paper on the close corporation/private company in Singapore, Malaysia, Taiwan and Japan was prepared. In order

to focus deliberations as the working parties progressed, draft recommendations and commentary were prepared and tabled for discussion. On some issues consensus developed quickly; on others, none was reached.

The approach did raise some difficulties of continuity; new working party members in the later modules arrived "cold" to issues that had received extensive consideration earlier in the process and were briefed on prior discussions and decisions. On the other hand, there was the benefit of diverse viewpoints and "fresh eyes" on an ongoing basis. Furthermore, working parties could be formed to include persons with particular interests or expertise.

There was considerable interest expressed in the reform efforts by academics and law reform bodies around the world. Comments and assistance were provided, primarily over the Internet, by academics in Europe, the U.K., South Africa, Singapore, Australia, New Zealand, Canada and the United States as well as the PRC. In addition, former members of New Zealand's Law Commission, the Corporations Law Simplification Task Force (Australia), the Corporations Directorate of Industry Canada, the Department of Trade and Industry in the U.K. and the Company Law Committee of the U.K. Law Society, all provided valuable and timely information.

Three outside consultants participated at various times. Mr. David Goddard, who had participated in the preparation of the New Zealand Law Commission's report on company law reforms which led to implementation of the New Zealand *Companies Act 1993*, provided the benefit of very recent law reform experiences in this area. Professor Len Sealy, then the S.J. Berwin Professor of Corporate Law at Gonville and Caius College, Cambridge University, provided ongoing assistance and commentary at every stage of preparation of the *Consultancy Report*. Mr. John Howard, one of the three original members of the Dickerson Committee responsible for the Canada Business Corporations Act, also provided assistance and commentary in the final stages of preparation.

2. The Politics of Process

(i) The Transition

Process is politics, of course. The political events of the time in Hong Kong did influence the process of the Review but perhaps not in the way many imagined. Initially, given the fact that the Review was commissioned by the outgoing administration with a deadline corresponding so closely with the resumption in sovereignty by the PRC, the assumption was sometimes made that the intention was to bring in new legislation before the transition, under the wire so to speak. This had never been contemplated since the *Consultancy Report* itself was merely a preliminary step in a process that would easily take five years or more.

Towards the end of the Review, in the weeks leading up to the handover, the question then became the influence which the mainland did or should have on the orientation of the recommendations. There again, the influences were not what might be imagined. During the course of the Review there had been no formal contacts or consultation with Beijing concerning to the Review process or its product, either on the part of the consultants, or the part of the Hong Kong administration. This was not particulary surprising or untoward.

However, in the process of preparing the Report (and in particular the background report looking at companies law in a number of jurisdictions), there were several days of discussions with different senior members of the Standing Committee for Legislative Affairs of the National People's Congress. In July 1994, shortly before the Hong Kong Review began, the PRC had implemented a companies law. Obviously this new legislation was of great interest to all those engaged in China work out of Hong Kong.

The discussions with the members of the Beijing Standing Committee were of an academic nature and for the purpose of mutual exchanges of information. As with all the academics and agencies which assisted in the Review, the *Consultancy Report* and various background papers were sent to Beijing as a matter of courtesy. So, although there is no doubt as to the interest which Beijing took in the process and its product, it was primarily an academic, and not an overtly political, interest.

Having said this, the question which, again, is repeatedly asked is the extent to which Hong Kong companies law should be aligned with that of the mainland. The short answer, for some of the reasons given above, is that it shouldn't. Very different economies at a very different stage of development. Different legal traditions and a different role for companies legislation. That the two will converge over time is inevitable but it will not happen overnight; it will be a much slower process of growing familiarity and accommodation.

In terms of which way the influences will flow, at this juncture, there seems little doubt that the mainland would look to Hong Kong for inspiration and direction. This has certainly been the case with respect to capital markets regulation where the SFC and the SEHK provide ongoing training and assistance to the mainland.

(ii) The Row over Legco

One unfortunate casualty of the political transition was a possible second volume to the *Consultancy Report*, which would have contained draft or model legislation to accompany the text of the *Consultancy Report*. This format was not new to Hong Kong, having been used in both the areas of insolvency and securities law. It was the format of the Dickerson Report, the Ghana Code, the Model Business Corporations Act and New Zealand Law Commission, *Company Law-Reform and Restatement, Report No. 9* (1989).

The virtue of draft or model legislation is that it provides precision to the generality of the recommendations. In fact, many of the subsequent questions that have arisen in the public consultation period as to the mechanics and application of the recommendations would have been answered by reference to a form of draft legislation.

Including draft legislation had been discussed for many months during the course of the Review. It had not been envisaged in the original mandate and would possibly have required an extension to complete. Producing draft legislation in a law reform report can have untoward consequences to the extent that it can be seen as preempting the role of other government departments.

Aggravating the situation in this case was the fact that early in 1997 a very conspicuous row broke out between the U.K. government and the PRC over the provisional legislature which the PRC announced it would put in place immediately upon taking over Hong Kong. This would have

the effect of decimating the Democratic Party representation and ousting the sitting legislature, the first to have been elected in Hong Kong in 1995 by a somewhat democratic procedure. The idea of producing a second volume of draft legislation to accompany the *Consultancy Report* died a quiet death in early January 1997.

(iii) Fashionability

Now for a word about fashionability. Hong Kong is a chameleon. It is a place that can change very quickly, and indeed, this has been a key to its economic success. Responsiveness, rapid shifts in the economy, opportunism, are second nature. It is a place where fashions sweep through town like a raging case of the measles.

It was apparent in the very early weeks of the Review, at the beginning of 1995, that the best means of addressing the Terms of Reference, the desire for rationalisation and simplicity, was to look to North American models. In certain circles, the prospect of no longer following U.K. law raised considerable alarm if not downright hostility.

By the time the Report was being finalised, two years later, in the spring of 1997, Hong Kong was firmly focused on all things Chinese: Cheongsams, Gong Li and Shanghai Tang were all over town. The China Club, with its dim sum, 1930s Shanghai decor and the Long March Bar, was the hottest spot to lunch. With its major recommendation being a turning away from U.K. law, the *Consultancy Report* by the time it made its appearance had became fashionable. Newspaper reports attributed its orientation to "obviously" political motives.

(iv) The Prospect of Hanging

The prospect of hanging is said to concentrate the mind wonderfully. The original mandate required a final report to be produced by the end of December 1996, but allowed for some slippage into 1997. Because of the impending change in sovereignty, there was no room for extending the mandate beyond July 1, 1997. The imposition of an historic and immutable deadline resulted in speed and focus. There was little time to waste and little dillydallying.

Focus was the consequence of a rigid time frame and very limited staffing. This was not a broad consultative effort. Consultation within Hong Kong was limited to working party sessions. Working party members were handpicked, high level representatives of various constituencies. The orientation of discussions, although involving diverse and sometimes conflicting viewpoints, was very much determined by the briefing books and background papers.

The result is a report which bears little resemblance to similar efforts which are the product of committees. It is written by one person and demonstrates an internal coherence and consistent point of view, in the tradition of some of the best reports of its type, Gower's 1962 Ghana Code[29] and the 1972 Dickerson Report.[30] The objective was to provide a conceptually consistent and coherent starting point for any legislative action, irrespective of the ultimate direction such action might take.

29 L.C.B. Gower, *Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana* (1961).

30 R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971).

Both a strength and a weakness, the *Consultancy Report* very much represents a very focussed view of the possible future direction of Hong Kong companies law. If it is the wrong direction, it is terribly wrong. The very tightly focused approach for both the process and the report itself may preclude discoveries and innovations that might have surfaced in a more diffuse and less pressured investigation, although the counter argument here is simply that that is not the Hong Kong way.

(v) Likely Fate

So, what happens to a law reform report commissioned by a dying colonial administration after a change in sovereignty? Does it get put on the shelf to gather dust?

A change in sovereignty is considerably more dramatic than a run-of-the-mill change in government. The actual administration in Hong Kong, however, demonstrates a great deal of continuity with that of pre-handover days. A policy of "localisation" requiring many senior positions in the administration to be held by ethnic Hong Kong Chinese who are not foreign passport holders began several years ago and had largely made its mark by July 1, 1997.

The fate of this *Consultancy Report* is finely balanced. The public consultation period runs to March 31, 1998. The *Consultancy Report* was commissioned as one independent of government, leaving the administration free to take it up or distance itself, as appropriate. The official government position, pending conclusion of the consultation period, is one of neutrality.

In some quarters there is enthusiasm for the proposals and the assumption that the government will proceed fairly quickly in the direction indicated in the *Consultancy Report*. In other quarters, there is greater circumspection, for a variety of reasons ranging from personality clashes to the perception that the adoption of the proposals could be detrimental to certain vested interests. Whether a champion emerges from the thickets, and what might prompt such an appearance, is an open question.

One possibility would be to let the *Consultancy Report* "age". Put the *Consultancy Report* in the closet for a few years and shake it out at another time; it has a classic cut, like a good tuxedo, and will still present well a few years down the line. Hong Kong has already waited 25 years for modern company law, it can wait a few more. The risk, of course, is that the current trends towards offshore incorporation, already remarkably strong in Hong Kong,[31] would accelerate, in effect moving the centre of gravity in commercial matters outside Hong Kong. Hong Kong would have missed the opportunity to become Asia's leading commercial law jurisdiction.

31 Over 70 percent of Hong Kong listed companies are incorporated outside Hong Kong and tens of thousands of businesses in Hong Kong use British Virgin Islands private companies. As one member of the Hong Kong Standing Committee on Company Law has said, "only the poor schmucks on the street who don't know any better would incorporate under Hong Kong law".

SCHEDULE A

REVIEW OF THE HONG KONG COMPANIES ORDINANCE

TERMS OF REFERENCE

Having regard to:-

(a) The Government's policy of minimum interference in the market;
(b) the economic and legal systems in Hong Kong;
(c) Hong Kong's status as an international financial and business centre;
(d) the particular and unique aspects of the corporate culture in Hong Kong;
(e) recent developments in companies law and regulation in other comparable jurisdictions; and
(f) the existing framework of securities-related law and regulation in Hong Kong,

consider and make recommendations on the following matters:-

A.
(a) The proper aims and objectives of the Companies Ordinance
(b) Whether private and public (and, in particular, listed) companies should continue to be subject to the same regulatory regime, under the Ordinance, in relation for example to requirements for accounts, or whether they should be the subject of distinct and separate regulation in the light of, inter alia,
(i) developments in the role and responsibilities of the Securities and Futures Commission since its establishment in 1989; and
(ii) the fact that 50% or more of the companies listed on the Hong Kong Stock Exchange are incorporated overseas,

and if the latter course of action is proposed, to make recommendations as to the nature of the respective regulatory regimes for private and public/listed companies.

B. The scope for and desirability of -
(a) rationalising and simplifying the Ordinance, including a greater use of subsidiary legislation and/or administrative arrangements;
(b) streamlining and simplifying the procedures prescribed under the Ordinance, including in relation to the incorporation of a company and the submission of returns;
(c) codifying duties and responsibilities and stipulating minimum qualifications and capacities for company directors;
(d) including more specific statutory assistance for minority shareholders, and other persons who deal with companies, who wish to forestall, or to seek redress against, misconduct or abuses by a company and/or its directors (including through easier access to the judicial process);
(e) extending financial and other disclosure requirements, having regard also to existing non-statutory rules in respect of listed companies;
(f) rationalising and making more effective the enforcement provisions and sanctions under the Ordinance;
(g) extending regulatory powers in relation to the investigation and inspection of a company's affairs; and
(h) providing alternative forms for the constitution of a company.

C. Whether Part XI of the Ordinance is sufficient to regulate the activities of companies incorporated overseas with a place of business in Hong Kong.

D. The relevance with respect to Hong Kong of the development of international business companies.

E. Such other related matters as the Secretary for Financial Services may from time to time specify.

November 23, 1994
Hong Kong

SCHEDULE B

REVIEW OF THE HONG KONG COMPANIES ORDINANCE

HIGHLIGHTS OF THE RECOMMENDATIONS

Simplification of the Ordinance
- Streamlining and rationalisation of structure
- Simplification and modernisation of statutory language
- Adoption of a "core company law" approach
- Removal of provisions relating to securities regulation, charges, insolvency and not-for-profit organisations
- Facilitation of solvent corporate reorganisations and restructuring, especially among related companies
- Decriminalisation of companies law; greater reliance on self-enforcement

Incorporation
- Quick, single-step incorporation procedures
- One person, one director companies
- Facilitation of electronic filing and record keeping
- Import/export provisions to facilitate international operations

Private Companies
- Creation of an optional statutory regime for private companies
- Streamlining formalities
- Provisions permitting informal and consensual operation
- Permitting shareholders to eliminate the board of directors
- Non-litigious dispute resolution mechanisms

Accounts and Audits
- Elimination of the Tenth Schedule; reference instead to external generally accepted accounting principles
- Private companies would have the option of eliminating the mandatory audit

Capital Structure
- Facilitation of the creation of modern, flexible capital structures
- Prohibition of par value shares and partially paid shares
- Optional pre-emptive rights
- Replacement of the capital maintenance requirements by a solvency test
- Provisions for optional use of uncertificated or book-entry securities

Directors and Executive Officers
- Statutory formulation of directors' and executive officers' duties
- Provision for action being taken without the necessity of a meeting
- Facilitation of meetings using telecommunications
- Duty of fair dealing in interested transactions
- Safe harbour provisions for interested director transactions, based on disclosure, disinterested voting and fairness to the company

Shareholders
- Broadening of the current unfairly prejudicial and just and equitable winding up remedies
- Creation of new shareholder remedies:
  - statutory derivative action
  - an appraisal/buy-out remedy triggered by fundamental changes
  - statutory compliance and restraining order
- Statutory unanimous shareholder agreement

International Implications
- Creation of modern legislation meeting international expectations which provides an alternative to offshore incorporation for Hong Kong businesses
- Avoidance of provisions having an extraterritorial effect
- Introduction of a simple "carrying on business" test for registration by foreign companies

Transitional Measures
- Three to five year transitional period for implementation
- Mandatory continuance by simple re-registration procedures for existing companies

Source: The *Consultancy Report* on the Review of the Hong Kong Companies Ordinance (March 1997).

SCHEDULE C

SUMMARY OF RECOMMENDATIONS

1.00 GENERAL RECOMMENDATIONS FOR A NEW BUSINESS CORPORATIONS ORDINANCE

1.01 Aims and Objectives. **The proper aims and objectives of companies law in Hong Kong should be:**

- to provide a simple, efficient and cost effective method of incorporation and ongoing corporate maintenance;
- to be enabling and permissive rather than regulating and prohibitive;
- to the extent possible, to be self-enforcing so as to avoid intervention of public authorities and to limit the necessity of recourse to the judicial system;
- to be written in clear, concise language so as to be accessible to business people as well as lawyers and accountants;
- to focus on "core company law", the birth, life and death of the enterprise;
- to strike a balance between the interests of management or majority shareholders on the one hand and shareholders or minority shareholders on the other hand, in keeping with modern commercial practices;
- to promote continuity, stability and certainty in commercial dealing;
- to refrain from being a vehicle for implementation of industrial relations, tax, social or monetary policy;
- to take account of and to meet international expectations with respect to the incorporation, operation and administration of modern companies.

1.02 Business Corporations Ordinance. Hong Kong should implement a modern, streamlined Business Corporations Ordinance drawing on the most appropriate aspects of existing North American and Commonwealth models. Continued primary reliance on the U.K. model of companies law is not advised.

1.03 Single Regime. With respect to core company law matters, the same regime should be applicable to both public and private companies. In addition, the new Ordinance should provide a basic optional regime for private companies that would facilitate their operation in an informal and consensual manner.

1.04 Securities Regulation. The new Ordinance should not regulate the capital markets activities of companies nor the protection, in the largest sense, of public investors; this should be left to the SFC and the SEHK. With the removal from companies legislation of securities regulation, the SFC should consider the need to re-enact existing, updated or comprehensive new provisions in securities legislation. In the process of extracting the securities law aspects from companies legislation, careful consideration needs to be given to the dangers of creating regulatory gaps as well as the need to address any inadequacies in existing statutory regulation.

1.05 Insolvency. The new Ordinance should not apply to insolvent winding up; matters pertaining to insolvency should be left to a comprehensive Insolvency Ordinance.

1.06 Charges. A study should be undertaken with a view to introducing a separate, comprehensive regime governing security interests in personal property (such as recommended by the U.K. Diamond Report). It would permit the elimination of Part III of the Ordinance, Charges. Until such time, Part III would continue in effect in conjunction with the new Ordinance.

1.07 Financial Institutions. The new Ordinance would continue to serve as the basic legislation governing the "core company law" aspects of regulated financial institutions in Hong Kong, essentially incorporation and its incidents; the regulatory aspects would be determined by the Hong Kong Monetary Authority and the Insurance Authority, as appropriate, and would preferably appear in their related legislation.

1.08 Not-for-profit Enterprises. The new Ordinance would not be applicable to not-for-profit enterprises, currently formed as companies limited by guarantee; the current Ordinance would continue to apply to such entities until such time as consideration is given to their separate treatment.

1.09 A new Not-for-profit Corporations Ordinance. Serious consideration should be given to implementation of an Ordinance governing incorporated not-for-profit organisations.

1.10 Structure of a New Ordinance. The following structure is proposed for the organisation of a new Ordinance:

OUTLINE FOR A BUSINESS CORPORATIONS ORDINANCE

Part 1: Interpretation
Part 2: Administration of the Ordinance
Part 3: Incorporation; Capacity and Powers
Part 4: Capital Structure
Part 5: Management and Administration
Part 6: Directors and Executive Officers
Part 7: Shareholders' Rights and Remedies
Part 8: Fundamental Changes
Part 9: Solvent Dissolution and Liquidation
Part 10: Private Companies/Closely Held Corporations
Part 11: Foreign Corporations/Overseas Companies
Part 12: Transitional Provisions
Part 13: General

2.00 ADMINISTRATION OF THE ORDINANCE

2.01 Consolidation and Updating Part VII. The provisions of Part VII of the existing Ordinance, General Provisions as to Registration, should be consolidated, and if necessary, updated in this Part. In particular, provision for the electronic keeping and filing of notices and other documents should be made.

2.02 Role of Registrar. The role of the Registrar should continue to be primarily an administrative and policy advisory one.

2.03 Charges. Pending reconsideration of the legislative treatment of "Charges", the Companies Registry would continue its administration of Part III of the current Ordinance.

2.04 Subsidiary legislation. Subsidiary legislation and standard forms should be used extensively to deal with technical filing requirements, fees, etc. in order to facilitate timely updating and amendment.

2.05 Offences. With respect to offences, the Twelfth Schedule should be eliminated; such offences which are to be retained or created should be regrouped in more generic categories in this Part of the Ordinance and accorded appropriate sanctions.

2.06 Enforcement. To the extent possible, companies legislation should be self-enforcing and self-executing; investigation and inspection by a government body should essentially be a residual remedy, available in the event that private civil recourses are inadequate or ineffective. Powers comparable to the existing investigation and inspection powers would be maintained.

2.07 Role of the Financial Secretary. The Financial Secretary should continue to have residual discretion to act in the public interest in certain circumstances (such as investigation).

3.00 INCORPORATION; CAPACITY AND POWERS

3.01 One-step incorporation. The new Ordinance would provide one-step incorporation by filing a simple application for incorporation.

3.02 One person companies. The new Ordinance would permit one person/one director incorporation.

3.03 Numbered companies. Provision should be made for numbered companies, and use of the company name.

3.04 Pre-incorporation contracts. Provisions for the adoption by the company of pre-incorporation contracts should be simplified.

3.05 Capacity, powers and privileges of natural person. A corporation should be given the capacity, powers and privileges of a natural person. Restrictions may be placed on the activities of a corporation in its constitution but the rights of third parties should be preserved in the event that a corporation acts in contravention of its articles or the Ordinance.

3.06 Constructive notice. The constructive notice doctrine should be eliminated except, temporarily, with respect to charges.

3.07 Indoor Management rule. A statutory formulation should be given to the indoor management rule (the so-called rule in Turquand's case).

4.00 CAPITAL STRUCTURE

4.01 Modern capital structure. A new Business Corporations Ordinance should provide for a modern, flexible capital structure.

4.02 No par value shares. Par value shares should be prohibited.

4.03 Classes and rights of shares. The corporate constitution should prescribe the classes of shares (if more than one) and the number of shares of each class that the company is authorised to issue if there is a limit (which there need not be). If there is only one class of shares, that class must have three fundamental rights of share ownership: the right to vote, the right to receive dividends when declared and the right to receive the net assets of the company upon dissolution. Where there is more than one class of shares, the rights, preferences, etc. should be stated in the corporate constitution; the three fundamental rights of share ownership should be attached to at least one class of shares although not all rights need be attached to any one class. For statutory purposes, the traditional distinction between common or ordinary shares and preference shares should be eliminated.

4.04 Series. Statutory provisions with respect to the use of series within classes of shares are unnecessary.

4.05 Partly paid shares. Partly paid shares should be prohibited.

4.06 Optional pre-emptive rights. Pre-emptive rights for existing shareholders should be optional; they may be provided for in the corporate constitution.

4.07 Solvency test. The concept of impairment of capital should be replaced by a solvency test to be used to determine the ability of the company to engage in a variety of activities: repurchase of its own shares (by way of redemptive provisions in the corporate constitution or otherwise), payment of dividends and other activities in the nature of a transfer of corporate assets to the possible detriment of creditors.

No "distribution" (widely defined) of company assets should be permitted if, after giving effect to it:

(1) the company would not be able to pay its debts as they become due in the usual course of business; or

(2) the company's total assets would be less than the sum of its total liabilities plus (unless the constitution provides otherwise) the amount that would be needed, if the company were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

4.08 Financial assistance. Provisions with respect to "financial assistance" for the purchase of company shares should be eliminated.

5.00 MANAGEMENT AND ADMINISTRATION

5.01 Companies' accounts. Companies should be required to prepare accounts that give a true and fair view of the state of affairs of the company. Details as to the form and content of accounts, to the extent required to be specified, should appear in subsidiary legislation; the Tenth Schedule of the Companies Ordinance (Accounts) should be eliminated.

5.02 Generally accepted accounting principles. Rather than detailing line item by line item the information to be contained in accounts, reference should be made to preparation of accounts in accordance with generally accepted accounting principles (GAAP). GAAP would be embodied in standards set by an independent accounting standards body or by a Hong Kong Society of Accountants process that would involve a wider representation of interested parties.

5.03 Waiver of generally accepted accounting principles. All companies should prepare their accounts in accordance with generally accepted accounting standards; consideration should be given as to whether private companies should be able to dispense with this requirement by means of unanimous shareholder agreement (unless required for other purposes).

5.04 Minimum financial information. As an aid to small companies in particular, the minimum financial information to be delivered to shareholders, unless they agree otherwise, should be stipulated in the legislation, or subsidiary legislation.

5.05 Filing of accounts. Unless required by other legislation (as should be the case for public and listed companies), companies would not be required to file accounts.

5.06 No mandatory audit. Company accounts should continue to be audited but shareholders should be able to dispense with an audit by unanimous agreement.

5.07 Formalities associated with directors' meetings. The formalities associated with routine directors' meetings such as notice, quorum, attendance, dissent, etc. should be set out in Part V, Management and Administration of the new Ordinance.

5.08 Formalities associated with shareholders' meetings. The formalities associated with routine shareholders' meetings such as notice, quorum, attendance, proxies, record date, etc. should be set out in Part V, Management and Administration of the new Ordinance.

5.09 Negotiable instruments. Securities certificates should be statutorily recognised as negotiable instruments.

5.10 Modernised security certificates system. Provisions with respect to security certificates, their form, content, registration and transfer should be modernised to provide for the optional use of "scripless" (book entry or "uncertificated") securities and, to the extent not dealt with under other legislation, the mechanics of their transfer (including the use of clearing agencies).

5.11 Part III retained. Pending consideration of the creation of a separate regime for the granting of security interests in personal property, Part III of the current Ordinance, Registration of Charges would continue to apply.

5.12 Modern record keeping. Provision should be made for modern record keeping, including electronic data processing. An obligation should be imposed to ensure the accurate preservation of data and its accessibility in written form to those entitled to it within a reasonable period of time.

5.13 Company records. The new Ordinance should contain a clear and concise statement of the records which must be kept by the company, their location and who has access to them (and in what circumstances and to what purposes.)

5.14 Corporate seal. Use of a corporate seal should be voluntary and no agreement should be invalid merely because a corporate seal is not affixed to it.

6.00 DIRECTORS AND EXECUTIVE OFFICERS

6.01 Unitary board structure retained. The traditional unitary board structure should be retained.

6.02 Board of directors. In private companies/closely-held corporations, a single decision making body should be an option; the responsibilities of the directors would be assumed by the shareholders.

6.03 Statutory power of directors. The board of directors should be given a direct grant of statutory power to manage, or supervise the management of, the company. This power should be made subject to any unanimous shareholder agreement.

6.04 Delegation of powers. The board of directors should be permitted to delegate all those powers which it is not required to exercise itself.

6.05 Functions not subject to delegation. Certain functions of the board of directors should not be subject to delegation, for example:

- submission to shareholders of any question requiring their approval
- filling an interim vacancy among directors, in the office of auditor, appointing or removing the chief executive officers
- in most circumstances, issuing securities
- declaring dividends
- purchasing, redeeming or otherwise acquiring shares issued by the company
- approving financial statements
- adopting, amending, repealing any constitutional documents

6.06 Directors' minimum qualifications. Directors should meet certain minimum qualifications:

- age of majority
- mental capacity (i.e. not found legally incapable)
- only individuals (no corporate directors)
- no one who has the status of an undischarged bankrupt unless permitted by court order
- no one who has been disqualified from acting as a director

6.07 One director. Private companies should be permitted to have a minimum of one director.

6.08 Shadow and alternate directors. The troublesome concepts of shadow and alternate directors should be eliminated.

6.09 Company officers. There should be no requirement for the appointment of any particular company officer such as a company secretary.

6.10 Removal of directors by shareholders. Shareholders should be able to remove directors by ordinary resolution, subject to class voting rights and the company constitution.

6.11 Meetings of directors. Meetings of directors should be permitted by means of electronic communications, unless otherwise specified in the company constitution.

6.12 Unanimous action. Directors should be able to act unanimously by written resolution without a meeting.

6.13 Statutory statement of directors' duties. There should be a statutory statement of directors' duties to act honestly and in the best interests of the company and to exercise the care, diligence and skill that a reasonably prudent person would. These duties should also be made applicable to those corporate officers appointed by the board.

6.14 Reliance on reports. Directors and officers should be able to rely in good faith on financial statements and other reports prepared by officers and employees as well as the professional advice of lawyers, accountants, etc.

6.15 Business judgment rule. There should be no need of a statutory formulation of the 'business judgment rule'.

6.16 Indemnifying directors. Companies should be permitted to indemnify directors and officers in specific circumstances; companies should be required to indemnify directors and officers in specific circumstances.

6.17 Insuring directors. Companies should be permitted to insure directors and officers except for a failure to act honestly and in good faith with a view to the best interests of the company.

6.18 Disqualification of directors. Disqualification of directors provisions should be eliminated for company law purposes. Those existing provisions relating to securities, insolvency or criminal activity should be reenacted in appropriate legislation.

6.19 Conflicts of interest. Consideration should be given to placing directors and executive officers (i.e. those appointed directly by the board) under a duty of fair dealing with respect to transactions they enter into with the company.

6.20 Qualification of interested transactions. Interested transactions should be upheld if (i) directors disclose to the board their material interest in the transaction; (ii) do not vote as a director on any resolution to approve the transaction; and (iii) the transaction was reasonable and fair to the corporation at the time it was approved. In the alternative, such transactions could also be approved by unanimous shareholder consent.

6.21 Shareholder approval of interested transactions. Shareholders should be able to vote to uphold a transaction by special resolution in certain circumstances.

6.22 Loans to directors. Transactions involving loans to directors should continue to be prohibited subject to certain exceptions.

6.23 Use of Corporate Information and Opportunity. Directors and officers should not disclose or use for their benefit a corporate opportunity or information that they obtain by reason of their position or employment except (i) with consent of disinterested board members, (ii) where disclosure is required by law or otherwise or (iii) where it is reasonable to assume that the disclosure or use of the information or opportunity will not be likely to prejudice the corporation.

7.00 SHAREHOLDERS' RIGHTS AND REMEDIES

7.01 Shareholders' rights and remedies. A separate part of the new Ordinance should be dedicated to matters dealing with shareholders, their rights and remedies.

7.02 Proposal at annual meeting. Any shareholder entitled to vote at an annual meeting should be able to submit a proposal to the company to be raised at the annual meeting and circulated prior to the meeting. The board of directors could refuse to circulate proposals in certain circumstances such as proposals designed to redress personal grievances or espousing political or other causes. In addition, or in the alternative, a proposal put forward by a minimum number or percentage of shareholders (e.g. the lesser of 25 shareholders or those holding 2°% of the voting shares) could not be refused by the board of directors.

7.03 Requisition to call meeting. Shareholders holding 5% of the voting shares should be able to requisition the directors to call a meeting of shareholders or, if the directors fail to act, a shareholder should be able to call a meeting itself. The time delay in which the directors may act should be fairly short, 21 days for example. The requisitioners should be reimbursed their expenses unless the meeting otherwise resolves.

7.04 Shareholders' rights to dispense with meeting. A resolution in writing signed by all shareholders entitled to vote should be sufficient to preclude the necessity of a meeting. A meeting should be required, however, in the event of the resignation or removal of a director or auditor who wishes to explain or contest the action. Shareholders should be able to dispense with the requirement for an annual general meeting (or other meetings) by unanimous shareholder agreement.

7.05 One share entitled to one vote. Unless otherwise provided by the company constitution, one share should be entitled to one vote. "Circular holdings" should be prohibited from voting.

7.06 Unanimous shareholder agreement. All companies should be able to make use of unanimous shareholder agreements to regulate (1) the exercise of corporate powers and management and (2) the relationship among shareholders.

7.07 Statutory remedies. There should be made available to shareholders a variety of statutory remedies designed to induce accountability of management and achieve the desired balance between flexibility in management powers and protection of shareholders, especially minority shareholders' interests. These statutory remedies should include the following:

Statutory Derivative Action
Oppression or Unfairly Prejudicial Action
Buy-Out or Appraisal Remedy
Compliance and Restraining Orders
Just and Equitable Winding-up

7.08 Statutory derivative action. There should be a statutory derivative action in the new Ordinance.

7.09 Unfairly prejudicial remedy. The current unfairly prejudicial or oppression remedy should be broadened. The remedy should be available to a broader class of persons, to include

any registered holder or beneficial owner, and any former registered holder or beneficial owner, of a security of the company or any of its affiliates;
any director or officer or former director or officer; and
the Financial Secretary.

The scope of the conduct that may be complained of would also be broadened to include conduct that is oppressive, unfairly prejudicial to or that unfairly disregards the interests of any security holder, director or officer.

7.10 Statutory compliance and restraining order. A shareholder or director should have the standing to apply to court for a statutory compliance and restraining order.

7.11 Just and equitable winding-up. The traditional "just and equitable" winding-up remedy should be retained, but the court should be given the option of making any other order it sees fit. The remedy should be dissociated from the more undesirable consequences of winding-up procedures in insolvency (such as the freezing of bank accounts).

7.12 Appraisal or "buy-out" remedy. A form of appraisal or "buy-out" remedy which does not necessitate judicial intervention should be adopted; the statutory buy-out remedy gives shareholders the right to have the company buy their shares upon the occurrence of a limited number of fundamental changes while permitting the company to proceed unimpeded with its proposed action. In the alternative, consideration should be given to introducing such a procedure but excluding its application to listed companies.

8.00 FUNDAMENTAL CHANGES

8.01 Amendments by special resolution. There should be regrouped in one section, all amendments to the company constitution that may be effected by special resolution of the shareholders. A special resolution should require a "super-majority" vote, i.e. 75%.

8.02 Dissenting shareholder entitled to be "bought-out". Where an amendment to the constitution would (1) affect substantially the nature of a shareholder's investment (e.g. remove or change any restriction on the nature of the business of the company or change the characteristics of its shares) or (2) where the company proposes a fundamental change such as an amalgamation, continuance in another jurisdiction (see recommendation with respect to continuance), or sale of substantially all of its property, a dissenting shareholder should be entitled to be bought out of the company at a "fair" price.

8.03 Class vote. In certain circumstances, a class vote should be held where a proposed amendment to the constitution would affect, directly or indirectly, the rights of that class of shares.

8.04 Corporate restructuring procedures. Simple procedures should be made available to provide for corporate restructuring such as by way of amalgamation without the necessity for court intervention or liquidation.

8.05 Restructuring of related companies. Restructuring of related companies and wholly-owned subsidiaries should be facilitated.

8.06 "Import" and "export" of companies. "Import" and "export" of companies into and out of Hong Kong should be permitted. Foreign companies should be able to re-incorporate in Hong Kong under the new Ordinance without the necessity of liquidation and the resulting disruption and interruption of corporate existence; Hong Kong

incorporated companies should be able to continue under the laws of incorporation of another jurisdiction in the same manner.

8.07 Court ordered arrangements. Provision should be made for court ordered arrangements for solvent companies where it is impracticable to restructure under other provisions of the legislation.

9.00 SOLVENT DISSOLUTION AND LIQUIDATION

9.01 Solvent dissolution and liquidation. Only solvent dissolution and liquidation should be dealt with in the new Ordinance.

9.02 Voluntary dissolution by simple filing. Voluntary dissolution should be effected by a simple filing (depending on the nature of the dissolution sought) and should take effect upon filing; the corporate existence would then be continued only for the purpose of winding up and liquidating the business and affairs of the entity.

9.03 Circumstances for simple filing. Voluntary dissolution by way of simple filing should be available in two instances; (1) before the company has commenced business and (2) where initiated by directors and shareholders.

9.04 Revocation of dissolution. Within a limited period of time a company should be able to revoke dissolution essentially in the same manner as it has been initiated.

9.05 Claims of creditors. Provision should be made for the claims of known and unknown creditors.

9.06 Administrative dissolution. The Registrar should be able to commence an administrative dissolution in limited circumstances, primarily where a company has failed to comply with its filing obligations under the new Ordinance.

9.07 Dissolution by the court. A court should be given broad discretion, both in terms of the grounds and the procedures adopted, to dissolve a company upon the application of the Financial Secretary or a delegated authority, a shareholder or a creditor.

10.00 PRIVATE COMPANIES/CLOSELY HELD CORPORATIONS

10.01 No separate ordinance. There should not be a separate specialised ordinance pertaining only to private companies/closely held corporations.

10.02 Purpose of legislative provisions. The purpose of legislative provisions specifically applicable to private companies/closely-held corporations should be to facilitate the creation of incorporated entities that, for internal purposes, function like partnerships or sole proprietorships.

10.03 Statutory definition. There should be a statutory definition of or conditions to be met for private companies/closely held corporations.

10.04 Definition of "private company". The traditional definition of "private company" should be retained. A private company has restricted the right to transfer its shares, has limited the number of shareholders to 50 and prohibits any invitation to the public to subscribe for its securities. In addition, a company which by means of a unanimous shareholder agreement abolishes the distinction between ownership and management, irrespective of number of shareholders, should also fall within the definition.

10.05 Optional regime. A separate part of the new Ordinance should contain an optional regime applicable to private companies/closely held corporations. The regime could be varied in the corporate constitution or by unanimous shareholder agreement. It should contain the following provisions:

- Standard share transfer restrictions and exceptions (e.g. transfer to trustee in bankruptcy, by operation of law);
- Preservation of limited liability despite failure to observe corporate formalities;
- No mandatory audit;
- Standard form buy-sell and buy back provisions to permit shareholders to leave;
- Recourse to mediation or arbitration to resolve shareholder disputes;
- Possibility of applying to court for the appointment of a rehabilitative receiver in the event of deadlock, etc.

10.06 Possibility of Eliminating Corporate Formalities. Private companies/closely held corporations should be able, by unanimous shareholders agreement or in their constitution, to eliminate certain corporate formalities and otherwise derogate from standard statutory provisions:

- no need to have an annual meeting of shareholders unless requested by a shareholder;
- no need to have separate bylaws/articles of association if constitution and statute sufficient;
- ability to choose limited corporate life if desired;
- possibility of dissolution at the request of a shareholder (or certain % of shareholders) or upon the occurrence of a specified event;

elimination of board of directors;
restriction of discretion or powers of the board or weighted voting rights;
operation of enterprise as if a partnership among shareholders;
creation of relationship among shareholders that would otherwise be only appropriate among partners.

11.00 FOREIGN CORPORATIONS/OVERSEA COMPANIES

11.01 Conflict of laws rule. For purposes of the new Ordinance, the traditional common law conflict of laws rule applicable to companies, i.e. that their creation, internal affairs, and termination are governed by the law of their place of incorporation, should be respected.

11.02 No extraterritorial effect. As a general principle, the new Ordinance should not contain provisions having an extraterritorial effect.

11.03 Threshold of registration. Registration of foreign incorporated companies should be required in Hong Kong but the threshold test should be changed.

11.04 Threshold test. The threshold test of carrying on business in the jurisdiction, including both an inclusionary and exclusionary list of what is or is not considered carrying on business, should be adopted for purposes of the new Ordinance.

11.05 Filing requirements simplified. The filing requirements for registration as a foreign company should be simplified. It should not be necessary to file the company constitution or accounts.

11.06 Service of process. An agent for service of process within Hong Kong should be required; alternative methods of service of process should be stipulated in default of an agent.

11.07 Disclosure of foreign status retained. Current requirements with respect to the obligation to disclose the foreign status of the company (on letterhead, at the place of business, etc.) should be retained.

11.08 Filing requirements. The filing requirements applicable to foreign companies under the new Ordinance should be coordinated with those of the Business Registration Ordinance; registration under the new Ordinance should be deemed to satisfy requirements of the Business Registration Ordinance.

11.09 International business companies. There appears to be no need to address the use of international business companies in a new Ordinance or otherwise.

12.00 TRANSITIONAL PROVISIONS

12.01 Mandatory continuance for companies. A new Ordinance should include a requirement of mandatory continuance for companies created under the old legislation over a transitional period of three to five years.

12.02 Simple reregistration procedure. Continuation under the new Ordinance should be effected through a simple reregistration procedure which should involve only minimally more effort and expense than the current annual filing and audit requirements.

Source: The *Consultancy Report on the Review of the Hong Kong Companies Ordinance* (March 1997).