NEW COMPANIES ORDINANCE IN HONG KONG

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On 3 March 2014, a new Companies Ordinance ("new CO") comprising of 921 sections and 11 schedules together with 12 pieces of subsidiary legislations will become effective. The new CO is not just a re-write of the current Companies Ordinance in plain and simple English but it also defines more clearly the powers and authority of the Companies Registry ("CR"). Furthermore, almost all the guidelines issued by the CR are now written into law which would enable better enforcement against defaults. This would augment a new regulatory regime for companies incorporated by or registered with the CR.

As in the past, there are fixed timelines for filing of various documents with the CR. A new concept 'Responsible Person' is now introduced in the new CO. A Responsible Person includes:

a) an officer or shadow director of the company or non-Hong Kong company who authorizes or permits, or participates in, the contravention or failure; OR

b) an officer or shadow director of a body corporate that is an officer or shadow director of the company or non-Hong Kong company; AND the body corporate authorizes or permits, or participates in, the contravention or failure. Shadow director in relation to a body corporate, means a person in accordance with whose directions or instructions (excluding advice given in a professional capacity) the directors, or a majority of the directors, of the body corporate are accustomed to act. Strictly speaking, personal details of the shadow director should also be filed with the CR in the specified form for directors but this has not been a usual compliance practice. This new concept covers a wide range of individuals involved in the compliance function of a company. For those professional firms providing services to companies in Hong Kong, they should be cautious in their service delivery in order not to be implicated in the breaches of the new CO.

Types of Companies

Currently 8 types of companies can be incorporated through the CR. They are:

1) Private company limited by shares;

2) Non-private company limited by shares;

3) Private company limited by guarantee without share capital;
4) Non-private company limited by guarantee without share capital;
5) Private unlimited company with share capital;
6) Non-private unlimited company with share capital;
7) Private unlimited company without share capital;
8) Non-private unlimited company without share capital.

They are now streamlined into 5:

1) public company limited by shares;
2) private company limited by shares;
3) public unlimited company with a share capital;
4) private unlimited company with a share capital;
5) company limited by guarantee without a share capital.

This change would not affect those companies already in existence whose types are no longer available for incorporation.

A private company is one which imposes restrictions on share transfer, invitation to the public to subscribe for any shares or debentures of the company and the number of members not exceeding 50. A public company is neither a private company nor a company limited by guarantee.

On incorporation, a company must have articles of association setting out regulations for the company. Those articles could be the model articles prescribed by the Financial Secretary of the Hong Kong Special Administrative Region or custom-made by the founder member(s). A founder member can be an individual or a body corporate.

There is no residency requirement for member(s). The minimum number for members is one.

Currently, companies must adopt both memorandum and articles of association ("M&A"). The new CO does not require existing companies to adopt new set of articles. All existing M&A could remain as they are and the provisions in the memorandum of association will be deemed to be part of the articles of association. For precautionary measure, it would be advisable to review the M&A for existing companies to ensure that they are in line with the provisions of the new CO.

Overseas companies can be registered in Hong Kong as non-Hong Kong companies. No significant change is introduced in the new CO to these companies.

No par regime

The current capital structure is divided into two parts. Authorised and paid up capital. Authorised capital means the maximum number of shares which can be issued by a company unless members' resolution is passed to alter the number. Paid up capital is the amount paid up on each share which should include the par value i.e. nominal value per share and, if applicable, premium pay on the share(s).

As this system is comparatively outdated globally, the new CO prescribes that, from then onwards, all shares will not have par value. The Board of Directors can determine the amount to be contributed to each share.

For existing companies, the conversion into the no par regime will be mandatory and the transition will be automatic. The CR has advised that no special action or filing needs to be taken on this change. However, companies should check whether certain provisions in their legal documents or constitution relating to the capital structure need to be amended.

Share buy-back / Share redemption / Reduction of capital

Share buy-back / redemption is now available to all types of companies with share capital and can be funded by:

1) Fresh issue of shares for the purpose;
2) Out of distributable profits;
3) Out of capital subject to solvency test being complied with. This option is not available to listed companies for share buy-back.

Companies undergoing share buy-back or share redemption must satisfy the solvency test. This means the company must be able to pay its debts in full within 12 months after the commencement of the winding up if it intends to commence winding up after the transaction; or within 12 months immediately following the date of the transaction. All the directors must sign a solvency statement and have it filed with the CR. Members' resolutions have to be passed and various filing have to be done with the CR.

Reduction of capital is also simplified if the company can satisfy the solvency test. The other alternative for reduction is to obtain Court approval which is more lengthy and costly. Examples of reduction of capital are:

- To extinguish or reduce the liability on any of its shares in respect of share capital not paid up;
- With or without extinguishing or reducing liability on any of its shares:
  - d) cancel any paid-up share capital that is lost or unrepresented by available assets, or
  - e) repay any paid-up share capital in excess of the company's wants.

The Board of Directors and the Company must comply with the procedures as laid down in Division 3 of the new CO. Any breach will, most probably, incur heavy penalties and / or imprisonment to those responsible for the breach.

Management

Management of a company is in the hands of the board of directors. A private company can have one director. The other types of companies must have at least 2 to constitute the board. There is no residency requirement for director(s). It is now stated in the new CO that a director must exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of a director in relation to the company; and the general knowledge, skill and experience that the director has. This means higher standards are expected from professionals like lawyers, accountants etc. when they discharge their duties as directors as compared to those with lesser education and professional / commercial experiences. It may be time for directors to consider whether they should ask their companies to arrange insurance policy to cover their potential liabilities as permitted under the new CO.

Currently a private company (not being a member within a group of which a listed company is a member) can appoint a body corporate as its director. Once the new CO is effective, there must be at least one natural person in the board. Those private companies having only body corporate as their directors must appoint one natural person, either to replace the existing body corporate or as an addition to the board, within 6 months from 3 March 2014 to comply with the new requirement.

Administration

As members are the ultimate owners of their companies (except for those companies limited by guarantee whose objects may be to serve the community at large and that the profits and assets will only be distributed to other organisations having similar objects), they have rights to protect their own interests. There are matters specified in the Companies Ordinance that would require approval by members. These matters either require simple majority ("Ordinary Resolution") or at least 75% votes ("Special Resolution") before they could become effective. Most of these

resolutions are proposed by directors.

Notwithstanding the foregoing paragraph, members can also take the initiative to pass resolutions to regulate certain transactions of the Company. Member or members holding 5% of the voting rights or a lower percentage as specified in the articles of association can request the circulation of a proposed resolution to be approved by the members together with a statement not exceeding 1000 words on the subject matter of the resolution.

If members are not satisfied with the performance or the directors, they can remove the directors by proposing and passing an ordinary resolution in accordance with the procedures laid down in the law.

The new CO also introduces measures to minimize the compliance costs to small-to-medium-sized companies. One such measure is the dispensation of the holding of annual general meeting ("AGM"). Under the new CO, all members can pass a resolution to dispense with the holding of AGM. Once passed, a company is not required to hold AGM unless and until such time the aforesaid resolution is revoked or otherwise ceases to have effect.

Financial statements

A new concept 'Accounting Reference Date' is now in the new CO. All companies must now fix their accounting reference date and to have audited financial statements available for members' approval. If this date is not fixed, it will be deemed to be the last day of the month in which the relevant anniversary of the company's incorporation falls. The first set of audited financial statements must be available within 18 months from the date of incorporation and thereafter every year. The board of directors should be aware of this and arrange preparation of audited financial statements within the statutory time frame. If in default, any member can complain to the CR which will take the necessary steps to ensure that the directors arrange this. Member(s) can also engage lawyers to take the directors to Court. Financial statements must comply with the reporting standards issued or specified by the Hong Kong Institute of Certified Public Accountants. Otherwise, if the directors are taken to Court for the default, they will face heavy penalties and/ or imprisonment.

The new CO introduces new exemption rules for private companies and for companies limited by guarantee. Those companies fulfilling two of the following three criteria i.e. not having

1) total annual revenue of HK$100 million,
2) total assets of HK$100 million or
3) 100 employees

will qualify for preparation of simplified financial and directors' report and do not have to prepare business review. These criteria also apply to group companies. Directors should liaise with their auditors how the new provisions relating to financial statements would affect their companies and to take the necessary steps to comply with the new law.

Closing down of companies

If it is envisaged that no business transactions will be undertaken by a company for a number of years, the directors can take steps to register the company as dormant and, thereafter, no further audit or other compliance work needs to be done.

However, if there is no plan to use the company in the future. It can be dissolved either by winding-up or de-registration. De-registration can now be applicable to all private companies and companies limited by guarantee. Companies with no liabilities, no legal proceedings of which the company is a party and no immovable assets can apply to the Inland Revenue Department for a certificate of no-objection. Once the certificate is to hand, application can be made to the CR to de-register it. This minimizes the costs for closing down companies when they are no longer required. It should be noted, how-

ever, that the books and records should be kept for 6 years and that the company can be brought back to life within 20 years on application to the Court.

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