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CHAPTER 6

STATUTORY OBLIGATIONS OF DIRECTORS*

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I. DIRECTORS

Scope of Chapter

This chapter outlines the concept of a "director" and covers: (1) the statutory requirements relating to directors (appointment, qualification, vacation of office and disqualification of directors); (2) the statutory prohibitions on companies giving loans to, and entering into certain other transactions with directors; (3) the statutory duty of care of directors and (4) certain other obligations imposed on directors and officers under the Companies Ordinance (Cap.622) (CO) and the retitled Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32) (CWUO). 6.001

II. CLASSIFICATION OF DIRECTORS

Black's Law Dictionary defines "director" as: 6.002

> [a] person appointed or elected to sit on a board that manages the affairs of a corporation or other organisation by electing and exercising control over its officers.[1]

For our purposes, this definition is somewhat too narrow, as under the CO as well as at common law, a person who has not been appointed or elected to sit on the board can be treated as a director, as will be seen in the discussion below.

De Jure, _De Facto_ and Shadow Directors

In terms of the ways in which a person becomes (to be treated as) a director by law, directors can be classified into appointed directors (or "*de jure* directors"), *de facto* directors and shadow directors. The need for treating a person who is not a *de jure* director as director lies in the necessity for ensuring that persons who exercise the functions of directors do not escape their legal responsibilities by not being formally appointed as director.[2] 6.003

A person who is appointed or elected to sit on a board of directors becomes a *de jure* director upon the appointment or election. Section 2 of the CO states that "director" includes any person occupying the position of director by whatever name called. That definition clearly covers *de jure* directors. The wording "by whatever name called" means that the definition includes persons appointed to an office which is effectively the same as the office of director even though the company's articles may use a different term, such as "governors".[3] Neither the definition of "director" nor other provisions in the CO expressly refer to "*de facto* directors" but, depending on the context,

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[1] *Black's Law Dictionary* (West Publishing, 8th ed 2004) 492.

[2] See *Re Hydrodan (Corby) Ltd* [1994] BCC 161; see also *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1; *Deputy Commissioner of Taxation v Austin* (1998) 28 ACSR 565; *Securities and Futures Commission v Mandarin Resources Corp Ltd* (HCCW 348/1996, [1999] HKEC 688); *Re Paycheck Services 3 Ltd* [2010] 1 WLR 2793 (SC(E)); *Lisa Alford, Neil Money (as Joint Liquidators of Snelling House Ltd) v Sally Ann Barton, Philip Barton, Sarah Barton, Solipetit SL* [2012] EWHC 440 (Ch).

[3] *Re Lo-Line Electric Motors Ltd* (1988) 4 BCC 415, 421.

provisions in the CO referring to directors can include *de facto* directors.[4] The definition of "director" in s.2 also does not expressly refer to "shadow directors", but the term "shadow director" is used in Cap.622, with some provisions in Cap.622 expressly extended to include "shadow directors".

De Facto Directors

6.004 The term "*de facto* directors" refers to persons who act as directors of the company, even though they have not been properly appointed as directors.[5]

In *Re Paycheck Services 3 Ltd, Holland v Revenue and Customs Commissioners*,[6] Lord Hope endorsed the definition that Millett J formulated in *Re Hydrodan (Corby) Ltd*:[7]

> A *de facto* director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a *de facto* director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the company's affairs or undertook tasks in relation to its business which can properly be performed by a manager below board level.

Whether a person would be regarded as a *de facto* director would depend on the duties performed by the person in the context of the operations and circumstances of the particular company.[8] Where a person takes on an active role in top-level management functions and is reasonably perceived by outsiders dealing with the company as a director, then the person may well be treated as a *de facto* director.[9] All the circumstances of the case must be examined, but it is relevant to look at factors such as whether there was a holding out by the company of the person as a director, whether the person used the title, whether the person had to make major decisions and whether the person had proper information (such as management accounts) on which to base decisions.[10]

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[4] Eg., CO s.465 (directors' duty of care) would include *de facto* directors: see *Corporate Affairs Commission v Drysdale* (1978) 141 CLR 236. Provisions such as CO s.461 (validity of acts of directors) and Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32) s.168H (disqualification of unfit directors) would also include *de facto* directors, but not provisions such as CO ss.453 and 454 (minimum number of directors) and s.641 (register of directors): see *Re Lo-Line Electric Motors Ltd* (1988) 4 BCC 415, 421–422.

[5] *Aktieselskabet Dansk Skibsfi nansiering v Wheelock Marden & Co Ltd* (Court of Appeal, 17 November 1994); *Re Hydrodan (Corby) Ltd* [1994] BCC 161, 163, cited in *Moulin Global Eyecare Holdings Ltd v Lee Sin Mei Olivia* [2009] 3 HKLRD 265, 293 (CFI) (reversed by the Court of Appeal on other grounds). See also Susan Watson and Chris Noonan, "Defining Directorship", available at http://ssrn.com/abstract=1695796.

[6] [2010] 1 WLR 2793, [29]; see also *Karla Otto Ltd v Bulent Eren Bayram* [2017] 2 HKLRD 124, [31].

[7] *Re Hydrodan (Corby) Ltd* [1994] BCC 161, 163; cited in *Moulin Global Eyecare Holdings Ltd v Lee Sin Mei Olivia* [2009] 3 HKLRD 265, 293 (CFI) (reversed by the Court of Appeal on other grounds).

[8] *Deputy Commissioner of Taxation v Austin* (1998) 28 ACSR 565.

[9] *Ibid*.

[10] *Secretary of State for Trade and Industry v Tjolle* [1998] BCC 282, 290; *Re Kaytech Intl plc* [1999] BCC 390, 402. See also *Re Red Label Fashions Ltd* [1999] BCC 308; *Secretary of State for Trade and Industry v Jones* [1999] BCC 336; *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1; *Karla Otto Ltd v Bulent Eren Bayram* [2017] 2 HKLRD 124, [32]; *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI 397, [56].

In *Deputy Commissioner of Taxation v Austin*,[11] Madgwick J held the defendant to be a *de facto* director of the company for the purpose of determining his liability for an unfair preference given in favour of Australia's tax authority. In that case, the defendant had resigned as a director but continued to perform directorial duties such as conducting negotiations with creditors (including the tax commissioner) on behalf of the company, countersigning and affixing of the company's seal, as well as signing company cheques.

In a UK case, *Alford v Barton*,[12] Moss QC ruled that the second defendant, who was not an appointed director, was a *de facto* director on the basis that he was the person at the company in a position to prevent damage to creditors by taking proper steps to protect their interests. The things that the defendant did included the handling of VAT issues following the sale of the company's only property, and withdrawing of the company's monies (for the benefit of himself, and/or his family and/or his family company). The factors that Moss QC had taken into consideration in reaching his lordship's conclusion on the second defendant's role as a *de facto* director include (1) that the second defendant had been involved in the company's day-to-day running; (2) that he dealt with the company's financial and VAT affairs; (3) that he was in a position to give instructions to the company's accountants; (4) dealt with the company's receivers as if he was solely in charge and (5) that he was a signatory on the company's bank account and that he had full power to act under the bank mandate to act in all material respects, including withdrawing the company's money without any limit.[13]

One of the situations where a person's liability as a *de facto* director can arise is where a corporate director is interposed between the defendant, who is a *de jure* director of that corporate director, and the subject company. The issue in such a situation is often whether the defendant can be characterised as a *de facto* director where his or her actions can be attributed entirely to the position which he or she occupied *de jure* as a director of that corporate director. Lord Hope answered this question in the negative in *Re Paycheck Services 3 Ltd, Holland v Revenue and Customs Commissioners*,[14] holding that it was impossible to overcome the distinction between a company (the corporate director here) and its directors simply by pointing to the quality of the acts done by the director and asking whether he was the guiding spirit of the subject company.

His Lordship agreed with Millett J in *Re Hydrodan (Corby) Ltd*[15] that:

> for a creditor of the subject company to obtain those remedies (for the defendant's breach of fiduciary duties) the individual must be shown to have been a director, *not just of the corporate director but of the subject company too* (emphasis added).[16]

In *Re Paycheck Services 3 Ltd*, a 3:2 majority of the UK Supreme Court held that as long as the relevant acts are done by the individual entirely within the ambit of the

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[11] (1998) 28 ACSR 565.

[12] [2012] EWHC 440 (Ch).

[13] *Ibid*., [27]–[30].

[14] [2010] 1 WLR.

[15] [1994] BCC 161.

[16] *Re Paycheck Services 3 Ltd* [2010] 1 WLR 2793, [43].

discharge of his duties and responsibilities as a director of the corporate director, then the individual would not be regarded as a *de facto* or shadow director of the company in which the corporate director is director.[17]

Shadow Directors

6.005 Section 2 of the CO defines a "shadow director" as a person in accordance with whose direction or instructions the directors or a majority of directors of the company are accustomed to act.[18] In *Re Hydrodan (Corby) Ltd*,[19] Millett J held that to establish that the defendant is a shadow director, the plaintiff must allege and prove:

> (1) Who are the directors of the company, whether *de facto* or *de jure*; (2) that the defendant directed those directors how to act in relation to the company or that he was one of the persons who did so; (3) that those directors acted in accordance with such directions; and (4) that they were accustomed so to act.

The concept of a shadow director is different from that of *de facto* director, although in some situations there could be overlap.[20] The purpose of the notion of shadow director is to identify those with real influence in the corporate affairs of the company, although it is not necessary that such influence should be exercised over the whole field of its corporate activities.[21] A shadow director has been described as like a "puppet master who controls the actions of the board".[22] The influence or control exercised by a shadow director may be strategic in character, defining the context in which, or conditions upon which, the company operates, or else contriving the transactions of significance to the company.[23] For a person to be a shadow director, his or her influence over the board must occur over a period of time and so the mere fact that

[17] [2010] 1 WLR 2793, [42], [53]–[54], [96] (sole director of a corporate director of another company held not to be *de facto* director of the latter company for the purposes of liable for misfeasance).

[18] However, a person is not to be considered as a shadow director by reason only that the directors or a majority of them act on advice given by the person in a professional capacity; see CO s.2 definition of "shadow director".

[19] [1994] BCC 161, 163; see also *Karla Otto Ltd v Bulent Eren Bayram* [2017] 2 HKLRD 124, [35]; *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI 397, [56].

[20] *Aktieselskabet Dansk Skibsfi nansiering v Wheelock Marden & Co Ltd* [1994] 2 HKC 264; *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340.

[21] *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340; *Karla Otto Ltd v Bulent Eren Bayram* [2017] 2 HKLRD 124, [35].

[22] *Re Unisoft Group Ltd (No 2)* [1994] BCC 766, 775, cited in *Moulin Global Eyecare Holdings Ltd v Lee Sin Mei Olivia* [2009] 3 HKLRD 265, 293 (CFI) (reversed by the Court of Appeal on other grounds). In *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340, Morritt LJ in the English Court of Appeal qualified this by stating that the requirement that the directors are accustomed to act in accordance with the putative shadow director's directions or instructions does not necessarily mean that the directors must have surrendered their own discretion and were simply subservient to the putative shadow director. Morritt LJ considered that if the board were accustomed to act on the directions or instructions of the putative shadow director, it is not necessary to demonstrate that their action was mechanical rather than considered. But for a critique of this approach, see Chris Noonan and Susan Watson, "The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?" [2006] *Journal of Business Law* 763. Morritt LJ's approach was accepted by Lewison J in *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 but Lewison J also accepted the correctness of earlier case law that held that creditors are entitled to protect their own interests by making demands on the debtor company and that creditors will not be regarded as shadow directors merely because the directors agree to requirements imposed by the creditors. On the latter point, see also *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47.

[23] *Australian Securities Commission v A S Nominees Ltd* (1995) 133 ALR 1, 52–53.

the directors acted in accordance with the person's instructions on a single occasion would not be sufficient.[24]

A parent company can be held to be a shadow director where it made the major policy decisions, exercised close control over the subsidiary's management and financial affairs, and where the directors of the subsidiary were accustomed to act in accordance with the parent company's directions or instructions.[25] In *Standard Chartered Bank of Australia Ltd v Antico*,[26] Hodgson J held that a company (P), which held 42% of the shares in another company (G), was a shadow director of G in circumstances where P imposed reporting requirements on G, exercised controls over the composition of the board of G and had played a decisive role in relation to a number of significant transactions entered into by G. The board of G in that case simply accepted the decisions of P in relation to those significant transactions as something necessary or as a *fait accompli*.[27]

It does not automatically follow that merely because a parent company may be treated as the shadow director of its subsidiary, the directors of the parent company will also be treated as shadow directors of the subsidiary. It will be necessary for the court to consider whether the directors of the parent company simply acted as a board of that company in giving instructions to the subsidiary, or whether the directors of the parent company gave individual or personal instructions to the board of the subsidiary. In the former situation, the parent company directors ought not to be treated as shadow directors of the subsidiary, but in the latter situation the directors giving individual instructions might be treated as shadow directors of the subsidiary.[28]

In *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd*,[29] Tong was the managing director of a company, MAEGL. MAEGL originally held 100% of the shares of another company (Cyberworks) but its shareholding was subsequently reduced to below 50% (ranging from 35% to 45% in the relevant periods). Tong was originally a *de jure* director of Cyberworks but was held by the court to have continued to act as a director afterwards, rendering him a *de facto* director.[30] The court accepted that it is logically possible for Tong to have become a *de facto* director, and for his exercise of control over the other (*de jure*) directors of Cyberworks to be attributed to MAEGL to render it a shadow director. In the circumstances of the case where Cyberworks was operated for the benefit of other companies in the MAEGL group (and not in its own interests), the court held that it was appropriate to regard Tong's conduct in controlling the other directors of Cyberworks to have been done in his capacity as managing director of MAEGL. Accordingly, Tong's control over the other directors was attributed to MAEGL, rendering MAEGL a shadow director of Cyberworks.[31]

[24] *Re Unisoft Group Ltd (No 2)* [1994] BCC 766, 775, cited in *Moulin Global Eyecare Holdings Ltd v Lee Sin Mei Olivia* [2009] 3 HKLRD 265, 293 (CFI). In the latter case, a claim that a non-executive director and member of the audit committee of a company was a shadow director of the subsidiary companies was struck out where there was no evidence that she exercised real influence over the affairs of the subsidiaries which were, on the evidence, controlled by the majority family owners of the companies. The CFI decision was reversed by the Court of Appeal on other grounds at [2010] 2 HKLRD 1096.

[25] *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI 397, [57]; and see also *Re Hydrodan (Corby) Ltd* [1994] BCC 161; *Ho v Akai Pty Ltd* (2006) 24 ACLC 1526; *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47.

[26] (1995) 18 ACSR 1.

[27] *Ibid.*, [63].

[28] *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI 397, [60].

[29] *Ibid.*

[30] *Ibid.*, [222]–[227].

[31] *Ibid.*, [249]–[250].

Types of Directors According to Functions

Managing Director or Chief Executive Officer

6.006 The managing director is a director who is appointed by the board as the company's chief executive officer. A managing director is both a director and a company employee[32] who is conferred, by the directors, with any of the powers exercisable by the directors.[33] During his tenure, a director so appointed is often not subject to retirement by rotation or taken into account in determining the rotation of retirement of directors.[34] A typical function of the managing director is to oversee the day-to-day running of the company's business and to supervise other senior executives. The precise role of a managing director is, however, not fixed by law but determined by the terms of his engagement.[35]

The term "chief executive officer" (CEO) is often used nowadays instead of "managing director". The functions of a director appointed as CEO are usually similar to those of managing directors.

Executive Directors and Non-executive Directors

6.007 Executive directors are full-time employees of the company. Non-executive directors (NEDs) do not have full-time involvement with the company. Non-executive directors with a sufficient degree of independence from the company's owners and managers are referred to as independent non-executive directors (INEDs). NEDs are often able to provide a perspective that is wider than executive directors in corporate decision-making, and they are likely to be more objective and more balanced in thinking, particularly in the case of INEDs.[36] NEDs may also be better placed to protect certain interests within the company or the interests of stakeholders who do not have a voice on the board, such as small shareholders and creditors.[37] Another important function of NEDs is that they serve as a check on the executive directors' control of company management.[38]

Listed companies, under the Listing Rules, are to appoint at least three INEDs who represent at least one-third of the board.[39] The meaning of INEDs is defined in r.3.13 of the Main Board Listing Rules (Main Board) and r.5.09 of the Growth Enterprise Market Listing Rules (GEM). There is little doubt that NEDs are subject to the same fiduciary obligations as executive directors.[40] NEDs are also subject to the duty of care, skill and diligence.[41]

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[32] *Anderson v James Sutherland (Peterhead) Ltd* [1941] SC 203.
[33] Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.33; predecessor CO Table A reg.111.
[34] Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.33(2); predecessor CO Table A reg.109.
[35] *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* [1955] 1 WLR 352 (Eng HL).
[36] E J Jacobs, "Non-executive Directors" [1987] JBL 269.
[37] *Ibid.*; see also Saleem Sheikh, "Non-executive Directors: Self-regulation or Codification?" (2002) 23(10) *Company Lawyer* 269.
[38] E J Jacobs, "Non-executive Directors" [1987] JBL 269, 270.
[39] Listing Rules (Main Board) rr.3.10, 3.10A; Listing Rules (GEM) rr.5.05, 5.05A.
[40] *ASIC v Adler* (2002) 168 FLR 253 (affirmed on appeal *Adler v ASIC* (2003) 179 FLR 1); *ASIC v Vizard* (2005) 145 FCR 57).
[41] *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498; *Law Wai Duen v Boldwin Construction Co Ltd* [2001] 4 HKC 403 (CA).

Alternate Directors

An alternate director is a person appointed to act in the place of a director when the latter is unable to attend meetings or otherwise function as a director. The appointment of an alternate director is possible if the articles of the company authorise a director to do so.[42] 6.008

Under s.478(1) of the CO, unless the company's articles provide otherwise, whether expressly or impliedly, an alternate director is deemed to be the agent of the director who appoints him or her and the director who appoints the alternate director is vicariously liable for any tort committed by the alternate director during his or her office. The alternate director, however, remains personally liable for any act or omission.[43] Section 478 of the CO alters the common law position which is illustrated by the Australian decision in *Anaray Pty Ltd v Sydney Futures Exchange Ltd*.[44] In that case, the alternate appointed by a director attended a board meeting and voted for a resolution on a matter on which the appointor director had a personal interest. A number of the articles of the company prohibited directors from voting on proposed resolutions on matters where they had a personal interest. The validity of the resolution that the alternate director voted for was challenged on the basis that the alternate director was disqualified from voting as he was his appointor's agent. The Supreme Court of New South Wales rejected the contention that an alternate director was an agent of his appointor. The basis of the court's decision on this point was that there were no provisions in the articles making an alternate director an agent of his appointor, nor was there any suggestion of any collusion between the alternate and his appointor. In Australia, there is no equivalent of s.478 of the CO, which deems the alternate the agent of the appointing director.

Generally speaking, an alternate director is treated as being in the same position as any other director and is consequently subject to the normal duties that a director owes to his or her company.[45] An alternate director is, however, not subject to directorial duties unless and until he or she has assumed directorial authority. Thus, a person who has been appointed as an alternate director but who has never been called upon to fulfil this role cannot be held liable for breaching of a directorial duty, if under the company's articles an alternate does not have any duty to exercise power until he or she is called upon to fulfil the role.[46] Also, an alternate has no status as a director when his or her appointor is present at the meeting.[47]

Nominee Directors

At a general level, the term "nominee director" can be used to refer to: 6.009

> persons who, independently of the method of their appointment, but in relation to their office, are expected to act in accordance with some understanding or

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[42] See, eg, Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.2 art.28; Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.30. The Table A articles in the predecessor CO do not have provisions for alternate directors.
[43] CO s.478(2).
[44] (1988) 6 ACLC 271.
[45] *Markwell Bros Pty Ltd v CPN Diesels Queensland Pty Ltd* [1983] 2 Qd R 508, 519 (Thomas J).
[46] *Playcorp Pty Ltd v Shaw* (1993) 10 ACSR 212.
[47] *Markwell Bros v CPN Diesels (Qld) Pty Ltd* [1983] 2 Qd R 508; *Playcorp Pty Ltd v Shaw* (1993) 10 ACSR 212.

arrangement which creates an obligation or mutual expectation of loyalty to some person or persons other than the company as a whole.[48]

In practice, a nominee director can be appointed to represent the interests of a particular stakeholder, such as a party to a corporate joint venture, the holding company,[49] a creditor,[50] or even employees or a government body.[51]

Reserve Directors

6.010 Under s.455 of the CO, a private company with one member, who is the sole director, may, in general meeting, notwithstanding anything in the company's articles of association, nominate a person (other than the company itself) of 18 years or above to be a reserve director of the company to act in the place of the sole director in the event of his or her death. The nominee will cease to be the reserve director where: (1) he or she has resigned from this post; (2) the company in general meeting has revoked his or her nomination or (3) the director in respect of whom the reserve director was nominated has ceased to be the sole director.[52]

III. QUALIFICATIONS

6.011 Generally speaking, the law does not prescribe any minimum professional or educational requirements before persons can act as a director. Historically, in the 19th century, directors were not necessarily appointed for their business acumen. For example, well-known figures might be appointed to the board in order to attract investors to the company on the basis of their reputation. Greater managerial abilities are expected of directors of commercial enterprises today,[53] but the law only provides for certain minimal qualifications for persons to be appointed as directors.

A natural person can be appointed as director only if the person is of 18 years of age or above.[54] There is no maximum age limit unless provided for in the articles.

An undischarged bankrupt is prohibited from acting as a director or taking part in the management of a company, either directly or indirectly, without the leave of the court as prescribed by s.480 of the CO. A person who contravenes this prohibition commits an offence[55] and also becomes personally liable for the debts and liabilities of the company incurred at a time when the person was involved in the management of the company in contravention of s.480 of the CO.[56] A person against whom a disqualification order has been made is also banned from acting as a company director.[57] The articles of companies also commonly provide that a director must not be of unsound mind.[58]

Previously, s.155 (repealed) of the predecessor CO provided that where the articles of association of the company impose a share qualification upon the company's directors, the directors who are not so qualified are under an obligation to obtain such qualification within two months with their appointments unless the articles provide a shorter period.[59] This provision was not reproduced in the CO.

There are also restrictions in the CO on the possibility of appointing a body corporate as director.[60]

The Listing Rules impose further requirements in relation to directors of companies listed on the Hong Kong Stock Exchange. Rule 3.09 states that directors of a listed issuer must satisfy the Exchange that they have the character, experience and integrity and are able to demonstrate a standard of competence commensurate with their position as directors of a listed issuer.

IV. APPOINTMENT

A public company must have at least two directors.[61] A company limited by guarantee is also required to have at least two directors.[62] A private company, on the other hand, is required to have at least one director.[63] As mentioned previously, where a private company has only one director who is the sole member, the company may nominate a reserve director who would act in case of the death of the director.[64] 6.012

The Registrar has power under s.458 of the CO to direct a company to appoint a director or directors to comply with the statutory requirements where the number of directors of the company has fallen below the statutory minimum. If the company fails to comply with the direction within the time period specified by the Registrar (which must be not less than one month or more than three months after the date on which the direction is given), the company and every responsible person[65] commits an offence.[66]

Initial Directors

The first directors of a company are those named in the incorporation form submitted to the Registrar.[67] The appointment of initial directors is subject to the written consent of the appointees.[68] 6.013

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[48] Companies and Securities Law Review Committee (Australia), "Nominee Directors and Alternate Directors" (Report No 8, 1989) 8.

[49] *Scottish Co-operative Wholesale Soc Ltd v Meyer* [1958] 3 All ER 66.

[50] *Levin v Clark* [1962] NSWR 686.

[51] Phillip Lipton et al, *Understanding Company Law* (LBC, 17th ed 2014) para.13.2.55.

[52] CO s.455(2).

[53] See Standing Committee on Company Law Reform, "Corporate Governance Review: Consultation Paper on Proposals in Phase I of the Review" (Hong Kong, July 2001) [6.06]–[6.07], [6.13]; Companies Registry, *A Guide on Directors' Duties* (Hong Kong, March 2014); Stock Exchange Listing Rules r.3.08(f), App 14 (Code on Corporate Governance Practices).

[54] CO s.459(1). See also [6.016].

[55] *Ibid.*, s.480(2).

[56] CWUO s.168O(1)(a) and 168O(3)(a). A person who is involved in the management of the company and acts or is willing to act on instructions given by a person who is an undischarged bankrupt will also be personally liable to the extent set out in CWUO s.168O(1)(b) and 168O(3)(b).

[57] CWUO Pt. IVA. See Section VI of this chapter for further discussion on disqualification.

[58] For example, Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.3 art.25(c); Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.27(c); predecessor CO Table A reg.90(d).

[59] See also predecessor CO Table A regs.79 and 90(a).

[60] See [6.017].

[61] CO s.453(1)(a) and 453(2).

[62] *Ibid.*, s.453(1)(b) and 453(2).

[63] *Ibid.*, s.454(1).

[64] See [6.022].

[65] CO s.3.

[66] *Ibid.*, s.458(6).

[67] *Ibid.*, ss.453(2) and 454(2).

[68] *Ibid.*, s.74.

Subsequent Directors

6.014 Under the Model Articles for public companies (Cap.622H, Sub.Leg.) Sch.1,[69] all of the first directors are required to retire from office at the first annual general meeting (AGM). At the AGM of every subsequent year, one-third of the directors, or if the number of directors is not three or a multiple of three, the number nearest one-third, are to retire from office, although a retiring director is eligible for election.[70] Vacancies created by retirement of directors are to be filled through an election to be conducted at the same meeting at which a director retires and in default, a director who has offered himself or herself for election is regarded as having been reappointed.[71] Directors are elected by ordinary resolution in accordance with the relevant stipulations in the articles.[72] No provisions are made for the rotation of directors in the Model Articles for private companies, but the general meeting has power to appoint new directors by ordinary resolution.[73]

Where the company is a public company or a company limited by guarantee, no motion for the appointment of two or more persons as directors by a single resolution can be made unless a resolution that such an appointment can be so made has first been passed at the meeting without any vote against it.[74] The rationale behind this prohibition on composite motions is to preserve the member's ability to refuse the appointment of a director without having to reject others.[75]

The power to appoint directors to fill casual vacancies or as an addition to existing directors can be vested in the board or the general meeting exclusively or granted concurrently to both corporate organs. The latter approach is adopted in the Model Articles[76] (as well as under the former Table A). However, any director appointed by the board only holds office until the next AGM.[77] If he or she is to continue in office after the AGM, it would be necessary for reappointment by the general meeting.

Where a new director is appointed, the company must send notice to the Registrar of the appointment, with particulars specified in its register of directors (name, identification number and residential address) together with a statement signed by the director stating that he or she has accepted the appointment, and a statement that the appointee has attained the age of 18, if that person is a natural person, within 15 days from the appointment.[78] The company must also enter the details of its directors in its own register of directors.[79]

[69] Companies (Model Articles) Notice (Cap.622H, Sub.Leg.), Model Articles (public companies) Sch.1 art.24. This provision is similar to those in the predecessor CO, Table A, regs.91, 94 (repealed).
[70] Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.25.
[71] *Ibid.*, Sch.1 art.24(8). However, the retiring director is not regarded as having been reappointed if: (1) at the meeting at which the director retires, it is expressly resolved not to fill the vacated office; or (2) a resolution for the reappointment of the director has been put to the meeting and lost; see Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.24(9).
[72] For example, see former Table A, regs.96 and 99 of the predecessor CO.
[73] Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.2 art.22.
[74] CO s.460.
[75] Clive M Schmitthoff (ed), *Palmer's Company Law* (Stevens & Sons Edinburgh, 24th ed 1987) Vol 1, 878.
[76] Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.2 art.22; Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.23.
[77] Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.2 art.22(4); Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.23(4).
[78] CO s.645.
[79] CO ss.641 and 643.

The managing director is appointed by the board of directors for such period and on such terms as they think fit.[80] Where articles so provide, a director may appoint an alternate director to act in his absence.[81]

Appointment by Outsiders

6.015 It is possible for an outsider to acquire a right to appoint a director pursuant to contractual arrangements. The supplier of either capital or debt finance, for example, may be granted the right of appointing a director pursuant to a term in the company's articles[82] or of a contract.[83] Where the right to nominate is conferred under a contract, however, this may not be specifically enforceable, as the court may be reluctant to compel the company to appoint the nominee where, for example, the nominee is unsuited for the office.[84] Directors may also delegate[85] their powers to appoint directors to enable the supplier of debt finance to nominate a director to protect the lender's interest.[86] Where the company is an incorporated joint venture, joint venturers may appoint nominee directors where such power is conferred under the terms of the shareholders' agreement.[87]

Liabilities of Under-age Directors

6.016 A natural person director must be at least 18 years of age at the time of appointment.[88] An appointment made in contravention of the statutory provision is void,[89] but an under-age person who purports to act as director or shadow director can still be liable under any provision of the CO or the CWUO notwithstanding that the person could not be appointed director (CO s.459(3)). This provision is modelled on s.157(5) of the Companies Act 2006 (UK). In the United Kingdom, the provision was introduced to deal with concerns that, notwithstanding the statutory provision, child directors were sometimes appointed in order to exploit their immunity from prosecution or the reluctance of enforcement authorities to pursue young persons.[90]

Corporate Directors

6.017 There is an outright prohibition on public companies appointing a body corporate as director.[91] Corporate directors also cannot be appointed for companies limited by guarantee.[92] For private companies, there is an absolute prohibition on corporate directors

[80] Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.33; predecessor CO Table A reg.109.
[81] Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.2 art.28; Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.30. Alternate directors would be within the s.2 definition of "director", and so notification of their appointment to the Registrar is required pursuant to CO s.645.
[82] *British Murac Syndicate Ltd v Alperton Rubber Co Ltd* [1915] 2 Ch 186.
[83] *Plantations Trust Ltd v Bila (Sumatra) Rubber Lands Ltd* (1915) 85 LJ Ch 801.
[84] *Ibid.*, [802] (Eve J).
[85] Pursuant to the directors' power of delegation as conferred under the articles: Model Articles (private companies) (Cap.622H, Sub.Leg.) Sch.2 art.5; Model Articles (public companies) (Cap.622H, Sub.Leg.) Sch.1 art.4; predecessor CO Table A reg.83.
[86] Robert R Pennington, *Company Law* (Oxford University Press, 8th ed 2001) 651.
[87] *Re Broadcasting Station 2GB Pty Ltd* [1964–1965] NSWR 1648.
[88] CO s.459(1).
[89] *Ibid.*, s.459(2).
[90] *Hansard*, HL GC Day 2, Vol 678 col 167 (1 February 2006).
[91] CO s.456(1)(a).
[92] *Ibid.*, s.456(1)(c).

CHAPTER 7

FIDUCIARY OBLIGATIONS OF DIRECTORS

Alice Leung

I. INTRODUCTION

Fiduciary: Acting in Interests of Other

The concepts of fiduciary, and the corresponding fiduciary obligations, were recognised as early as 1795 in *York Buildings Co v Mackenzie*[1] in which the House of Lords said: 7.001

> He that is entrusted with the interest of others, cannot be allowed to make the business an object of interest to himself because from the frailty of nature, one who has the power, will be too readily seized with the inclination to use the opportunity for serving his own interest at the expense of those for whom he is entrusted.[2]

Likewise in Hong Kong, Ma J (as he then was) said in *Kao Lee v Yip v Koo Hoi Yan*[3] that:

> ... the essence of a fiduciary relationship is one of trust and confidence (or, to use another common term, good faith) between the fiduciary and the person whom I shall hereinafter refer to as the beneficiary.

However, the "law has never provided a comprehensive definition of a fiduciary".[4] The term "fiduciary" does not denote a definitive class of relationships but is in fact used as a "veil behind which individual rules and principles have been developed".[5] Millet LJ observed that a:

> ... fiduciary is not subject to fiduciary obligations because he is a fiduciary it is because he is subject to them that he is a fiduciary.

Although there are recognised categories of fiduciary relationships,[6] generally "a person attracts fiduciary duties where he undertakes an obligation to act in the interests of others".[7] Courts are especially cautious about introducing fiduciary principles into commercial relations and the higher obligations that they entail. A director is a recognised category of fiduciary. The question is not whether they owe a fiduciary duty to the company but the scope of the duty in the circumstances. In *Poon Ka Man Jason v Cheng Wai Tao*[8] Spigelman NPJ observed at [87] that:

> The facts and circumstances of a particular case may be such as to modify the subject matter to which the fiduciary duties of a director apply. However, such modification must be binding in the corporate context. Such modification does not need to be formal — as in a provision in the constitutive documents or a shareholders' resolution — as long as it is, in substance, equivalent to a formal modification.

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[1] (1795) 8 Bro Parl Cas 42 (HL).
[2] *York Buildings Co v Mackenzie* (1795) 8 Bro Parl Cas 42, 63 (HL).
[3] [2003] 3 HKLRD 296.
[4] Sukhminder Panesar, "Fiduciary Relationships and Constructive Trusts in a Commercial Context" (2005) 16(12) ICCLR 479, 480.
[5] PD Finn, *Fiduciary Obligations* (Law Book Company, 1977) 1.
[6] For example, solicitor-client, trustee-beneficiary, principal-agent, director-company. See FN 5, 201, para.467.
[7] *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681.
[8] (2016) 19 HKCFAR 144. This case is discussed further below.

Fiduciary: Agent or Relationship of Ascendency

In *Libertarian Investments Ltd v Hall* (*Libertarian*),[9] the Court of Final Appeal re-examined the principles regarding fiduciary duties. It noted Brennan CJ's[10] suggestion that a fiduciary duty arises in two broad overlapping situations, namely agency and where there is a relationship of ascendency or influence by one party over another.

Not Every Duty Owed by Fiduciary Is Fiduciary Duty

The existence of a fiduciary relationship does not mean that every duty owed by a fiduciary to the beneficiary is a fiduciary duty.[11] The converse is also true.[12] Although the parties' relationship may be generally non-fiduciary, particular duties may import fiduciary duties and equitable remedies.

Distinction with Purely Commercial Relationship

As for the distinction with a purely commercial relationship in *Libertarian*,[13] Ribeiro PJ stated:

> In negligence and contract the parties are taken to be independent and equal actors, concerned primarily with their own self-interest. Consequently, the law seeks a balance between enforcing obligations by awarding compensation and preserving optimum freedom for those involved in the relationship in question, communal or otherwise. The essence of a fiduciary relationship, by contrast, is that one party pledges herself to act in the best interest of the other. The fiduciary relationship has trust, not self-interest, at its core, and when breach occurs, the balance favours the person wronged. The freedom of the fiduciary is diminished by the nature of the obligation he or she has undertaken — an obligation which "betokens loyalty, good faith and avoidance of a conflict of duty and self-interest": *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592 at 606, 40 DLR (3d) 371, 11 CPR (2d) 206. In short, equity is concerned, not only to compensate the plaintiff, but to enforce the trust which is at its heart.

Companies Ordinance (Cap.622)

Sections 465–466 and 473 of the Companies Ordinance (Cap.622) (CO) codified the directors' duty of care, skill and diligence in the exercise of their powers and performance of their functions.

The Companies Registry has published "A Guide on Directors' Duties" to explain the duties and recommend directors to read the guide.

Listed Companies

The Stock Exchange of Hong Kong Limited has also reinstated such directors duty for company whose shares are listed in the Stock Exchange of Hong Kong Limited in the Rules Governing the Listing of Securities of the Stock Exchange of Hong Kong Limited.[14]

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[9] (2013) 16 HKCFAR 681.
[10] *Breen v Williams* (1995–1996) 186 CLR 71.
[11] *Permanent Building Society v Wheeler* (1994) 14 ACSR 109.
[12] *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681.
[13] *Ibid.*
[14] Rule 3.08 of the Rules Governing the Listing of Securities on the Main Board of the Stock Exchange of Hong Kong Limited.

II. NON-EXECUTIVE, *DE FACTO* AND SHADOW DIRECTORS

Different Types of Directors

The definition of a "Director" in the CO now includes any person occupying the position of director (by whatever name called).[15] While the default position is that every director owes the company fiduciary duties, there are nuances when it comes to directors who are not executive directors. 7.002

Non-Executive Director

Non-executive directors are directors who do not take part in the day-to-day operations of the company. Such directors owe the same fiduciary duties towards a company as do executive directors.[16]

De facto Director

De facto directors were defined by Millett J as:

> ... a person who assumes to act as a director. He is held out as a director by the company, claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a *de facto* director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could probably be discharged only by a director. It is not sufficient to show that he was concerned in the management of a company's affairs or undertook tasks in relation to its business which can probably be performed by a manager below board level.[17]

Once the *de facto* director performs the functions of a director, they owe the same fiduciary duties as an executive director in relation those functions performed.[18]

There is not a single test as to whether someone is a *de facto* director:

> A number of tests have been suggested of which the following are the most relevant. First, whether the person was the sole person directing the affairs of the company (or acting with others equally lacking in a valid appointment), or if there were others who were true directors, whether he was acting on an equal footing with the others in directing its affairs: *Re Richborough Furniture Ltd.* Second, whether there was a holding out by the company of the individual as a director, and whether the individual used the title: *Secretary of State for Trade and Industry v Tjolle*. Third, taking all the circumstances into account, whether the individual was part of "the corporate governing structure": *Secretary of State for Trade and Industry v Tjolle*, at pp 343–344, approved in *Re Kaytech International plc* [1999]

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[15] CO s.2(1). This repeats the definition previously found in the predecessor CO.
[16] *Secretary of State for Trade and Industry v Goldberg* [2004] 1 BCLC 597; *Dorchester Finance v Stebbing* [1989] BCLC 498.
[17] *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180.
[18] *Re Canadian Land Reclaiming and Colonizing Co* (1880) LR 14 Ch D 660; *Ultraframe UK Ltd v Fielding* [2004] RPC 24.

> 2 BCLC 351, 423, where Robert Walker LJ also approved the way in which Jacob J in *Tjolle* had declined to formulate a single test. He also said that the concepts of shadow director and de facto director had in common "that an individual who was not a de jure director is alleged to have exercised real influence (otherwise than as a professional adviser) in the corporate governance of a company" (at p.424)

This was Deputy Judge Hunsworth's summary, in *Karlo Otto v Bulent Eren Bayram* (*Karlo Otto*),[19] of Lord Collins of Mapesbury's review of the tests in *HMRC v Holland*.[20] *Karlo Otto* was applied in *South China Media Ltd v Kwok Yee Ning*[21] when a defendant whose title was "advertising director", who was held out as such to clients and had the authority to enter into contracts. They were held to be a de facto director.

Shadow Director

A "shadow director" is defined in the CO as: "a person in accordance with whose directions or instructions (excluding advice given in a professional capacity) the directors or a majority of the directors of the company are accustomed to act".[22] Although shadow directors owe duties towards the company, they do not owe the same fiduciary duties to the same extent as executive, non-executive or *de facto* directors.

As explained by Lewison J in *Ultraframe (UK) Ltd v Fielding*:[23]

> In contrast to a *de jure* or *de facto* director, a shadow director does not undertake or agree to act in relation to the company in any such way. A shadow director directs or instructs those who themselves owe a fiduciary duty to the company and will not fall under the definition of shadow director until it is clear that the fiduciaries are accustomed to follow his directions or instructions. He does not thereby assume any obligation of loyalty to the company, and the company does not look to him to promote its interests. Instead, the company continues to look, at all times, to the *de facto* or *de jure* directors it has in place. It is against those persons that the company may have a complaint for breach of a fiduciary duty.

Lewison J further observed:[24]

> It seems to me, therefore, that I must be cautious before accepting that a shadow director "undoubtedly" owes fiduciary duties to the company of which he is a shadow director. The instructions that a shadow director gives (and which the *de jure* directors act upon) may be quite inimical to the company's interests .... I am not persuaded that the mere fact that a person falls within the statutory definition of "shadow director" is enough to impose upon him the same fiduciary duties to the relevant company as are owed by a *de jure* or *de facto* director. In truth, it seems to me that the use of labels such as "shadow director", which is a statutory

[19] [2017] 2 HKLRD 124.
[20] [2010] 1 WLR 2793.
[21] [2018] HKDC 194.
[22] CO s.2(1). This is the same as the definition formerly found in the predecessor CO save for the inclusion of "(excluding advice given in a professional capacity)".
[23] [2006] FSR 17, [1280].
[24] *Ultraframe (UK) Ltd v Fielding* [2006] FSR 17, [1284]–[1285].

> definition, may serve only to obscure the real question. The real question is not what is the proper label to attach? It is: in what circumstances will equity impose fiduciary obligations on a person with regard to property belonging to another?

In *Karlo Otto* Deputy Judge Hunsworth observed:[25]

> The essential element of being a shadow director, as the name suggests, is that of pulling the strings from behind the stage in such a way that the actual directors are essentially puppets who move only in accordance with the way the strings are pulled.

In that case the defendant was in a romantic relationship with the founder of the group. He became increasingly involved in the group's affairs, including being the sole administrator of a bank account of one of the group's companies, and this continued even after the relationship ended. Deputy Judge Hunsworth held that he was a de facto director but not a shadow director. Further by taking control of one of the group's bank accounts, the defendant entered into a fiduciary relationship. As for being a shadow director, the founder continued to run the company during their relationship and was not a puppet. In *Karlo Otto v Bulent Eren Bayram*,[26] which concerned a family company, the defendant who had previously advised the family and provided legal advice to the company, was appointed as a non-executive director of the company and a member of its audit committee. The claim that she was a shadow director was struck out. The members of the family were in control of the company, and the defendant was no more or less than professional "hired help" to provide respectability to the board.

III. TO WHOM DO DIRECTORS OWE A DUTY?

Company

The traditional view was that directors only owed duties to the company, not to the shareholders,[27] and such duties are not owed to associate companies[28] because the directors are agents of the company and not its shareholders. 7.003

Shareholders: Duty Owed in Special Circumstances

English jurisprudence has evolved since *Percival v Wright*[29] and now recognises that directors owe fiduciary obligations to shareholders in special circumstances. This was recognised in the New Zealand case of *Coleman v Myers*.[30] This case was applied in the English cases[31] of *Re Chez Nico (Restaurants)*[32] and *Platt v Platt*.[33]

[25] *Karlo Otto v Bulent Eren Bayram* [2017] 2 HKLRD 124.
[26] [2009] 3 HKLRD 265.
[27] *Percival v Wright* [1902] 2 Ch 421.
[28] *Gore-Browne on Companies* (Jordan, 45th ed 2004) Vol 1, 15–17.
[29] [1902] 2 Ch 421.
[30] [1977] 2 NZLR 225.
[31] See also Australian cases of: *Hooker Investments Pty Ltd v Baring Bros Halkerston & Partners Securities* (1986) 10 ACLR 462 and *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACLC 895.
[32] [1992] BCLC 192.
[33] [1999] 2 BCLC 745.

Subsequently in *Peskin v Anderson*,[34] it was held that "special circumstances" would include events "which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities, which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders".[35] Mummery LJ stated:

> There are, for example, instances of the directors of a company making direct approaches to, and dealing with, the shareholders in relation to a specific transaction and holding themselves out as agents for them in connection with the acquisition or disposal of shares or making material representations to them; or failing to make material disclosure to them of insider information in the context of negotiations for a take-over of the company's business or supplying to them specific information and advice on which they have relied. These events are capable of constituting special circumstances and of generating fiduciary obligations, especially in those cases in which the directors for their own benefit seek to use their position and special inside knowledge acquired by them to take improper or unfair advantage of the shareholders.[36]

The New Zealand cases of *Coleman v Myers*[37] and *Brunning v Glavanics*,[38] which directors were held to owe fiduciary duties towards shareholders, were referred to in the judgment of *Peskin* and were reconciled on the ground that these two cases established fiduciary duties where there were familial relations involved between the director and shareholders.[39] The position in *Peskin* is supported by *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd*[40] where Arden LJ opined that a fiduciary relationship will be found in cases where a person undertakes a duty of loyalty to another.

Hong Kong Cases

Hong Kong courts have similarly held that directors owe fiduciary duties to the shareholders, although the point has not been given substantive consideration. For instance, in *Jademan (Holdings) Ltd v Wong Chun Loong*,[41] Jones J concluded that by reason of misappropriation of company funds by the directors, the directors were in breach of their fiduciary duties to the creditors and shareholders of the company:

> Both the 1st and 2nd defendants in their capacities as directors owed a fiduciary duty to the creditors and shareholders of their companies. They had a duty to act responsibly and to use company funds for proper purposes.

[34] [2001] 1 BCLC 372. See also *Brunninghausen v Glavanics* (1999) 17 ACLC 1247.
[35] *Peskin v Anderson* [2001] 1 BCLC 372, 379.
[36] *Ibid.*
[37] [1977] 2 NZLR 225.
[38] (1999) 46 NSWLR 538.
[39] See *Gore-Browne on Companies* (Jordan, 45th ed 2004) Vol 1, 380.
[40] [2006] 1 BCLC 60.
[41] (HCCL 15/1990, [1992] HKLY 736).

In *Komal Patel v Chris Au*,[42] there was a good arguable case for the claim by the plaintiffs against the defendants in relation to the misappropriation and misapplication of funds of the business and the Defendant director and nominee shareholders breach of fiduciary duties as trustee. Furthermore, in *Re Peregrine Investments Holdings Ltd*,[43] Le Pichon J held that directors owed fiduciary duties to shareholders to act "*bona fide* in their best interests". However, where the fiduciary duties are owed to the company, shareholders cannot enforce the breach of such duties.[44]

Although the cases cited show that Hong Kong courts have recognised specific fiduciary obligations owed to the shareholders, it is unclear on what basis the Hong Kong courts have recognised such duties, that is, whether such duties are imposed because of the specific facts of the case in which the relationship between the director and shareholder gives rise to fiduciary obligations or whether such duties are imposed merely because the director is acting in his or her capacity as director.

Directors Do Not Generally Owe Duty to Creditors

Directors generally do not owe fiduciary duties to the creditors of a company by mere reason of their position.[45] However, where the company is insolvent, courts have imposed the obligation on directors to consider the interests of the company's creditors.[46] *Peoples Department Stores Inc (Trustee of) v Wise*[47] from the Canadian Supreme Court clarified that directors of Canadian companies do not owe a separate fiduciary duty to creditors when the company is insolvent.[48] The judges unanimously held that:

> [A]t all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.[49]

It was further held that:

> The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency". That phrase has not been defined moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is deterioration in the corporation's financial stability. In assessing the actions of directors it is evident that any honest and good faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors. If unsuccessful, it will not qualify as a breach of the statutory fiduciary duty.[50]

[42] [2014] HKEC 1156, [54].
[43] [1998] 2 HKLRD 670.
[44] *Lee Tak Samuel v Chou Wen Hsien* [1982] HKLR 350.
[45] Phillip Smart, Katherine Lynch and Anna Tam, *Hong Kong Company Law: Cases, Materials and Comments* (Butterworths, 1997) 233.
[46] Smart et al (see FN 44), 234. See also *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627.
[47] [2004] 3 SCR 461.
[48] Robert E Milnes, "Do Directors Owe a Fiduciary Duty to Creditors? A Resounding 'No' from the Supreme Court in Re People's Department Stores Ltd" (2005) 20 BFLR 3, 3.
[49] See *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 SCR 461, [43].
[50] *Ibid.*, [46].

People's is not inconsistent with leading English, Commonwealth and Irish cases[51] and merely reiterates the principle that directors do not owe duties towards creditors *per se* but owe the duty to the company to consider the interests of creditors during times of insolvency.[52] This was reiterated by Godfrey Lam J:[53]

> … the authorities[54] relied upon by the Liquidator for suggesting that a duty had arisen on the part of Wing Fai's directors to take account of creditors' interests suggest that such duty would arise only if the company was insolvent or in a "very dangerous financial position" or in similar condition.

On the facts that was not the case.

IV. FIDUCIARY OBLIGATIONS OF DIRECTORS

7.004 Finn states that:

> In formulating and in commenting on the fiduciary obligation the courts have spoken only in large and general terms. But what is clear is that they have in fact imposed a general obligation on fiduciaries — an obligation to act "in the interests of" or "for the benefit of" their beneficiaries — and that this obligation sets the ring to the fiduciary's freedom of action in his office.[55]

The duties imposed on directors emanate from the general principle that a director must act in the best interest of the company. A director has the following recognised duties:

(1) Duty to act with care, skill and diligence reasonably expected of a person of their knowledge and experience;

(2) Duty to act *bona fide* in the company's best interest;

(3) Duty not to make secret profits;

(4) Duty not to act in conflict; and

(5) Duty to act for a proper purpose.

[51] Andrew Keay, "Directors' Duties — Do Recent Canadian Developments Require a Rethink in the United Kingdom on the Issue of the Directors' Duties to Consider Creditor Interests" (2005) 18(5) *Insolvency International* 65.

[52] See also *Walker v Wimborne* (1976) 137 CLR 1; see also *Spies v R* (2000) 18 ACLC 727 (where the High Court of Australia stated that directors do not owe an independent duty to creditors by reason of being directors); *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215.

[53] *Liquidator of Wing Fai Construction Co Ltd v Yip Kwong Robert* (HCCW 735/2002, [2017] HKEC 2528).

[54] *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218; *Re MDA Investment Management Ltd* [2004] 1 BCLC 217.

[55] PD Finn, *Fiduciary Obligations* (Law Book Company, 1977) 15.

V. DUTY OF CARE, SKILL AND DILIGENCE

Companies Ordinance (Cap.622) ss.465 and 466

Section 465 of the CO introduced a new statutory duty of care. The statutory duty of care replaces the common law rules and equitable principles regarding a director's duty of care. Section 465 provides: 7.005

465. Duty to Exercise Reasonable Care, Skill and Diligence

1) A director of a company must exercise reasonable care, skill and diligence.

2) Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with —

   a) The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and

   b) The general knowledge, skill and experience that the director has.

3) The duty specified in s.465(1) is owed by a director of a company to the company.

4) The duty specified in s.465(1) has effect in place of the common law rules and equitable principles as regards the duty to exercise reasonable care, skill and diligence, owed by a director of a company to the company.

5) This section applies to a shadow director as it applies to a director.

6) For the purposes of s.465(5), a body corporate is not to be regarded as a shadow director for any of its subsidiaries by reason only that the directors, or a majority of the directors, of the subsidiary are accustomed to act in accordance with its director or instructions.

Furthermore, s.466 of the CO provides:

466. Civil Consequences of Breach of Duty to Exercise Reasonable Care, Skill and Diligence. Without affecting other provisions of this Ordinance or the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32), the consequences of breach (or threatened breach) of the duty specified in s.465(1) are the same as would apply if the common law rules or equitable principles that s.465(1) replaces applied.

Common Law and Equity Still Relevant

Lo and Qu emphasise that the previous case law is relevant to the statutory duty:[56]

[56] Lo and Qu, *Law of Companies in Hong Kong* (Sweet & Maxwell, 3rd ed 2018) para.8.146.

> The standard of care as set out in the English provision (and which is the same under Hong Kong's CO s.465) has been accepted as codifying the existing common law in England. Accordingly, since the statutory duty is derived from the general law, the existing cases which apply the type of dual objective or subjective standard set out in s.465 would be relevant to interpretation … (and … the scope of s.465)

Dual Objective and Subjective Standard

The relevance of case law can be seen from the discussion below in Lo and Qu add at para.8-144:

> [CO] s.465(2)(a) sets out the "minimum objective standards expected of all directors" and that this standard might be raised, based on the director's knowledge, skill, and experience, by s.465(2)(b).

Traditionally Low Threshold

The duty of care, skill and diligence does not arise merely by virtue of equitable principles governing fiduciary obligations but also arises under the laws of contract and tort.[57] Traditionally, the standard of care, skill and diligence was low due to the reluctance of the judiciary to interfere with the internal management of a corporation.[58] Romer J in *Re City Equitable Fire Insurance Co Ltd*,[59] laid down three propositions:

(1) "A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience … It is perhaps only another way of stating the same proposition to say that directors are not liable for mere errors of judgment".[60]

(2) "A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed …".[61]

(3) "In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly … Business cannot be carried on upon principles of distrust. Men in responsible positions must be trusted by those above them, as well as by those below them, until there is reason to distrust them".[62]

Although there has been discussion at to whether the statements set out by Romer J set the standard of care too low, such statements have been applied in *Law Wai Duen v Boldwin Construction Co Ltd*.[63] In *Dorchester Finance Co Ltd v Stebbing*,[64] Foster

[57] Bruce S Butcher, *Director's Duties: A New Millennium, A New Approach?* (Kluwer Law International, 2000) 31.
[58] *Ibid*., 37.
[59] (1925) Ch 407.
[60] *Ibid*., 428–429.
[61] *Ibid*., 429.
[62] *Ibid*., 429. See also *Elite Dragon Ltd v Bel Global Resources Holdings Ltd* (HCCL 8/2014, [2017] HKEC 82[illegible] which it was held there were grounds for suspicion.
[63] [2001] 3 HKLRD 430.
[64] [1989] BCLC 498.

J paraphrased the propositions set out by Romer J and agreed that the propositions as paraphrased below accurately summarise the law:

> (a) A director is required to exhibit in performance of his duties such a degree of skill as may reasonably be expected from a person with his knowledge and experience. (b) A director is required to take in the performance of his duties such care as an ordinary man might be expected to take on his own behalf. (c) A director must exercise any power vested in him as such honesty, in good faith and in the interests of the company.[65]

Modern Objective and Subjective Test

In *Norman v Theodore Goddard (a firm) and Others (Quirk, third party)*[66] Hoffmann J found that the common law duty of care and skill as owed by a director was accurately stated in s.214(4) of the Insolvency Act 1986 which stipulates:

> … the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the general knowledge, skill and experience that that director has.[67]

Other cases since have adopted the same position.[68] The test set out in *Norman* clarifies the test set out in *City Equitable Fire Insurance* by expressly distinguishing the objective and subjective elements. Although the principles stated in *City Equitable Fire Insurance* are classic statements of the law, such principles are no longer sufficient in the present day circumstances where corporate governance is paramount in ensuring the balance of interests of all parties. The decision of *Norman* sets a new path for English jurisprudence to enable more guidance from courts as to what is expected of directors during the discharging of duties.

Business Judgment Rule

Despite the expansion and clarification by English jurisprudence of the elements comprising of the duty of care, skill and diligence, it is Australian jurisprudence that has taken the innovative step of formulating a statutory "business judgment rule" following a series of corporate governance failures in the 1990s. This is now to be found in s.180(2) of the Australian Corporations Act 2001 (Cth) and provides a "safe harbour"

[65] *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498, 501.
[66] [1991] BCLC 1028.
[67] *Ibid*., 1030–1031.
[68] See *Re D'Jan of London Ltd* [1993] BCC 646; *Re Simmon Box (Diamonds) Ltd* [2000] BCC 275; *Re Westlowe Storage and Distribution Ltd* [2000] 2 BCLC 590; *Bairstow v Queen's Moat Houses plc Marcus v Queen's Moat Houses plc* [2000] 1 BCLC 549.

to directors who have acted in good faith, informed themselves about the subject matter of the judgment to the extent that they believed was reasonable, and rationally believed that the judgment was in the best interests of the corporation. These provisions were introduced following the widening of the duties of directors by a number of decisions of the Australian courts.

Prior to the Corporation Act 2001, *Daniels v Anderson*[69] (commonly known as the "AWA Case"), the New South Wales Court of Appeal expounded what later became known as the "business judgment rule".[70] *AWA* is seen as an important precedent in that the court clarified that a director's fiduciary obligations do not preclude the common law duty of care, as:

> A person who accepts the office of director of a particular company undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform … The duty is a common law duty to take reasonable care owed severally by persons who are fiduciary agents bound not to exercise the powers conferred upon them for private purpose or for any purpose foreign to the power and placed … at the apex of the structure of direction and management. The duty includes that of acting collectively to manage the company. Breach of the duty will found an action for negligence at the suit of the company.[71]

The director's duty to exercise due care, skill and diligence has been accepted and adopted in English courts in *Re Barings plc (No 5) Secretary of State for Trade and Industry v Baker (No 5)*[72] and has now been given statutory force in Hong Kong.

Jonathan Parker J stated three general propositions[73] regarding the directors' duty of care, skill and diligence:

(1) "Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors".

(2) "Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions".

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[69] (1995) 16 ACSR 607.
[70] *Ibid.*, 664–665.
[71] *Ibid.*, 668.
[72] [1999] 1 BCLC 433, 488.
[73] *Ibid.*, 489. The three propositions were derived after surveying the following authorities: *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425; *Re City Equitable Fire Insurance* [1925] Ch 407; *Re Norman Holding Co Ltd* [1991] BCLC 1; *Re D'Jan of London Ltd, Copp v D'Jan* [1994] 1 BCLC 561; *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1993] BCLC 1282; *Martin v Webb*, 110 US 7 (1884); *Briggs v Spaulding*, 141 US 132, *Rankin v Cooper*, 149 F 1010; *Atherton v Anderson*, 99 F 2d 883; *Federal Deposit Insurance Corp v Bierman*, 2 F 3d 1424 (1993).

(3) "No rule of universal application can be formulated as to the duty referred to in (2) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company".

VI. DUTY TO ACT *BONA FIDE* IN THE COMPANY'S BEST INTEREST

Good Faith

Equity has long recognised the need for parties to deal with each other in good faith especially when the relationship between the parties is not "at arm's length".[74] Directors by virtue of being agents of the company wield a wide range of powers and are entrusted to make important decisions that affect the survival of a company. 7.006

The duty to act "*bona fide* for the benefit of the company as a whole" originates from Lindley MR in *Allen v Gold Reefs of West Africa Ltd*[75] whilst he was commenting on how powers conferred by a company's articles should be exercised. In *Re Smith and Fawcett Ltd*,[76] Lord Greene MR held that directors were to exercise the power in accordance with what they considered to be the best interests of the company.[77] The burden of proof is on those who claim the director breached the duty to act *bona fides*.[78]

Examples

Under the general duty to act *bona fide*, Finn recognises eight duties of good faith[79] including the duty:

(1) not to exert undue influence;

(2) not to misuse property held in a fiduciary capacity;

(3) not to misuse information derived in confidence;

(4) not to purchase property dealt with in a position of confidential character;

(5) not to act in conflict of duty and interest;

(6) not to inflict actual harm on an "employer's" business; and

(7) not to act in conflict of duties.

To this can be added the examples, and authorities, given in Lo and Qu "The Law of Hong Kong Companies" (Sweet & Maxwell, 2018) in that chapter 8 at paras.8.026 and 8.027:

(1) acting contrary to the constitution;

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[74] See *Keech v Sanford* (1726) 2 Eq Cas Abr 741.
[75] [1900] 1 Ch 656, 671.
[76] [1942] Ch 304.
[77] *Ibid.*, 306.
[78] *Charles Forte Investments Ltd v Amanda* [1963] 3 WLR 662.
[79] PD Finn, *Fiduciary Obligations* (Law Book Company, 1977) 79–81.

(2) unsecured personal loans to directors;

(3) selling properties at gross undervalue to persons associated with director; and

(4) dismissing staff so as to paralyse company operations.

"Bona fide"

The phrase "*bona fide*" and its limits 'were considered in 1883 in *Hutton v West Cork Railway Co*[80] where Bowen LJ opined:

> *Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bona fide* yet perfectly irrational. The test must be what is reasonably incidental to, and within the reasonable scope of carrying on, the business of the company.[81]

When considering the exercise of a director's spending powers, Evershed MR said:

> The test there again is not whether it is *bona fide*, but whether, as well as being done *bona fide*, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit.[82]

In considering the meaning of the phrase "*bona fide* for the benefit of the company as a whole", Evershed MR observed:

> Certain things, I think, can be safely stated as emerging from those authorities. In the first place, it is now plain that "*bona fide* for the benefit of the company as a whole" means not two things but one thing. It means that the director must proceed on what, in his honest opinion, is for the benefit of the company as a whole.[83]

The Company

The phrase "the company" has been defined by various cases to include the members as a whole.[84] In *Greenhalgh v Arderne Cinemas Ltd*[85] Evershed MR held:

> … the phrase "the company as a whole" does not (at any rate in such a case as the present) mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body. That is to say, you may take an individual hypothetical member and ask whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.

[80] (1883) 23 Ch D 654.
[81] *Ibid.*
[82] *Ibid.*, 672.
[83] *Greenhalgh v Arderne Cinemas, Ltd* [1951] Ch 286.
[84] See also *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260, 281.
[85] [1951] Ch 286.

In considering the best interests of the association, being a company limited by guarantee, Megarry J stated in *Gaiman v National Association for Mental Health*[86] that:

> The association is, of course, an artificial legal entity, and it is not very easy to determine what is in the best interests of the association. The interests of some particular section or sections of the association cannot be equated with those of the association, and I would accept the interests of both present and future members of the association, as a whole, as being a helpful expression of a human equivalent.[87]

In *Darvall v North Sydney Brick & Tile Co Ltd*,[88] Mahoney JA stated that *prima facie*, if a director of a company exercises his powers in *bona fide* belief that the decision was in the best interests of the company, the validity of the decision is not affected by the director's ignorance of relevant facts or by inducement by a misrepresentation of an officer or member of the company.

If a director does not exercise a power in *bona fides*, the act may be declared null and void and the director will be liable for all consequential and foreseeable losses.

VII. DUTY TO ACT FOR A PROPER PURPOSE

Applicable Principles

The applicable principles that consider whether a director has acted for an improper purpose (as in the recent *Wongs Investment Development Holdings Group Ltd v China Kingstone Mining*[89]) were summarised by Ipp J in *Permanent Building Society v Wheeler*:[90] 7.007

> (a) Fiduciary powers and duties of directors may be exercised only for the purposes for which they were conferred and not for any collateral, or improper purpose. (b) It must be shown that the substantial purpose of the directors was improper or collateral to their duties as director of the company … (c) Honest or altruistic behaviour by directors will not prevent a finding of improper conduct on their part if that conduct was carried out for an improper or collateral purpose … (d) The court must determine whether but for the improper or collateral purpose the directors would have performed the act impugned.[91]

Proper Purpose

The duty to act for a proper purpose is set out in the prominent cases of *Hogg v Cramphorn Ltd* (*Hogg*)[92] and *Howard Smith Ltd v Ampol Petroleum Ltd* (*Howard Smith*).[93] Lord Wilberforce stated in *Howard Smith*:

[86] [1971] Ch 317.
[87] *Gaiman v National Association for Mental Health* [1970] 3 WLR 42.
[88] (1989) 16 NSWLR 260, 322. See also *Mills v Mills* (1938) 60 CLR 150.
[89] [2015] HKEC 1349, [13].
[90] (1994) 14 ACSR 109.
[91] *Ibid.*, 137.
[92] [1967] Ch 254.
[93] [1974] AC 821.

> In their Lordships' opinion it is necessary to start with a consideration of the power whose exercise is in question, in this case a power to issue shares. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not. In doing so it will necessarily give credit to the *bona fide* opinion of the directors, if such is found to exist, and will respect their judgment as to matters of management having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls.[94]

If Purpose of Share Allotment Is to Destroy Existing Majority Then Unlawful

Hogg and *Howard Smith* were applied in *Wong Kam San v Yeung Wing Keung*[95] and an allotment of shares was declared void. If the substantial purpose of the allotment is to destroy an existing majority or to create a new majority, which did not previously exist even if it was not for the self-interest of the directors, that is unconstitutional and unlawful.

Director Acting with Dual Purpose

Where an act was carried with dual purposes, the act will be invalid if the primary purpose of the act breaches the duty to act for proper purposes. Lord Wilberforce went on to state in *Howard Smith*:

> … it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers. If there is added, moreover, to this immediate purpose, an ulterior purpose to enable an offer for shares to proceed which the existing majority was in a position to block, the departure from the legitimate use of the fiduciary power becomes not less, but all the greater. The right to dispose of shares at a given price is essentially an individual right to be exercised on individual decision and on which a majority, in the absence of oppression or similar impropriety, is entitled to prevail. Directors are of course entitled to offer advice, and bound to supply information, relevant to the making of such a decision, but to use their fiduciary power solely for the purpose of shifting the power to decide to whom and at what price shares are to be sold cannot be related to any purpose for which the power over the share capital was conferred on them. That this is the position in law was in effect recognised by the majority directors themselves when they attempted to justify the issue as made primarily in order to obtain much needed capital for the company. And once this primary purpose was rejected as it was by Street J, there is nothing legitimate left as a basis for their action, except honest behaviour. That is not, in itself, enough.[96]

[94] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 835G–835H.
[95] [2007] 2 HKLRD 267.
[96] *Ibid.*, 837F–838B.

Expulsion of Director

In *Lee Tak Samuel v Chou Wen Hsien*,[97] the Privy Council held that although the expulsion power should not be exercised for an ulterior purpose, the construction of the Articles of Association rendered the expulsion of a director valid in spite of ulterior motives so long as the stated events for a valid expulsion had been satisfied:

> To hold that bad faith on the part of any one director vitiates the notice to resign and leaves in office the director whose resignation is sought, would introduce into the management of the company a source of uncertainty which their Lordships consider is unlikely to have been intended by the signatories to the articles and by others becoming shareholders in the company. In order to give business sense to the article, it is necessary to construe the article strictly in accordance with its terms without any qualification, and to treat the office of director as vacated if the specified event occurs. If this were not the case, and the expelled director challenged the *bona fides* of all or any of his co-directors, the management of the company's business might be at a standstill pending the resolution of the dispute by one means or another, in consequence of the doubt whether the expelled director ought or ought not properly to be treated as a member of the board.[98]

Hence when considering the duty to act for a proper purpose, one should have due regard to the Articles of Association not only to ascertain the nature of the power but also whether the power entails a consideration of proper purposes.

Company No Longer Required to State Objects

The old doctrine of *ultra vires* is now largely obsolete. Under the old doctrine where a company acted or transacted in a matter outside its stated objects,[99] such transactions were void as *ultra vires* and could not be ratified at the company's general meeting.[100]

The general positions set out in the CO are:

(1) s.82 provides a company is no longer required to state its objects;

(2) s.115 provides that a company has the capacity and the rights, powers and privileges of a natural person;

(3) s.116 provides that if objects are stated, the company must not do any act that it is not authorised to do so by the articles (s.116(1)) a member may bring proceedings to restrain the company from doing any act in contravention of s.116(1)–116(3); and an act is not invalid because the company because it contravenes s.116(1)–116(5);

(4) under s.117 where a person deals with a company in good faith "the power of the company's directors to bind the company, or authorise others to do

[97] [1985] BCLC 45.
[98] *Lee Tak Samuel v Chou Wen Hsien* [1985] BCLC 45, 50.
[99] *Ashbury Railway Carriage and Iron Co Ltd v Richie* (1875) LR 7 HL 653.
[100] The English Companies Act 1989 was designed to abolish the doctrine of *ultra vires* in the United Kingdom. Hong Kong took similar steps by the Companies (Amendment) Ordinance 1997 where s.5A–5C were added to the predecessor CO. Sections 82, 115 and 116 of the current CO were derived from predecessor CO s.5A–5C.

so, is to be regarded as free of any limitation under any relevant document of the company"; and

(5) finally, while the memorandum of association has been abolished under the CO, the matters it traditionally covered are to be included in the articles of association, and under s.98 conditions of memorandum of association of an existing company are to be regarded as provisions of the articles.

VIII. DUTY NOT TO ACT IN CONFLICT

Strict Duty Not to Act in Conflict

7.008 A fiduciary's personal interest must not conflict with fiduciary duties imposed. This principle is often referred to as the "No Conflict Rule". In *Aberdeen Rail Co v Blaikie Brothers*,[101] the House of Lords reiterated the duty not to act in conflict:

> … it is a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. It obviously is, or may be, impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the *cestui qua trust* which it was impossible to obtain.

It was also stated in *Bray v Ford*[102] by Lord Herschell:

> It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule.[103]

Quoting *Boulting v ACTAT*,[104] Finn clarified that the conflict must be real and that the no conflict rule must be applied realistically.[105] This was recently re-emphasised by Spigleman NPJ in *Poon Ka Man Jason v Cheng Wai Tao*.[106]

It is not uncommon in Hong Kong for a person to be a director of more than one company. In *London and Mashonaland Exploration Co v New Mashonaland Exploration Co*[107] it was held by Chitty J that there was nothing in the articles which prohibited the director from acting as a director of another company. Interestingly, there was fierce

[101] [1843–1860] All ER 249.
[102] [1896] AC 44.
[103] *Ibid.*, 51–52.
[104] [1963] 2 QB 606.
[105] PD Finn, *Fiduciary Obligations* (Law Book Company, 1977) 204.
[106] (2016) 19 HKCFAR 144.
[107] [1891] WN 165.

criticism of this case,[108] and there was doubt as to whether this case and the cases[109] that relied on *London* were correct. It seems the general position is that a person who is a director of two competing companies falls foul of the no-conflict rule in the absence of informed consent.[110]

In *Poon Ka Man Jason v Cheng Wai Tao*,[111] the key question was whether the no-conflict rule applies when the business model that had been agreed on in a chain business, specifically a restaurant chain, consisted of one company for each agreed operation and even if there was a conflict, whether the business partners had assented to one founder going off to establish new businesses under different companies, as sole director and shareholder, which were in competition with the first company, Smart Wave. By a 3:2 majority, the court decided there was a conflict. Spigelman NPJ emphasised that the scope of fiduciary duties was moulded by circumstance, and here the agreement that the company would be the first in a chain was interconnected with the agreement that the parties would be substantial shareholders in each vehicle, and Ribeiro PJ held "Smart Wave, as the first restaurant in what was to become a chain of restaurants, had an interest in the establishment and operation of the chain as it developed".[112] The duty not to act in conflict is partially codified in this current CO.

Director Must Declare Material Interest

Section 536 of the CO[113] provides that:

> (1) If a director of a company is in any way, directly or indirectly, interested in a transaction, arrangement or contract, or a proposed transaction, arrangement or contract, with the company that is significant in relation to the company's business, and the director's interest is material, the director must declare the nature and extent of the director's interest to the other directors.

Article 15 of Sch.1 of the Model Articles for Public Companies (Cap.622H, Sub.Leg.) and art.16 of Sch. 2 of the Model Articles for Private Companies (Cap.622H, Sub.Leg.), if adopted, deal with conflict of interest. They provide the director must neither vote or be counted for quorum purposes in respect of the transaction, arrangement or contract.

Loans to Directors

Under s.500 of the CO, unless there is "prescribed approval", a company must not make a loan to a director or a body corporate controlled by a director. The predecessor

[108] Michael Christie, "The Director's Fiduciary Duty not to Compete" (1992) 55 *Mod L Rev* 506, 506.
[109] See *Bell v Lever Bros Ltd* [1932] AC 161.
[110] Lo and Qu, *Law of Companies in Hong Kong* (Sweet & Maxwell, 3rd ed 2018) Chapter 8.
[111] (2016) 19 HKCFAR 144.
[112] Per Spigelman NPJ at [114]–[125] and Ribeiro and Fok PJJ (agreeing) at [91]. In dissenting, and holding there was no breach of fiduciary duties, Tang PJ (Bokhary NPJ agreeing) emphasised the limited nature of the company under the agreement as it was only entitled to run one restaurant. Tang PJ added that the remedy may lie in breach of agreement.
[113] Section 536 of the current CO is derived from predecessor CO s.162. Section 536 is broader than former s.162. For instance: (1) s.536 applies to "transaction, arrangement or contract" as opposed to simply "contract; (2) the disclosure obligations extend to the director's connected entities; and (3) there must be disclosure of "nature and extent", not just "nature". See Lo and Qu, *Law of Companies in Hong Kong* (Sweet & Maxwell, 3rd ed 2018) Chapter 8, paras.8.091–8.092.

provision[114] to this s.500 did not provide for a prescribed approval. Sections 500–504 of this CO deal with these prohibitions:

(1) s.501 concerns quasi-loans

(2) s.502 regarding entities connected to director; and

(3) s.503 prohibits a company from entering into a transaction as creditor for the director.

What constitutes "prescribed approval" can be found at s.496 of the CO. Sections 505–511 of the CO contain the exceptions.

IX. DUTY NOT TO MAKE SECRET PROFITS

Stems from Non-Conflict Rule

7.009 This duty stems from the duty not to act in conflict but deserves to be mentioned separately by reason of the extensive case law considering this specific duty. The principle is often referred to as the "No Profit Rule". It is strictly applied.

The leading case on the duty of the director not to make a secret profit is *Regal (Hastings) Ltd v Gulliver*.[115] Unless the director made the profit with full consent and knowledge of the principal, the director is liable to account for any secret profit made in conflict with the principal's interest.[116] As observed by Lord Russell of Killowen:

> The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of *bona fides* or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.[117]

Lord Wright opined:

> … both in law and equity, it has been held that, if a person in a fiduciary relationship makes a secret profit out of the relationship, the court will not inquire whether the other person is damnified or has lost a profit which otherwise he would have got. The fact is in itself a fundamental breach of the fiduciary relationship. Nor can the court adequately investigate the matter in most cases. The facts are generally difficult to ascertain or are solely in the knowledge of the person who is being charged.[118]

[114] Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32) s.157H.
[115] [1967] 2 AC 134. This passage was cited in *Tripole Trading Ltd v Prosperfield Ventures Ltd* (2006) 9 HKCFAR 1.
[116] *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399.
[117] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144–145.
[118] *Ibid.*, 154–155.

Corporate Opportunity Doctrine

A further subdivision the "no secret profits" rule is the development of the corporate opportunity doctrine. In *Canadian Aero Service Ltd v O'Malley*,[119] the Canadian Supreme Court found:

> An examination of the case law … shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired … The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private, the factor of time in the continuation of fiduciary duty where the alleged breach occurs after termination of the relationship with the company, and the circumstances under which the relationship was terminated, that is whether by retirement or resignation or discharge.

Contract Cannot Be Ratified

A contract entered into in contravention of the corporate opportunity doctrine cannot be ratified by shareholders in a general meeting.[120]

Fiduciary's Exploitation Must Be Such as to Attract Rule

In *Bhullar v Bhullar*,[121] the English Court of Appeal surveyed leading authorities on the duty not to make secret profits and the corporate opportunities doctrine. Jonathan Parker LJ stated:

> I agree with Mr Berragan that the concept of a conflict between fiduciary duty and personal interest presupposes an existing fiduciary duty. But it does not follow that it is a prerequisite of the accountability of a fiduciary that there should have been some improper dealing with property "belonging" to the party to whom the fiduciary duty is owed, that is to say with trust property … In a case such as the present, where a fiduciary has exploited a commercial opportunity for his own benefit, the relevant question, in my judgment, is not whether the party to whom the duty is owed (the company, in the instant case) had some kind of beneficial

[119] (1973) 40 DLR (3d) 371.
[120] *Cook v Deeks* [1916] 1 AC 554.
[121] [2003] 2 BCLC 241.