

CHAPTER 28

Company Law

INTRODUCTION

There are various vehicles for conducting business. The three basic modes are the 'sole proprietorship', the 'partnership' and the 'company'. The simplest of these is the 'sole proprietorship'. This is where one person trades for himself. He is then responsible for all capital, labour and other essentials for running the business. He has to have his own capital, premises (either owned or leased) and do the day-to-day running of the business himself or employ people to do it. If he does not have capital or sufficient capital, he has to borrow from friends or lending institutions. As an individual he may have difficulty in raising the necessary funds, as banks and other lenders usually require collateral to secure the lending. If he is able to borrow, he is solely responsible for the repayment, together with the interest. He is also solely responsible for all liabilities incurred in the course of trade. It would be obvious then, that this mode of doing business is more suitable for a relatively small trade. If the business grows and more capital and labour are required, the sole trader often considers taking on other persons who can contribute in these areas. They can then pool their resources and expand the business. The sole trader and the other persons then become 'partners' and the business is carried on as a 'partnership' (see next chapter). Partners are jointly liable for all the debts of the partnership and the concept of limited liability is not available to them, unless it is a limited partnership, in which case all partners except one, may limit their liability. However, because of the formalities attending a limited partnership and the availability of the company structure, limited partnerships are not common.

The company mode of doing business has many attractions. One of the primary features of a company is that liability of its members may be limited. Another is that it has a legal personality of its own, separate from its members and capital may be raised more readily. The company mode also has many formalities and is usually more expensive. Consequently, it is more suitable for larger businesses. Partnerships which are growing are usually converted to the company structure to take advantage of the corporate personality, limited liability and other features not available to partners.

The substance of company law in Hong Kong is to be found in the *Companies Ordinance* (Cap 32), as amended from time to time. There is also a body of subsidiary legislation supporting the Ordinance, such as for instance, the *Companies (Winding-up) Rules*, amongst others. However,

the Ordinance is not in the nature of a comprehensive code on the subject and therefore principles of common law and equity are still relevant. Having been a colony of the United Kingdom till July 1997, it is **not** surprising that company law in Hong Kong owes its origins to the early English companies legislation. The current framework is basically modeled on the *English Companies Act of 1948*. Despite the resumption of sovereignty over Hong Kong by China, the application of English common law and rules of equity is preserved under article 8 of the Basic Law. Apart from companies legislation, Hong Kong also has a comprehensive set of laws governing dealings in securities, such as the *Securities and Futures Ordinance* (Cap 571), 2002, which in fact consolidates some ten previous ordinances, including the *Securities Ordinance* (Cap 333).

The *Companies Ordinance* provides a mechanism whereby one or more persons may incorporate a company under the Ordinance by complying with certain registration formalities. Once registered, the company becomes an artificial legal person from the date of incorporation and acquires a legal personality separate from its shareholders. A company has the capacity and the rights, powers and privileges of a natural person: section 5A (1).

In the case of a limited company, it also acquires the limited liability status, meaning that though the company is fully liable for its debts, the shareholders' liability is limited to the extent, if any, unpaid on their shares. On the other hand, a partnership is an extension of the sole trader. The *Partnership Ordinance* governs the 'relation which subsists between persons carrying on a business in common with a view of profit'. The relationship is essentially contractual in nature and contract and agency principles apply. As noted above, an essential difference between companies and partnerships is that partners in a partnership do not have limited liability and hence are fully liable for partnership debts. In a limited partnership, though, all partners may have limited liability except for one.

This chapter deals with the law relating to companies registered under the *Companies Ordinance* (Cap 32).

TYPES OF COMPANIES

Registered Companies

A company is a type of corporation registered under the *Companies Ordinance*. Since the amendment of the *Companies Ordinance* in 2003 (Ordinance No 28 of 2003) (effective 13 February 2004), a company (whether with or without limited liability), may be incorporated by one or more persons for a lawful purpose: section 4(1). Prior to the amendment, the Ordinance required at least two persons.

There are three types of company which may be registered under the Ordinance: section 4(2). These are:

- (a) a company limited by shares – a company whose members' liability is limited to the amount, if any, unpaid on their shares;
- (b) a company limited by guarantee – a company whose members' liability is limited to such an amount as they have undertaken to contribute to the assets of the company in the event of winding up; guarantee companies with a share capital are no longer possible: section 4(4); and
- (c) unlimited company – a company whose members' liability is not limited.

Limited companies may be divided into private and public companies. Under section 29(1) of the Ordinance, a private company is one which by its articles,

- (a) restricts the right to transfer its shares;
- (b) limits its members to 50, not including company employees and former employees who have continued to be members;
- (c) prohibits any invitation to the public to subscribe for its shares or debentures.

All other companies are public companies. If a private company amends its articles whereby any of the provisions (a)–(c) is removed, it will cease to be a private company and a prospectus or a statement in lieu of prospectus must be filed with the Registrar of Companies within the stipulated period.

Listed Companies

Companies registered under the Ordinance may issue publicly listed securities. Apart from the Ordinance, listed companies must also comply with the Listing Rules of the Stock Exchange of Hong Kong and the provisions of the *Securities and Futures Ordinance*.

INCORPORATION REQUIREMENTS

The Registrar of Companies

The officer responsible for the administration of the *Companies Ordinance* is the Registrar of Companies, appointed by the Chief Executive. The Registrar supervises the Companies Registry. Though the Ordinance does not specifically state the powers and duties of the Registrar, there are references throughout the Ordinance to these. All incorporation and other documents required by the Ordinance must be lodged with the Companies Registry. The Registrar maintains several registers and indexes such as the Index of Company Names, the Index of Directors (for Listed companies) and the Register of non-Hong Kong Companies. In addition, the Registrar is obliged to maintain individual files for every company registered, with full particulars and documents, such as the memorandum and articles, annual returns, charges, directors

and secretaries, debenture-holders, members, substantial shareholders and the like. The idea is that all these documents, being public documents, are available to the public for inspection, on payment of the requisite fee. The memorandum of the company would also contain its registered office address. This is to enable the service of legal documents, notices and other communications by persons interested.

Constitutional Documents

Under section 4(1) of the Ordinance, one or more persons may register a company. The former limitation in section 345(1) prohibited the formation of a company, association or a partnership of more than 20 persons (with certain exceptions) which had as its object the acquisition of gain, without registration as a company under the Ordinance or under any special legislation. This limitation is no longer in force: Ordinance No 30 of 2004.

The constitutional documents of a company are its memorandum and articles of association. By virtue of sections 9 and 15 of the Ordinance every company must lodge a memorandum, but not all companies need lodge articles. In the case of a company limited by shares, if no articles are lodged, section 11(2) provides that the company must adopt the regulations in Table A – the ‘model articles’. However, where articles are lodged, Table A regulations would still apply to the extent not excluded or modified by the lodged articles.

In the case of unlimited companies and companies limited by guarantee, articles must be registered, as Tables C, D and E articles are not deemed to be default articles of such companies.

The memorandum of association has provisions which mainly concern the relationship between the company and outsiders. It must contain clauses setting out the name of the company, the objects of the company (now optional: section 5(1A)(b), except where a company proposes to apply for a licence under section 21 to dispense with the word ‘limited’ at the end of its name: section 5(1A)(a); the share capital clause, the liability clause and the subscriber clause, stating the number of shares each subscriber has agreed to take. The memorandum lodged must be as near as possible to the model memoranda in the First Schedule, though companies may adapt them to their specific requirements.

The articles of association contain provisions concerned with the internal regulation of the company, such as, amongst others, the division of powers, shares, directors, meetings, dividends and obligations of members generally.

Name of Company

The company name is chosen by the persons intending to form the company – the promoters. The name can either be in the English or Chinese language or both. These appear on the Certificate of Incorporation. A company limited by shares or guarantee must have a

word 'Limited' or its abbreviation, 'Ltd' at the end of the name. It is an offence to carry on business using 'Limited', 'Corporation' or 'Incorporated' at the end of a company name without the company being duly registered with limited liability.

The Registrar maintains an index of company names. No company can be registered by a name which is the same as that in the index or by the same name as a body corporate established under an Ordinance. The Chief Executive's consent is required before using any name which, in his opinion, may give the impression that the company is connected with the government. Likewise, consent must be obtained if the name includes words such as the following: 'Building Society', 'Chamber of Commerce', 'Cooperative', 'Kaifong', 'Mass Transit', 'Municipal', 'Savings', 'Tourist Association', 'Trust', 'Trustee' and 'Underground Railway'.

Upon registration the Registrar certifies that the company is incorporated and, in the case of a limited liability company, that it is limited.

INCORPORATION AND CONCEPT OF SEPARATE LEGAL PERSONALITY

A singular feature of companies is that from the date of the Certificate of Incorporation, a company becomes a body corporate and assumes a legal personality of its own, distinct from its members. It is a separate legal entity, an artificial legal person, unlike a partnership which has no separate entity status. After early challenges to the concept of separate legal personality, it was finally established in 1897 by the House of Lords in the celebrated case of *Salomon v Salomon & Co Ltd* [1897] AC 22.

Salomon v Salomon & Co Ltd [1897] AC 22

Facts: Salomon was a boot manufacturer trading under the name of 'Salomon & Co' for many years. Later he formed a private limited company under the then English companies legislation. The subscribers to the memorandum were Salomon, his wife and five children. Salomon and his two eldest children were directors. Salomon sold his business to the newly formed company for £39,000. All the shareholders agreed to the price. The purchase price was paid by £1,000 cash, 20,000 fully paid shares of £1 each and an issue of debentures to Salomon for £10,000. Some £8,000 went to discharge existing debts. Salomon then held 20,001 shares with his wife and five children holding the remaining six of the total 20,007 shares issued by the company. Subsequently, as a result of a slump in the trade the company went into liquidation. The assets of the company were sufficient to discharge the debentures, but the unsecured creditors who were owed some £8,000 got nothing. It was maintained on behalf of the unsecured creditors that Salomon & Co Ltd was virtually a 'one-man'