THE LAW SOCIETY OF HONG KONG 香港律師會

Submissions by the Law Society

Consultation Paper
Share Capital, The Capital Maintenance Regime
Statutory Amalgamation Procedure

	Questions	Response
Question 1	Do you agree that Hong Kong should adopt a mandatory system of no-par for all companies with a share capital?	Yes
Question 2	Do you agree that a period of about 12 months would be reasonable for companies to review their arrangements before migration to no-par? If you think another period more appropriate, please specify what that is and your reasons.	The period should be not less than 24 months. It is quite usual for businesses in Hong Kong to be carried out by a large number of single-purpose companies in a group under common control. For groups such as these, management will have to review the arrangements of each of the group companies before migration to no-par. In these situations, 12 months would not be adequate.
Question 3	Do you agree that there should not be any legislative control over the setting of the issue price of the no-par shares?	Yes. The existing rule against issue of shares below par value does not provide any safeguard against the issue of shares below what they are worth either. The move to a no-par

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		regime is not a reason for legislating how share issue price is to be fixed. This should remain the responsibility of the board acting in the interests of the company.
Question 4	Assuming the abolition of par value while the existing capital maintenance rules are largely maintained, do you favour:	
	(a) The abolition of the merger relief; or	No. The abolition of merger relief will be unduly harsh, and make Hong Kong incorporated companies largely inflexible as compared to companies incorporated elsewhere.
	(b) Its application to the amount in excess of the subscribed capital of the acquired company attributable to the shares acquired or cancelled; or	No. The merger relief should be applied to the amount of the consideration in excess of the fair value (or book value) of the acquired company attributable to the shares acquired or cancelled. The subscribed capital of the acquired company attributable to the shares acquired or cancelled does not represent the value of the acquired company.
	(c) Some other alternatives (please specify)?	None
	Please provide reasons.	
Question 5	Assuming the abolition of par value while the existing capital maintenance rules are largely maintained, do you favour:	
	(a) The abolition of the group reconstruction relief; or	No

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	(b) Its application to the excess of the consideration for the shares over the base value of the assets transferred; or	Yes, but suggest discussion with accountants as to whether the fair value of the assets transferred should be an alternative to the base value of the assets transferred.
	(c) Some other alternatives (please specify)?	None
	Please provide reasons.	
Question 6	Do you agree with, or have any comments on, the proposals outlined above on:	
	(a) Capitalisation of profits with or without an issue of shares;	Yes
	(b) Issuance of bonus shares without the need to transfer amounts to share capital;	Yes. This would effectively be a share subdivision.
	(c) Consolidation and subdivision of shares; and	Yes
	(d) Redeemable shares.	We agree that it is possible to provide for redeemable shares in a fully no-par environment and the proposal to maintain them. We agree that payment for redeemable shares can continue to be computed by reference to the par value if that was the term of its issue prior to migration to no-par. However, additional provisions should also be introduced to deal with payment for redeemable shares which were issued at

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		a premium prior to migration to no-par. Such provisions should reflect the intention of the current section 49A(2) in relation to payment of any premium payable on redemption, suitably adapted because the share premium account (and also capital redemption reserve) would be amalgamated with the share capital account immediately before the migration to no-par share capital under the legislative deeming provision proposed.
	(e) Other implications	Despite the migration to no par, and the amalgamation of the share capital amount with the share premium amount, the expenses for issuing shares (which is now deductible from the share premium account) shall be allowed to be deducted from the share capital.
Question 7	Do you agree that the requirement for authorised capital should be removed?	Yes
Question 8	Do you see value in companies having a choice whether to retain or delete the authorised capital from their Articles of Association?	Yes. Shareholders of some companies may wish to restrict the issue of shares to a pre-determined maximum amount.
Question 9	Do you see value in retaining the option of having partly paid shares? Please provide reasons.	Yes. The financing choice of partly-paid shares should not be removed. Some members favour removal of partly paid shares, except in the case of shares allotted under an employee share scheme. For partly paid shares allotted under an employee share scheme, they should not be transferable, unless and until the

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		shares are fully paid. If the legislature removes partly paid shares, a migration period of say 12 months should be given for the shareholder to pay up the outstanding balance of the partly paid shares (except for those partly paid shares allotted under an employee share scheme).
Question 10	Do you agree that the amount unpaid on partly paid shares should be defined by reference to the issue price, without a need to distinguish between shares issued before and after migration to no-par?	We agree that the amount unpaid on partly paid shares should be defined by reference to the issue price. However, we see the merit of the requirement in Australia and Singapore to distinguish between shares issued before and after migration to no-par, in order to preserve the distinction in a par value environment between amounts outstanding on the par value (which is covered by statute) and that on the premium (which the liquidator must sue in contract for).
Question 11	Where partly paid shares without a par value are subdivided, do you agree that there should be reallocation (by legislation) of the outstanding liability on existing shares to the new shares to maintain the pre-existing ratios?	Yes
Question 12	Do you agree that Hong Kong should NOT adopt the solvency test approach to creditor protection which applies to all forms of distribution? Please provide reasons.	Yes. We agree with the same reasons set out in the SCCLR's recommendation in paragraph 3.12 of the Consultation Paper. However, some members consider that the solvency test approach has its attractions because creditor protection is now more focused on expectation of solvency, and this approach is worth re-exploring in future when the concept of corporate governance is more strongly embedded in the corporate

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		culture in Hong Kong.
Question 13	Should the solvency test currently used in Hong Kong (which is basically a cash flow test) be modified by including a balance sheet test?	No. We think adding the balance sheet test would give rise to undue hardship to companies. For instance, current accounting practices require revaluation of investment properties annually resulting in large fluctuation of asset values in the balance sheet. Such change of value of a company's long term assets normally does not affect a company's ability to meet its liabilities when due. Inclusion of a balance sheet test would impose undue restrictions on a company. Some members, however, favour the inclusion of a balance sheet test for they consider that it offers protection to creditors. This echoes the requirements of the US Revised Model Business Corporation Act and the New Zealand Companies Act.
Question 14	Do you agree that reduction of capital should continue to be subject to judicial control and there is no need to introduce a court-free procedure as an alternative process in addition to the current rules?	Yes. We agree with the view of the SCCLR. However, some members consider that court sanction can be dispensed with: creditors' interest can be safeguarded by requiring notice of reduction and giving creditors the right to object via court process. In addition, share buyback has the same effect as reduction of share capital but the current rules do not require share buyback to be court sanctioned.

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Question 15	If your answer to Question 14 is negative (i.e. you think that an alternative court-free process for reduction of capital should be introduced):	
	(a) Should it be available to all companies (whether listed or unlisted) or just private companies or private and unlisted public companies; and	For those members who favour the court-free process, they consider that this should be made available to all companies. The distinction between listed and non listed companies is not particularly relevant as a number of listed vehicles are incorporated in Bermuda, which allows for capital reduction without court sanction, subject to solvency test.
	(b) Should all directors make the solvency declaration, or is it sufficient for the majority to do so?	Those members who favour the court-free process agree that all directors should make the solvency declaration.
Question 16	Should the current provisions on buy-backs in relation to protection of creditors be:	
	(a) retained;	Yes
	(b) amended to allow public companies (whether listed or unlisted) to fund buy-backs from capital subject to the solvency and other procedural requirements currently applicable to a buy-back out of capital by private companies; or	No. Public companies require more protection than private companies.
	(c) amended to allow all companies (whether listed or unlisted) to fund buy-backs (regardless of the source of funds) subject to a solvency requirement (in a manner similar to that of the SCA)?	No

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Question 17	Is there a case for legislating for treasury shares for all companies (as in Singapore)?	No. We agree with the SFC decision in its Consultation Conclusions in July 1999. Some members favour legislating for treasury shares as in Singapore for this allows companies to deal with repurchased shares more effectively. Safeguards such as suspended dividends and voting rights should be implemented to prevent abuse.
Question 18	Should the current financial assistance provisions be streamlined in a manner similar to the NZCA?	No Some members consider that the current regime on financial assistance is complex and burdensome. They favour the New Zealand legislative approach to regulate financial assistance.
Question 19	If your answer to Question 18 is in the negative, would you prefer instead:	
	(a) the current provisions be retained;	Yes
	(b) the prohibition of financial assistance be abolished in respect of private companies (as the UK has done); or	No
	(c) making solvency an additional exception to the prohibition for all companies (whether listed and unlisted) in a manner similar to the SCA?	No
Question 20	Do you consider that there is a need for Hong Kong to have	In relation to intra-group amalgamation other than listed

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	a court-free statutory amalgamation procedure, in addition to the existing court-sanctioned procedure?	companies, this may be considered. However, amalgamation of two or more companies not being of the same group of companies, and intra-group amalgamation involving listed companies, should be implemented by the existing court-sanctioned procedure. Section 166 of the CO is used quite frequently for takeovers and mergers of listed companies where court sanctions provide the necessary supervision and protection. Some members are however of the view that the court-free statutory amalgamation procedures may be extended to inter-group amalgamation between companies (other than listed companies)
Question 21	If your answer to Question 20 is positive, should the court-free statutory amalgamation procedure be based on the elements outlined in Table A above? If you think that there should be alternative or additional elements, please explain.	In relation to intra-group amalgamation, the court-free statutory amalgamation procedure outlined in Table A is acceptable.

The Law Society of Hong Kong

Company and Financial Law Committee

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