

**Hong Kong Bar Association's comments on
Rewrite of the Companies Ordinance -
Consultation Paper on Company Names, Directors' Duties,
Corporate Directorship and Registration of Charges**

Question 1(a)

1. The Bar supports this recommendation.
2. Although, as the Court recognized in Hitachi Ltd v Hitachi Wei Chu (Hong Kong) Limited [2007] 4 HKC 602 at 609, there exists other avenues to enable a successful plaintiff in a passing-off action to bring about a change of the defendant's name, including (a) resort to s.22A of the Companies Ordinance ("CO"); (b) contempt proceedings; and (c) the plaintiff relying on an unpaid costs order to petition the winding up of the defendant, we do not believe these avenues provide an adequate answer for 2 reasons. First, they may not be available to the plaintiff. In the case of s.22A, the Registrar of Companies ("**Registrar**") may decline to give a direction. Also, contempt proceedings are only useful if the defendant is actually traceable – in many passing off cases the defendant simply does not surface and suffers judgment entered in default. Second, even in the case of the plaintiff relying on the unsatisfied costs order to petition the winding up of the defendant, this exercise would involve considerable time and expense on the part of the plaintiff.
3. Accordingly, the Bar considers it appropriate to empower the Registrar to act on a court order to direct a company to change its name within a specified period.

Question 1(b)

4. The Bar also supports this recommendation. Under the current framework, default in compliance with directions given by the Registrar under ss.22(2) and 22A(1) of the CO would only attract a fine (and an additional default fine if the default persists), and in the case of s.22(2), the officers of the company may be liable for imprisonment. This is unsatisfactory, as in the case of

continued non-compliance the Registrar has to go through the roundabout route of and to incur costs in using winding up proceedings to obtain the desired result. The power to order imprisonment is of no assistance in a case where the defendant and its officers cannot be traced. Accordingly, the Bar agrees that the Registrar should also be empowered to change a company's name to its registration number where the company has defaulted in complying with the direction of the Registrar.

Question 2(a)

5. The Bar agrees with the proposal set out in paragraphs 2.16 and 2.17 of the Consultation Paper.

Question 2(b)

6. What constitutes a "genuine business need" is best left to be decided by the Registrar. Any attempt to define such a need will either be too general and therefore devoid of any meaningful indication or too narrow, which will have the effect of restricting the ability of the Registrar to consider whether a case of genuine business need has been made out by the applicant in the particular context of its business.

Question 3

7. The Bar does not have any further input on this question.

Question 4(a)

8. Whilst the Bar recognizes the trend in various commonwealth jurisdictions is gearing towards codification of director's duties, the Bar has reservations as to whether there is any need to do so in Hong Kong.
9. As the Bar understands, what codification aims to achieve is essentially two-fold: (a) to improve accessibility of the director's duties to the general public

and (b) reform. The Bar takes the view that these aims could be (and indeed in some case have been) achieved without codification.

- (1) On the question of accessibility, the Bar has reservations as to whether codification would lead to any substantial change. First, the court would still retain a central role in the exposition and application of the statutory duties, as it does in the case of common law and equitable duties. Thus, the public would still have to look to the case law to ascertain the scope and nature of the statutory duties. Second, currently the major common law and equitable duties have been set out in non-statutory guidelines which are widely distributed and the directors are required to sign an acknowledgement of receipt and perusal of the same when submitting a company's annual return. That already serves the purpose of informing the general public and directors of the duties owed.
- (2) On the question of reform, the Bar notes that the court has no difficulty in adapting the common law and equitable duties to the changing circumstances of the world. Unless there is to be a radical change in the nature or content of director's duties (which the Bar does not understand to be the proposal), it may be preferable to follow the common law to allow the law to be developed on a case-by-case basis, taking into account the new demands arising from changing circumstances.
- (3) The Bar also notes that the UK has introduced a modern version of "duty to act in the best interest of the company" by incorporating the concept of "enlightened shareholder value" ("ESV"). This reform has not found its way into the Australian and Singaporean codification. The Bar takes the view that it is premature and inappropriate to introduce ESV into Hong Kong company law. Unlike the UK, where concepts of corporate social responsibility and ESV have been mooted for some time (see e.g. www.csr.gov.uk), these concepts have yet to take root in Hong Kong. Further consideration, promotion and consultation should be undertaken for the purpose of deciding whether ESV should be incorporated into our company law.

10. The Bar also takes the view that codification, depending on its scope, may also bring about confusion. For instance, whether codification is to be complete or partial will have an effect on the application and relevance of existing case law as well as future judicial determinations. If Hong Kong is to follow the UK approach (statutory duties replacing common law/equitable duties), questions may arise as to whether the court, in construing the statutory duties, should have regard to the existing common law/equitable principles, or whether the legislature should stipulate the factors which the court should take into account in its construction exercise. Alternatively, if Hong Kong is to adopt the Australian and Singaporean approach that the statutory duties are only additional or supplemental to the common law/equitable duties, problems may arise from having 2 separate regimes. The problems would be particularly pronounced if the codification also introduces new remedies for breach of the statutory duties. The public would have no means to know all the duties a director is charged with, which is the principal purpose of codification.
11. If, however, it is considered appropriate to codify the directors' duties, we consider it appropriate to follow the Australian / Singapore approach which have the flexibility of allowing further development of directors' duties under common law.

Question 5(a)

12. The Bar supports the recommendation set out in paragraph 4.5 of the Consultation Paper. The Bar does not believe that abolishing corporate directorship for private companies would necessarily have the effect of reducing the attractiveness of Hong Kong as a place for doing business. The Bar believes that the corresponding enhancement in corporate transparency and accountability (in particular in the ability to identify a particular person or group of persons as being in control of the company, as opposed to a postal number in, say, the BVI) would increase the level of confidence in dealing with Hong Kong companies.

Question 6

13. The Bar supports the proposal not to adopt the possible changes described in paragraphs (A), (B), (C), (D) and (G) of Appendix V.
14. However, the Bar considers there is merit in adopting the changes described in paragraphs (E), (F) and (H) of Appendix V.
15. Paragraph (E) Pledge: So far as pledge is concerned, it seems that there is merit in requiring registration of pledge of shares and other marketable securities. It is not uncommon to find companies in particular those engaging in financial business, holding substantial shares and other marketable securities as their assets. If the value of the shares and marketable securities is substantial, their status (i.e. whether encumbered or not) will be highly material to the financial state of the companies. However, any persons or entities dealing with the company will have no independent means to find out whether the shares and marketable securities are encumbered.
16. Paragraph (F) Trust receipts: the Bar does not agree with the analysis regarding trust receipts. As stated in paragraph 19 below, the nature of security created by a trust receipt is an equitable charge. The use of trust receipt is also not uncommon in trade financing.
17. Paragraph (H) Shares and Other Marketable Securities: There is no logical reason why fixed charge on shares and marketable securities should not be registered. It seems that the Australian model is a commendable way to deal with registration of fixed charge on shares and other marketable securities.

Question 7

18. The Bar supports this proposal.

Question 8

19. The Bar supports this proposal.

Question 9

20. The discussion in paragraph 5.14 of the Consultation Paper assumes that charges on goods may not exist in isolation, but usually coupled with a floating charge over a company's entire undertaking. This assumption is not entirely correct. The creation of a charge over goods often arise in the context of trade financing, most notably through the use of trust receipt and cargo receipt. It was held in Re Far East Structural Steelwork Engineering Limited (in liquidation), HCCW 354/2001, 27 October 2004, per Kwan J, at para. 40 that the security created by the trust receipt and cargo receipt is an equitable charge and falls within the meaning of a "bill of sale". This holding was not challenged on appeal in Re Far East Structural Steelwork Engineering Limited (in liquidation), CACV 348/2004, 15 June 2006, although the Court of Appeal by a majority came to a different conclusion and held that the charge created by the trust receipt and cargo receipt comes within the exception under s.2 of the Bills of Sale Ordinance.
21. It is neither unusual nor uncommon for a charge to be created over goods. It has certainly been used by merchants to conduct trade financing. There is no good reason why the reference to "bill of sale" in section 80(2)(c) of the CO should be deleted. The Bar considers that the provision should be retained but with clarification along the lines of section 263(3) of ACA.

Question 10

22. The Bar considers it appropriate not to define the term "book debts" for the reasons set out in paragraphs 5.16 of the Consultation Paper.
23. The Bar supports the proposal under Question 10(c).

Question 11

24. The Bar has no objection in principle to the proposal in paragraph 5.20 of the Consultation Paper. However clarification may be required for limitation purposes – logically, it would appear that time should begin to run as from the

expiry of the prescribed time, as opposed to when the lender makes a formal demand for repayment.

Question 12(a)

25. The Bar supports the proposal for registration of both the instrument of charge and the prescribed particulars so that the public can apprise of the extent to which the company's assets have been encumbered. Even under the present regime, certain instruments of charge are required to be registered (see sections 80(3) and 82(1) of CO and regulation 5 of Companies (Forms) Regulations). There is no logical distinction as to why certain instrument of charge should be registered while others do not have to be registered.
26. If there is any confidential information which the parties to the instrument do not want to disclose, they can be set out in a side letter which is not registrable.

Question 12(b)

27. The Bar does not supports the proposal for replacing the certificate of due registration with a receipt. The legislative purpose of the certificate and its conclusiveness have been the subject of extensive judicial consideration In re C.L. Nye Ltd. [1971] Ch 442; In re Yolland, Husson & Birkett Ltd. [1908] 1 Ch 152; National Provincial and Union Bank of England v. Charnley [1924] 1 KB 431; In re Eric Holmes (Property) Ltd. (in liquidation) [1965] 1 Ch 1052; In re Mechanisations (Eaglescliffe) Ltd. [1966] 1 Ch 20; R v Registrar of Companies, ex p Central Bank of India [1986] 1 QB 1114; Re Lin Securities (Pte) Ltd. [1988] SLR 340; Exeter Trust Ltd. v. Screenways Ltd. [1991] BCLC 888; and United Overseas Bank Ltd. v. The Asiatic Enterprises (Pte) Ltd. [1999] 4 SLR 226 and most recently by Kwan J in Re Moulin Global Eyecare Holdings Limited, HCCW 470/2005, 4 June 2008, at paras. 129 to 132. The certificate was for the protection of the chargee rather than members of the public or the company concerned. It should not lightly be displaced because of administrative convenience. If the certificate is replaced by a receipt, a principal purpose of the certificate, which is to provide certainty on the particulars registered, will be defeated.

28. If the proposal under Question 12(a) is implemented, the instrument of charge will be registered and available to the Registrar, who can readily verify the information from reviewing the instrument. Still further, if it is considered desirable to enhance the accuracy of the particulars provided by the company, criminal sanction may be imposed for providing incorrect particulars to the Registrar, which is presently lacking under section 81 of CO.

Question 13

29. The Bar does not support this proposal. It is difficult to see how this proposal can be justified bearing in mind that the primary obligation to register the charge (which will not be changed, see paragraph 5.19 of the Consultation Paper) is on the company holder, though the charge holder can also effect registration on its own volition under s.81(2) of CO. The sanction would be disproportionate and unjustified in a case where the incorrect particulars are submitted by the company and the charge holder failed to check the register and to apply for consequential rectification.

Questions 14(a) and (b)

30. The Bar supports the proposal in paragraph 5.27 of the Consultation Paper and agrees that 21 days would be an appropriate period. The Bar notes that the time limit for registration under Land Registration Ordinance (Cap.128) is only 1 month.

Question 15(a) and (b)

31. The Bar does not support the proposal of introducing an administrative mechanism to replace the current framework of court approval for late registration of charges.
32. The Bar takes the view that the current framework has the following advantages:-
- (1) Approval is not automatic but depends upon the applicant's satisfying the court that there is a proper reason for allowing late registration.

- (2) In so doing, it emphasizes and reinforces the importance of registering charges in time. Automatic grant of extension would send out the wrong message that companies and/or charge holders need not be vigilant in ensuring timely registration.
- (3) Though the applications are often made *ex parte*, the court would still have the opportunity to consider, on the basis of materials presented, whether, and if so how, its discretion should be exercised. In particular, the court would be able to consider what conditions would be apposite in any given case – for instance, a Re Charles order ([1935] WN 15) is only appropriate where the solvency of the company is in doubt or liquidation is imminent. The flexibility is lost in the case of automatic extension with standard conditions.
- (4) The grant of extension is valid until set aside (whether as provided for in a Re Charles order or otherwise) and the charge registered pursuant thereto would likewise be valid. This would provide certainty over the proposed scheme where the late registered charge might be deemed ineffective after a period of time on the contingency of the company going into liquidation.

Hong Kong Bar Association

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