

# **Rewrite of the Companies Ordinance**

## **Consultation Conclusions on Company Names, Directors' Duties, Corporate Directorship and Registration of Charges**

### **BACKGROUND**

1. On 2 April 2008, the Financial Services and the Treasury Bureau (“FSTB”) launched the second public consultation on the rewrite of Companies Ordinance (“CO”) covering Company Names, Directors’ Duties, Corporate Directorship and Registration of Charges. The consultation paper on the proposals (“Consultation Paper”) was circulated to relevant professional bodies and practitioners, chambers of commerce, financial services regulators, academics, the Standing Committee on Company Law Reform (“SCCLR”)<sup>1</sup> and the four dedicated Advisory Groups comprising representatives from relevant professional and business organisations, academics and members of the SCCLR. It has also been posted on the FSTB’s CO rewrite website.
2. During the consultation period, we organised a consultation forum to seek public views on 28 May 2008 and a focus group meeting on registration of charges on 29 May 2008. We had also attended several meetings/forums of other interested organisations to brief the participants on the proposals and listen to their views. A list of the forums and meetings we attended is at Appendix I.

### **OUTCOME OF CONSULTATION**

3. The consultation ended on 30 June 2008. A total of 61 submissions from 59 deputations were received, including some that were received after the end of the consultation period. A list of the respondents is at Appendix II. A compendium of the submissions is also available at the FSTB’s CO Rewrite website<sup>2</sup>.

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<sup>1</sup> The SCCLR mainly advises the Government on necessary amendments to the CO. Its members include representatives of the Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as individuals from relevant sectors and professions such as accountancy, legal and company secretarial.

<sup>2</sup> Available at [http://www.fstb.gov.hk/fsb/co\\_rewrite/](http://www.fstb.gov.hk/fsb/co_rewrite/).

4. We have considered the respondents' views in consultation with the SCCLR. The majority of respondents indicate general support for most of the proposals. Nevertheless, there are a few proposals that draw reservation or objection from a substantial number of respondents. A summary of the respondents' comments and our responses are summarised below.

### **Company Names**

#### ***A. "Shadow Companies" (Questions 1 & 3)***

5. We proposed to empower the Registrar of Companies ("the Registrar") to act on a court order directing a defendant company to change its infringing name, and substitute its infringing name with its registration number if the company fails to comply with the Registrar's direction to change its name.
6. We also asked for further views on how the company name registration system could be improved for the purpose of tackling the problem of "shadow companies".

### **Respondents' views**

7. An overwhelming majority of the respondents supported the proposal. They generally considered the proposal useful to tackle the problem of "shadow companies"<sup>3</sup>. Some of them suggested that the specified period within which the defendant company is required to change its name should be made as short as possible in order to minimise the period of misuse of the infringing name by shadow companies.
8. As for further views sought on tackling "shadow companies", some respondents suggested that the Government should reconsider the feasibility of introducing a company names adjudication system

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<sup>3</sup> These refer to those companies incorporated in Hong Kong at the Companies Registry with names which are very similar to existing and established trademarks or trade names of other companies and pose themselves as representatives of the owners of such trademarks or trade names when contracting with Mainland manufacturers to produce counterfeit products bearing such trademarks or trade names.

adopted in the United Kingdom (“UK”), or a system similar to the domain name dispute resolution system in Hong Kong operated by the Hong Kong International Arbitration Centre. They believed that such proceedings would be less lengthy and costly than court proceedings.

9. In addition, a few respondents suggested further measures to tackle the problem of “shadow companies” as follows:
  - (a) the Registrar should refuse the registration of company names which are likely to infringe the intellectual property rights of others;
  - (b) the Registrar should strike off from the register a company which did not comply with a direction to change name issued by the Registrar. It was considered that if a company had its name changed to its registration number, it would most likely that such company, with a numbered name, would become inactive, and eventually, the Registrar would take steps to strike off such a company in the future for lack of activities;
  - (c) some respondents were of the view that the Companies Registry (“CR”) should make more use of provisions under sections 22(2)<sup>4</sup> and 22A<sup>5</sup> of the current CO to tackle the problem of shadow companies as they considered that the CR had adopted a too narrow interpretation of such provisions and restricted their application in tackling the problem. Some also suggested that the Companies Names Guideline of the CR should be expanded to give a more detailed interpretation of the meaning of “the same” in determining an infringing name;
  - (d) information on those companies which have been directed by the Registrar to change or whose names have been substituted with a registration number by the Registrar should

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<sup>4</sup> Section 22(2) of the CO provides that the Registrar may direct a company to change its name within such period as he may specify if, among other things, it is too like a name appearing in the Registrar's index of company names.

<sup>5</sup> Section 22A of the CO provides that the Registrar may direct a company to change its name, if in his opinion the name gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public.

be publicised. Some respondents considered it important for such information to be made readily available to the public because default companies could still carry on counterfeit activities by abusing the Certificate of Incorporation originally issued by the Registrar to the infringing companies; and

- (e) the current limitation period of 12 months within which the Registrar may direct a company to change its name is too short, some respondents proposed that the time period be extended to say, 18 months.

### **Our response**

- 10. We welcome the overwhelming support of the proposal from the respondents and will introduce the necessary legislative amendments as soon as possible.
- 11. In respect of the other suggestions set out in paragraphs 8 and 9 above, our responses are as follows:
  - (a) As the UK's new company names adjudication system had just commenced operation in October 2008, it would be prudent to keep its implementation under review and make reference to any experience gained from the UK when considering the way forward of the proposal;
  - (b) Hong Kong's domain name dispute resolution system is based on a mandatory arbitration proceeding specified in the Registration Agreement between the administrator of domain names (namely, Hong Kong Domain Name Registration Company Limited) and the applicant. As the arbitration system is based on a contract between private parties, the procedure can be more flexible and less formal in nature<sup>6</sup>. However, as company name disputes involve the exercise of statutory regulatory power by a government department, due process must be ensured. Informal and flexible proceedings

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<sup>6</sup> For example, the parties do not need to attend a tribunal physically and the arbitration proceedings can be conducted through facsimile, postal or courier services and the Internet.

would be inappropriate;

- (c) we remain of the view that the Registrar should not refuse the registration of a company name simply because the name is likely to infringe the intellectual property rights of another party. As explained in paragraph 2.5 of the Consultation Paper, our company registration system and trademark registration system are distinct and separate. It is inequitable to grant trademark owners a monopoly over company names covering all kinds of business activities. Moreover, it is impracticable for the Registrar to check each and every proposed company name against all registered trademarks and to judge whether a name is likely to infringe the intellectual property rights of others;
- (d) it would be inappropriate to strike a company off the register simply because it fails to comply with a direction to change name<sup>7</sup>. As a company will be dissolved upon being struck off the register, it may adversely affect the interests of third parties, such as creditors, and may create uncertainties over the liabilities and obligations of the company and its officers;
- (e) the CR reviews, from time to time, its guidelines on company names, including those on interpretation of names being “too like”, to facilitate enforcement against shadow companies. It will exercise judgment to assess whether the company names in question would create confusion as to identity. As regards section 22A of the CO, we are of the view that it should only be used in the event that what the company actually does is different from what its name implies it does (if the name implies anything) and that difference is likely to cause harm to the public. The provision cannot be used to tackle the problem of “shadow companies”;
- (f) the information of the companies which have failed to comply with the Registrar’s directions to change name is being published at the CR’s website<sup>8</sup>. The CR will keep

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<sup>7</sup> We intend to maintain the current policy that the Registrar will only strike a company off the register if it appears to him that the company is defunct

<sup>8</sup> [http://www.cr.gov.hk/en/statistics/docs/stat\\_name.pdf](http://www.cr.gov.hk/en/statistics/docs/stat_name.pdf)

updating the information. Moreover, the CR has since January 2008 included a warning statement in all Certificates of Incorporation and Certificates of Change of Names that company name registration does not confer any intellectual property rights on the use of a company name; and

- (g) There appears to be no strong case for extending the limitation period within which the Registrar could direct a company to change its names. Under the present provision, CR has already advised members of the public to lodge their complaints in good time before the expiry of the 12 months' period. In practice, CR would entertain any complaints received two weeks before the expiry of the 12 months' period.

#### ***B. "Hybrid Names" (Question 2)***

12. We asked views on a proposal to provide the Registrar with a discretionary power to approve a "hybrid name" where the applicant could show to the satisfaction of the Registrar that there was a "genuine business need" and how a "genuine business need" should be defined.

#### **Respondents' views**

13. About half of the respondents supported the proposal. They considered that the proposal could be of benefit to the commercial community, especially in Hong Kong where the combined use of Chinese and English words was very popular. Among those who supported this proposal, different views were expressed as to what should constitute a "genuine business need"<sup>9</sup>. Some preferred the

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<sup>9</sup> Some examples of views on what should constitute "genuine business needs" are:

- (a) the Registrar's discretionary power should be strictly limited and the phrases used in a hybrid name should be widely used in the society (i.e. similar to 卡拉 OK or X光);
- (b) association in a joint venture;
- (c) the product or service already exists and the hybrid name describing the product should have been accepted in consensus at least by the people in the industry; and
- (d) representing the trade mark, design, copyright or patent which are directly linked to the Intellectual Property.

term to be clearly defined while some others suggested the issue should best left to be decided by the Registrar<sup>10</sup>.

14. On the other hand, a significant number of respondents disagreed with the proposal<sup>11</sup>. They considered that there was no genuine business need for hybrid names. A respondent pointed out that companies were already allowed to use hybrid trade names in the conduct of business. Moreover, some were concerned that the permission of hybrid names might lead to huge increase in the number of misleading “shadow companies” and cause confusion to the public, including consumers and make it more difficult for trademark owners to complain against shadow company names. One respondent said that most software systems could not incorporate both English and Chinese languages at the same time. So there would be numerous other instances where the full company name could not be shown or used properly and it would be difficult to accurately write contracts, update name directories, search the Internet etc.

### **Our response**

15. In view of the diverse views expressed on the proposal and the concern about possible abuses by shadow companies, it would be prudent to put the proposal on hold for the time being, at least until the problem of shadow companies clearly subsides. Nevertheless, the Companies Registry will allow phrases like “X 光” and “卡拉 OK” (for X-Ray and Karaoke respectively) in company names because they have no direct Chinese equivalents and they are already used in other legislation.

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<sup>10</sup> For example, the Hong Kong Bar Society argues that any attempt to define such a need would either be too general and therefore devoid of any meaningful indication or too narrow, which would have the effect of restricting the ability of the Registrar to consider whether a case of genuine business need had been made out by the applicant in the particular context of its business.

<sup>11</sup> Including, among others, the Law Society of Hong Kong, The British Chamber of Commerce in Hong Kong, the Hong Kong General Chamber of Commerce and the Consumer Council, and the Hong Kong Institute of Chartered Secretaries.

## **Directors' Duties**

16. We asked whether the general duties of directors should be codified and, if so, whether the United Kingdom (“UK”) approach, including the new duty to promote the success of the company having regard to a number of factors such as the interests of employees, the impact of the company’s operations on the community and the environment etc. that reflected the “enlightened shareholder value” should be adopted. (*Question 4*)

## **Respondents' views**

17. Views of the respondents were divided and finely balanced. Almost half of them supported the codification of directors’ general duties<sup>12</sup>. They considered that codification would make the directors’ duties clearer and more accessible. However, of those who supported codification, only a few supported incorporating the “enlightened shareholder value” into the statutory duties. Many expressed strong reservation, citing such reasons like heavy burden on directors, the requirement being unclear and difficult to comply with, and the concept of “enlightened shareholder value” was not widely accepted in Hong Kong.
18. A slightly larger number of respondents<sup>13</sup> disagreed with the proposal to codify directors’ general duties. Some of them believed that codification of the directors’ duties, unless to the full extent, would not clarify the law but only cause confusion. They considered that while a general statement of directors’ duties would not achieve any useful purpose, detailed codification would reduce the flexibility that the court had for interpretation and development of the law. A few opined that codification was premature, particularly as the UK’s reform on directors’ duties had just come into operation recently and had not been fully tested. A few such as the Hong Kong General Chamber of Commerce (HKGCC) floated the idea of codifying and clarifying the standard of care,

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<sup>12</sup> The supporters include the Chinese General Chamber of Commerce (CGCC), the Federation of Trade Unions, and some professional bodies like the HKICPA and ACCA.

<sup>13</sup> The opponents include a number of business organizations including the HKGCC, the Association of Bank, several listed companies and some professional bodies such as the Law Society, Bar Association, the Hong Kong Institute of Chartered Secretaries (HKICS) and the Hong Kong Institute of Directors.

skill and diligence required to be exercised by a director. They were concerned about the somewhat controversial approach found in some recent judicial decisions which have created uncertainty and sometimes inconsistencies for directors' guidance<sup>14</sup>. In this respect, they suggested that a subjective/objective test as under section 174 of the UK Companies Act 2006 ("CA 2006") should be adopted to provide clarification and improve the corporate governance in Hong Kong.

19. Other alternatives to make directors' duties clearer and more accessible being floated by some respondents are:
  - (a) updating and improving the non-statutory guidelines on directors' duties promulgated by the CR; and
  - (b) providing continuing education or even mandatory training of directors to enhance the awareness of their duties.

### **Our response**

20. The consultation indicates that the idea of codifying the directors' general duties remains highly controversial. Responses are highly divided save as the issue regarding the proposal to incorporate the "enlightened shareholder value" concept into the duties of directors, which has received only limited support. It would be premature to go down the route of comprehensive codification at this stage. Nevertheless, we see some merit in clarifying the directors' standard of care, skill and diligence as proposed by some respondents.
21. We agree that the subjective test in the old case law<sup>15</sup>, i.e. such skill as may reasonably be expected from a person of the particular director's knowledge and experience is too lenient nowadays. Principle 4 (duty to exercise care, skill and diligence) of the Non-statutory Guidelines on Directors' Duties issued by the CR in

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<sup>14</sup> For example, the subjective test as adopted in **Law Wai Duen v Baldwin Construction Co Ltd** [2001] 4 HKC 403 to the effect that the degree of skill expected of a director is that which can be reasonably expected of a person of his or her knowledge and experience was considered to be too low.

<sup>15</sup> The subjective test is based on *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 428.

2004 already comprises of a twofold objective/subjective standard<sup>16</sup> which is closer to the modern judicial stance taken towards the determination of the standard of care expected of directors. Nevertheless, because of the absence of a clear authority under the common law in Hong Kong in this respect, there is some uncertainty as to how far the mixed objective/subjective test will be adopted and applied by the Hong Kong court. A clear statutory statement on the duty of care, skill and diligence setting out the standard would clarify the law and provide consistent guidance to directors.

22. Section 174 of CA 2006 provides that:

- (1) a director of a company must exercise reasonable care, skill and diligence.
- (2) This means that the care, skill and diligence that would be exercised by a reasonably diligent person with –
  - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
  - (b) the general knowledge, skill and experience that the director has.

23. Paragraphs (1) and (2)(a) of section 174 of the CA 2006 provides an objective test whereas paragraph (2)(b) a subjective test. The objective test is the minimum standard. It can be adjusted upwards to reflect any special skill, knowledge and experience possessed by a particular director but cannot be adjusted downwards to accommodate someone who is incapable of attaining the basic standard of what can reasonably be expected of the reasonably diligent person carrying out the same function.

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<sup>16</sup> Principle 4 reads: “A director of a company must exercise the care, skill and diligence that would be exercised by a reasonable person with the knowledge, skill and experience reasonably expected of a director in his position. In determining whether he has fulfilled this duty, the court will also consider whether he has exercised the care, skill and diligence that would be exercised by a reasonable person with any additional knowledge, skill and experience which he has.”

24. We believe that the adoption of the mixed test approach along the lines of section 174 of CA 2006 would be conducive to enhancing corporate governance in Hong Kong. We propose that the statutory statement should replace the corresponding common law rules as the retention of the latter may result in dual standards and hinder the development of the statutory provision. The statutory statement will be incorporated into the draft CB for further public consultation.

### **Corporate Directorship**

25. We asked whether corporate directorship should be abolished altogether in Hong Kong subject to a reasonable grace period, or should be restricted by requiring every company to have at least one natural person as its director, like in the UK. (*Question 5*)

### **Respondents' views**

26. There were diverse views on whether corporate directorship should be abolished or restricted. A majority of respondents agreed that corporate directorship would increase difficulties in enforcement or may hamper transparency and accountability. Many of them, including the MPFA and Consumer Council, supported the abolition of corporate directorships, subject to a grace period. However, a few argued that their continue existence should not be a problem as they had not caused any major problem in the past<sup>17</sup>.
27. At the same time, a large number of respondents acknowledged that corporate directorship provided flexibility in the management of companies and served some useful purposes. The key reasons cited are summarised below:

- (a) investors and clients residing outside Hong Kong may require

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<sup>17</sup> The arguments include (a) the number of Hong Kong companies with corporate directors was relatively small in number; and (b) there are sufficient compliance and transparency requirements and safety checks built into the existing system to combat money laundering and terrorist financing measures in Hong Kong, e.g. it is not possible for a private company to open a bank account in Hong Kong without identifying the ultimate beneficiary.

corporate service providers or financial institutions to provide nominee director service to handle their business matters (e.g. signing of documents) promptly in Hong Kong;

- (b) for corporate service providers, corporate directorships have a number of advantages. First, the clients may find greater trust in a professional corporate service provider than an individual. Second, corporate directorships are less expensive than individual directorships because the latter would require greater insurance coverage for staff so acting and such cost is likely to be passed on to the customers resulting in higher fees. Third, the high turnover of staff in the corporate services industry would require frequent filing of updates of directors with the CR, which is both costly and time consuming. Fourth, corporate directorships can provide more flexibility, e.g. allowing for more than one person to be the authorised signatory or representative under the corporate director; and
- (c) some other companies may use corporate directors for legitimate reasons. For example, in cases where directors have to take business trips on a frequent basis, it would be more convenient and flexible if a corporate director is used so that other directors of the corporate director can also sign the necessary documents whenever another director is out of town. A parent company may also act as a director of its subsidiaries or associate companies.

28. There were different assessments on the likely impact of abolition of corporate directorship. Some believed that it would not reduce the attractiveness of Hong Kong as a place of doing business. On the other hand, some were concerned that it would encourage an exodus of companies to incorporate in other jurisdictions, such as BVI, that permitted corporate directorship. As many non-Hong Kong companies operating in Hong Kong do not register as they should under Part XI of the CO, the use of non-Hong Kong companies rather than Hong Kong companies would not be conducive to enhancing corporate governance in Hong Kong. A few respondents such as the Hong Kong Trustees' Association

were concerned that the corporate secretarial industry would be adversely affected.

29. Among those who saw some value in keeping corporate directorship, a majority supported adopting the UK approach, i.e. allowing corporate directorship on the condition that at least one of the directors was a natural person. Many saw it as striking a balance between providing flexibility while enhancing transparency<sup>18</sup>. Nevertheless, some queried the UK approach on the ground that it provided no guarantee that an appropriately qualified individual of good standing would be appointed as director. In this respect, they suggested two alternatives:
- (a) maintaining corporate directorship on the condition that (i) the corporate director should be a Hong Kong company or a non-Hong Kong company registered under Part XI of the CO or a company incorporated in a place where public search of the company can be obtained; and (ii) all directors of the corporate director should be natural persons, i.e. there will be no multiple layers of corporate directorships<sup>19</sup>; or
  - (b) introducing a system of registering corporate service providers and their nominee director companies would go a long way towards resolving this accountability issue.

### **Our response**

30. In view of the equally strong opinions on the need to enhance corporate governance and transparency and the legitimate commercial need for flexibility, the UK approach appears striking an appropriate balance between the two. It should also be able to meet the anti-money laundering and counter-terrorist financing concern of the Financial Action Task Force to a large extent. The

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<sup>18</sup> Supporters of the UK approach include, among others, the HKGCC, CGCC, Chinese Manufacturers' Association of Hong Kong, Chamber of Hong Kong Listed Companies, ACCA, Hong Kong Association of Banks (HKAB), and HKICPA. For example, the HKAB remarked that the UK approach satisfied the flexibility aspect and personal accountability issue while enhancing compliance by authorized institutions in respect of connected lending (pursuant to section 83 of the Banking Ordinance) and statutory guidelines relating to the prevention of money laundering and terrorist financing activities.

<sup>19</sup> The alternative was proposed by HKICS, among others.

alternative in paragraph 29(a) involves complex conditions, such as requiring all directors of the corporate director (which could be a non-Hong Kong company) to be natural persons that would be difficult to monitor and enforce.

## **Registration of Charges**

### ***A. Changes not recommended (Question 6(a) and (b))***

31. We asked whether the following changes listed in Appendix V of the Consultation Paper should not be adopted in Hong Kong -
- (a) comprehensively codifying the law on priorities where there is more than one charge over the same property created by a company;
  - (b) introducing an advance or provisional registration system;
  - (c) providing a legislative clarification of the kinds of retention of title clause that constitute a registrable charge;
  - (d) registering sale or absolute assignment of book debts (or receivables);
  - (e) registering pledges;
  - (f) registering trust receipts if they operate for more than a specified period of time;
  - (g) registering insurance policies; and
  - (h) registering fixed charges on shares (and other marketable securities).

### **Respondents' views**

32. While the majority of respondents agreed that the above changes should not be adopted in Hong Kong, some respondents raised, among other things, concerns in respect of the registrability of the following securities –
- (a) *Assignment of insurance policies and charge over shares*: a few respondents were concerned whether assignment of insurance policies and charges over shares needed to be registered under section 80 of the CO as they might constitute charges over book debts (in the case of share charges, the

inclusion of dividends as a subject matter covered by the charge might constitute book debts). Also, as a matter of procedure, the CR had accepted these charges delivered to it for registration. If the policy was that they were not registrable, the CR's practice should reflect it. Considerations should therefore be given to expressly provide in the law that it is specifically excluded from registration.

A few respondents considered that charges on shares should be registered to avoid "false wealth" in order to protect the potential buyers of private companies in particular.

- (b) *Assignment of rental or sale proceeds*: A couple of respondents sought clarification on whether assignments of rental or sale proceeds by way of security usually given in relation to construction projects were registrable.

### **Our response**

33. We have considered whether there is any need to clarify in the legislation the registrability of an assignment of insurance policy by way of security, a fixed charge over shares of a company and an assignment of rental or sale proceeds by way of security in view of the comments from a few respondents. However, we believe it is clear at common law that "insurance policy" and "shares" do not fall within the meaning of "book debts" while rental and sale proceeds that arise in the ordinary course of business can properly be regarded as "book debts". We do not consider it necessary or desirable to re-state the common law position in the legislation. This is to avoid any confusion or misunderstanding that an express clarification of the registrability of these documents in the new legislation would operate to change the legal position prior to its enactment. We therefore recommend maintaining the status quo (i.e. not to make any express provision regarding an assignment of insurance policy by way of security, a fixed charge over shares of a company and an assignment of rental or sale proceeds by way of security).

34. While a few respondents considered that charges on shares should be registered for the avoidance of “false wealth”, we are of the view that third party will unlikely be misled by the non-registration since in a charge over shares, especially shares of listed companies, the chargee will usually take control and custody of the charged shares and the dividend on the charged shares will be payable to the chargee/mortgagee as the registered holder thereof. It should also be noted that registration will not be practical because of the changing nature of investment portfolios which could result in frequent registration applications. The concern that lack of registration of charges over shares in private companies will take away the protection for potential buyers of private companies can be addressed because buyers will usually rely on the warranties given by the vendors that the shares sold are free from encumbrances and will have a right to claim damages in case of breach.

***B. Charges on Aircrafts and Interests in them (Question 7)***

35. We proposed that charges on aircrafts and interests in them should be made registrable.

***Respondents’ views***

36. The majority of the respondents supported the proposal. A few advised that they would leave this question to the aviation industry to comment. On the other hand, a few respondents (who are the key players in the aviation industry) did not support the proposal. Since they had already kept Civil Aviation Department (“CAD”) notified of aircraft mortgages<sup>20</sup> and the airline industry would move towards an international system of registration, they considered registration of charges on aircrafts burdensome and unnecessary.

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<sup>20</sup> Under the Air Navigation (Hong Kong) Order 1995 (Cap. 448C), ownership (or the holding of legal or beneficial interest) is a key factor affecting whether an aircraft may be registered in Hong Kong and whether the aircraft may be used for public transport or aerial work. At present, notification of aircraft mortgages to CAD is not a mandatory requirement though such notification provides a means to ensure the continuing compliance with the ownership requirement.

### **Our response**

37. Upon closer examination with further research, it seems that it may be arguable that as some<sup>21</sup> charges on aircrafts and interests in them could be registrable as bills of sale, they may have already been registrable under section 80(2)(c) of the CO. In order to remove any ambiguity, we recommend legislative clarification as to the registrability of aircraft charges by expressly providing for the registration of charges on aircrafts and interests in them. The recommendation is made because the main reason for registration of charges under the CO is to provide information to persons who wish to assess the financial position of a company, such as credit reference agencies, prospective charge holders, investors and financial analysts, to enable them to ascertain whether or not the assets of the company are encumbered. Hence it is desirable to register such charges with the Registrar so that persons who wish to obtain information on the range of securities that a particular company has granted do not need to search several registers. It should also be noted that aircraft is not the only type of assets that has a separate register but is still required to be registered with the Registrar.

### ***C. Debentures (Question 8)***

38. We proposed that section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures should be deleted on the ground that it is redundant for being duplicating with some other heads of registrable charges.

### **Respondents' views**

39. The vast majority of the respondents supported the proposal.

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<sup>21</sup> It is arguable that not all mortgages over aircrafts are necessarily registrable under s 80(2)(c) since some could fall within one or more of the carve outs from the definition of 'bill of sale' and consequently s 80(2)(c). Some of these could be (1) bills of sale of goods in any place outside of Hong Kong and (2) assignment for the benefit of the creditors of the person making the same.

### **Our response**

40. We will adopt the proposal.

#### ***D. Bills of Sale (Question 9)***

41. We asked whether the reference to “bills of sale” in section 80(2)(c) of the CO should be (i) retained as is, (ii) retained but clarified along the lines of section 262(3) of the Australia Corporations Act 2001 (“ACA”) or (iii) deleted.

### **Respondents’ views**

42. While the majority of the respondents supported that the reference to “bills of sale” should be deleted, some mentioned that charges on personal chattels, equipment or goods without being coupled with any other security were not uncommon and they were currently registered under section 80(2)(c) of the CO.

### **Our response**

43. While there is some support for deleting the reference to “bills of sale”, a number of respondents have pointed out that a bill of sale, although rare, may still be of relevance in cases where the charged assets are personal chattels, plant, machinery or equipment, etc. It would seem imprudent to delete section 80(2)(c) without any substitute. We have considered section 262(3) of the ACA as an alternative. However, as some respondents commented, the formulation in the ACA is also not entirely satisfactory<sup>22</sup>. On balance, in view of the facts that charges over personal chattels are still registrable under the reference to bills of sale in some comparable jurisdictions and that the existing system does not seem to cause any problems, we recommend retaining section 80(2)(c).

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<sup>22</sup> For example, section 262(3) of the ACA includes reference to a charge on a growing crop which seems not suitable in the Hong Kong context.

*E. Book Debts (Question 10)*

44. We asked whether the term “book debts” should be statutorily defined or left to the courts to define. We also proposed that a lien on subfreights and cash deposits should be expressly excluded from the registration requirement.

**Respondents’ views**

45. The majority preferred the term “book debts” to be left to the courts to define on the grounds that it was difficult to define “book debts”, and the definition in ACA appeared to be complex and would still require court interpretation, and leaving to the courts to define would allow its definition to be evolved through case law. On the other hand, many respondents who supported statutory definition did not further elaborate their reasons. Those who explained their reasons considered that a statutory definition could reduce uncertainty and make the law clearer.
46. The vast majority of the respondents supported that a lien on subfreights should be expressly excluded from the registration requirement. The great majority of respondents also supported that a charge over cash deposits should be expressly excluded from the registration requirement. However, a couple of respondents expressed that cash deposits could be charged in favour of a party other than the depository bank and hence this type of charge should not be excluded to give notice to the public that the account was subject to a security interest in favour of a third party.

**Our response**

47. In accordance with the majority views of the respondents, we will leave the term “book debts” to the courts to define. We will also expressly exclude a lien on subfreights and a charge over cash deposits from the registration requirement. Specifically, for cash deposits, there will be practical difficulties if a distinction is to be maintained for a charge created in favour of the deposit-taking institution and a third party, thus resulting, for example, in requiring a charge over cash deposits created in favour of, say, a

stock broker or investment financier or over a margin deposit or any other financial products resembling a charge over cash deposits to be registrable as a charge over book debts. In a financial market where transactions move very quickly within a very short period of time, this requirement would make registration too burdensome.

***F. Automatic Statutory Acceleration of Repayment (Question 11)***

48. We proposed that the automatic statutory acceleration of repayment in section 80(1) of the CO should be replaced with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time.

**Respondents' views**

49. The vast majority of the respondents supported the proposal.

**Our response**

50. We will adopt the proposal.

***G. Revised Registration Procedures (Questions 12 - 14)***

51. We proposed that both the instrument of charge and prescribed particulars should be registrable and open to public inspection. We also proposed that the Registrar should no longer issue a certificate of due registration, but a receipt showing the particulars submitted for registration, as well as the date on which the instrument of charge and the particulars are submitted for registration. The period to register a charge should be shortened to 21 days<sup>23</sup>.

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<sup>23</sup> Question 13 of the Consultation Paper also asked that if the proposal to register instrument of charge with the CR was not adopted, whether the charge holder should be precluded from relying on rights to the security in excess of those referred to in the particulars submitted for registration. Since the proposal to register the instrument of charge is adopted (paragraph 55 refers), the respondents' views to our enquiry on excess right would become inapplicable.

### *Respondents' views*

52. The majority of the respondents supported the proposal to register both the instrument of charge and prescribed particulars. For those who objected to the proposal, their concerns included –
- (i) Charge documents are confidential and it is not realistic to expect parties to keep their specific commercial arrangements in separate documentation which may place an undue burden on the way parties document their transactions;
  - (ii) It would be unfair to impose a burden on the public to review the entire charge document, some of which may be highly complex; and
  - (iii) The proposal creates unnecessary cost. A simple online registration to let others know that a security does exist should be sufficient.
53. The majority of the respondents also supported the proposal for the Registrar to issue a receipt instead of a certificate of due registration. A few of their support was given conditional upon, inter alia, the instrument of charge to be registered and available for inspection, or a simple online registration system with the provision of a limited amount of information to be adopted. Some respondents however considered that there should be some official proof of due registration and a certificate should continue to be issued, though the word “due” (meaning “conclusive evidence that all requirements of this Part with respect to registration have been complied with” under section 83(2) of the CO) could be removed if that was a concern.
54. In addition, the majority of the respondents supported the proposal to shorten the period to register a charge to 21 days. A few of their support was given conditional upon, inter alia, the CR no longer verifying the details of the particulars submitted to it, the administrative mechanism for late registration as described in

Question 15 to be adopted or a simple online registration system to be adopted. For those who objected, the reasons for their objection included a reasonable time should be allowed to register a charge, and that the concern about it being unfair to subsequent chargees who registered their charges more quickly was not relevant since this happened very rarely and the first chargee would probably have a negative covenant prohibiting the second charge.

**Our response**

55. In view of the general support to the revision of the registration procedures, we recommend that both the instrument of charge and prescribed particulars should be registrable and open to public inspection. As the instrument of charge is registered together with the particulars of charge, the CR could be relieved from checking the particulars of charge and in such case, the CR can issue a certificate as to the fact that the prescribed particulars of the charge (in a specified form) and the instrument of charge have been delivered to the CR. The certificate will show the name of the company creating the charge, the name of the specified form containing the prescribed particulars of the charge delivered<sup>24</sup> and the date on which such specified form together with the instrument of charge are submitted to the CR for registration. The reference in section 83(2) of the CO regarding "conclusive evidence" of compliance with all registration requirements will be deleted. The CR will no longer issue a certificate of due registration. The period of registration should be shortened to 21 days.
56. In respect of a satisfaction of a debt or debts secured by a charge registered under the CO or a release of a property in whole or in part from a registered charge, for the purpose of section 85 of the CO<sup>25</sup>, the evidence required by the Registrar under section 85(3) shall accompany an application under that section for entering by the Registrar on the register a memorandum of satisfaction of the debt(s) secured by a registered charge or a memorandum of the release of a property in whole or in part from a registered charge ("M2 Form")<sup>26</sup>. Such evidence for discharge of a registered

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<sup>24</sup> Including a unique identifier in the form of a bar code number assigned to the form

<sup>25</sup> This provision is a voluntary requirement only.

<sup>26</sup> Currently, the evidence is required only if the M2 Form is signed by the company/mortgagor itself.

charge is usually in the form of an instrument of release or (as the case may be) partial release executed by the chargee in favour of the chargor in respect of a registered charge (the “Evidence for Payment / Release”). As we recommend that instruments of charge will be registrable, for consistency sake, we also recommend that the Evidence for Payment / Release should be registered<sup>27</sup> and open to public inspection in respect of entry by the Registrar of such a memorandum.

57. While some respondents have raised concerns about the undesirable impact of the proposal to register the instrument of charge, we believe the additional workload created should somewhat be offset by the simplification of the prescribed particulars to be filed. The filing of the instrument of charge also facilitates the shortening of the registration process which will then reduce the period where a charge is “invisible” to outside parties.

#### ***H. Introducing an Administrative Mechanism for Late Registration of Charges (Question 15(a) and (b))***

58. We asked whether an administrative mechanism should be introduced for late registration of charges.

#### **Respondents’ views**

59. Views were equally divided. Those who supported the proposal mainly considered that it could enhance efficiency and save cost. On the other hand, those who did not support mainly quoted the reasons listed in paragraph 5.33 of the Consultation Paper<sup>28</sup>, that

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<sup>27</sup> The evidence should be registered no matter who signed the M2 Form.

<sup>28</sup> The reasons listed in paragraph 5.33 of the consultation paper are –

- (i) unlike the existing regime under which all charges which appear on the register are effective, there will be uncertainty over whether some of the charges as registered are effective until expiry of the specified period. The charge holder may be disadvantaged in certain situations as a result of such uncertainty. For example, under the current system, while the charge holder may be asked by the court to establish at the point of a late registration application that the company is not insolvent, the task would be less onerous than presenting retrospective evidence after a lapse of time. It may also be difficult for the charge holder to secure the necessary assistance or cooperation from the company to prove its solvency, especially at a time when the company in question has gone into insolvent liquidation; and
- (ii) the proviso in paragraph 5.31(2) could not fully replicate the current discretionary power exercised by the court. For example, the proviso excludes the possibility of a late registration

the present system had been working well and could better encourage timely registration as the justifications.

### **Our response**

60. In view of the divided views and the concerns raised, we recommend maintaining status quo, i.e. an administrative mechanism should not be introduced.

## **CONCLUSION**

61. In summary, the following proposals should be adopted:
- (a) The Registrar should be empowered to act on a court order directing a defendant company to change its infringing name, and substitute its infringing name with its registration number if the company fails to comply with the Registrar's direction to do so (*Question 1*);
  - (b) The proposal to provide the Registrar with a discretionary power to approve a "hybrid name" if there is a "genuine business need" will not be adopted. Nevertheless, the CR will allow phrases like "X光" and "卡拉OK" in company names because they have no direct Chinese equivalents and they are already used in other legislation(*Question 2*);
  - (c) The directors' duty of care, skill and diligence should be codified in the CB along the lines of section 174 of CA 2006. The other general duties of directors should not be codified (*Question 4*);

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being valid even if the company is insolvent at the time of late registration when it would have been in the interests of the company and its unsecured creditors to do so.

(The two provisos in paragraphs 5.31(1) and (2) are –

- (1) late registration would be made without prejudice to parties with rights against the property of the company that forms the subject matter of the charge and who have acquired such rights before the charge is actually registered; and
- (2) late registration should be deemed to be ineffective (i.e. the charge is void against the liquidator and creditors of the company) if the company goes into insolvent liquidation within a certain period after the actual registration of the charge unless the charge holder relying on the late registration establishes that the company was solvent at the time that the charge was registered.)

- (d) Subject to a grace period, every company must have at least one director who is a natural person (*Question 5*);
- (e) All the changes listed in Appendix V of the Consultation Paper should not be adopted in Hong Kong (*Question 6(a) and (b)*);
- (f) There should be legislative clarification expressly providing that charges on aircrafts and interests in them are registrable. (*Question 7*);
- (g) Section 80(2)(a) of the CO requiring the registration of a charge for the purpose of securing any issue of debentures should be deleted (*Question 8*);
- (h) Section 80(2)(c) of the CO should be retained (*Question 9*);
- (i) The term “book debts” should be left to the courts to define. A lien on subfreights and a charge over cash deposits should be expressly excluded from the registration requirement (*Question 10*);
- (j) The automatic statutory acceleration of repayment in section 80(1) of the CO should be replaced with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time (*Question 11*);
- (k) Both the instrument of charge and prescribed particulars should be registrable and open to public inspection. The Registrar should issue a certificate as to the fact that the prescribed particulars of the charge (in a specified form) and the instrument of charge have been delivered to the CR. The certificate will show the name of the company creating the charge, the name of the specified form containing the prescribed particulars of the charge delivered and the date on which such specified form together with the instrument of charge are submitted to the CR for registration. The reference in section 83(2) of the CO regarding "conclusive

evidence" of compliance with all registration requirements will be deleted. The CR will no longer issue a certificate of due registration. The period to register a charge should be shortened to 21 days. For the purpose of section 85 of the CO, the Evidence for Payment / Release together with the specified application form should be registered and open to public inspection (*Questions 12- 14*); and

- (1) An administrative mechanism for late registration of charges should not be introduced (*Question 15(a) and (b)*).

## **WAY FORWARD**

62. The Administration will incorporate all the proposals into a draft Bill to be issued for further public consultation in mid-2009.

**Financial Services and the Treasury Bureau  
December 2008**

**List of Forums and Meetings Attended**

<b>Date</b>	<b>Organising Parties</b>	<b>Nature</b>
15 May 2008	The Hong Kong Institute of Directors *	Forum
19 May 2008	Labour Advisory Board, Labour Department *	Meeting
27 May 2008	The Society of Chinese Accountants and Auditors *	Forum
28 May 2008	Companies Bill Team, Financial Services and the Treasury Bureau	Forum
29 May 2008	Hong Kong Institute of Certified Public Accountants *	Seminar
29 May 2008	Companies Bill Team, Financial Services and the Treasury Bureau	Focus Group Meeting
5 June 2008	The Law Society of Hong Kong *	Seminar
6 June 2008	Small and Medium Enterprises Committee, Trade & Industry Department *	Meeting
17 June 2008	The Association of Chartered Certified Accountants *	Seminar

\* We were invited by the organising parties to attend the forums and meetings to further introduce the proposals on the company names, directors' duties, corporate directorship and registration of charges in the Rewrite of the Companies Ordinance. Comments on the proposals were also received from members of the organising parties through discussions.

**Respondents**

*Organisations*

1. American Chamber of Commerce in Hong Kong, The
2. Arthur K. H. Chan & Co.
3. Arthur Lam & Co. CPA
4. Asian Patent Attorneys Association, Hong Kong Group, The
5. Association of Chartered Certified Accountants, The
6. Association of Women Accountants (Hong Kong) Limited
7. British Chamber of Commerce in Hong Kong, The
8. Canadian Certified General Accountants Association of Hong Kong
9. Cathay Pacific Airways Limited
10. CCIF CPA Limited
11. Chamber of Hong Kong Listed Companies, The
12. Chartered Institute of Management Accountants, Hong Kong Division, The
13. Chinese General Chamber of Commerce, The
14. Chinese Manufacturers' Association of Hong Kong, The
15. Clifford Chance
16. CLP Holdings Limited
17. Consumer Council
18. Companies Registry and Intellectual Property Practitioners Liaison Committee
19. Deacons
20. Hermes Equity Ownership Services Limited

21. Hong Kong Aircraft Engineering Company Limited
22. Hong Kong Association of Banks, The
23. Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies, The
24. Hong Kong Bar Association
25. Hong Kong Chinese Enterprises Association, The  
[\* 3 submissions from members]
26. Hong Kong Federation of Insurers, The
27. Hong Kong Federation of Trade Unions, The
28. Hong Kong General Chamber of Commerce
29. Hong Kong Institute of Certified Public Accountants
30. Hong Kong Institute of Chartered Secretaries, The
31. Hong Kong Institute of Directors, The
32. Hong Kong Institute of Trade Mark Practitioners, The
33. Hong Kong Investment Funds Association
34. Hong Kong Monetary Authority
35. Hong Kong Stockbrokers Association Limited
36. Hong Kong Trustees' Association Limited
37. Hongkong and Shanghai Banking Corporation Limited, The
38. Hutchison Whampoa Limited
39. Institute of Accountants in Management, The
40. International Management Association
41. Japan Electronics & Information Technology Industries Association
42. KPMG
43. Law Society of Hong Kong, The

44. Mandatory Provident Fund Schemes Authority
45. Mayer Brown JSM, Susan POON
46. Mayer Brown JSM, Kenny WONG
47. Society of Chinese Accountants and Auditors, The
48. Sovereign Group, The
49. Swire Pacific Limited
50. Tricor Services Limited

*Individuals*

51. Eric CHIU, China Insurance Group Investment Holdings Company Limited
52. HO Tak Wing
53. Gordon JONES
54. Cally JORDON
55. LAM Wai Hong
56. LOW Chee Keong
57. Charles MAYO, Simmons & Simmons
58. Paul MOK
59. SZETO Ho Kwong