

Acknowledgement

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GENERAL OUTLINE

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¶1-000 Purpose of this Manual

This Manual is designed to help you cope with the duties and responsibilities that the law imposes on, and the community expects of you as a company director. In particular, it seeks to identify those areas and activities in which you have a potential personal liability.

The topics included in this Manual are comprehensive, ranging from discussion on the most fundamental issues such as a director's fiduciary duties to a hotly debated topic in recent years, corporate governance. This Manual will raise awareness in directors and/or would-be directors so that they are better equipped with the knowledge to play the role of a corporate leader.

This chapter discusses the sources of Hong Kong law governing the operations and functions of the corporation and the implications of the corporate as an entity.

Legislative structure

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¶1-020 Sources of Hong Kong laws referred to in the Manual

This section provides a brief introduction to all the laws referred in this Manual.

Company law

Company law in Hong Kong is mainly governed by the provisions of the *Companies Ordinance* (Cap 32) and, in a few areas, common law. Listed companies are also subject to the terms of the *Securities and Futures Ordinance* (Cap 571). The *Companies Ordinance* (Cap 32) was modelled on the United Kingdom *Companies Act 1862*. Company legislation in Hong Kong now differs in detail from company legislation in England but the underlying general principles still remain the same. Whilst decisions of the House of Lords, and of the Privy Council (on non-Hong Kong appeals) made prior to 30 June 1997 are persuasive authority in Hong Kong, the Court of Final Appeal

can also “depart from previous decisions of the Privy Council on appeals from Hong Kong” in developing Hong Kong’s “own versions of the common law... to suit local circumstances of Hong Kong” (*China Field Ltd & Anor v Appeal Tribunal (Buildings) & Anor* [2009] 5 HKC 231, CFA and see *A Solicitor (24/07) v Law Society of Hong Kong* [2008] 2 HKC 1, CFA). Further, as the Hong Kong legislation has drawn on several common law jurisdictions other than England, the Hong Kong courts are able to “refer to precedents of other common law jurisdictions” (Art 84 of the *Basic Law*). The *Companies Ordinance* (Cap 32) is supplemented by subsidiary legislation which includes the *Companies (Disqualification Orders) Regulation*, *Companies (Forms) Regulations*, *Companies (Report on Conduct of Directors) Regulation*, *Companies (Winding Up) Rules* and *Companies (Disqualification of Directors) Proceeding Rules*, which also govern company law in Hong Kong. Unless otherwise stated, all section references in this chapter and in this Manual are to the Hong Kong *Companies Ordinance*.

Since 2006, the Government of the HKSAR has undertaken an extensive review of the company legislation with a view to rewriting the *Companies Ordinance*. Three papers have issued, and several amendments have been made to the ordinance based on suggestions from papers 1 and 2 in particular. The *Companies (Amendment) Ordinance 2010* (with effect, partly on 10 December 2010 and the rest on 1 February 2011) dealt with some of the recommendations from Company Law Rewrite Paper 2 including company names, extension of the statutory derivative action to include “multiple derivative actions”, and extended electronic communications. The Companies Registry has published guidelines on Company Names to assist with observance of the new provisions; materials on electronic filing of documents and information have also been provided by the Registry.

On 14 January 2011, a *Companies Bill* was introduced into the Legislative Council (“LegCo”) (expected to take at least 18 months through committee) which recommends extensive amendment to the existing ordinance. For directors, particular clauses of interest are those contained in Part 10, Directors and Company Secretaries, clauses 444 to 474, and Part 11, Fair Dealing by Directors, clauses 475 to 506. Part 10 deals with various matters including appointment, removal, resignation of directors and of company secretaries, liabilities and contains a codification of the care, skill and diligence duty of directors and provides that the “penalty” on breach will be subject to common law and equitable principles as currently apply (clauses 456 and 457); Part 11 deals with all types of companies, and can in certain cases refer to a former director.

Liability

Unlike partnerships, where partners are generally liable without limitation for the firm's debts, members of registered limited companies are liable either to the unpaid portion of his shareholding (if any) or to his guarantee. A company may also be unlimited in which case, members' liability is unlimited.

Takeovers and mergers

Takeovers and mergers are governed by the Codes on Takeovers and Mergers and Share Repurchases which represent the integration of the previously separate Takeovers Code and the Share Repurchases Code. The Codes do not have the force of law; they seek to cultivate an environment of voluntary compliance. Their administration is undertaken by the *Takeovers and Mergers Panel*.

Income taxation

The system of taxation operating in Hong Kong is that of a territorial basis, ie only income with a Hong Kong source is subject to tax. Income tax is levied under the *Inland Revenue Ordinance* (Cap 112). It can be categorised into "salaries tax" and "profits tax".

Individuals are chargeable for salaries tax on any income with a Hong Kong source which has been obtained from an office, employment or pension. However, note that even though services may be rendered in Hong Kong, an employee may not be subject to salaries tax if the period he spent in Hong Kong does not exceed a total of 60 days during the year of assessment.

Individuals, corporations, partnerships and all unincorporated businesses carrying on a trade, profession or business in Hong Kong are subject to profits tax on profits which are generated from sources within Hong Kong. In determining liability to profits tax, assessable profits or loss, as the case may be, are aggregated to determine the total loss or profit.

Labour law

The set of ordinances which govern labour law in Hong Kong includes the following:

- *Employment Ordinance* (Cap 57);
- *Contracts for Employment Outside Hong Kong Ordinance* (Cap 78);
- *Employers' Retraining Ordinance*;
- *Labour Relations Ordinance* (Cap 55);
- *Labour Tribunal Ordinance* (Cap 25);
- *Trade Unions Ordinance* (Cap 332);

- *Sex Discrimination Ordinance* (Cap 480); and
- *Disability Discrimination Ordinance* (Cap 487).

Besides statutory provisions, labour law in Hong Kong is also based on English common law concepts. The relationship between the employer and the employee is based on the individual contract of employment and there is little restriction from legislation affecting the freedom to contract. This contractual basis is supplemented by statutory minimum standards. There is little reliance on collective bargaining and industrial action. Matters such as confidentiality, restraint of trade and the distinction between employees and contractors are governed by the common law. Some rights and protections in the *Employment Ordinance* (Cap 57) are negotiable but others are compulsory and may not be opted out of.

Since 1 May 2011, the *Minimum Wage Ordinance 2011* has provided a minimum wage for every employee in Hong Kong other than those referred to in sec 6 and in sec 7; for those to whom it applies, they are entitled to receive the minimum wage of HK\$28 per hour.

In *HKSAR v Lor Wai Por* [2010] 6 HKC 157, sec 64B of the *Employment Ordinance* was applied to the sole director of a one-member company by making him an "employer" within the definition in sec 2 of that Ordinance. He was then personally liable to employees for unpaid wages.

¶1-040 Application of precedents from United Kingdom

Whilst English cases are cited in company law in Hong Kong, they are of persuasive authority. Following recent decisions of the Court of Final Appeal (see ¶1-020) Hong Kong courts "must develop the common law of Hong Kong to suit the circumstances of Hong Kong" (*China Field Ltd & Anor v Appeal Tribunal (Buildings) Ltd & Anor* [2009] 5 HKC 231, per Lord Millett NPJ at 257; and see *A Solicitor (24/07) v Law Society of Hong Kong* [2008] 1 HKC 1). Article 84 of the *Basic Law* then makes it clear that Hong Kong Courts are able to follow relevant precedents from any other common law jurisdiction. As changes in company law reflect legislation in Australia, New Zealand and Singapore as well as England, the courts have a broad base of decisions that they can consult if they so wish.

¶1-060 Importation of English law

The development of company law in Hong Kong can be traced to three distinct periods. The first covered the years from 1865 to 1948, the second from 1948 to 1984 and the third from 1985 to today. The current ordinance had its beginnings in the *Companies Ordinance 1865* which was based on the English *Companies Act 1862*. The latter was the consolidation of English

legislative changes of the preceding 20 years. Subsequent consolidations of the English *Companies Act* in 1908 and 1929 were duplicated in 1911 and 1932 respectively.

This synchronisation of company law in the two jurisdictions ended with the introduction of the English *Companies Act 1948*, when the new provisions were not similarly enacted in Hong Kong. This Act incorporated a majority of the recommendations of the Cohen Committee whose terms of reference were "to consider and report what major amendments are desirable in the *Companies Act 1929* and, in particular, to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest". A further divergence arose in 1967 when Hong Kong did not duplicate the English reforms which incorporated some of the recommendations of the Jenkins Committee.

Subsequently there were no significant changes to the *Companies Ordinance* until 1984. In that year, the *Companies (Amendment) Ordinance* was enacted. The amending provisions reflected the majority of the recommendations contained in the Second Report of the Companies Law Revision Committee published in 1973. This relied heavily on the English *Companies Act 1948*.

In early 1984 the Hong Kong government, in response to the last recommendation of the Second Report of the Companies Law Revision Committee, established the Standing Committee on Company Law Reform which was mandated "to advise on amendments required to the *Companies Ordinance* as and when experience has shown them to be necessary". In keeping with the practices of the past, the Standing Committee has attempted to keep abreast of the development of company law in the United Kingdom.

There is a distinct trend of divergence between the United Kingdom and the Hong Kong enactments due in part to the different pace of company law reform but also because of the different legal demands imposed upon the United Kingdom as a member of the European Union.

Corporate characteristics

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¶1-160 General

The classic definition of the purpose of incorporation is provided by Chief Justice Marshall of the US Supreme Court (in *Dartmouth College v Woodward NH* (1819) 4 Wheat 518) where he said:

"A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons is considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities, that corporations were invented, and are in use. By these means, a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being."

The principal characteristics of a company can be displayed by comparing the company with the partnership.

The essential distinction between a company and a partnership is one of structure. A company is a person distinct and separate from its members, a partnership, on the other hand, is two or more persons trading together. The partnership is not a separate, legal entity in Hong Kong.

There are many other points of comparison as detailed below.

¶1-180 Perpetual succession

A company has a continued existence and can be dissolved only by operation of law. A continuity of business is therefore certain and is unaffected by the death of even the principal shareholder. Per *Greer LJ in Stepney Corporation v Osofsky* (1937) 3 All ER 289 at p 291 CA, "A corporate body has no soul to be saved or body to be kicked".

Where the company has only one member, the Ordinance provides that the existing member as the sole director may nominate a reserve director to act in his place in the event of the death of the sole director (sec 153A(6)).

The element of perpetual succession enables a company to hold property without the constant problem of transmitting it from one generation to the next. "It is chiefly for the purpose of clothing bodies of men in succession, with these qualities and capacities, that corporations were invented and are now in use" (per *Marshall CJ in Dartmouth College v Woodward NH* (1819) 4 Wheat 518). With a partnership, the retirement or death of a partner usually brings the partnership to an end.

¶1-200 Personality

A company's separate existence means that it may contract at arm's length with its shareholders. It has the right to sue and be sued in its corporate name and the right to hold, deal and dispose of property. Title to all assets vests in the company.

In *Roberts v Coventry Corporation* (1947) 1 All ER 308, the owner of land which was acquired compulsorily by a local authority was a director and majority shareholder of the company which was a tenant of the land. She alleged that if the company were dispossessed of the land the value of her shares would suffer. The court held that she could not claim compensation. Per *Croom-Johnson J* "a corporator in a company has no direct claim as corporator in respect of a loss which the company makes".

In *Macaura v Northern Assurance Co Ltd* (1925) AC 619, a landowner in Ireland sold all the timber on his estate to a company. He and his nominees held all the shares in the company. After the sale the landowner insured the timber in his own name. Two weeks later the timber was destroyed in a fire.

The House of Lords held that a claim on the insurance policy must fail as it was not his timber but that of the company.

See ¶1-160.

¶1-240 Transferability of interest

Other than England, the Hong Kong Courts are able to "refer to precedents of other common law jurisdictions" (Art 84 of the *Basic Law* (Cap 2101)). Since 2006, the Government of the HKSAR has undertaken an extensive review of the company legislation with a view to rewriting the *Companies Ordinance*. Three papers have been issued, and several amendments have been made to the Ordinance based on suggestions from Papers 1 and 2 in particular. The *Companies (Amendment) Ordinance 2010* (with effect, partly on 10 December 2010, and the rest on 1 February 2011) dealt with company names, extension of the statutory derivative action to include "multiple derivative actions", and extended electronic communications. The Companies Registry has published guidelines on company names to assist with observance of the:

- new provisions, as well materials on electronic filing of documents; and
- information. On group accounts also see the *Financial Reporting Council Ordinance* (Cap 588) which provides for international standards of accounting to be adopted.

Shares constitute personal property and are capable of being transferred for value. The transfer of shares is subject to any restrictions contained in a company's Articles of Association (sec 65). A partner can only transfer his status as a partner with the consent of all other partners.

¶1-260 Business action

Unity of action in a company emerges from a centralised authority in its board of directors. The directors can very effectively limit the number of persons who can bind them as agents, for members of a company as such are neither managers nor agents (unlike partners in a firm). On the other hand, the shareholders can maintain a control over the company's directors who are special agents of the company and who have their power solely from the statutory provisions regulating them and the Articles of Association of the company.

¶1-280 Number of members

Section 29 indicates that a private company must not have more than 50 members. Public companies are not limited in respect of their membership