

**CORPORATE
GOVERNANCE
AND
COMPLIANCE IN
HONG KONG**

**Third Edition
Volume 1**



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Kong is lagging seriously behind other comparable jurisdictions. However, it would be neither possible nor appropriate to have detailed comparative summaries of the law and practice on all aspects of corporate governance in other jurisdictions if the issues and topics are not to be submerged under a mass of detail and the book is to be kept within a manageable and readable size.

I would also caution that, given the nature of the subject and the very fast changing environment of corporate governance, in both Hong Kong and elsewhere in the world, it is inevitable that some of the material in this book will require further revision upon the book's publication. Corporate governance is a constantly changing subject and, while writing this book, there are, at least, seven major reform initiatives under way which will have very significant implications for Hong Kong's corporate governance regime: the FSTB's proposals to enhance the regulation of listed entity auditors; the SFC's consultation on the principles of responsible ownership; HKEx's consultation on WVR; HKEx's proposed consultation on making compliance with the ESG Guide a code principle; the planned phased implementation of the legislation regarding the introduction of scrippless securities; the possible introduction of some form of class actions; and the possible introduction of new legislation to regulate charitable bodies, many of which are not-for-profit companies. I have tried to minimise this as much as possible by tracking, to the best of my ability, the progress and current positions of these major reforms where these are known as at the date of publication of this book.

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Note:

*All references to dollars are to Hong Kong dollars unless otherwise stated.

*All references to 'he' also includes 'she'.

4. THE LISTING RULES

4.1 Overview

[4-37] The Listing Rules for both the Main and Growth Enterprise Market ('GEM') Boards are, like the CO and the SFO, massive, highly-technical documents which govern the initial listing and continuous compliance requirements of all issuers listed on the Main and GEM Boards. As such, the Listing Rules are, to all intents and purposes, a 'quasi-Companies Ordinance' for listed companies, particularly in the case of the overwhelming majority of listed companies which are not Hong Kong companies and subject to the majority of the CO's provisions, with the exception of Part 16 and some other provisions. This status is reinforced by the numerous references to the CO throughout the Rules and all listed companies are expected to comply with these provisions. Furthermore, a large number of the Rules have a significant corporate governance dimension.⁸

[4-38] In this rather unusual regulatory situation, the main drivers for corporate governance reform in Hong Kong, as far as listed companies are concerned, will tend to be the Listing Rules and CG Code (considered below) rather than the CO: a case of the non-statutory tail tending to wag the statutory dog! For the purpose of this chapter, the author has briefly summarised the structure of both sets of Listing Rules, drawing attention to those provisions in the rules which are particularly relevant to corporate governance issues.

4.2 Distinction between the Main and GEM Boards

4.2.1 Overview

[4-39] The GEM is a stock market set up by SEHK for growth companies that do not fulfil the requirements of profitability or track record. The GEM operates on the philosophy of 'buyers beware' and 'let the market decide' based on a strong disclosure regime. Its rules and requirements are designed to foster a culture of self-compliance by listed issuers and sponsors in the discharge of their respective responsibilities. The key major features of greater, more frequent and timely disclosure support this philosophy.

⁸ In order to seek the market's opinion on proposals to align the Listing Rules with the provisions of the new Companies Ordinance and Hong Kong Financial Reporting Standards ('HKFRS'), HKEx issued a Consultation Paper on Review of Listing Rules on disclosure of financial information with reference to the new Companies Ordinance and Hong Kong Financial Reporting Standards and proposed minor/housekeeping rule amendments (August 2014). The Consultation Conclusions (March 2015) indicated that a large majority of respondents supported all of HKEx's proposals. It is intended that the revised Listing Rules will come into effect for accounting periods ending on or after 31 December 2015.

[4-40] The GEM requires a listing applicant to disclose in detail its past business history and its future business plans which are key components of the listing documents. After listing, a GEM issuer is required to make a half yearly comparison of its business progress with the business plan for the first two financial years, publish quarterly accounts in addition to half yearly and annual accounts and a shorter period is allowed to make available this information to the public. To allow market participants easy access to information, the GEM has a separate website⁹ which provides comprehensive information covering all aspects of the market including company announcements and other information of listed issuers, trade prices and market statistics.

4.2.2 GEM sponsor scheme

[4-41] In recognition of the pivotal role that a GEM sponsor plays in the listing process, a GEM sponsor is required to satisfy a set of detailed eligibility criteria and assume clear responsibilities in the discharge of its duties. Amongst its duties, a GEM sponsor is required to conduct due diligence and to satisfy itself, to the best of its knowledge and belief and having made due and careful enquiries, that proper disclosures have been made.

4.2.3 Corporate governance

[4-42] From the time of listing, an issuer is required to establish a strong corporate governance base to facilitate its compliance with the GEM Listing Rules and adherence to proper business practices. These measures include the appointment of a qualified accountant to supervise its finance and accounting functions, designating an executive director as the compliance officer, appointment of three independent directors and the establishment of an audit committee and a remuneration committee. In the first two years after listing, a GEM issuer is also required to retain a compliance advisor to advise and assist the company and its directors in the discharge of their listing obligations.

4.2.4 Role of the SEHK

[4-43] At the time of listing, the SEHK reviews the listing documents of an applicant to ensure that they comply with the requirements of the CO, the CWUMPO and the GEM Listing Rules. However, the SEHK does not assess the commercial viability of any applicant. The SEHK similarly reviews all public announcements made by an issuer after it has been

⁹ Please see: http://www.hkgem.com/root/e_default.aspx accessed 13 February 2025.

listed. The responsibility for the correctness, quality and sufficiency of the disclosed information made by an issuer rests ultimately with the issuer and its directors.

[4-44] In addition, the SEHK actively monitors the trading of securities on the GEM and the compliance with the GEM Listing Rules by issuers and sponsors. It will undertake strong enforcement and institute appropriate disciplinary actions if necessary where breaches of the GEM Listing Rules are identified.

4.3 Main Board

[4-45] The Main Board Listing Rules comprise two principal volumes. Volume 1 covers the following subjects: General, Equity Securities, Investment Vehicles, Debt Securities, HKEC-Listing and Guidance/Practice Notes.¹⁰

[4-46] The key corporate governance requirements are set out in the following chapters of the Main Board Listing Rules:

- (1) Chapter 3 — Authorised Representatives, Directors, Board Committees and Company Secretary: directors' duties; independent non-executive directors; audit committees; and the Code on Corporate Governance Practices;
- (2) Chapter 4 — Accountant's reports and pro-forma financial information: professional standing of accountants; contents of accountants' reports; applicability of disclosure standards in the CO, Hong Kong Financial Reporting Standards and International Financial Reporting Standards;
- (3) Chapter 11 — Listing Documents: the details of listing documents relating to equity securities;
- (4) Chapter 11A — Prospectuses: the requirements relating to prospectuses;
- (5) Chapter 13 — Continuing Obligations: general obligation of disclosure; meetings; distribution disclosure of financial information; interim reports; preliminary announcements of results for a financial year; notification; corporate communications to non-registered holders of securities; directors' dealings; directors' service contracts; and nomination of directors.
- (6) Chapter 14 — Notifiable Transactions: classification of notifiable transactions; notification, publication and shareholders' approval requirements;

¹⁰ Position as at 31 December 2014.

- (7) Chapter 14A — Connected Transactions: definition of 'connected person' and 'connected transactions'; categories of 'connected transactions'; exemptions; waivers; reporting and announcement, circular and reporting requirements; and independent shareholders' approval;
- (8) Appendix 16 D2 — Disclosure of Financial Information: basic financial information; information in annual reports, including the need to comply with many requirements in the CO; summary financial reports; summary interim reports; and recommended additional disclosure, eg, management discussion and analysis.

4.4 GEM Board

[4-47] The GEM Board Listing Rules comprise one principal volume. Similar to Volume 1 of the Main Board Listing Rules, this covers the following subjects: General, Equity Securities, Investment Vehicles, Debt Securities, HKEC-Listing and Guidance/Practice Notes. In total, there are 368 chapters, 65 practice notes and 138 appendices.¹¹ To a large extent, the GEM Board Listing Rules mirror the Main Board Listing Rules but there are some significant additions as outlined below.

[4-48] The key corporate governance requirements are set out in the following chapters of the GEM Board Listing Rules:

- (1) Chapter 5 — Directors, Company Secretary and Corporate Governance Matters: directors' duties; independent non-executive directors; company secretary; compliance officer; audit committees; board practices and procedures; and securities dealings transactions by directors;
- (2) Chapter 7 — Accountant's reports and pro-forma financial information: professional standing of accountants; contents of accountants' reports; applicability of disclosure standards in the CO, Hong Kong Financial Reporting Standards and International Financial Reporting Standards;
- (3) Chapter 14 — Listing Documents: the details of listing documents relating to equity securities;
- (4) Chapter 15 — Prospectuses: the requirements relating to prospectuses;
- (5) Chapter 17 — Continuing Obligations: general obligation of disclosure; meetings; nomination of directors; changes; distribution of financial information; corporate communications

¹¹ Position as at 31 December 2014.

to non-registered holders of securities; directors' dealings; and directors' service contracts;

- (6) Chapter 18 — Financial Information: distribution of financial information; preliminary announcement of results for a full financial year; half-year reports; and quarterly interim reports;
- (7) Chapter 19 — Notifiable Transactions: classification of notifiable transactions; notification, publication and shareholders' approval requirements;
- (8) Chapter 20 — Connected Transactions: definition of 'connected person' and 'connected transactions'; categories of 'connected transactions'; exemptions; waivers; reporting and announcement requirements; and independent shareholders' approval.

4.5 Differences between the Main Board and GEM Board Listing Rules

4.5.1 Overview

[4-49] Generally speaking, the Main and GEM Board Listing Rules have similar structures and contents but there are some significant differences.

4.5.2 Distribution of financial information

[4-50] The GEM Board Listing Rules have a specific chapter (Chapter 18) on financial information covering the distribution of financial information, preliminary announcement of results for a full financial year, half-year reports and quarterly interim reports which, in the case of the Main Board Listing Rules, is largely subsumed in Chapter 13—Continuous Disclosure. Mandatory quarterly reporting requirements have been removed since 1 January 2024.

4.5.3 Quarterly reporting

[4-51] Under Chapter 18 of the GEM Board Listing Rules, all companies listed on this board have to prepare quarterly reports in marked contrast to companies listed on the Main Board for which the introduction of quarterly reporting is still a subject of not inconsiderable controversy.

4.5.4 Appendix 16 D2 of the Main Board Listing Rules

[4-52] Companies listed on the Main Board are subject to Appendix 16 D2 to the Main Board Listing Rules which sets out in considerable detail the disclosure of financial information by listed companies and has no equivalent under the GEM Board Listing Rules.

4.6 The Corporate Governance Code

4.6.1 Overview

[4-53] It would be very challenging for anyone reading the CO, SFO and the Listing Rules to distil from this legislation and rules any principles and guidance on good corporate governance. Particularly in the case of the CO, many of the provisions regarding the key elements of good corporate governance, such as directors, shareholders and accounts and audit, are couched in very legalistic if not, on occasions, almost archaic and impenetrable language. Furthermore, these provisions have grown incrementally over a considerable period of time and have not necessarily been framed with the promotion of good corporate governance in mind.

[4-54] In addition, the CO is silent on key elements of corporate governance, eg, the structure and composition of the board, the distinction between executive, non-executive and independent non-executive directors, board committees to deal with audit, remuneration and nomination matters, etc. Other than containing a somewhat cyclical definition of a 'director', the CO does not contain statutory definitions of what constitutes a 'board', an 'audit committee', a 'remuneration committee', a 'nomination committee', an 'executive director', a 'non-executive director' and an 'independent non-executive director'. To some extent, these omissions are remedied, at least in the case of listed companies, by the CG Code which is based on the UK Code on Corporate Governance (previously called the 'Combined Code').

4.6.2 The UK Corporate Governance Code

[4-55] The first version of the UK Code on Corporate Governance, the Code of Best Practice, was first promulgated in 1992 by the UK Committee on the Financial Aspects of Corporate Governance (the 'Cadbury Report') to apply to companies listed on the London Stock Exchange ('LSE'). The Code is a guide to a number of key components of effective board practice. It is based on the underlying principles of all good governance: accountability, transparency, probity and focus on the sustainable success of an entity over the longer term.¹² It aims to set out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders.

[4-56] All companies incorporated in the UK and listed on the Main Market of the LSE are required under the Listing Rules to report on how they have applied the Combined Report in their annual report and

¹² The UK Corporate Governance Code, 'Governance and the Code' (June 2010) at para 4.

accounts. Overseas companies listed on the Main Market are required to disclose the significant ways in which their corporate governance practices differ from those set out in the Code. The Combined Code contains broad principles and more specific provisions. Listed companies are required to report on how they have applied the main principles of the Code, and either to confirm that they have complied with the Code's provisions or—where they have not—to provide an explanation. This is the 'Comply or Explain' principle which is fundamental to the corporate governance regimes in the UK and Hong Kong.

[4-57] Subsequently, the Combined Code was reviewed in 2005 and 2007. Previously, two versions were in force: the 2006 edition, which applied to accounting periods beginning on or after 1 November 2006; and the June 2008 edition which applied to accounting periods beginning on or after 29 June 2008. However, the financial crisis, which came to a head in 2008–09, triggered widespread reappraisal, locally and internationally, of the governance systems which might have alleviated it. As outlined in Chapter 1, in February 2009, Sir David Walker was asked to review the governance of banks and other financial institutions in the UK. As a consequence, the FRC decided to bring forward to 2009 the review of the Code scheduled for 2010 so that corporate governance in other listed companies could be assessed at the same time. The revised code, which was re-titled the UK Corporate Governance Code, was published in June 2010. Subsequent revisions of the Code were published in September 2012 and September 2014. Following reviews, the FRC published the 'UK Corporate Governance Code 2018' in July 2018 which broadened the definition of governance and emphasised the importance of positive relationships between shareholders and stakeholders. On 22 January 2024, the FRC published a revised version of the 'UK Corporate Governance Code 2024', which continues to operate on a 'comply or explain' basis and will come into effect for accounting periods beginning on or after 1 January 2025 (other than Provision 29 which will apply to financial years beginning on or after 1 January 2026).

4.6.3 The Hong Kong Corporate Governance Code

(a) Nature of Code

[4-58] The CG Code is a non-statutory document issued under the Listing Rules.¹³ To a very large extent, it is based on the UK Corporate Governance Code mentioned above. The first CG Code was implemented on 1 January 2005 and subsequently extensively revised in 2010 and 2011. The latest CG Code enhancement published on 10 December 2021 had taken effect

¹³ Appendices 14 of the Main Board Listing Rules and 15 of the GEM Listing Rules.

on 1 January 2022. There has been a restructuring of the appendices to the Listing Rules that take effect from 31 December 2023.

(b) The 'comply or explain' regime

[4-59] Rules 3.2513.89 of the Main Board Listing Rules and 517.10134 of the GEM Listing Rules provide that the CG Code contained in Appendices 14 C1 and 15 C1 of the Main Board and GEM Board Listing Rules respectively sets out the principles of good corporate governance and two levels of recommendations: (1) code provisions; and (2) recommended best practices. Issuers are expected to comply with, but may choose to deviate from the code provisions. The recommended best practices are for guidance only. However, issuers may also devise their own code on corporate governance practices on such terms as they may consider appropriate: (1) the mandatory requirements for disclosure in an issuer's Corporate Governance Report, and (2) the principles of good corporate governance, the code provisions ('CP') on a 'comply or explain' basis and certain recommended best practices. Issuers are encouraged to adopt the recommended best practices ('RBP') on a voluntary basis.

[4-60] Issuers must state whether they have complied with the code provisions set out in Part 2 of Appendix C1 for the relevant accounting period in their interim reports (and summary interim reports, if any) and annual reports (and summary financial reports, if any). An issuer may deviate from the code provisions (ie, adopt action(s) or step(s) other than those set out in the code provisions) provided that the issuer sets out the Considered Reasons and Explanation must state whether they have complied with the code provisions ('CP') set out in the Code for the relevant accounting period in their interim reports (and summary interim reports, if any) and annual reports (and summary financial reports, if any). Where the issuer deviates from the code provisions, the issuer must give considered reasons in the Corporate Governance Report which must be issued in accordance with Appendix 14 C1 of the Listing Rules.¹⁴ Non-compliance with any code provision without giving considered reasons will be considered a breach of the Listing Rules.¹⁵ At present, there are 78 code provisions.

¹⁴ The Corporate Governance Report requires listed issuers to provide information on: corporate governance practices, directors' securities transactions, board of directors, chairman and chief executive officer, non-executive directors, board committees, auditor's remuneration, company secretary, shareholders' rights, investor relations, share interests of senior management, investor relations, internal controls and management functions.

¹⁵ Comments by David Graham, Chief Regulatory Officer and Head of Listing in 'Comply or explain: A guide to compliance with Hong Kong's Corporate Governance Code' CSj (September 2014).

[4-61] Issues are encouraged to state whether they have complied with them and give considered reasons for any deviation for the recommended best practices. Issuers are encouraged, but are not required, to state whether they have complied with recommended best practices ('RBP') and give considered reasons for any deviation. Consequently, compliance with the recommended best practices relies very heavily on the mindset of issuers regarding the implementation of good corporate governance practices. At present, there are 11 recommended best practices.

[4-62] The preamble to Appendices 14 C1 and 15 C1 of the Main Board and GEM Board Listing Rules respectively elaborates in greater detail on procedure regarding compliance and non-compliance with the code provisions as follows:

Issuers are expected to comply, but may deviate from, the code provisions. The recommended best practices are for guidance only. Issuers may also devise their own code on corporate governance on the terms they consider appropriate.

This Corporate Governance Code sets out: (a) the mandatory requirements for disclosure in an issuer's Corporate Governance Report; and (b) the principles of good corporate governance, the code provisions on a "comply or explain" basis and certain recommended best practices. Issuers are encouraged to adopt the recommended best practices on a voluntary basis.

Issuers must state whether they have complied with the code provisions for the relevant accounting period in their interim reports (and summary interim reports, if any) and annual reports (and summary financial reports, if any).

Every issuer must carefully review each code provision and, where it deviates from any of them, it must give considered reasons:

- (a) in annual reports (and summary financial reports), in the Corporate Governance Report; and
- (b) in interim reports (and summary interim reports), either:
 - (i) by giving considered reasons for each deviation; or
 - (ii) to the extent that it is reasonable and appropriate, by referring to the Corporate Governance Report in the preceding annual report, and providing details of any changes with considered reasons for any deviation not reported in that annual report. The references must be clear and unambiguous and the interim report (or summary interim report) must not contain only a cross-reference without any discussion of the matter.

Issuers are encouraged, but not required, to state whether they have complied with the recommended best practices and give considered reasons for any deviation.

4.6.4 Structure and contents of the Corporate Governance Code

[4-63] Following the structure of the UK Corporate Governance Code, the CG Code is divided into six main chapters as follows:

- A. Corporate Purpose, Strategy and Governance, Directors: A.1 Corporate Strategy, Business Model and Culture, The Board, A.2 Corporate Governance Functions, Chairman and Chief Executive Officer, A.3 Board Composition, A.4 Appointments, re-election and removal, A.5 Nomination Committee, A.7 Responsibilities of directors and A.6 Supply of and access to information;
- B. Board Composition and Nomination, Remuneration of Directors and Senior Management: B.1 Board Composition, Succession and Evaluation, B.2 Appointments, Re-Election and Removal, B.3 Nomination Committee, The level and make-up of remuneration and disclosure;
- C. Directors' Responsibilities, Delegation and Board Proceedings, Accountability and Audit: C.1 Responsibilities of Directors, Financial Reporting, C.2 Chairman and Chief Executive, C.3 Management Functions, C.4 Board Committees, C.5 Conduct of Board Proceedings and Supply of and Access to Information, C.6 Company Secretary, Audit Committee;
- D. Audit, Internal Control and Risk Management, Delegation by the Board: D.1 Financial Reporting, Management Functions and D.2 Risk Management and Internal Control, Board Committees, D3 Audit Committee, Corporate Governance Function;
- E. Remuneration, Communication with Shareholders: E.1 The Level and Make-Up of Remuneration and Disclosure Effective Communication and E.2 Voting by Poll;
- F. Shareholders Engagement: F.1 Effective Communication, F.2 Shareholders Meetings, Company Secretary.

[4-64] The relevant code provisions and recommended best practices will be considered in detail as appropriate under the relevant subject headings in the subsequent chapters.

4.7 Consultation Paper on Review of the Code of Corporate Governance Practices and Associated Listing Rules

[4-65] In December 2010, HKEx launched a major review of the Code.¹⁶ Substantive changes have been made following a comprehensive review, which resulted in the number of Code Provisions (subject to 'comply or explain') increasing from 45 to 74. According to the Consultation Paper, the

¹⁶ Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules (December 2010).

principal objective was to promote a higher level of corporate governance among issuers, the importance of which was highlighted by the recent financial crisis. Other major markets and international financial centres had already implemented, or were currently implementing, reforms on corporate governance. The changes proposed were generally in line with international best practice.¹⁷

[4-66] In December 2010, HKEx launched a major review of the Code. According to the Consultation Paper, the principal objective was to promote a higher level of corporate governance among issuers, the importance of which was highlighted by the recent financial crisis. Other major markets and international financial centres had already implemented, or were currently implementing, reforms on corporate governance. The changes proposed were generally in line with international best practice.

[4-67] Under the proposals, a small number of code provisions and recommended best practices were promoted to the Listing Rules because of their importance, eg, RBP A.3.2 that INEDs should form at least one-third of an issuer's board and CP B.1.1 regarding remuneration committees. Furthermore, a majority of the proposals upgrade recommended best practices to code provisions, eg, RBP A.4.4 regarding nomination committees and RBP A.5.5 regarding directors' training.¹⁸ The principal aim of the amendments was to encourage better accountability of issuers and directors by including the following measures:

- (1) improve transparency by bolstering requirements for disclosure and communication with shareholders;
- (2) enhance the quality of directors and company secretaries by requiring training;
- (3) require greater involvement in issuers' board committees by INEDs;
- (4) recognise company secretaries' contributions to corporate governance and define their role and function; and place emphasis on the leadership role of the chairman of the board in corporate governance matters.¹⁹

[4-68] The key recommendations will be considered in detail as appropriate under the relevant subject headings in the subsequent chapters.

17 Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules (December 2010) at para 1.

18 Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules (December 2010) at para 2.

19 Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules (December 2010) at para 3.

4.8 Market reaction

[4-69] An editorial in the *South China Morning Post* anticipated that three of the proposed reforms, namely the mandatory requirement for one-third of an issuer's board to be INEDs; the requirement for all directors to receive eight hours training every year; and limit the number of boards on which a director can serve, would receive particular opposition: 'the excuses rolled out in 2004 (when many companies were found not to comply with the requirement to have three INEDs by the deadline) can be expected to do the rounds again ...'. Furthermore, 'as a financial hub that aspires to a long-term future as a global financial centre, Hong Kong should be at the forefront of raising standards'.²⁰ In the event, out of these reforms, the mandatory requirement for one-third of an issuer's board to be INEDs proceeded²¹ and the requirement for all directors to receive eight hours of training was modified to require issuers to disclose the actual amount of training received by directors.²² However, the requirement to limit the number of boards on which a director can serve was abandoned.²³ The provisions of the revised CG Code were implemented in a phased programme in the course of 2012.

4.9 Impact of the Corporate Governance Code

[4-70] In the revised CG Code, many recommended best practices have been upgraded to the status of code provisions which will strengthen the Code's ability to influence the corporate governance culture of listed companies. This is particularly noticeable in the case of Parts A, D, E and F regarding directors, delegation by the board, communication with shareholders and company secretary where all the Code's requirements take the form of code provisions. In the words of a commentary on the revised Code, 'These newer tougher rules are certainly going to put greater emphasis on the responsibilities and accountabilities of both directors and senior management'.²⁴ Furthermore, 'given Hong Kong's strong financial regulatory framework, listed companies can certainly leverage the benefits of the governance code changes to really consolidate, demonstrate and validate who in the organisation is accountable for governance-related activity'.²⁵

20 'New listing rules sure to draw same old excuses' *South China Morning Post* (12 February 2011).

21 Consultation Conclusions on Review of Corporate Governance Code and Associated Listing Rules, October 2011 at para 94.

22 Consultation Conclusions on Review of Corporate Governance Code and Associated Listing Rules, October 2011 at paras 83-86.

23 Consultation Conclusions on Review of Corporate Governance Code and Associated Listing Rules, October 2011 at para 76.

24 'Preparing for governance code changes' CSJ (January 2012).

25 'Preparing for governance code changes' CSJ (January 2012).

[4-71] For the first time, the CG Code has recognised and codified the company secretary's critically important role in ensuring and promoting good minimum standards in qualifications, experience and training. In early 2012, the HKICS published several articles in CSj to ensure that all its members were fully aware of the impact which the revised CG Code would have on their work. Apart from highlighting the new provisions regarding company secretaries, the articles covered issues to which company secretaries should have particular regard including: providing the board with monthly updates; shareholder communication policy; insurance for directors; bundling of resolutions; voting by poll; enhancing the effectiveness of board committees; and board evaluation.²⁶

4.9.1 The purpose of a 'comply or explain' approach

[4-72] The aim of the framework established by the CG Code, as explained by David Graham, HKEx's Chief Regulatory Officer and Head of Listing, is to give companies the room to find their own ways to fulfil the spirit of the Code.²⁷ The 'comply or explain' approach is a framework that enables companies to put together the best possible corporate governance regime for their own circumstances. Companies can adhere to the Code's principles by choosing between complying with code provisions or adopting alternative measures so long as they disclose clearly and thoroughly their reasons for choosing the latter. In view of this the CG Code encourages companies to consider their own individual circumstances, the size and complexity of their operations and the nature of the risk and challenges they face to determine the most suitable and appropriate solutions.

4.9.2 The meaning of compliance with a code provision

[4-73] According to David Graham, it is common practice amongst listed companies to make blanket statements in their corporate governance reports to the effect that they have complied with all the code provisions except for 'A, B and C'. However, he stressed that it is important for companies to ensure that they have carefully considered whether they have complied with each and every part of a code provision before making such a statement.

26 'Governance needs you' CSj (January 2012) and 'Governance needs you' CSj (March 2012).

27 'Comply or explain: a guide to compliance with Hong Kong's Corporate Governance Code' CSj (September 2014).

4.9.3 HKEx spot-checks compliance

[4-74] HKEx conducts spot checks of companies' compliance with the CG Code from time to time as part of its ongoing monitoring activities. Recently, it came to the Exchange's attention that, in some cases, companies had confirmed compliance with a code provision but, upon closer inspection of their corporate governance reports, this turned out not to be the case. For example, a number of companies failed to comply with CP A.5.6 which states that the nomination committee (or the board) should have a policy regarding the diversity of its board members, and should disclose the policy, or a summary of it, in its corporate governance report. Whilst nearly all companies whose corporate governance reports were examined by HKEx stated that they had complied, a number of them neither made the required disclosure, nor gave reasons for this departure from the code provision. To bring this to the attention of listed issuers, HKEx has reminded all issuers that only compliance with all aspects of a code provision amounts to compliance.²⁸

4.9.4 Not 'box ticking'

[4-75] David Graham stressed that corporate governance compliance is not box ticking. The aim of the CG Code is to achieve the substance of good corporate governance, not the form. In this respect, the note to CP A.5.6 states that: 'Board diversity will differ according to the circumstances of each issuer. Diversity of board members can be achieved through considering a number of factors, including but not limited to gender, age, cultural or education background, or professional experience. Each issuer should take into account its own business model and specific needs, and disclose the rationale for the factors it uses for this purpose'.²⁹

[4-76] During HKEx's spot checks, the Exchange found many companies disclosing their board diversity policies in identical language to the note to the code provision. While this may constitute compliance in form, it may not necessarily constitute compliance in substance if the company has, in fact, never considered the issue seriously. The Note is there to serve as a prompt for companies to seriously consider the substance of their board diversity policy.³⁰

28 See HKEx's letter to listed issuers 'Re: Guidance on compliance with the Corporate Governance Code' (2 July 2014).

29 'Comply or explain: A guide to compliance with Hong Kong's Corporate Governance Code' CSj (September 2014).

30 'Comply or explain: A guide to compliance with Hong Kong's Corporate Governance Code' CSj (September 2014).

4.9.5 Is explaining an inferior solution to complying with a code provision?

[4-77] David Graham stressed that the underlying philosophy of the CG Code is that 'one size does not fit all', which recognises the reality that all companies are different and, accordingly, their corporate governance solutions may also differ. Companies should also look at their own circumstances when contemplating whether to adopt a particular code provision or to opt for a more suitable alternative. The CG Code reminds shareholders that these alternative solutions are not breaches. However, this is subject to the company's explanation giving clear and considered reasons for adopting an alternative solution and illustrating how its actual practices are consistent with the relevant Principle and contribute to good corporate governance. Adopting a boilerplate approach and merely quoting commonly used reasons for deviations from the code provisions is not helpful to shareholders. Companies should bear in mind, when preparing corporate governance reports that their explanations should be as full as is necessary to meet HKEx's and their shareholders' expectations.³¹

4.10 Consultation Paper on Review of the Corporate Governance and Related Listing Rules

[4-78] In April 2021, HKEx launched another review of the Code. According to the Consultation Paper, the proposals were to aim at enhancing directors' independence, board diversity and ESG disclosure and standards, among others. The HKEX has also published a new Corporate Governance Guide for Boards and Directors to assist issuers in complying with the new requirements.

[4-79] Under the amended CG Code and Listing Rules, issues are required to:

- (1) Culture: Listed company boards are required to align the issuer's culture with its purpose, values and strategy, and all directors are required to act with integrity, lead by example and promote the desired culture under new CP A.1.1. Listed issuers are also required to establish anti-corruption and whistleblowing policies under new CP D.2.7 and CP D.2.6 (which was previously a RBP only) respectively. Information relating to issuers' anti-corruption and whistleblowing policies is already required to be disclosed on a comply or

³¹ 'Comply or explain: A guide to compliance with Hong Kong's Corporate Governance Code' CSj (September 2014).

explain basis in ESG Reports under Appendices 27 and 28 to the Main Board and GEM Listing Rules, respectively.

- (2) Board independence: Listed issuers are required to establish a mechanism(s) to ensure independent views are available to the board and conduct an annual review of the implementation and effectiveness of these mechanisms under new CP B.1.4. For INEDs serving more than nine years ('Long Serving INEDs'), a new INED should be appointed at the issuer's next annual general meeting and the length of tenure of each existing INED on a named basis should be disclosed in the shareholders' circular under new CP B.2.4. The HKEX did not adopt its proposal to require the re-election of Long Serving INEDs to be approved by issuers' independent shareholders (ie shareholders other than controlling shareholders and their associates). Their re-election remains subject to shareholders' approval under CP B.2.3. However, revisions to CP B.2.3 require additional disclosures on factors considered, process and discussion of the board or the nomination committee in reaching the determination that the Long Serving INED is still independent and should be re-elected. The requirement for listed issuers to have a nomination committee chaired by an INED or the chairman of the board and comprising a majority of INEDs has been promoted to a Listing Rule under new Main Board Listing Rule 3.27A and GEM Listing Rule 5.36A.
- (3) Diversity: A single-gender board is not considered to be a diverse board under the revised Main Board Listing Rule 13.92 and GEM Listing Rule 17.104. Numerical targets and timelines must be set for achieving gender diversity at board level, and annual review of board diversity policy. Disclosure must be made on gender ratios in the workforce (including senior management), plans or measurable objectives the issuer has set for achieving gender diversity.
- (4) Communications with shareholders: Mandatory disclosure on shareholders communication policy, and annual review of its effectiveness under new paragraph L of the Mandatory Disclosure Requirements.
- (5) ESG: ESG reports must be published at the same time as annual reports under the revised Main Board Listing Rule 13.91 and GEM Listing Rule 17.103(5)(d).

[4-80] The key recommendations will be considered in detail as appropriate under the relevant subject headings in the subsequent chapters.

**CORPORATE
GOVERNANCE
AND
COMPLIANCE IN
HONG KONG**

**Third Edition
Volume 2**



**Vincent Lung
Christy Chak**

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Kong is lagging seriously behind other comparable jurisdictions. However, it would be neither possible nor appropriate to have detailed comparative summaries of the law and practice on all aspects of corporate governance in other jurisdictions if the issues and topics are not to be submerged under a mass of detail and the book is to be kept within a manageable and readable size.

I would also caution that, given the nature of the subject and the very fast changing environment of corporate governance, in both Hong Kong and elsewhere in the world, it is inevitable that some of the material in this book will require further revision upon the book's publication. Corporate governance is a constantly changing subject and, while writing this book, there are, at least, seven major reform initiatives under way which will have very significant implications for Hong Kong's corporate governance regime: the FSTB's proposals to enhance the regulation of listed entity auditors; the SFC's consultation on the principles of responsible ownership; HKEx's consultation on WVR; HKEx's proposed consultation on making compliance with the ESG Guide a code principle; the planned phased implementation of the legislation regarding the introduction of scripless securities; the possible introduction of some form of class actions; and the possible introduction of new legislation to regulate charitable bodies, many of which are not-for-profit companies. I have tried to minimise this as much as possible by tracking, to the best of my ability, the progress and current positions of these major reforms where these are known as at the date of publication of this book.

GORDON WE JONES

Hong Kong

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Note:

*All references to dollars are to Hong Kong dollars unless otherwise stated.

*All references to 'he' also includes 'she'.

and appropriate forum for resolving these issues, as there is nothing in Hong Kong under the Rules of the High Court to regulate such derivative actions.

- (3) The co-existence arrangement has been in existence for over four years and has not caused any major problems notwithstanding the comments made by the Court of Final Appeal in the *Waddington* case.
- (4) As there are still uncertainties as to what other issues about derivative actions may arise in the future and how some uncertainties (unspecified) regarding the SDA provisions may be resolved, it would be safer to keep the CDA at this stage.

5.12.4 Public consultation

[19-73] As a result of the consultation exercise, more respondents, including major business and professional bodies such as the Hong Kong Association of Banks, the Hong Kong Bar Association, the HKICS and the HKIoD, supported the retention of CDA for reasons that it would provide necessary protection to shareholders in Hong Kong for obtaining remedies in relation to non-Hong Kong companies. There were also arguments that there would not be any confusion arising from the retention and litigants could select the appropriate route that suits their case.⁷⁴ Consequently, the FSTB agreed to retain the CDA in the Companies Bill.⁷⁵ Section 732(6) of the CO makes clear that the existence of the SDA does not affect the rights of a member of a company to bring proceedings on behalf of the company under a CDA, subject to the court's power under section 736 to dismiss such proceedings.

6. INJUNCTIONS

6.1 History of reform

6.1.1 The SCCLR's recommendations

[19-74] The SCCLR considered that the availability of general powers to award injunctions (without needing to come under the unfair prejudice provisions) could help to prevent potential breaches of the law. Furthermore, such cases would not involve the need for considerable evidence and costs. Consequently, the SCCLR proposed that the courts should be given a wider power to restrain directors or other persons from entering into transactions

⁷⁴ Consultation Conclusions, August 2010, para 35.

⁷⁵ Consultation Conclusions, August 2010, para 36.

in breach of the law under the former CO or in relation to breaches or potential breaches of fiduciary duties.⁷⁶

6.1.2 The former Companies Ordinance (Cap 32)

[19-75] Where a person has, in relation to a 'specified corporation', engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute, inter alia, an actual or attempted contravention of the former CO, the court may, on the application of the FS or a member or creditor of the company whose interests have been affected by this conduct, grant an injunction to stop the conduct and, if the court considers it desirable, require the offender to take appropriate remedial action (section 350B(1) of the former CO). Furthermore, the power of the court to grant an injunction restraining a person from engaging in such conduct may be exercised:

- (1) whether or not it appears to the court that the person intends to engage again, or continue to engage, in that conduct;
- (2) whether or not he has previously engaged in that conduct; and
- (3) whether or not there is an imminent danger of substantial damage to any other person if he engages in that conduct (section 350B(2) of the former CO).

[19-76] In addition, there are broadly similar provisions empowering the court to grant an injunction where a person, in relation to a 'specified corporation', has refused or failed, is refusing or failing, or is proposing to refuse or fail, to do an act or thing which he is required to do under the CO (section 350B(3) and (4) of the former CO). The court is also empowered to award damages (section 350B(7) of the former CO).

6.2 The Companies Ordinance (Cap 622)

[19-77] Sections 728–730 of the CO restate the provisions of the former CO.

6.3 Cases using the injunction provisions

[19-78] Recent cases using this provision are *Re PAL Active Ltd*⁷⁷ in which an injunction was granted pursuant to section 350B(1)(h) of the former CO and *Sanju Environmental Protection (Hong Kong) Ltd v Wang Lishan*

⁷⁶ CGR Phase I, para 19.03.

⁷⁷ *Re PAL Active Ltd* [2009] HKCU 1705 (unreported, HCMP 2001/2008, 30 October 2009) (CFI).

& Ors⁷⁸ which relates to injunctions to restrain the passing, carrying out or giving effect to certain board resolutions under sections 728–730 of the CO.

7. FOREIGN COMPANIES

[19-79] It should be noted that there are special considerations regarding the application of the remedies in Part 14 of the CO to companies not incorporated in Hong Kong. For petitions for unfair prejudice, applications for inspection of books and records and derivative actions, it must be shown that the company had a 'place of business' in Hong Kong. In the case of petitions for just and equitable winding up, the courts must be satisfied that the company has 'sufficient connection' to Hong Kong. Technically speaking, this is a three-stage test as laid down in *Re Gottinghen Trading Ltd*,⁷⁹ but the principal overriding factor is to establish a sufficient connection, in the broad sense, with Hong Kong.

[19-80] In establishing sufficient connection with Hong Kong, factors such as the location of the company's assets, location of its business operations and whether there are any creditors in Hong Kong will be considered. Failure to consider these requirements would mean that the court will find that it has no jurisdiction to determine the dispute. This was the main reason why the petitioner lost in the recent shareholder dispute litigation *Re Yung Kee Holdings Ltd*⁸⁰ (currently under appeal) where an unfair prejudice action and a petition for just and equitable winding-up of unregistered companies were brought.

8. CLASS ACTIONS

8.1 Background

[19-81] It is clear from the use to date of the above statutory provisions by shareholders that they are not at all widely used, doubtless because of the principal obstacles of disinclination, time and cost, notwithstanding the improvements brought about by the introduction of the SDA. At present, it is not impossible for the claims of a number of persons against the same defendant to be determined by a single court action in Hong Kong. There are significant hurdles in such multi-party action. Order 15, rule 12 of the Rules of the High Court (Cap 4A) permits a number of plaintiffs who have the 'same interest' in any proceedings to join together in litigation.

78 *Sanju Environmental Protection (Hong Kong) Ltd v Wang Lishan & Ors* [2023] 2 HKLRD 242, [2023] HKCU 816, [2023] HKCFI 531.

79 *Re Gottinghen Trading Ltd* [2012] 3 HKC 299, [2012] 3 HKLRD 453 (CFI).

80 *Re Yung Kee Holdings Ltd* [2012] 6 HKC 246 (CFI).

Rule 12(2) also empowers the court, on the application of the plaintiffs, to appoint a defendant to act as the representative of the other defendants being sued. A judgment or order given in representative proceedings will be binding on all persons so represented. However, this rule has been underused since the 'same interest' requirement⁸¹ has been taken to mean that all class members have to show identical interests of fact and law, although the courts have tried to relax this requirement.

8.2 History of reform

8.2.1 The Chief Justice's Working Party on Civil Justice Reform

[19-82] In 2000, the Chief Justice appointed a Working Party to review the civil rules and procedures of the High Court. The interim report in 2001 by the Chief Justice's Working Party on Civil Justice Reform⁸² recommended that a comprehensive regime for class actions was desirable in Hong Kong to provide a more efficient, well-defined and workable system for multi-party litigation. One of the recommendations in the final report, published in 2004, was that:

- (1) In principle, a scheme for multi-party litigation should be adopted. Schemes implemented in comparable jurisdictions should be studied by a working group with a view to recommending a suitable model for Hong Kong.⁸³
- (2) The Working Party said that the introduction of a multi-party litigation scheme was widely supported, including bodies such as the Special Committee on Personal Injuries of the Hong Kong Bar Association and the Consumer Council.⁸⁴ The final report also suggested that it might be appropriate for the Chief Justice or Secretary for Justice to refer the subject of multi-party proceedings to the Law Reform Commission ('LRC') of Hong Kong.⁸⁵

81 Following the case of *Markt & Co Ltd v Knight Steamship Co Ltd* [1910] 2 KB 1021 (CA, Eng).

82 Civil Justice Reform Interim Report and Consultative Committee, November 2001.

83 Chief Justice's Working Party on Civil Justice Reform, *Civil Justice Reform: Final Report* (2004), Recommendation 70 at 240.

84 Chief Justice's Working Party on Civil Justice Reform, *Civil Justice Reform: Final Report* (2004) at 239, para 464.

85 Chief Justice's Working Party on Civil Justice Reform, *Civil Justice Reform: Final Report* (2004) at 240, para 465.

8.2.2 Law Reform Commission Sub-Committee

[19-83] At its meeting on 5 September 2006, the Law Reform Commission agreed that the subject of class actions should be taken on as a project, with the following terms of reference:

- (1) To consider whether a scheme for multi-party litigation should be adopted in Hong Kong and, if so, to make suitable recommendations generally.
- (2) A Law Reform Commission sub-committee under the chairmanship of Mr Anthony Neoh SC, was appointed in November 2006 to consider this subject and to make proposals to the Commission for reform. Subsequently, on 5 November 2009, the Law Reform Commission ('LRC') issued a public consultation paper which proposed a comprehensive regime for multi-party legislation in Hong Kong.⁸⁶

8.2.3 The Law Reform Commission's recommendations

(a) Benefits of class actions

[19-84] Recommendation 1 of the LRC Report states that:

We believe that there is a good case for the introduction of a comprehensive regime for multi-party litigation so as to enable efficient, well-defined and workable access to justice, and would welcome public views as to whether such a regime should be introduced.⁸⁷

Chapter 3 of the Report sets out the not insignificant benefits which would result from the introduction of class actions. Plaintiffs benefit from the improved access to justice; defendants benefit from avoiding multiple-related law suits, the finality of disputes and early opportunity of disclosure, and negotiated certification; society benefits from increased judicial economy, the enhancement of justice, and the deterrence of wrongdoing (behaviour modification); and the plaintiffs, defendants and the courts benefit from procedural certainty and consistency of rulings.⁸⁸

(b) Improved access to the judicial process

[19-85] One of the principal barriers to the civil justice process in Hong Kong, as previously noted, is the very high cost of litigation. The introduction of class actions is designed to improve access to the judicial

⁸⁶ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions (the 'LRC Report').

⁸⁷ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, Executive Summary, para 6.

⁸⁸ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, Executive Summary, paras 23-30.

process in cases where a single plaintiff's claim may not be economically viable to pursue. In comparison, the aggregate claims of the 'plaintiff' class, it is argued, may become substantial enough to justify the potential costs. In addition, multi-party litigation can also help to overcome other barriers to the commencement of legal proceedings such as the fear of sanctions from employers or others in a position to take reprisals; fear of involvement in the legal system; and ignorance of legal rights. Class actions also have potential benefits for the judicial system. They can facilitate the binding resolution of civil disputes and thereby eliminate the need to revisit issues or claims in separate proceedings. This also benefits the defendants since they would not have to spend money or face adverse publicity as a result of many potential legal actions.

(c) Arguments against class actions

[19-86] Against these benefits, the main arguments against the introduction of class actions are that, based on the US experience, they may lead to unnecessary, costly and frivolous law suits and benefit entrepreneurial lawyers. In addition, there are concerns about the time needed to dispose of class action proceedings as limited empirical studies reveal that class actions tend to consume more judicial resources than typical civil cases. The LRC's Consultation Paper points out, however, that there are many features of the US legal system which are not replicated in Hong Kong such as exemplary, punitive or treble damages; juries in civil trials; contingency fees and parties bearing their own costs. Furthermore, as the local consumer market is much smaller than its US counterpart, it is likely that there will be fewer class actions and the size of the class in any action is likely to be smaller.⁸⁹

(d) 'Opt-in' and 'opt-out' approaches

[19-87] Chapter 4 of the LRC Report considers the different merits of the 'opt-out' and 'opt-in' approaches. The LRC recommends that, in order to filter out cases that are clearly not viable, class action proceedings should only be allowed to continue if they have been certified by the court. In addition, the new class action regime should adopt an 'opt-out' approach. Under this approach, once the court certifies that a case is suitable for a class action, any member of the class, as defined in the order of court, would be automatically bound by the subsequent litigation, unless he opts out of the class action within the time limits prescribed by the court order.⁹⁰

⁸⁹ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, paras 31-37.

⁹⁰ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, paras 42-45 and recommendations 3 and 8.

(e) **Class action cases from other jurisdictions**

[19-88] Chapter 7 of the LRC Report considers the handling of class action cases from other jurisdictions. Where the proceedings involve parties from outside Hong Kong, an 'opt-in' procedure will be the default position, with a discretion given to the court to adopt an 'opt-out' procedure if the particular circumstances of the case warrant it.⁹¹ The LRC also proposes to introduce the new regime initially in the Court of First Instance and defer its extension to the District Court for at least five years until a body of case law on the new procedures has been established. Once extended to the District Court, District Court judges would be given the power to transfer complex cases to the Court of First Instance.⁹²

(f) **Funding of litigation**

[19-89] Chapter 8 of the LRC's Report explores one of the most difficult issues regarding the possible introduction of class actions in Hong Kong, namely the funding of litigation.⁹³ The new class action regime would not achieve its aim of improving access to civil justice if a suitable funding model could not be found which permits plaintiffs with limited means to take proceedings. The Consultation Paper acknowledges that if the current funding arrangement for litigation where 'costs follow success', were to be applied to a class action regime, it would constitute a major obstacle to commencing a class action.

(g) **Possible funding options**

[19-90] In this respect, possible funding options were as follows:

- (1) *Legal aid*: The existing statutory framework is detailed in the Legal Aid Ordinance (Cap 91). If it was agreed that class actions should be funded from this source, this option would necessitate an amendment to the Ordinance.⁹⁴
- (2) *Class action fund*: A dedicated class action fund could be established which would make discretionary grants. There might be a means test on applications or the exaction of a

91 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, paras 61-75 and recommendation 5.

92 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, recommendation 8.

93 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, paras 76-96.

94 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, para 83 and recommendation 6.

financial contribution such as a proportion of the proceeds of a successful action.⁹⁵

- (3) *Third party funding*: In other jurisdictions, the funding of class actions by commercial entities or litigation-funding companies ('LFC') has become increasingly common. This involves an LFC contracting with one or more potential litigants to pay the costs of the litigation and accepting the risks of paying the other party's costs if the case fails. In return, the LFC has control of the action and, if the case succeeds, is paid a share of the proceeds, usually after the reimbursement of costs. However, as this arrangement offends the common law rule against maintenance and champerty, which continues to apply in Hong Kong, this rule would have to be changed if LFCs were to be introduced. Furthermore, it would be necessary to introduce appropriate controls on the operation of LFCs in class actions in order to avoid the risk that LFCs seek to obtain excess proceeds (and perhaps legal costs) from the parties by settling out of court.⁹⁶

[19-91] Not unexpectedly, the LRC concluded that each of these options for funding class action proceedings would present difficulties: public funding would be needed for a general expansion of legal aid to class action proceedings, or to establish a class action fund, and the introduction of LFCs would have considerable ramifications and should be treated with caution.⁹⁷ The LRC favoured the introduction of funding for class action proceedings in Hong Kong on a sectoral basis. This would involve applying the new class action regime to one or more of the sectors where there are already funding mechanisms in place, with a view to testing out its operation.⁹⁸

(h) **Sectoral funds**

[19-92] Possible sectoral funds which could be used in this manner include:

- (1) *The Investor Compensation Fund*: The SFC's Investor Compensation Fund ('ICF') could fund class actions in the

95 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, para 84.

96 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, paras 85-87.

97 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, para 88.

98 The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, para 89 and recommendation 7.

securities field but, to use the ICF in this way would change its purpose and alter its nature considerably. If it was agreed that the ICF could be used in this manner, primary legislation would be required.⁹⁹

- (2) *The Consumer Legal Action Fund*: The Consumer Council's Consumer Legal Action Fund ('The Fund') is a trust fund established in 1994 to give greater consumer access to legal remedies by providing financial support and legal assistance. Legal assistance may be in the form of advice, assistance and representation by a solicitor and counsel. If the consumers' legal action is successful, a contribution to be calculated is to be paid to the Fund but, if it is unsuccessful, they need not make any payment other than the application fees. The fund pays for all the consumers' costs and expenses. The LRC considers that consumer claims are particularly suitable for class action litigation and priority should be given to funding class action litigation in this area. However, 'given the focus of the Fund on consumer claims, it would not extend to public law cases and other forms of funding would be required to meet the financial needs in those cases'.¹⁰⁰

[19-93] The LRC also suggested that a third sectoral source of funding could come from the Hong Kong Association of Minority Shareholders ('HAMS'), were such a body to be set up. However, it almost immediately states that this option is not likely to provide an option for funding class actions in the financial sector in the short term, not least because the proposal has already been rejected by the SCCLR.¹⁰¹ The reasons why the SCCLR did not support the creation of HAMS are discussed in Chapter 20.

(i) Public consultation

[19-94] In the public consultation exercise, 35 out of the 61 respondents favoured the introduction of class actions while the remainder either opposed the concept or had reservations. In order to avoid unnecessary suits and those without merit, the LRC recommended that class actions should only be accepted if they have been accepted by a court as is the case elsewhere. It also recommended that an opt-out approach should

⁹⁹ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, para 90.

¹⁰⁰ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, paras 92-93.

¹⁰¹ The Law Reform Commission of Hong Kong Class Actions Sub-committee's Consultation Paper on Class Actions, para 91 and recommendation 7(3).

be used, meaning those who are defined to be of the same class would automatically be bound by the class action unless they opted out. Anthony Neoh commented that:

It is generally accepted that a class action regime would achieve little unless there were mechanisms in place to enable plaintiffs with limited funds to take proceedings. As a comprehensive funding mechanism is unlikely to be put in place in the short term, the Consumer Council's HK\$18 million Consumer Legal Action Fund should be properly injected with resources to make it readily available to fund class actions brought by consumers.¹⁰²

However, a contrary opinion was voiced by David Webb, a corporate governance activist, who doubted the fund's usefulness, noting that only three out of 143 applications to it were approved in 2009-10.¹⁰³

[19-95] The LRC has suggested that class actions be phased in, beginning with consumer cases, in order to avoid a flood of unnecessary applications. Furthermore, at least at the outset, it is clear that the level of public funding available for such actions will be limited. In view of this prioritisation and funding constraints, it seems clear that class actions will be not be available as a remedy for litigants in company cases for a considerable time to come, if at all. However, if they could be introduced for such cases, an editorial in the South China Morning Post opined that they could be a potent weapon, given the increased willingness of people to resort to the courts to resolve disputes.¹⁰⁴

(j) Implementation

[19-96] The Department of Justice has established a cross-sector Working Group to study and consider the proposals of the LRC's report comprising members representing stakeholders in the private sector, the relevant Government bureaux and departments, the two legal professional bodies and the Consumer Council, and a representative from the Judiciary whose role is confined to providing input to the deliberations from the perspective of interface with court operations. Up to 31 March 2015, the Working Group had held nine meetings. In addition, a Sub-Committee of the Working Group has been formed to assist the Working Group on technical issues that might arise during its deliberations of the subject matter. Up to 30 April 2015, the Sub-Committee had held nine meetings.

¹⁰² Stuart Lau and Adrian Wan, 'Law reform commission backs class action suits' *South China Morning Post* (29 May 2012) <https://www.scmp.com/article/1002312/law-reform-commission-backs-class-action-suits> accessed 20 January 2025.

¹⁰³ Stuart Lau and Adrian Wan, 'Law reform commission backs class action suits' *South China Morning Post* (29 May 2012) <https://www.scmp.com/article/1002312/law-reform-commission-backs-class-action-suits> accessed 20 January 2025.

¹⁰⁴ 'Class actions can be a potent weapon' *South China Morning Post* (6 June 2012).

The Administration will map out the way forward in the light of the Sub-Committee's recommendations.¹⁰⁵

9. THE PRESENT POSITION

[19-97] On the basis of the above, it would appear that, to date, the new provisions regarding shareholder remedies have been used relatively sparingly. The cases invoking the statutory derivative action have been overwhelmingly used by private companies while those regarding inspections and injunctions hardly at all. The reasons for this are likely to be exactly the same as those set out in the background section of this chapter,¹⁰⁶ ie, cost, time and inclination considerations, and it is most unlikely that the situation will improve, if at all, in the near future. Whether or not the introduction of class actions leads to any improvements remains very much dependent on not only the form which class actions, if introduced, will take but also the willingness of retail shareholders stand up and be counted if class actions are introduced. At present, both of these factors are either unknown or uncertain.

105 Item 55 in the section of the LRC's website regarding implementation, available at <http://www.hkreform.gov.hk/en/implementation/> accessed 20 January 2025.

106 See [19-7] et seq.

CHAPTER 20

SHAREHOLDER ACTIVISM

1. BACKGROUND

[20-1] In theory, shareholders reward good corporate governance because it reduces the risk of fraud and indicates better corporate management. Where shareholders actively monitor and are prepared to take action against corporate governance abuses, companies are under significant pressure to stay clean. Unfortunately, this is the theory and the reality is very different. Shareholder activism is virtually non-existent in Hong Kong and confined to certain high-profile individuals rather than groups. In practice, most shareholders tend to focus on short-term performance and vote with their feet if they are unhappy with a company. Corporate governance in Hong Kong still tends to be a 'top-down', as opposed to 'bottom-up' affair where the Government and regulators provide most of the initiatives regarding the adoption of higher standards. The main drawback of this model is that the threat of regulatory action is not always as effective in persuading companies to raise their corporate governance game as the incentive provided by shareholder engagement.¹

[20-2] The lack of shareholder activism (or, to be more accurate, prevalence of shareholder apathy) in Hong Kong is well known. To a significant extent, this is due to the cultural norms in Asian society which tend to be more deferential and less confrontational than in North American and European society, although this is changing. One of the consequences is that what little shareholder activism which exists in Hong Kong tends to be led by non-Chinese investors and shareholder activists like David Webb. When the SCCLR commenced the Corporate Governance Review in 2000, item 1 of the terms of reference referred to: 'the lack of shareholder activism as a natural force for improving corporate governance'.²

1 'Class Actions for Hong Kong' CSj (January 2010) at 40.

2 CGR Phase I, page v.

[20-3] It should be stressed that this is not a problem unique to Hong Kong. In November 2009, Lord Myners, the then UK Treasury Minister, criticised UK shareholders from avoiding their responsibilities as owners in the following terms: 'If the banking crisis has taught us anything, it's that bad decisions went unchallenged. Good governance requires good judgment, robust decisions and requires owners to care. Shareholders need to be the drivers. It lies fairly and squarely with the owners of companies, not government and regulators. Shareholders should not be gamblers, they are owners. Most do not believe they are owners, do not feel responsibility for companies. Ownerless corporations disadvantage public equity, because agents are not held to account by owners'.³

2. THE HONG KONG ASSOCIATION OF MINORITY SHAREHOLDERS⁴

2.1 Background

[20-4] In order to strengthen the collective voice and action of minority retail shareholders, one possibility is to establish a minority shareholder association. The only time that this was proposed in Hong Kong was when a number of shareholder activists, principally David Webb, proposed the establishment of the Hong Kong Association of Minority Shareholders ('HAMS') in July 2001. Under this proposal, HAMS would comprise three divisions, each responsible for a specific area of work as follows:

- (1) *Policy*: to promote and lobby for improvements to the legislative and regulatory framework for investment.
- (2) *Corporate Governance Ratings*: to incentivise good corporate governance and deter bad corporate governance, by means of a comprehensive and objective corporate governance rating system.
- (3) *Enforcement*: converting the framework into a meaningful deterrent to bad corporate governance, by quasi-class action litigation of the worst cases on behalf of investor members.

2.2 The policy division

[20-5] HAMS intended to lobby for better laws and regulations to protect investors, a 'top-down' approach to reform with the eventual goal of establishing a framework which allowed 'bottom-up' action at

³ 'Class Actions for Hong Kong' CSJ (January 2010) at 40.

⁴ This section is derived from David Webb's article 'The HAMS Initiative: Representing & Activating Minority Shareholders', July 2001, available at <https://webb-site.com/articles/hams.asp> accessed 20 January 2025.

the shareholder level. It would seek the opinions of its members through internet communication and internet polling. A full time professionally staffed policy division including experienced lawyers, accountants and practitioners would make proposals for structural reforms, and responses to other proposals. The policy division would interact with other players in the corporate governance system including the Government's (then) Financial Services Bureau, the SFC, the Stock Exchange, the Law Society, the (then) HKSA, the Bar Association, the HKIoD, the various chambers of commerce, etc.

2.3 The corporate ratings division

[20-6] A professionally staffed corporate ratings division, comprising experienced lawyers, accountants and investment professionals, would continually assess each and every listed company with an objective scoring system for various aspects of corporate governance, including quality and frequency of disclosure, dealings with related parties, independence and accountability of directors, and produce an overall score. The corporate governance ratings were intended to be comprehensive covering all companies and would be reviewed when a major event occurred at a company, such as a takeover or a large 'connected transaction' with a related party. Otherwise, it would be reviewed annually. Reasons for upgrades and downgrades would be provided. HAMS would also publish voting recommendations in relation to a company proposal. The corporate governance ratings would be freely published and newspapers would add a new 'CG' column next to 'P/E' and 'Yield' in their stock listings so that investors would begin to take more notice of corporate governance risks.

2.4 Enforcement division

[20-7] The enforcement division would be staffed by a team of highly skilled lawyers and other professionals to target the worst cases of abuses with the highest chances of success by claiming and, if necessary, suing for damages. It would also leverage off the findings of the findings of any Market Misconduct Tribunal hearing under the (then) new SFO, using these findings as evidence. Once a case was in progress, HAMS could advertise for any member who would be a plaintiff (having been a shareholder at the appropriate time) and this would include anyone who joined HAMS to participate in the action. The hundreds or even thousands of members who would be represented by HAMS would receive a proportionate share of the damages recovered if the case was won.

[20-8] In this way, it was hoped that HAMS would achieve a quasi-class action, without actually reforming the entire legal system, and would

overcome the costs of individual legal representation. Furthermore, the size of the potential claims would then form a disincentive to bad corporate governance. The enforcement division would also press claims against companies and their directors for bad governance, such as false and misleading statements, breach of fiduciary duty, oppression of minority shareholders and expropriation of assets. Like the other divisions, the enforcement division would be financed from the HAMS operating budget but it would also seek to recover its costs plus a surplus on those cases which it won. In this respect, it was believed that the creation of a credible well-funded litigation deterrent would deter bad corporate governance and increase the willingness of offenders to reach a settlement without necessarily admitting liability.

2.5 Funding

[20-9] As it was not possible to fund HAMS sufficiently from private means, it would be necessary to impose a 'Good Governance Levy' of 0.005% on every stock market transaction. This would amount to approximately \$20.00 per annum for every investor with investments of \$200,000.00 if they turned it over once a year. However, such a levy would have to be prescribed by legislation.

[20-10] Mr Webb also produced a paper entitled 'The HAMS Proposals' which was considered by the SCCLR at the Standing Committee's 157th Meeting on 10 November 2001. As a result of the very lengthy discussion with Mr Webb on various aspects of the HAMS proposal, the SCCLR rejected the proposal for a number of reasons as outlined below.⁵

3. THE PROBLEMS WITH THE ORIGINAL HAMS MODEL

3.1 Accountability and governance

[20-11] A crucial part of the HAMS proposal was that it should be publicly funded through a statutory levy on all stock market transactions, ie, a tax. While the proposed levy might be low in percentage terms, the amount that was to be raised and allocated by HAMS was substantial (HK\$ 200,000 million or more). The proposed governance structure of HAMS envisaged a board of directors which would be quite independent of the Government despite the fact that it was to be funded by a substantial amount of public monies. In other words, it would be a privately-owned and controlled but

publicly-funded body. The SCCLR, quite rightly, considered this to be highly undesirable and not something which it could recommend. If such a body were to be publicly funded, it would have to be publicly accountable. In turn, this would mean that HAMS would have to be established as a statutory body with consequential Government involvement in the constitution of the board and statutorily defined lines of accountability and responsibility which was not part of David Webb's original proposal. As a result of the discussion, it was clear that the HAMS proposal of an independent public body was incompatible with the requirement that there should be public accountability for the use of public funds.

3.2 Membership

[20-12] The levy would have to be paid by all investors irrespective of whether or not they subsequently joined HAMS. However, the board of governors would be elected only by those investors who decided to become members. In other words, HAMS would not be representative of all members of the investing public. Furthermore, there would also be uncertainty as to whether the membership would, in practice, monitor the performance of HAMS, particularly given the lethargy of retail investors in monitoring the companies in which they had shares.

3.3 Levy

[20-13] Hong Kong's transaction costs were among some of the most expensive in the world and a further levy would only increase these at a time when ways of reducing these costs were being examined. In addition, HAMS's alleged independence may be compromised each year by having to persuade the Government to continue the levy.

3.4 Duplication of the SFC's role and resources

[20-14] The SFC was already funded by a levy on stock market transactions. It also had powers to intervene as and when appropriate on behalf of minority shareholders. Consequently, the proposed enforcement role of HAMS, which would account for the overwhelming majority of expenditure, would only duplicate work which was already the SFC's responsibility. Furthermore, if the object of HAMS was to improve corporate governance, the emphasis should be on 'prevention' rather than 'cure' as, by the time that a case needs to be taken to court, it would be too late to take any effective action against the abuse in question without substantial expenditure of court costs with no certain result.

⁵ The SCCLR's 18th Annual Report 2001-02, Ch 5 at 27-32.