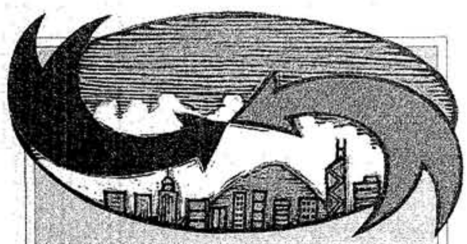

FORUM

Conflicting Provisions in the Companies Ordinance

Section 48B(3)(c) of the Companies Ordinance should have been repealed in 1991, argues Philip Smart

There exists in Hong Kong, a practical problem (hitherto unrecognised) concerning a company's use of its share premium account when redeeming redeemable preference shares.

At first blush it might appear that there should be no problem at all, because s 48B(3)(c) of the *Companies Ordinance* seems expressly to allow a company to use its share premium account in providing for the premium payable on the redemption of redeemable preference shares. However, it is submitted that when, in 1991, the reforming provisions on capital and shares (including redeemable shares) were introduced by the *Companies (Amendment) Ordinance* 1991, the old section s 48B(3)(c) should have been repealed. The failure to delete s 48B(3)(c) means that there is today a direct conflict between ss 48B(3)(c) and 49A(1)(b). The latter section, introduced in 1991, requires 'any premium' payable upon a redemption of shares to be paid out of distributable profits or, in certain circumstances (see s 49A(2)), the proceeds of a fresh issue of shares.

It can only be that the failure to amend s 48B(3)(c) was a mistake. Section 48B(3) is a replica of what was s 56(2) of the UK *Companies Act* 1948, and that provision was repealed when the UK company law on redeemable shares (as well as capital and distributions) was reformed in the early 1980s (see s 130(2) of the UK *Companies Act* 1985). Those reforms were reproduced in the Hong Kong *Companies (Amendment) Ordinance* 1991, but it would appear that the draftsman forgot to copy the consequential amendment in respect of the share premium account (ie s 48B(3)(c)).

The net result is that s 48B(3)(c) is quite inconsistent with s 49A(1)(b) as well as certain other provisions, discussed below, introduced in 1991. In accordance with basic principles of statutory interpretation, s 48B(3)(c) must be taken to have been repealed by s 49A(1)(b). (A similar irregularity occurred in 1991 when consequential amendments to Table A were left out of the *Companies (Amendment) Ordinance* 1991: the amendments were speedily introduced in 1993 after the mistake had been pointed out by this commentator.)

Section 48B(3) of the Companies Ordinance

Section 48B(3) provides that the share premium account may, notwithstanding anything in subsection (1), be applied by the company:

(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

(b) in writing off:

(i) the preliminary expenses of the company; or

(ii)the expenses of, or the commission paid or discount allowed on, any issue of shares of the company; or

(c) in providing for the premium payable on redemption of any redeemable preference shares of the company.

Figure 1

The Statutory Framework

Where shares are issued for an amount in excess of their par value, that excess is said to be share 'premium' (rather than share capital). Section 48B(1) of the *Companies Ordinance* requires that where shares are issued at a premium, the issuing company must create in its books of account a 'share premium account' and transfer the aggregate amount or value of the premium to that account. The share premium account is, pursuant to s 48B(1) of the Ordinance, treated as if it were paid up capital, subject to s 48B(3) (see figure 1).

Section 48B(3) was introduced into the *Companies Ordinance* in 1974 as a replica of s 56(2) of the UK *Companies Act* 1948.

In the early 1980s, UK law concerning redeemable shares was reformed, specifically so as to allow redeemable ordinary shares as well as redeemable preference shares (see UK *Companies Act* 1985, ss 159–181). Moreover, very detailed provision was made for the financing of any redemption of shares including (in appropriate cases and subject to specific safeguards) a redemption out of capital by a private company. The UK legislation accordingly repealed s 56(2) of the 1948 Act; and the current provision (s 130(2) of the 1985 Act: 'application of share premium') now contains no reference to using share premium in relation to the premium payable on the redemption of redeemable preference shares.

However, the UK legislation does contain a saving provision (ss 180(1) and (2) of the 1985 Act) which in relation to preference shares issued prior to the reforms coming into operation, allows any premium payable on redemption still to be paid out of the share premium account. (For full details see *Gower's Principles of Modern Company Law*, Gower, LCB, 5th ed, 1992 at p 225.)

The 1991 Amendments

In Hong Kong, the scheme of UK legislation, as well as most of its de-

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tail, was directly copied in the *Companies (Amendment) Ordinance* 1991. Thus, currently in Hong Kong (just as in the UK):

- A company may issue redeemable ordinary shares as well as redeemable preference shares.
- Redeemable shares may (subject to s 49I) only be redeemed out of distributable profits or the proceeds of a fresh issue (see s 49A(1)(b)).
- Any premium payable on redemption must normally only be paid out of distributable profits (see s 49A(1)(b)) – this is subject to s 49A(2) which in limited circumstances allows any premium payable on redemption to be paid out of the proceeds of a fresh issue of shares.
- There is a saving provision contained in ss 49R(1) and (2) which allows, in relation to preference shares issued before the commencement of the *Companies (Amendment) Ordinance* 1991 (ie 1 September 1991), any premium payable on redemption to be paid out of the share premium account instead of out of profits, 'notwithstanding the repeal by the *Companies (Amendment) Ordinance* 1991 . . . of any provision of this Ordinance'.

In short, there is a clear conflict between ss 48B(3)(c) and 49A(1)(b). The intention must have been to repeal s 48B(3)(c) – otherwise the saving provision in ss 49R(1) and (2) obviously would not have been required. In other words, the UK legislation was precisely copied, except that the draftsman overlooked the need to copy the consequential amendment to the equivalent of s 48B(3)(c).

This conclusion is further supported by reference to ss 79A and 79B. Section 79B(1) prohibits any 'distribution' except out of 'profits available for the purpose' (which expression is defined as a company's accumulated realised profits less its accumulated realised losses). A 'distribution' is defined in s 79A as meaning 'every description of distribution of a company's assets to its members except: (b) the redemption . . . of any of the company's own shares out of capital or out of unrealised profits *in accordance with ss 49 to 49S*' [emphasis added]. But the use by a company of the share premium account relying upon s 48B(3)(c) would not be 'in accordance with ss 49 to 49S', and would by definition amount to an unlawful distribution (not being out of profits available for the purpose).

Conclusion

Section 48B(3)(c) should have been amended or repealed in 1991. It is directly contrary to s 49A(1)(b) and quite inconsistent with the saving provision (s 49R(1) and (2)) as well as ss 79A and 79B. In accordance with general principles (*leges posteriores priores contrarias abrogant*) s 48B(3)(c) must be taken to have been impliedly repealed by the *Companies (Amendment) Ordinance* 1991 (see Bennion, *Statutory Interpretation*, 2nd ed, 1992, p 204).

The current position is therefore that a premium payable on redemption of redeemable preference shares may only be paid out of the share premium account (instead of out of profits) where the preference shares in question were issued prior to 1 September 1991. In respect of shares issued after that date, purported reliance upon s 48B(3)(c) will result in an unlawful distribution. Further legislative intervention is clearly required, not least to validate any mistaken reliance upon s 48B(3)(c) in relation to shares issued after 1 September 1991.

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