A company's name must be in English and/or Chinese. A company name cannot consist of symbol e.g. "の" or in any other languages. If a company wants to have such name for carrying on business, it may consider registering such name as a trade name under the Business Registration Ordinance (Cap.310).

Note that:

- trade names cannot be ended with the word "limited";
- a company could not have the monopoly on the use of a trade name; and
- a company may consider registering a trade name with symbols or in other language as a trade mark under Trade Marks Ordinance (Cap.559 Laws of Hong Kong).

Except for those names which require prior approval from the Registrar (as set out in the above), it is not the practice, nor is it required, to "obtain the prior approval" of the Registrar on the use of a particular company name, and the Registrar will not take a view on whether a proposed company name would be easily confused with the name of another company, before it issues a Certificate of Incorporation or Certificate on Change of Name. However, the Registrar, after the issue of that certificate, has discretion to require a company to change its name within the period specified in the Registrar's direction,[11] if those names which:

- in the opinion of the Registrar should not be registered – too much similarity, causing confusion, not fulfilling the assurances, suggesting relationship with the Government or the Financial Secretary does not approve; and
- are restrained for use under a court order.

The Registrar also has the power to direct a company to change its name under section 109 of the CO if such name:

- gives a misleading indication of the nature of the company's activities; *and*
- is likely to cause harm to the public; *or*
- should not be registered because
  - the use of the name would constitute a criminal offence, or
  - is offensive or otherwise contrary to the public interest.

If the company fails to comply with such direction within the specified period, the Registrar may replace the company name a registration number (section110 of the CO).

Back on 6 January 2014, pursuant to the power prescribed under section 24 of the CO, the Registrar issued "Guideline on Registration of Company Names for Hong Kong Companies", to explain the requirements for registration of a company name for Hong Kong companies. The Guideline took effect on 3 March 2014.

[11] CO, s.108.

The Objects Clause and the Dilution of the Ultra Vires Doctrine

1.008 The objects clause of a company sets out the purpose for which the company has been set up. It defines the capacity of a limited company when it deals with third parties. An action carried out by a company which is outside its objects clause is null and void; technically this is called *ultra vires*. Action *ultra vires* cannot be enforced by the company or the third party; it also cannot be ratified by the company in a general meeting:[12]

A limited company, except for those companies listed below, can elect to include (or exclude) an objects clause in its articles of association.[13] Those companies which are mandatorily required to include objects clauses in their articles of association upon incorporation are:

(i) Those companies for which the Registrar has exercised its power to dispense with the word "Limited" (or "有限公司" in Chinese) in their names pursuant to section 103 of the CO; and

(ii) Any company which is subject to any other legislation that has prescribed the inclusion of objects clause.[14]

If a limited company does not include an object clause in its articles of association, it will have the capacity and the rights, powers and privileges of a natural person of full age.[15] On the other hand, if a limited company elects to *include objects clauses in its articles of association*, then, that company:

(i) may do anything which it is permitted or required to do by its articles of association or by any other legislation or rule of law;[16]

(ii) shall not carry on any business or do anything that is not authorised by its articles of association and shall not exercise any power which is expressly excluded or modified by its articles of association;[17] and

(iii) a member of a company may bring proceedings to restrain the doing of an act in contravention of its stated objects clauses.[18]

However, it should be noted that act of a company (including a transfer of property to or by the company) is not invalid by reason only that it has done anything in contravention to its stated objects clauses.[19]

Liability of its Member

1.009 The articles of association of a limited company (both the companies limited by shares and the companies limited by guarantee) must state that its members' liability

[12] See *Ashbury Railway Carriage and Iron Co Ltd v Riche* (1875).
[13] CO, s.82(2).
[14] CO, s.82(3).
[15] CO, s.115(1).
[16] CO, s.115(2).
[17] CO, ss.116(1) and 116(2).
[18] CO, s.116(3).
[19] CO, s.116(5).

same class have already been issued and the company was entitled to commence business at least one year before the issue.[49]

The new CO (Cap.622) has a general prohibition of commissions, discounts and allowances.[50] Section 148 provides for permitted commissions and subsequent s.149 allows capital to be applied in writing off certain expenses and commissions.

III. INCREASE OF CAPITAL

Power of Company to Alter Share Capital

2.013 A limited company may alter its share capital in any one or more of the following ways.[51]

The company may: (a) increase its share capital by allotting and issuing new shares in accordance with Part 4; (b) increase its share capital without allotting and issuing new shares, if the funds or other assets for the increase are provided by the members of the company; (c) capitalize its profits, with or without allotting and issuing new shares; (d) allot and issue bonus shares with or without increasing its share capital; (e) convert all or any of its shares into a larger or smaller number of shares; and (f) cancel shares – (i) that, at the date the resolution for cancellation is passed, have not been taken or agreed to be taken by any person; or (ii) that have been forfeited.[52]

A limited company may alter its share capital as referred to in paras (e) or (f) only by resolution of the company.[53] Such resolution may authorize the company to exercise the power: (a) on more than one occasion; and (b) at a specified time or in specified circumstances.[54] If shares are cancelled under para (f), the company must reduce its share capital by the amount of the shares cancelled.[55] For the purposes of Part 5 (Transactions in relation to Share Capital) a cancellation of shares under s.170 of the CO is not a reduction of share capita.[56]A limited company's articles may exclude or restrict the exercise of a power conferred by this s.170.[57]

Exercise of the Power

2.014 These powers may be exercised in general meetings[58] or, where appropriate, using the written resolution procedure.[59] Generally, under express regulations the appropriate resolution is an ordinary resolution.[60] If the articles do not provide for increase of capital, it will be necessary to amend the articles to so provide.[61] The notice convening a meeting to consider a resolution to increase the capital should state the amount of the proposed increase.[62] The currency of the increase need not be the same as that of the original capital.[63]

Where the articles provide for increase of capital etc those provisions must be observed if the increase is to be valid and effective.[64]

Notice of the alteration of capital (other than for an increase of capital) must be given to the Registrar of Companies in the specified form NSC11 within one month of the alteration.[65]

Fettering the Company's Power to Increase the Capital

The power to increase capital can be abused. In private companies where there is conflict between members, capital is often increased and an issue of new shares made, in order to cause a dilution in the shareholding of the opposition. Dilution is a common complaint in unfair prejudice cases.[66] 2.015

So it is not uncommon in private companies, and joint venture companies in particular, for the articles or a separate shareholder agreement to provide for unanimous approval for an increase of capital.[67] A company cannot fetter its statutory powers, so if such a restriction appears in the articles[68] or in a separate shareholder agreement to which the company is a party, the restriction will not be binding on the company. However, the restriction may be binding on those shareholders party to the agreement (but not shareholders not party to the agreement, unless they adhere to the agreement in some manner),[69] so that, for example, it might be possible to obtain an injunction against a shareholder who was intending to vote contrary to what had been agreed or even damages for breach of contract, if loss could be proved. The Hong Kong courts seem to have gone further in deciding that not only can the company not fetter its statutory rights, but neither can members fetter their statutory powers.[70]

IV. REDUCTION OF CAPITAL

Maintenance of Capital Doctrine

This doctrine of the maintenance of the capital of a company has already been mentioned[71] and more will be said about it later.[72] A company's capital was sacrosanct and not allowed to be returned to members. The reduction of the capital of a company 2.016

[49] CO, s.50(1), (2).
[50] *Ibid*., s.147.
[51] *Ibid*., s.170(1).
[52] *Ibid*., s.170(2).
[53] *Ibid*., s.170(3). CO, ss.140 and 141 contain provisions requiring a resolution of the company for an allotment of shares. Those sections may be relevant to an alteration of share capital referred to in paras (a), (c), (d), above. In the subdivision the proportion between the amount paid and the amount, if any, unpaid on each reduced share must be the same as it was in the case of the share from which the reduced share is derived; CO, s.170(5).
[54] CO, s.170(4).
[55] *Ibid*., s.170(6).
[56] *Ibid*., s.170(7). For reduction of capital see s.2.016 et seq.
[57] *Ibid*., s.170(8).
[58] See Part 5 paras 5.019 et seq.
[59] See CO, s.548 set seq.
[60] And for Model Articles, see Companies (Model Articles) Notice (Cap.622H), Sch 1 art 87, Sch 2 art 69.
[61] See CO, s.87. For amendment of articles see Part 1, para 1.011 *et seq*.
[62] CO, s.171(2)(b); *MacConnell v E Prill & Co Ltd* [1916] 2 Ch 57.
[63] *Ibid*., s.172(1); *Re Scandinavian Bank Group plc* [1988] Ch 87 and see 2.001.
[64] See *Tsao Chin Lan v Tin Ka Kung* [1995] 2 HKC 671 (CA).
[65] CO, s.171(1). The notice must include a statement of capital; see s.171(2)(c) and s.201. For non-compliance under ss.171 and 171(4).
[66] See *Tseng Yueh Lee Irene v Metrobilt Enterprise Ltd* [1994] 2 HKC 684; *Ng Yat Chi v Max Share Ltd* [2001] 1 HKLRD 561 (CA), affirmed [2001] 3 HKLRD 299 (CFA); and see Part 8 para 8.092.
[67] *Russell v Northern Bank Development Corp Ltd* [1992] 1 WLR 588 (HL).
[68] For the contractual effect of the articles, see CO, s.86 and Part 8 para 8.064.
[69] *Russell v Northern Bank Development Corp Ltd*, n 68 above.
[70] *Re Greater Beijing Region Expressways Ltd* [1999] 4 HKC 807; *Muir v Lampl* [2005] 1 HKLRD 338. See also Part 8 para 8.071.
[71] See para 2.007.
[72] See para 2.029.

must also be entered in its register of members.[27] Chief Justice Li explains in *Ng Yat Chi v Max Share Ltd*[28] that a shareholder must be registered in order to be a member of the company or a contributory and to exercise the rights attached to that status under the articles and the CO. If the lack of registration is, however, due to the wrongful act of the company, the company may be estopped from denying membership.[29] In *Re Mak Shing Yue Tong Commemorative Association Ltd*[30] it was submitted that certain petitioners were not entered in the company's register and so they could not petition for winding up or for alternative relief under section 168A of the predecessor CO. But their membership had been approved and the only outstanding matter was the company entering them in the register. It was held that it would be unjust to refuse recognition of the parties as members. However, in *Re Chungshan Commercial Association Hong Kong*[31] the court declined to consider whether estoppel would apply because of the 116 persons whose membership was in dispute only three had responded to the court's invitation to be heard on the matter. It was held that their appointments as members did not comply with the association's articles and were invalid.

If shares are transmitted to a person by operation of law,[32] for example in circumstances of death and bankruptcy, while the interest in the shares vests in the personal representative or the trustee in bankruptcy concerned they must agree to be entered on the register of members before they become a member.[33] Lord Justice Lindley explains in *Re Bowling and Welby's Contract*:[34] "The purchaser … says that the executor of a deceased member is not a member. That is correct. You cannot look upon the executors and administrators of a deceased member as being 'members' unless they become such". The Hong Kong courts have followed this decision and held that a personal representative is not a member and therefore cannot vote at meetings of the company.[35] The need for agreement is justified by the fact that being a member may be subject to personal liability and so the personal representative must agree before being treated as a member.

III. CAPACITY TO BECOME A MEMBER

Introduction

4.005 To become a member of a company, a person must have the capacity to contract with the company. Capacity is governed by the general law of contract, but the capacity of minors and companies requires more detailed consideration.

[27] CO, s.2(1) definition of "member" and s.112(3). As to the register of members, see s.627 of the CO.
[28] [1998] 1 HKLRD 866 at 873 (CFA).
[29] *Kitnasamy s/o Marudapan v Ngatheran s/o Manogar* [2000] SLR 598, (Singapore Court of Appeal).
[30] [2005] 4 HKLRD 328.
[31] (unrep., HCMP 3253/2004, [2007] HKEC 129). See also n 72 below.
[32] See Chapt 3 of this Book, paras 3.016–3.017.
[33] See *Palmer's Company Law* (R 93 Nov 2003), para 7.006.
[34] (1895) 1 Ch 633 at 670 (CA).
[35] *Yan Kwok Yin v Yan Kwok Kee* [1997] HKLRD 1199.

Minors

4.006 Subject to the articles of a particular company, a minor[36] may become a member but has the right to avoid any allotment of shares by the company, or any transfer of shares from an existing member, before or within a reasonable time of attaining full contractual capacity.[37] Until a minor repudiates an allotment or transfer, he or she is contractually bound in the same way as any other member, and can be sued for calls. However, if the minor repudiates the share contract, he or she cannot be sued for calls made before or after repudiation.

On repudiating shares allotted to them, minors cannot recover the price they paid for their shares unless there was a total failure of consideration.[38]

Companies

4.007 A company is a legal entity distinct from its members[39] and as such it has the capacity to enter into contracts[40] and thus to contract to become a member of another company,[41] subject only to any restriction imposed by its own objects.[42]

A company cannot, however, subscribe for or purchase its own shares and thus become a member of itself. This principle was established in *Trevor v Whitworth*[43] which held that a company could not purchase its own shares, even though there was an express power to do so in its memorandum, since this would amount to a reduction of capital. Companies Ordinance (Cap.622) s.267 reinforces this general principle by prohibiting the company from acquiring its own shares but allows for exceptions. The processes of redeeming and buying back shares, for example, entail a company purchasing its own shares but there are safeguards in terms of how the purchase is financed, and the shares redeemed or bought back must be treated as cancelled.[44]

Whilst a holding company must, by definition, be a member of its subsidiary, s.113 of the CO (Cap.622) provides that a subsidiary company is generally prohibited from being a member of its holding company and any allotment or transfer of shares[45] in a holding company to its subsidiary is void.[46]

This general prohibition does not however apply where the subsidiary company is concerned as personal representative or as trustee. But if the holding company or any of its subsidiaries is beneficially interested under the trust, and is not simply interested by way of security for the purposes of a transaction entered into in the

[36] The Age of Majority (Related Provisions) Ordinance 1990 (Cap 410) reduced the age of minority from 21 to 18 years.
[37] *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452 and see *Palmer's Company Law* (R 94, Feb 2004) para 7.010.
[38] *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452.
[39] *Salomon v Salomon and Co Ltd* [1897] AC 22.
[40] A company has the capacity, rights, powers and privileges of a natural person: CO, s.115(1).
[41] In its capacity as a member, a company attends meetings and votes by means of a representative, appointed by the board of directors, or by proxy; see CO, ss.606 and 596 respectively.
[42] CO, s.116.
[43] [1887] 12 App Cas 409, HL.
[44] CO, Part 5 Division 4 (ss.233-273).
[45] In relation to a company limited by guarantee or unlimited which is a holding company, whether or not it has a share capital, shares must be construed as including a reference to the interest of its members, whatever the form of their interest, see CO, s.113(12).
[46] CO, s.113(1).

Accordingly, *McLeod's* case may be reconciled with the two people rule as standing for the proposition that, a quorum provision does not require the *physical* presence of the required number of persons but simply the sufficient representation of the required number of persons (whether in person and / or by proxy) to make a quorate meeting, *subject* to the proviso that at least two members must be *physically* present in compliance with the two people rule. In other words, it may be argued that the two people rule is a standalone *overriding* rule, which is separate and distinct from the *additional* requirement as to quorum.[32] In practice, however, the two people rule has often been treated as essentially a question of quorum.[33]

(iii) Critique of the two people rule. On the whole, the Court has adopted a relatively inflexible approach in insisting on the *physical* presence of two or more persons at a meeting. Even Sheppard J commented *obiter* in *Shergold's* case that the Court has placed too much emphasis on the literal meaning of the word "meeting".[34] As a matter of principles, it is difficult to see what the practical benefits of the Court insisting on the two people rule are. The most obvious case is where one person attending a meeting already holds proxies for all other remaining members of a class. In that case, given the unanimous assent of members, the formalities of a meeting could be dispensed with under the *Duomatic* principle. Even in situations where a single member represents two or more (but not all) members in a meeting, little harm could be done in relaxing the "two people rule". The gist of a meeting should be the meeting of the mind of the members of the class and it should not be frustrated simply because not all members are *physically* present provided their views are properly ventilated (say by proxies). This must be the rationale for developing the *Duomatic* principle and the rules on written (or circular) resolutions and decisions. That would also be consistent with decisions dispensing with contemporaneous physical presence in making decisions.[35]

Contextual Deviations from Ordinary Meaning

5.009 Notwithstanding the traditional approach in cases on attendance by proxies, the Court may permit a limited departure from the conventional approach where, as per Lord Coleridge CJ in *Sharp v Dawes*, it can be shown that the word "meeting" bears a meaning different from the ordinary meaning. Before one can hold that there is a "meeting" of one person there must be some special context "to show that a meeting of one person is good enough".[36]

(i) Meeting of a class of one member. The Court may depart from the ordinary meaning of "meeting" where there is only one member of the class or group of which a meeting is required and where in its context the draftsmen of the statutes or articles

[32] See also *Re London Flats Ltd* [1969] 1 WLR 711.

[33] See eg *James Prain & Sons, Petitioners* (1947) SC 325; *Re Salvage Engineers Ltd* [1962] 1 MLJ 438.

[34] As *per* Sheppard J, a different construction that a person attending in his own right and as proxy for another should constitute a meeting could have practical benefit in some cases, and such construction would not do violence to the statutory provisions (or articles) which contemplate attendance, not only personally, but also by attorney or by proxy. Notwithstanding such observations, Sheppard J did not wish to depart from established authorities in the conventional approach.

[35] See *Re Bonnelli's Telegraph Co Colliers' Claim* (1871) LR 12 Eq 246; *Byng v London Life Association* [1989] 2 WLR 738.

[36] *Re Action Waste Collections Pty Ltd* (1976) 2 ACLR 253 at 259.

must be taken to have contemplated such a possibility. In those circumstances, there could never be a meeting of the class in question if the ordinary meaning of "meeting" is applied without relaxation. Strict application of the conventional approach would lead to absurdities which, presumably, would be contrary to the intention of the draftsmen in question. The rationale behind the requirement for meetings is that the members shall be able to attend in person so as to debate and vote on matters affecting the company.[37] Such rationale is not in any way compromised or prejudiced by validating a meeting attended by one person when such person is the only member of the class or group of which a meeting is required.[38]

In the leading English decision of *East v Bennett Brothers Ltd*,[39] the articles provided that new preference shares might only be issued if sanctioned by an extraordinary resolution of pre-existing preference shareholders at a separate meeting. At a meeting presided over by the single holder of all existing preference shares, it was resolved that new preference shares be issued. It was held that the shares were validly issued. The Court accepted *as a starting point* that a meeting must consist of more than one person in an ordinary case but applied a contextual approach and said the object of the provision was that, before affecting the rights of the preference shareholders, it should be necessary to obtain their assent to that course. Further, the Court said the persons framing the articles must have in their minds the possibility that this particular class of shares might fall into the hands of one person (in which case such person could not form a meeting with himself in the ordinary sense), and must thereby be taken to have used the word "meeting" not in the strict sense it was usually used but as including the case of one single shareholder.

Applying this limited exception, a meeting attended by a sole director was a meeting within the meaning of section 317 of the Companies Act 1985 (concerning declaration of directors' interests) since, in the context of legislation which specifically authorises sole directorships and where Table A provides for a committee for one, the legislature could not have intended by use of the word "meeting" in section 317 to exclude sole directors.[40] This is in line with authorities that a board of directors may appoint a quorum of one or delegate their powers to a committee of one.[41] Similarly, in meetings convened for approving schemes of arrangement under section 425 of the Companies Act 1985,[42] it is inevitable from the need (where appropriate) to divide members or creditors into different classes for approving a scheme that a class may in some cases comprise of only one person. It has been held that where one class comprised of only one creditor, a meeting attended by the creditor would satisfy the statutory requirements for a meeting.[43]

(ii) Other contextual deviations. In other instances, if the context so requires, the term "meeting" whilst normally indicating that more than one person must be present

[37] *Byng v London Life Association Ltd* [1989] 2 WLR 738.

[38] Alternatively, relaxation could also be justified by reference to the *Duomatic* principle which dispenses with the need to comply with the formalities of a meeting upon unanimous assent of shareholders.

[39] [1911] 1 Ch 163.

[40] *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1995] 3 WLR 108.

[41] *Re Fireproof Doors Ltd* [1916] 2 Ch 142; *Re Taurine Co* (1884) LR 25 Ch D 118.

[42] Equivalent to s.166 of Cap.32 (now see Part 13 Division 2, CO).

[43] *Re RMCA Reinsurance Ltd* [1994] BCC 378; see also *Re Hastings Deering Pty Ltd* (1985) 3 ACLC 474.

person for whom it was intended (in time, where that was material), good service has been effected.[220] Under section 572(1) of the CO, notice of a general meeting must be given in either hard copy form or in electronic form, or by making the notice available on a website, or partly by one of those means and partly by another. Where notice is to be given on a website, such notice must be available on the website throughout the period beginning on the date of the notification and ending on the conclusion of the meeting and must: (a) state that it concerns a notice of a company meeting; (b) specify the place, date and time of the meeting; and (c) in the case of an annual general meeting, state that it is an annual general meeting.[221] Separately, insofar as the company has given an electronic address in a notice calling a meeting, it is to be regarded as having agreed that any document or information relating to proceedings at the meeting may be sent by electronic means to that address, subject to any conditions or limitations specified in the notice.[222]

Where notices were not served on time due to postal strike and the company's articles provided an alternative method of service in such a case, it is at least arguable that the service cannot be deemed to have been effective.[223]

Special Cases

5.046 Subject to other provisions in the articles, section 835 of CO permits notice to be given by the company to the joint holders of a share by giving the notice to the joint holder first named in the register of members in respect of that share. Furthermore, section 836 of the CO permits notice to be given to the persons entitled to a share in consequence of death or bankruptcy of member by sending it through post addressed to them at an address in Hong Kong supplied by the persons claiming to be so entitled. Until such address is supplied, notice may be given in any manner as if the death or bankruptcy had not occurred.

Accidental Omission to Give Notice

5.047 A company's articles usually contain a saving clause on accidental omission to give notice. For instance, under Article 37 of the Model articles, the accidental omission to give notice of a meeting to, or the non-receipt of notice of a meeting by, any person entitled to receive notice shall not invalidate the proceedings at that meeting. An express provision to such effect (subject to any provision of the company's articles except notice given under sections 567, 568 or 616) can be found under section 579 of the CO. Where Article 37 applies, the effect is that the notice for the meeting will be deemed to have been duly given for the purposes of the statutory requirement.[224]

[219] *Hastie & Jenkinson v McMahon* [1990] 1 WLR 1575, *per* Glidewell LJ at 1585 (applied in *John PhilipsGoddis Grandtag Financial Consultancy & Insurance Brokers Ltd* (unrep., HCMP 23/2006, 20 April 2006).

[221] CO, s.573.

[222] *Ibid.*, s.572(2).

[223] *Bradman v Trinity Estates plc* [1989] BCLC 757.

[224] *Re West Canadian Collieries Ltd* [1961] 3 WLR 1416. In that case, notices were duly sent by post to all shareholders except nine shareholders who held a total of 101 shares out of an issued share capital of 692, 718 shares. The omission arose since the address plates relating to them were kept separately (as their previous dividend warrants had been returned by the postal authorities or had not been cashed) but were inadvertently not put back with those of other members when the notices were issued. It was held that the omission was accidental and thus notice for the meeting was to be deemed to have been duly given.

Such provision should not, however, be construed so as to dispense with notice to an appreciable or large number of shareholders.[225]

An omission founded on a misapprehension or error of the law, of fact, or of mixed law and fact, is not accidental because there was a conscious or deliberate decision not to serve notice on certain people.[226] The omission would be accidental if it arises, for instance, from postcode error, delivery failure by couriers, etc. An adoption in error of a different protocol for effecting service, being an administrative decision designed to achieve an efficient procedure for notifying members (as distinct from a conscious decision not to serve persons who are known to be members), would also result in the accidental omission to serve the relevant members.[227]

Contents of Notice of Meetings

Introduction

A company's articles usually impose some requirements on the contents of a notice of meeting. 5.048

Under section 576(1) of the CO (and similarly under Article 35 of the Model Articles), there is an express provision which requires a company to ensure that a notice of a general meeting: (a) specifies the date and time of the meeting; (b) specifies the place of the meeting (and where applicable the principal place and the other place(s) of the meeting); (c) states the general nature of the business to be dealt with at the meeting; (d) states that the meeting is an annual general meeting in the case of a notice calling such meeting; and (e) if a resolution is intended to be moved, includes notice of a resolution and (where the company is not a wholly owned subsidiary) includes or is accompanied by a statement containing the information and explanation (if any) reasonably necessary to indicate the purpose of the resolution.[228] The requirements in (a), (b) and (c) above are subject to any provision of the company's articles.[229] Further, whilst contravention of the requirement in (e) above constitutes an offence committed by the company and every responsible person thereof, it does not *per se* affect the validity of a resolution passed at a general meeting of the company, without prejudice to the application of any common law rules or equitable principles or the provisions of any other Ordinance as regards the validity of a resolution.[230]

The notice of a meeting of a company shall give a fair warning of the nature and business of the meeting and disclose all facts necessary to enable the shareholder to determine in his own interest whether to attend the meeting. What is to be deemed

[225] *Holmes v Life Funds of Australia Ltd* [1971] NSWLR 860.

[226] *Musselwhite v GH Musselwhite & Son Ltd* [1962] 2 WLR 374 (where there was a failure to serve a notice on a member because the solicitor involved had thought that, erroneously, the plaintiffs having executed transfers of their shares to another person were no longer entitled to receive notice); *Royal Mutual Benefit Building Society v Sharman* [1963] WLR 581 (where it was held that the failure to give notice to holders of uncompleted shares on the erroneous basis that they had no voting rights was not accidental); *Re Compaction Systems Pty Ltd* [1976] 2 NSWLR 477 (where it was held that the omission to give a holder of non-voting "B" shares must be regarded as deliberate and was not an "accidental omission", and that this was so whether such omission was based on a mistake of fact, or of law, or of mixed fact and law).

[227] *Re Peninsula and Oriental Steam Navigation Co* [2006] EWHC 389 (Ch).

[228] CO, s.576(1).

[229] *Ibid.*, s.576(2).

[230] *Ibid.*, ss.576(4), (5) and (6).

Voting on Polls

Right to Demand a Poll

5.097 The right to demand a poll existed at common law and a member could not be deprived of such right without the clear words of a statute[488] or a special custom inconsistent with such right.[489] Indeed, such a right receives statutory protection in that any provision in a company's articles shall be void in so far it would make ineffective a demand for a poll (on any question other than election of the chairperson or the adjournment of the meeting) made by: (a) at least 5 members having the right to vote; (b) member(s) representing at least 5% of the total voting rights of all members having the right to vote; or (c) the chairperson of the meeting.[490] In other words, once a demand for a poll is made by any member(s) falling within (a), (b) or (c) above, such demand should be entertained notwithstanding any provision in the articles to the contrary. Further, the instrument appointing a proxy shall be deemed to confer authority to demand or join in demanding a poll[491]. Section 591(4) of the CO further makes clear that a demand by a proxy counts as a demand by the member in scenario (a) above and as a demand by a member representing the voting rights that the proxy is authorized to exercise in scenario (b) above.

For companies adopting the Model Articles, a poll may be demanded by: (a) the chairperson, (b) at least two members present in person or by proxy, (c) any member(s) present in person or by proxy and representing not less than 5% of the total voting rights[492] It may be noted that the Model Articles enables two members to demand a poll whilst the statute permits articles to require up to five members for making effective demand for a poll. For the above purposes, the word "member" includes a joint holder of shares.[493], A poll could be demanded before or on the declaration of the result of the show of hands[494]. However, a demand for a poll would be too late if it was made after the meeting had proceeded to other business.[495] It is sufficient to communicate to the chairperson the demand for a poll without demanding the same publicly.[496] Further, where a chairperson has the power under the articles to demand a poll, such power is not an unfettered one, and could not be regarded as a personal right which may be exercised according to the chairperson's own wishes.[497] The chairperson must demand a poll if, before or on the declaration of the result on a show of hands, the chairperson knows from the proxies received by the company that the result on a show of hand will be different from that on a poll.[498] The demand for a poll may be withdrawn.[499]

[488] *R v The Wimbledon Local Board* (1882) 8 QBD 459.
[489] *Campbell v Maund* (1836) 5 AD&E 865.
[490] CO, s.591(2).
[491] *Ibid*., s.591(3).
[492] Model Articles, Art 45 (2).
[493] *Siemens Brothers & Co Ltd v Burns* [1918] 2 Ch 324.
[494] CO, s.590(3).
[495] *R v Thomas* (1883) 11 QBD 282 at 284; See also *Campbell v Maund* (1836) 5 AD&E 865.
[496] *Re Phoenix Electric Light and Power Company* (1883) 31 WR 398.
[497] See the discussion on "Powers and duties of chairman (re: voting)" above.
[498] CO, s.592.
[499] Model Articles, Art 45(4).

In the case of a meeting of a class of members of a company, any holder of shares of the class in question present in person or by proxy may demand a poll.[500]

Nature and Effect of Voting on Polls

5.098 A poll is not a new meeting but rather a mode of ascertaining the sense of the meeting which is continued for that purpose.[501] A meeting should be treated as continuing until the result of the voting on the poll is ascertained (which date shall be the date of the resolution).[502] Those organising a poll vote are entitled to know how people vote so that the validity of the votes could be scrutinised, and there is no right to confidentiality when voting on a poll.[503] When a poll is taken it is an abandonment of what has been done before on a show of hands (the latter being only a rude and imperfect declaration of sentiments of members).[504] If no poll was taken after it had been duly demanded, the previous resolution passed on a show of hands was void (even if there was nothing contrary to good faith).[505] In such circumstances, the Court may also order that a meeting be re-convened and proceed to a poll,[506] although a similar action has been dismissed by the Court on the ground that the company (rather than a particular member) is the proper plaintiff to sue.[507]

The company must record in the minutes of proceedings of the general meeting in respect of a resolution decided on a poll: (a) the result of the poll; (b) the total number of votes that could be cast on the resolution; (c) the number of votes in favour of the resolution; and (d) the number of votes against the resolution, failing which the company and every responsible person thereof shall be liable to a fine.[508] Separately, section 595 of the CO provides that nothing in Subdivision 8 of Part 12 of the CO (*i.e.* sections 588 to 595 of the CO) shall affect any provision of a company's articles governing the making of objection to a person's entitlement to vote and providing for the determination of the objection to be final and conclusive, or the grounds upon which the aforesaid determination may be questioned in legal proceedings.

Manner of Voting on Polls

5.099 For companies adopting the Model Articles, on a poll votes may be given either personally or by proxy,[509] and every member shall have one vote for each share of which he is the holder[510]. In the case of a company not having a share capital, every member present in person and every proxy present who has been duly appointed by a member entitled to vote on the resolution shall each have one vote, subject to any

[500] CO, s.623(6).
[501] *R v The Wimbledon Local Board* (1882) 8 QBD 459 at 465.
[502] *Holmes v Lord Keyes* [1958] 2 WLR 772.
[503] *Haarhaus & Co GmbH v Law Debenture Trust Corp plc* [1988] BCLC 640.
[504] *Anthony v Seger* (1789) 1 Hagg Con 9.
[505] *R v Cooper* (1870) LR 5 QB 457.
[506] *Ex p Grossmith* (1841) 10 LJ QB 359.
[507] *MacDougall v Gardiner* (1875) 1 Ch D 13; See also the discussion on the "Irregularity Principle" in Part 5 (VIII).
[508] CO, s.594.
[509] Model Articles, Art 46 (3). Although the chairman may direct the manner in which the poll is to be taken, that does not entitle him to enlarge the right of voting by directing the poll to be taken otherwise than by voting in person or by proxy, eg by voting papers: *McMillan v Le Roy Mining Co Ltd* [1906] 1 Ch 331.
[510] Model Articles, Art 46 (3). See also CO, s.588(3)(a).

the supervision, where he was aware of some deficiencies in internal control but had failed to seek thorough explanations and where he failed to share what information he had as to the problems with the non-executive directors. The non-executive directors were held not to be negligent in circumstances where they did set a general policy for the currency transactions and there was no reason for them to believe that the policy was not adhered to by senior management. The non-executive directors were not aware of the problems of internal control and the books of account, and the auditors had assured the board that the profits shown in the accounts were genuine. On the facts, the non-executive directors were entitled to rely on senior management and the external auditors.

In *ASIC v Healey*,[316] the Federal Court of Australia looked at the scope of directors' duties in relation to the company's financial statements. In that case, the directors had approved consolidated financial statements but the financial statements failed to disclose significant matters: there was a failure to disclose AUS$1.5 billion of short-term liabilities which were classified as non-current liabilities, and also a failure to disclose guarantees of short-term liabilities of an associated company of US$1.75 billion that had been given after the balance sheet date. The information not disclosed was a matter of significance to the assessment of the risks facing the corporate group and the non-disclosure meant that the financial statements failed to comply with the relevant accounting standards and did not give a true and fair view. The court held that both executive and non-executive directors of the company had breached their duty of care. The court accepted that directors can delegate the drafting of financial statements to management and that directors need not be familiar with the complexities of accounting standards. However, the court held that, in light of the statutory responsibilities of directors for the company's financial statements,[317] directors must read and understand the financial statements, consider whether the financial statements are consistent with their knowledge of the company's financial position, consider the statutory requirements, and make further enquiries if matters revealed in the financial statements call for such enquiries. As directors are required to understand financial statements, they must understand the terminology used in financial statements, including the concepts of current and non-current assets and liabilities (this classification being relevant to the assessment of solvency and liquidity). The directors cannot substitute reliance upon the advice of management for their own attention and examination of important matters within the board's statutory responsibilities. In the present case, the directors were negligent as they were aware of or should have been aware of the information which was not disclosed, and were aware of or should have been aware of the relevant accounting principles requiring disclosure of that information. The directors had failed to take reasonable steps to consider whether the short-term debts and guarantees should have been disclosed. They failed to make enquiries of management and failed to have apparent errors corrected.

[316] (2011) 83 ACSR 484.
[317] In the Hong Kong context, see Cap.622, ss.379–380.

IX OTHER STATUTORY OBLIGATIONS OF DIRECTORS AND OFFICERS

Accounting Records and Financial Reporting

Accounting Records

Companies must keep adequate accounting records. The accounting records must be sufficient to: 6.052

(a) show and explain the company's transactions;

(b) disclose with reasonable accuracy the company's financial position and financial performance; and

(c) enable the directors to ensure that the financial statements comply with the Ordinance.[318]

In particular, the accounting records must contain: (a) daily entries of all sums of money received and expended by the company, and the matters in respect of which the receipt and expenditure takes place; and (b) a record of the company's assets and liabilities.[319]

The directors are required to take all reasonable steps to secure the company's compliance with the obligation for keeping adequate accounting records. If the directors fail to do so, they are liable to a maximum fine of $300,000.[320] There is a defence available where the director proves that he had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that the requirements of s.373 were complied with and was in a position to discharge that duty.[321] A director who wilfully fails to take all reasonable steps to secure compliance with s.373 is liable to both a fine of $300,000 and imprisonment for 12 months.[322]

The test of whether a director has taken all reasonable steps to secure compliance with the statutory provision is an objective one, taking into account all the circumstances of the case.[323] It is insufficient that the director subjectively believed that he had taken all reasonable steps.

In *R v Yung Leonora*,[324] the director was responsible for the accounts of the company up until a time when she was required by the majority shareholder to leave the company. The books and records were kept up to date when the accounts were within the director's control, but there were missing books for the period after her leaving. The court held that the director did not fail to take all reasonable steps to secure compliance with the predecessor CO, s.121 (now Cap. 622, s.373) in

[318] Cap.622, s.373(2).
[319] Cap.622, s.373(3).
[320] Cap.622, s.373(5). See also Cap.32, s.274.
[321] Cap.622, s.373(7).
[322] Cap.622, s.373(6). The defence under s.373(7) does not apply to the offence under s.373(6).
[323] *Australian Securities Commission v Fairlie* (1993) 11 ACLC 669.
[324] [1994] 3 HKC 141.

fact of the possibility of an adverse costs order against the company, in the event of the company not succeeding in the derivative action, would not be relevant as "[t]his consideration begs the question because, if it is in the best interests of [the company] to bring the action, the risk that a costs order may be made against it if it is unsuccessful cannot mean it is not in its best interests to pursue its claim".[257] In addition, the fact that the company is in a poor financial position and may be unable to bear the costs of the litigation is not necessarily relevant, as the court can grant leave on the basis that the applicant is prepared to bear in the first instance the costs of the litigation.[258]

Australian courts have also held that the fact that the applicant has a personal interest in the outcome of the proposed action is not significant or decisive,[259] and the fact that the applicant would have a conflict of duties if the action proceeded because of his relationship with the companies involved in the proposed litigation is a relevant factor tending to show that the action might not be in the interests of the company.[260]

In Canada, it has also been suggested that in deciding whether the proceedings appear to be in the interests of the company, the court could give weight to the decision of an independent and impartial board.[261] A similar approach has been taken in Hong Kong, where the Court of First Instance has accepted that in cases in which the board has made a bona fide commercial decision that it is not in the interests of the company that proceedings are commenced, then the board's view will be given considerable weight; but in cases in which the prospective claim is against a director, the board's view may be of less relevance.[262]

In *Re Li Chung Shing Tong (Holdings) Ltd*,[263] leave was granted by Harris J for the plaintiff minority shareholders to bring an action on behalf of the company against a director and a supervisor in connection with a recall of the company's products due to contamination. The court accepted that on the face of it one or more people within the company's senior management failed to exercise due diligence to ensure the safety and quality of the manufacturing of the products. The court considered that the commercial considerations against taking proceedings were outweighed by the strong case of a breach of duty by the putative defendants. The court held that the fact that the contamination incident was a "one-off" was no answer to the fact that wrongdoing was perpetrated against the company and was not a reason for concluding that the action is prima facie not in the interests of the company.

[257] *McLean v Lake Como Venture Pty Ltd* [2004] 2 Qd R 280 at 286.
[258] *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKLRD 274 at 288; and see also para 8.052 below.
[259] *Ehsman v Nutectime International Pty Ltd* (2006) 58 ACSR 705.
[260] *Transmetro Corporation Ltd v Kol Tov Pty Ltd* (2009) 71 ACSR 582 (appeal dismissed: *McEvoy v Caplan* (2010) 78 ACSR 167).
[261] *Bellman v Western Approaches Ltd* (1981) 130 DLR (3d) 193; see also the Singapore decision in *Re Winsa Paper Products Pte Ltd* [2004] 4 SLR 768.
[262] *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKLRD 274 at 283–284. Although an independent board's view could be taken into account in looking at whether there might be sound business reasons for the company to decide not to pursue the action, it is submitted that the court should not simply defer to the decision of the board, but must ultimately be satisfied itself as to whether the proceedings *prima facie* appears to be in the interests of the company or not.
[263] [2011] 5 HKLRD 274.

Serious Question to be Tried

Like the first requirement, the "serious question to be tried" criterion is of a relatively low threshold.[264] A similar requirement applies in Australia,[265] and Kwan J in *Re F & S Express Ltd*[266] accepted the principles set out in the Australian decisions on this criterion, namely that the court will not normally enter into the merits of the proposed derivative action to any great degree, and the applicant has the same relatively low threshold to surmount as in the case of an application for an interlocutory injunction.[267] That threshold requires the applicant to show at least a probability that the company will succeed in establishing its entitlement to the relief sought at the full trial.[268] The prospects of the plaintiff's success are to be investigated only to a limited extent, and the court should be slow to find against the plaintiff unless the prospects are so slim that it cannot be said that there is any expectation of success.[269] There is no need to weigh the prospects of failure against the prospects of success, and all that has to be seen is that the plaintiff has prospects of success which, in substance and reality, exist.[270] **8.039**

However, there must be information put to the court in the pleadings and evidence for the court to be satisfied as to whether there is a serious question to be tried. For example, in *Charlton v Baber*,[271] the court was not satisfied that there was a serious question to be tried in relation to a claim that the directors were in breach of fiduciary duty by causing the company to grant uncommercial loans in circumstances where the applicant did not provide any information as to what the terms of the loans actually were. In the same case, the court was however satisfied that there was a serious question to be tried in relation to another claim concerning an improper payment of dividends to one class of shareholders (to the exclusion of other classes), in circumstances where the constitution of the company was tendered as evidence and where the constitution did not on its face indicate that the dividend rights of the different classes of shares were different.

In *Re F&S Express Ltd* [272] the Court of First Instance granted leave for the plaintiff shareholder to bring an action against a director for alleged breaches of duties. The company did not appear at the hearing to oppose the application, and the court was satisfied on the basis of the pleadings and the complaints made in a letter to the director (which had gone unanswered) that there was a serious question to be tried.

In *Re Grand Field Group Holdings Ltd*,[273] leave was granted to commence proceedings against the company's directors for breaches of fiduciary duties where there was evidence that significant funds were channeled to entities connected with

[264] *Re Grand Field Group Holdings Ltd* [2009] 3 HKC 81; *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKLRD 274 at 285.
[265] Corporations Act 2001 (Aust) s.237(2)(d).
[266] [2005] 4 HKLRD 743 at 746.
[267] *Swansson v R A Pratt Properties Pty Ltd* (2002) 42 ACSR 313 at 318.
[268] *Charlton v Baber* (2003) 47 ACSR 31 at 45.
[269] *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKLRD 274 at 285.
[270] *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKLRD 274 at 285, citing *Mothercare Ltd v Robson Books Ltd* [1979] FSR 466 at 474.
[271] (2003) 47 ACSR 31.
[272] [2005] 4 HKLRD 743.
[273] [2009] 3 HKC 81.

shares,[577] however not all breaches of duties by directors necessarily have a prejudicial effect on the members.[578] There might not be any prejudice if the conduct has not altered the company's position nor the position of the members.[579] Trivial breaches of legal duties might not give rise to prejudice,[580] however certain legal rights conferred by the Ordinance or the articles may well be regarded as important by the courts. The Court of Final Appeal in *Wong Man Yin v Ricacorp Properties Ltd*[581] cautioned against taking a "cavalier approach" to the legal rights of members, observing that provisions such as section 114 of the predecessor CO (now section 571 of the CO (Cap.622)), regarding the minimum length of notice required for company meetings, exist to protect the rights of members, and requirements for proper notice of board meetings under the articles exist to ensure the proper management of the company. The court stated that: "Failure to serve due notice of a company or board meeting is not ... to be lightly treated as a mere technicality. There must be circumstances justifying such a conclusion".[582]

Unfairness

8.082 In *Re Taiwa Land Investment Co Ltd*,[583] Fuad J noted the ordinary meaning of the word "unfair" as being "not fair or equitable; unjust". The courts have observed that the legislature had adopted the concept of "fairness" to replace "oppression" to free the court from technical considerations of legal right and to confer a wide power to do what is just and equitable.[584] Two different approaches had been adopted under the old oppression remedy. The restrictive approach required that the conduct be "burdensome, harsh and wrongful"[585] or involve the oppressed being constrained to submit to something which is unfair to them as the result of some overbearing act or attitude on the part of the oppressor.[586] This suggested that the concept of oppression was to be interpreted narrowly, perhaps confined to situations where the conduct is unlawful or infringes upon some right of the shareholders. There was however a wider view of oppression, namely that the concept covered not only conduct amounting to a lack of probity, but also conduct amounting to a lack of fair dealing in the affairs of the company to the prejudice of its members,[587] or conduct involving a visible departure

[577] *Re Elgindata Ltd* [1991] BCLC 959.

[578] *Re Blackwood Hodge plc* [1997] 2 BCLC 650 (breaches of fiduciary duties, including failure to disclose a conflict of interest, did not cause loss to the company nor to the members, and hence there was no prejudice suffered). See also *Rock Nominees Ltd v RCO (Holdings) plc (in liq)* [2004] 1 BCLC 439 (Eng CA).

[579] *Re a Company (No 001761 of 1986)* [1987] BCLC 141 (no prejudice to the petitioner in a joint venture company arising simply from the co-venturer personally repaying a loan owed to a bank and taking over the mortgage previously held by the bank); and see also *Wong Man Yin v Law Lam Wai* (unrep, HCA 6260/1997 and HCMP 1571/2000, [2001] HKEC 740).

[580] *Wong Man Yin v Law Lam Wai* (unrep, HCA 6260/1997 and HCMP 1571/2000, [2001] HKEC 740) at para 31.

[581] [2003] 3 HKLRD 75 at 89.

[582] [2003] 3 HKLRD 75 at 89.

[583] [1981] HKLR 297. See also *Thomas v H W Thomas Ltd* [1984] 1 NZLR 686; *ASC v Multiple Sclerosis Society of Tas* (1993) 10 ACSR 489 at 515.

[584] *O'Neill v Phillips* [1999] 2 All ER 961 at 966 *per* Lord Hoffmann (HL); *Re Texgar Ltd* [2002] 1 HKLRD 687 at 693; *Wong Man Yin v Ricacorp Properties Ltd* [2003] 3 HKLRD 75 at 87–88 (CFA).

[585] *Scottish Co-Op Wholesale Society Ltd v Meyer* [1958] 3 All ER 66 at 71 *per* Viscount Simonds; *Re H R Harmer Ltd* [1958] 3 All ER 689; *Re Jermyn Street Turkish Baths Ltd* [1971] 1 WLR 1042.

[586] *Re Jermyn Street Turkish Baths Ltd* [1971] 3 All ER 184.

[587] *Scottish Co-Op Wholesale Society Ltd v Meyer* [1958] 3 All ER 66 at 84 *per* Lord Keith.

from the standards of fair dealing and a violation of the conditions of fair play on which shareholders who entrust their money to a company are entitled to rely.[588] It was this second broader approach which was adopted by the Jenkins Committee in recommending the unfair prejudice remedy,[589] and the courts have accordingly recognised that this broad approach is applicable under section 724.[590] In that regard, the courts have further emphasised that the provision should be applied flexibly to meet the circumstances of the case[591] and be interpreted in a liberal spirit to advance the remedy since it had been designed to suppress an acknowledged mischief.[592]

However at the same time the courts have stated that although their discretion in the unfair prejudice provision is wide, the court cannot do whatever the individual judge happens to think fair, but rather, the court must apply the concept of fairness judicially and in accordance with rational principles.[593] These principles on the notion of fairness have now been set out authoritatively by Lord Hoffmann in the judgment of the House of Lords in *O'Neill v Phillips*.[594] Lord Hoffmann emphasised that the concept of fairness for the purpose of the unfair prejudice remedy must be understood in its commercial context. This context has two features: (1) that a company involves an association of persons formed for an economic purpose, with the terms of the association contained in the constitution (and separate shareholders' contracts, if any); and (2) that company law has developed from the law of partnership, which was treated by equity as a contract of good faith. Lord Hoffmann stated:

> "The first of these two features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith".[595]

Therefore unfair prejudice may arise where the conduct infringes on legal rights of members such as in a breach of the Ordinance or the constitution of the company, but

[588] *Elder v Elder & Watson Ltd* 1952 SC 49 at 55 *per* Lord Cooper.

[589] See para 8.072 above.

[590] See *Re Taiwa Land Investment Co Ltd* [1981] HKLR 297; *Yuen Sau Fai v Yun Jip Auto Services Ltd* [1990] 1 HKC 15 at 18–19, affirmed on appeal *Yun Jip Auto Services v Yuen Sau Fai* [1990] 1 HKC 20 (CA).

[591] *Re Texgar Ltd* [2002] 1 HKLRD 687 at 693; *Lam Sum Po v Kam Fai Electroplating Factory Ltd* (unrep, HCCW 534/2000, 12 May 2004) at para [82].

[592] *Re Taiwa Land Investment Co Ltd* [1981] HKLR 297; *Re Saul D. Harrison and Sons plc* [1995] 1 BCLC 14 *per* Lord Hoffmann.

[593] *Wong Man Yin v Ricacorp Properties Ltd* [2003] 3 HKLRD 75 at 88 (CFA); *Re a Company (No 00709 of 1992), O'Neill v Phillips* [1999] 2 All ER 961 (HL). See also *Re Texgar Ltd* [2002] 1 HKLRD 687 at 693; *Re Kam Fai Electroplating Factory Ltd* (unrep, HCCW 534/2000, [2004] HKEC 556) at para 82; *Re Posgate and Denby (Agencies) Ltd* [1987] BCLC 585; *Re Saul D Harrison and Sons plc* [1995] 1 BCLC 14; *Re JE Cade and Sons Ltd* [1992] BCLC 213 at 227; *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304.

[594] *Re a Company (No 00709 of 1992), O'Neill v Phillips* [1999] 2 All ER 961 (HL). See also the judgment of Lord Hoffmann in *Re Saul D Harrison and Sons plc* [1995] 1 BCLC 14.

[595] [1999] 2 All ER 961 at 967.

> "The directors shall have power to determine who shall be entitled to sign … on the company's behalf bills …, cheques … contracts and documents".

A branch manager of the company, acting beyond his authority, signed seven bills of exchange in the name of the company to a seller to pay for his personal goods. At first instance,[201] the court held that by reason of the rule in *Turquand's* case, the branch manager could have been delegated with such signing power under the company's articles, therefore, the company was bound by the signature of the branch manager. The English Court of Appeal reversed the decision of the lower court and held, *inter alia*, that:

1. The company could not be bound simply because its articles empowered the directors to decide who may sign bills of exchange on behalf of the company, because to do so would allow any one to sign a bill of exchange in the name of the company;[202]
2. It was wrong, in the absence of evidence, to assume that the branch manager was a person who has ostensible authority to sign bills on behalf of the company,[203] and
3. Upon reading the articles (which empowered the directors to delegate), the third party still needed to inquire whether or not the directors had in fact nominated that particular individual to sign the bills.[204]

The Court of Appeal also highlighted the distinction between a director and a director officer of the company in terms of the necessity of the inquiries to be made:

> "… There are cases where that inquiry need not be made … If you are dealing with a director in a matter in which normally a director would have power to act for the company you are not obliged to inquire whether or not the formalities required by the articles have been complied with before he exercises that power …"[205]

In *First Energy (UK) Ltd v Hungarian International Bank Ltd*,[206] the English Court of Appeal affirmed the decision of the lower court which drew a distinction between an agent's apparent authority to:

(i) enter into a transaction with a third party on behalf of the company; and

(ii) make representation to (or communicate with) a third party on behalf of the company which conveys information regarding the company's position in relation to the transaction.

[201] *Kreditbank Cassel GmbH v Schenkers Ltd* [1926] 2 KB 450 (King's Bench).
[202] *Kreditbank Cassel GmbH v Schenkers Ltd* [1927] 1 KB 826 (Court of Appeal) *per* Atkin LJ at 842.
[203] *Ibid*., *per* Atkin LJ at 843.
[204] *Ibid*., *per* Atkin LJ at 844.
[205] *Ibid*., *per* Atkin LJ at 844.
[206] [1993] 2 Lloyd's Rep. 194.

In this case, the plaintiffs negotiated with the senior manager in charge of the Manchester office of the defendant bank for a credit facility. The senior manager, as known to the plaintiffs, did not have authority to sanction a credit facility for the plaintiffs. However, he signed a letter to the plaintiffs informing them that the bank was willing to offer a credit facility upon the plaintiffs' completion of certain formalities. The plaintiffs completed the formalities but the defendant bank cancelled the credit facility. It was held that while the senior manager did not have the actual authority to sanction the credit facility, he was held out by the bank to have apparent authority to write the letter to the plaintiffs to communicate such an offer on behalf of the bank, thus, the bank was bound by the letter. In Steyn LJ's judgment:

> "… suppose a company confers actual or apparent authority on X to make representations and X erroneously represents to a third party that Y has authority to enter into a transaction; why should not such a representation be relied upon as part of the holding out of Y by the company?[207] … the law recognises that in modern commerce an agent who has no apparent authority to conclude a particular transaction may sometimes be clothed with apparent authority to make representation of fact ….[208]

Secretaries

9.040 Under both Cap.622 and the predecessor CO, company secretaries are officers of the company. However, unlike a director, they are usually not involved in the commercial decisions of the company. Their main role is to carry out the decision of the board or the general meeting of the company by providing the necessary administrative support.[209]

Earlier case authorities suggest that a secretary used to play a limited role in the company. It was held that a secretary was a mere servant and did not carry any authority to represent the company.[210] In *George Whitechurch v Cavanagh*,[211] the managing director transferred some of his shares in the company to a creditor without tendering the share certificate. The secretary of the company fraudulently certified that the managing director had lodged the relevant share certificate in the office of the company. The company subsequently refused to issue new share certificate to the creditor on the ground that the old share certificate was not produced for cancellation. It was held that a secretary had no apparent authority to certify the receipt of the share certificate if it had not in fact be lodged in the office of the company and the plaintiff could not hold the company liable for the fraudulent act of its secretary.

In the last few decades, however, the role of the secretary has been greatly expanded. In *Panorama Developments Ltd v Fidelis Furnishing Fabrics Ltd*,[212] the secretary of the company hired cars from the plaintiff for the company's business. The cars were in fact fraudulently used by the secretary for his private purposes. The

[207] *First Energy (UK) Ltd v Hungarian International Bank* [1993] 2 Lloyd's Rep 194, at p 203.
[208] *Ibid*., at p 204.
[209] *Pennington's Company Law* (Butterworths, 8th edn, 2001), p 146.
[210] *Barnett v South London Tramways Co* (1887) 18 QBD 817, *George Whitechurch Ltd v Cavanagh* [1902] AC 117, *Ruben v Great Fingall Consolidated* [1906] AC 439.
[211] [1902] AC 117.
[212] [1971] 2 QB 711.

The SFO also provides for forms of criminal liability related to the offer process, defined as "market misconduct". A person is liable to up to seven years' imprisonment and a fine of HK$1,000,000 if he includes another person to deal in securities by making any fraudulent or reckless misrepresentation.[161] More seriously, a director is liable to 10 years' imprisonment if, with intent to deceive the shareholders or creditors of a company about its affairs, he publishes or concurs in publishing a written statement or account (which can include a prospectus) which, to his knowledge, is or may be misleading, false or deceptive in any material respect.[162] It is an offence for any person who knowingly or recklessly discloses, circulates or disseminates, or authorises (or is concerned in the disclosure, circulation or dissemination of) information that is false or misleading as to a material fact (or is false or misleading through the omission of a material fact) and which is likely to induce the subscription for, or the sale or purchase of securities in Hong Kong by another person.[163] Any person who contravenes any such provision will incur criminal liability. Under these circumstances, the person is liable on conviction on indictment to a fine of HK$10,000,000 and to imprisonment for 10 years; or on summary conviction to a fine of HK$1,000,000 and to imprisonment for three years.[164]

Regulation of Advertisements of Prospectuses

10.038 A prospectus can contain advertisements, and advertisements can also be issued in respect of prospectuses to invite public subscription for offers.[165] In terms of the prospectus, advertisement may only be made by licensed intermediaries, authorised financial institutions, authorised exchange companies or clearing house and corporations to holders of their securities, or professional investors. Any other person issuing an advertisement would be liable to criminal penalties.[166] The contents of advertisements for prospectuses are also regulated as part of the disclosure regime for public offers of securities.[167]

Particulars Contained in Advertisements

10.039 According to the retitled Cap.32, the advertisement must contain the following mandatory particulars or particulars to the like effect:[168]

- A statement that the advertisement is issued by the company to which the advertisement relates;
- A warning statement that potential investors should read the prospectus for detailed information about the company and the proposed offering before deciding whether or not to invest in the shares or debentures concerned; and
- A statement that the advertisement does not constitute an offer or an invitation to induce an offer by any person to acquire, subscribe for or purchase the shares or debentures concerned.

The advertisement is allowed to contain the following discretionary particulars:

- The name of the company to which the advertisement relates and the place of incorporation of the company;
- A description of the shares or debentures offered or proposed to be offered;
- The dates on which, and the places at which, the prospectus to which the advertisement relates is or will be available to the public;
- Details of the administrative procedures relevant to investors that are likely to assist their participation in the offer;
- If a listing is being applied for in Hong Kong or elsewhere, a statement that the company is seeking listing of, and permission to deal in, the shares or debentures concerned on the stock exchange or stock exchange concerned; and
- Legends designed to clarify the legal nature of the advertisement if, but only if, the legends are consistent with the advertisement not being a prospectus; and guidelines published under section 38BA of the retitled Cap.32.

Apart from the foregoing, there shall be no other discretionary particulars, subject to section 38B (2AA) of the retitled Cap.32.

Prohibited Contents of Advertisements

10.040 Under the SFO,[169] an advertisement shall not contain references to ability to advise by intermediaries that are not licensed or authorised. A person commits an offence if he issues, or has in his possession for the purposes of issue:

(a) an advertisement in which to his knowledge that: (i) a person holds himself out as being prepared to advise on securities,[170] future contracts,[171] corporate

[161] SFO, s.107. Fraudulent misrepresentation and reckless misrepresentation are defined therein.
[162] Theft Ordinance, s.21.
[163] SFO, s.298.
[164] *Ibid.*, s.303.
[165] Retitled Cap.32, s.2.
[166] SFO, s.103.
[167] The term "prospectus" does not include any document which falls within s.38B(2) of the retitled Cap.32 which allows issuers to public certain "awareness advertisements" relating to offers of securities.
[168] Retitled Cap.32, Sched 19.

[169] SFO Sched 5.
[170] "Advising on securities" refers to (but is not limited to) "giving advice on whether, which, the time at which or the terms or conditions on which securities should be acquired or disposed of; or issuing analyses or reports, for the purposes of facilitating the recipients of the analyses or reports to make decisions on whether, which, the time at which, or the terms or conditions on which securities are to be acquired or disposed of".
[171] "Advising on future contracts" means (but is not limited to) "whether, which, the time at which, or the terms or conditions on which future contracts should be entered into; or issuing analyses or reports, for the purposes of facilitating the recipients of the analyses or reports to make decisions on whether, which, the time at which, or the terms or conditions on which, future contracts are to be entered into".

of such securities, securities collateral or futures contracts according to oral or written directions, or a standing authority as defined in sections 7 to 9 of the Rules. Licensees that pledged client securities in contravention of the Rules for their own dealings could be punished by the SFC.[408] However, in the case of *Win Wong Securities Ltd v Lee Wai Meng*,[409] the court accepted that the licensee's initially unauthorised but later ratified trades were to be regarded as authorised, and thus, the client had to bear the losses incurred to his account as a result of the trading. This holding may open an undesirable exception to the strict letter of the Rules. However, it is noted that the licensees informed the client as soon as the mistaken trade was made, and the client did ratify. Further, the client's absence from court in defence probably raised the finding of facts in favour of the plaintiff licensees. Thus, subsequent ratification is accepted judicially as an authorisation for trades in the client's account.

Segregation of Client Money

10.102 The Securities and Futures (Client Money) Rules made pursuant to section 149 of the SFO requires client money received from or on behalf of a client to be kept in one or more segregated accounts.[410] Intermediaries are however allowed to deduct from such money commissions for brokerage and reimbursements.[411] Intermediaries may only use the money in accordance with section 5 of the Rules, which provides that intermediaries have to pay the money to the client or otherwise make such payment according to written directions or standing authority from the client.[412] Intermediaries who transferred money from client accounts to meet their house short positions would be punished.[413] Further, intermediaries that have failed to maintain adequate internal controls over the treatment of client money would also be punished. In its enforcement against Quam Securities Ltd,[414] the SFC has taken to task a firm that asked its Mainland China clients to pay into an employee's personal bank account in China for the purpose of transferring money into firm accounts held in Hong Kong. Negligent behaviour with respect to Mainland China clients' accounts has also been highlighted in another enforcement actions.[415] Intermediaries who abuse their relatives' client accounts may

[408] Disciplinary action against Gain Asset Management, which was settled at a HK$500,000 fine, 25 Apr 2005, http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/HTMLGeneralNews?openAgent. More serious pledging of client's shares without consent was carried out by Irene So Wai Yin, whose licence was surrendered for 5 years, 1 Mar 2005, http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/HTMLGeneralNews?openAgent. See also SFAT Application No 10/2006 (Hung Hing Chuen) where an intermediary dealing in a client's account for someone other than the client was made liable.

[409] [2005] HKEC 1893.

[410] Keeping client money in an unauthorised financial institution could result in enforcement, see SFC's fine of HK$400,000 against Guotai Junan Securities Ltd, 8 Sep 2005, http://www.sfc.hk/sfc/html/EN/general/general.html.

[411] Section 4 of the Rules.

[412] Sections 7 and 8 of the Rules.

[413] SFC reprimands and fines Cheung's Securities Brokers Limited, 1 Sep 2005, http://www.sfc.hk/sfc/html/EN/general/general.html.

[414] SFC reprimands and fines Quam Securities Company Limited and its responsible officer $1.3 million for internal control deficiencies in handling Mainland clients' accounts, 19 May 2011.

[415] Eg, SFC reprimands and fines Christfund and responsible officers $2.5 million for internal control deficiencies in handling Mainland clients' accounts, 17 June 2010.

also be punished.[416] Interest earned on the segregated account is regarded as part of client money and is to be treated according to sections 4 and 5 of the Rules.[417] It should be noted that the scope of written directions and standing authority could be rather wide, and thus, intermediaries are not unduly prevented from smooth trading for clients so long as the safeguard that client's authority has sanctioned such trading, is established.

Since 2006, the SFC has stepped up its enforcement against intermediaries who misappropriate client moneys or assets in custody, threatening bans for life from participating in the financial services industry for those who are taken to task.[418]

Keeping of Records

10.103 Intermediaries are required, under section 151 of the SFO, and pursuant to the Securities and Futures (Keeping of Records) Rules, to keep a variety of financial accounts and records. The records are:

(a) accounting and trading records of the intermediary business including profit and loss accounts, balance sheets, accounts showing all client assets received and held, records of all movements of client assets, and monthly reconciliations of the intermediary's positions with associated entities, the exchanges, clearing houses, other intermediaries, custodians and banks, and records showing compliance with the Client Securities Rules and Client Money Rules discussed above, as well as the Financial Resources Rules;[419]

(b) where dealings in securities are concerned, records of any underwriting or sub-underwriting arrangements;[420]

(c) particulars relating to the counterparty, market value of positions, interest rate differentials and quote and execution prices for leveraged foreign exchange trading;[421]

(d) in respect of securities margin financing, records of margin policies, and particulars of collateral and custodian arrangements;[422] and

(e) in respects of asset management, records of assets and liabilities and any financial commitments or contingent liabilities.[423]

The records should reflect a true and fair view of the intermediary's positions and states of affairs, to enable a proper audit to be carried out, and to be made using

[416] SFC Reprimands and Fines Business Securities Limited and Business Futures Limited for Internal Control Failures, and Suspends Szeto Kin Chuenfor Misconduct Including Concealing Discretionary Arrangement in a Client's Accounts from the SFC, 25 Sep 2006.

[417] Section 6 of the Rules.

[418] "Those Who Steal Client Assets face Life Ban", SFC Policy Release, 22 Dec 2006.

[419] Section 3 of the Rules.

[420] Section 5 of the Rules.

[421] Section 6 of the Rules.

[422] Section 7 of the Rules.

[423] Section 8 of the Rules.

The past 2013 witnessed a drama involving Alibaba's shifting Hong Kong to New York for its highly-anticipated listing. Alibaba operates online shopping sites such as Taobao and Tmall. Alibaba could value at US$60 billion or more,[634] making it the largest technology IPO since Facebook Inc.'s listing in 2012, which raised US$16 billion. Alibaba wants to structure its IPO in a way that founders can maintain a measure of control over the company after it goes public. Hong Kong Exchanges & Clearing, the owner of the Hong Kong exchange, does not allow dual-class voting, a common structure in the US that enables insiders to control a company after its IPO. Facebook, Google Inc. and other companies all organised that way that they issue two classes of stock with different voting rights, giving founders and corporate officers a greater control in shareholder votes. Founders of US tech groups such as Google, Facebook and Zynga all have kept control of key decisions and board composition after floating using dual-class share structures.

In its negotiation with the Hong Kong Stock Exchange, Alibaba made a proposal allowing the company's leading executives, in a group called a partnership (including Jack Ma and others executives, altogether 20 partners, owning a little more than 10% of Alibaba) to nominate a majority of its directors after its debut. The structure would hand the partnership the kind of control over Alibaba's destiny that US technology companies have accomplished with dual-class shares, where founders have more voting rights than everyone else. The purpose of putting the partnership arrangement (rather than a straightforward dual share-class structure) in place is to keep the executives' vision of corporate culture intact. The internal partnership structure can make key founders control of the group's strategic direction and culture. Ma and the top executives own about 10% of the company, compared with about 24% owned by Yahoo and 37% by Softbank. Yahoo and Softbank are said to support Alibaba's partnership structure. In the negotiation, Alibaba indicated a level of flexibility to cut the number of partners and bind them to a three year share sale ban if Hong Kong regulators were willing to approve the management structure.[635] Hong Kong Exchange refused to allow Alibaba to hand-pick most of its board members. Alibaba plans to adopt the board-nomination system when it is moving to the US for a listing.

Opinion is divided on whether bourse acted wisely. While corporate governance activists cheered the outcome, it will be a blow to Hong Kong Stock Exchange which loses out on one of the most anticipated listings. In the first three quarters of 2013, 30 companies have had initial listings on the Hong Kong bourse, raising US$7.4 billion while 76 IPOs were on Nasdaq where US$10.3 billion has been raised and 69 new listings on NYSE where issuers raised US$24.1 billion.[636] Hong Kong Stock Exchange's decision cost it a boost to revenues in 2013. The deal could have added 2-3%, or about HK$200 million to its 2013 revenues.[637] It may have other side effects of the decision squeezing out Chinese internet companies. Thus far, only two

[634] Paul J Davies and Arash Massoudi, "Alibaba Switches $60bn IPO out of HK", Financial Times, 26 September 2013, 1.

[635] Ray Chan, "Alibaba Abandons Hong Kong for New York, Sources Say", South China Morning Post, 26 September 2013 (online).

[636] Paul J Davies and Arash Massoudi, "Alibaba's Waiver Demands Were A Step Too Far for HK Exchange", Financial Times, 26 September 2013, 18.

[637] Paul J Davies, "Alibaba Abandons $60bn Hong Kong Listing", Financial Times, 25 September 2013 (online).

internet companies from mainland China had listed in the city out of more than 30 that had gone public in the past decade.[638] In response to Hong Kong Stock Exchange's rejection of its proposal, Joe Tsai, Alibaba's cofounder and vice chairman who has been leading the IPO effort, said "the question Hong Kong must address is whether it is ready to look forward as the rest of the world passes it by".[639] His comments deserve a deeper analysis.

Technically, this may be a right decision as the decision is a positive signal demonstrating Hong Kong Stock Exchange's willingness not to loosen its standards. It is hard for the regulators to make an exception for one new listing, which may open the floodgate causing subsequent complaints. The decision is important for its long-term prospects as market integrity. The decision confirms Hong Kong regulators' reputation of ensuring absolute transparency in disclosure as well as suitability for listing.[640] Hong Kong listing rules explicitly ban dual-class shares and have no place for Alibaba's intention to control the make-up of its board. Hong Kong Stock Exchange's concern is legitimate as the partnership structure may give top executives more rights than ordinary shareholders by allowing them to nominate a majority of candidates for election to the firm's board of directors. Allowing a dual-class share structure means the preferential treatment of one group of shareholders over another. The Securities and Futures Commission, Hong Kong's ultimate listing authority, has consistently held its position: a structure giving one group of shareholders more power than another is not acceptable, the position that moves away from the conventional principle of one share one vote. The SFC and the exchange's listing committee have made it clear that no exemption will be provided for any company because local listing rules do not allow preferential treatment for one set of shareholders. Accepting Alibaba's request means a significant change to the current listing rules. In denying Alibaba special status, Hong Kong's regulators made clear they are not willing to compromise when it comes to safeguarding small investors and treating all shareholders alike. The Hong Kong Stock Exchange needs take precedence over shareholder interest in the exchange's charter.

The Hong Kong government also showed its support of the SFC's stance in the controversy over Alibaba's listing plans and rejected calls to strip the stock exchange of its power to approve listings.[641] The exchange has dual functions, being a market player as well as a regulator, involving conflicts of interest. According to Hong Kong law, the government has the final say on any listing issue and the chief executive can issue directives to the SFC even though this power has never been exercised. But some

[638] Tencent is one of two mainland internet stockes. Tencent's market value soared to US$98 billion from US$800 million when it listed in 2004. Tencent stock accounts for about 3% of the Hong Kong exchange's average daily turnover and is among the top five traded stocks. Reuters, "Loss of Alibaba IPO Spurs Calls for Reforms of Hong Kong Listing Rules", 27 September 2013 (online).

[639] Matt Jarzemsky and Juro Osawa, "Alibaba Jabs at Hong Kong Bourse", The Wall Street Journal, 27 September 2003, C3.

[640] Compared to Hong Kong regulators, the US SEC is not a prudential regulator and focuses more on whether a company's disclosure includes all information that investors would regard as material to their investment decision, including whether the company meets the corporate governance standards of the relevant stock exchange.

[641] Enoch Yiu, "Hong Kong Official Backs Market Regulator in Alibaba Listing Row", South China Morning Post, 10 October 2013 (online).

at its simplest, … debars a shareholder from suing to recover a loss which is merely a reflection of the loss suffered by the company of which he is shareholder".

No Right of Action by Shareholders Against Directors Making Unlawful Distribution

11.079 In the context of unlawful distribution by the directors, it would appear that the *Prudential* principle would preclude a shareholder from commencing proceedings against directors in his or her own capacity for unlawful distribution but rather it would be for the company to commence a derivative action against the directors. In the case of *Shaker v Al-Bedrawi*,[151] the English Court of Appeal held that a shareholder has no right of action against directors where the action for a sum of money misappropriated from the company or unlawfully distributed, as the company was entitled to the whole of that sum, such that the reflective loss principle would apply to bar the plaintiff's proceedings. (However, in that case, the principle did not apply to preclude the plaintiff from bringing a claim as beneficiary under a trust against a trustee to account for profit made by him unless the defendant could show that the whole of the claim sum reflected the company loss which the company could claim.)

Right of Action by Shareholders by Way of Unfair Prejudice Petition?

Jurisdiction to make an Order for Payment to the Company which could have been Obtained by the Company in a Derivative Action

11.080 Given the width of the powers of the court to make any order it thinks fit to give in a petition complaining of unfair and prejudicial conduct, the question arises whether a shareholder may bring such a petition on the basis that the directors of a company has made unlawful distributions. The Court of Final Appeal has authoritatively held in *Re Chime Corp Ltd*[152] that there is jurisdiction for the court on a petition to order payment to the company of compensation, or grant of restitution to the company that could have been obtained by the company in a derivative action. However, even though it was said there was jurisdiction in the strict sense, the circumstances where it would exercise it would be rare and exceptional. It is necessary to show that the remedy is one which as a matter of proper practice, the court should grant.[153]

Whether the Essence of the Complaint is Misconduct Rather than Mismanagement

11.081 It has been held that where the nature or essence of the complaint, looked at together with the relief sought, is that there has been misconduct then a derivative action should be brought. However, if the nature of the complaint is mismanagement then a petition may be brought by a shareholder.[154]

[151] [2003] 2 WLR 922.
[152] (2004) 7 HKCFAR 546.
[153] *Ibid* at paras 27, 41 and 61.
[154] *Ibid* at paras 48, 61 and 62. See also *Waddington Ltd v Chan Chun Hoo Thomas* (2008) 11 HKCFAR 370 at para 77; *Re Shun Tak Holding* [2009] 5 HKLRD 743 at para 35.

Not to Circumvent the Rule in Foss v Harbottle and may Amount to an Abuse of Process

11.082 However, the use of the unfair prejudice petition in order to circumvent the rule in *Foss v Harbottle* in a case where the nature of the complaint is misconduct rather than mismanagement would be an abuse of process.[155] In *Re Shun Tak Holdings Ltd*, Kwan J (as she then was) held that there were policy reasons underlying the requirements for shareholders to bring derivative actions, namely that there was a safeguard or filter by the threshold requirement or leave application to prevent unmeritorious claims which did not exist in a shareholder's petition.[156]

IV. THE DECLARATION AND PAYMENT OF DIVIDENDS

The Declaration of Dividends

Final vs. Interim Dividends

11.083 Often the distinction is drawn between final dividends and interim dividends. Final dividends are declared in the annual general meeting. Interim dividends are those dividends which are declared at some time between the ordinary general meetings of the company.[157]

Who Decides Whether to Declare and How Much?

The Power to Declare Dividends

11.084 The power to declare dividends, both final and interim, will usually be expressly provided for in the articles of a company. In the absence of which, the power will be implied as necessary and incidental to the powers of directors under their powers to manage the affairs of the company.[158] However, the question of whether there is power to declare dividend is obviously distinct from the question of whether directors will exercise their power to declare and pay dividend. Although there is no general rule requiring the company to distribute its profits, the question is always that of the proper construction of the articles of the company.[159] The articles may require the distribution of profits or conversely require that profits be retained in the company.

The Declaration of Dividends

11.085 Historically, the declaration of dividends was left to shareholders in general meeting but the modern practice now recognizes the decision as to whether to and how much dividend to pay best lies with the directors. This accords with the notion that

[155] See *Re Chime Corp Ltd* (2004) 7 HKCFAR 546 at para 63. See also *Re Shun Tak Holding* [2009] 5 HKLRD 743 where the shareholder's petition was struck out for abuse of process.
[156] *Ibid* at paras 39–42.
[157] *Re Jowitt* [1922] 2 Ch 442 at 447.
[158] *Thairlwall v Great Northern Rail Co* [1908–10] All ER Rep 556.
[159] *Evling v Israel & Oppenheimer* [1918] 1 Ch 101 at 108.

subsidiaries, including consultancy services, supply of after-sale services,[118] purchase and procurement of raw materials and equipment, local and foreign distribution of products, financing, transportation and warehousing services, technical and personnel training services.[119]

In addition, holding companies are allowed to engage in a wider range of activities such as export of Chinese products as agent, distributor or through establishment of an export purchasing organization, sale of products manufactured by its subsidiary FIEs as agent,[120] sale of imported products from the parent company,[121] after-sale services, balancing foreign exchange amongst its FIEs, assisting its FIEs in raising loans and providing guarantees, establishment of research and development centres,[122] outsourcing, marketing, shipping and storage service.[123] A foreign invested holding company may further establish other holding companies as a promoter.[124] The broader range of businesses excluding tax consolidation and flexible debt funding rules help the holding company unify the financial management of its subsidiaries.[125] Foreign invested holding companies are allowed to use Renminbi from their investment profits in China to carry out more investment projects,[126] to engage in financial leasing,[127] and to take outsourcing contracts of overseas companies.[128] It is apparent that a holding company can engage in activities that neither a traditional FIE nor an RO can. To multinational companies, a holding company represents a new structuring option in a restricted investment environment.

Apart from all the potential benefits, the requirements for establishing holding companies are stricter than those applicable to common JVs and WFOEs. A foreign investor applying to establish a holding company must fit at least one of the following requirements: (i) it has a minimum asset value of US$400 million in the year pr

[118] Holding companies can provide services to FIEs in which the holding companies and foreign investors together hold 25% of the registered capital. Interim Provisions on Investment Companies Established with Foreign Investment 1995, Article 6. At least 10% of the registered capital of an underlying FIE to which the holding company wishes to provide services must be held by the holding company rather than the foreign investor. The Explanation on Questions Relating to Interim Provisions on Investment Companies Established with Foreign Investment 1996, Article 6. The unanimous consent of the board of directors of such FIE must be obtained before the holding company provide services to the FIE. Interim Provisions on Investment Companies Established with Foreign Investment 1995, Article 5(2).

[119] Interim Provisions on Investment Companies Established with Foreign Investment 1995, Article 5; Provisions on Investment Companies Established with Foreign Investment 2004, Art.10.

[120] The Explanation on Questions Relating to Interim Provisions on Investment Companies Established with Foreign Investment 1996, para 5; the Opinion on Directing the Examination and Approval of Foreign-invested Enterprises 1996, para 2.1.4.1.

[121] Holding companies are prohibited from providing intermediary trading services to their investors. Interim Provisions on Investment Companies Established with Foreign Investment 1995, Article 6.

[122] MOFCOM's Opinion on Directing the Examination and Approval of Foreign-invested Enterprises 1996, Part 2, Para 2.1.4.5.

[123] Provisions on Investment Companies Established with Foreign Investment 2004, Arts 10, 13 and 15.

[124] Provisions on Investment Companies Established with Foreign Investment 2004, Art.14.

[125] The aggregate investment of a holding company may be up to 10 times its registered capital. MOFCOM's Opinion on Directing the Examination and Approval of Foreign-invested Enterprises 1996, Part 2, Para 2.1.2.1. Holding companies are indirectly permitted to use substantial debt funding, with a debt to equity ratio of up to 9:1, exceeding the more restrictive debt/equity ratios imposed on FIEs.

[126] Supplementary Provisions to the Holding Company Provisions of 2004 (issued by the MOFCOM on 26 May 2006), Art.1.

[127] *Ibid*., Art.9.

[128] *Ibid*., Art.2.

the application, it has established at least one FIE in China with actual paid-in capital of more than US$10 million, and three or more preliminary project proposals for future FIEs already approved; or (ii) it has established at least 10 FIEs (either production-oriented or infrastructure-related) with total paid-in registered capital of over US$30 million.[129] The minimum registered capital of a holding company is US$30 million.[130] In addition, the foreign investor must possess a good credit standing.[131] Given its practical use and strict qualification requirements, only very large multinational companies with a significant and established presence in the PRC have sought to establish holding companies in China.

Some holding companies can even be converted into a "regional headquarters of a multinational company" with more cross-border business capacities[132] as long as they are able to meet some prohibitive requirements. The benefits of being qualified as a regional headquarters include abilities (i) to import and sell the products of the multinational company, (ii) to undertake service outsourcing business for domestic and foreign companies, and (iii) to engage in logistics and distribution services.

However, it is worth noting that foreign invested holding companies still have some shortcomings. The foreign invested holding company cannot satisfy other needs, namely, majority shareholder's control of an FIE, a general trading right to sell imported finished products, and the manufacturing of multiple types of products by one legal entity. In other words, the foreign invested holding company only has service, investment and limited sales functions, but not a manufacturing function. Its high income tax rate (25%) and lack of tax holidays also make it unattractive to multinationals for group integration purposes.

FIEVC

There is a separate regime for the incorporation of foreign invested venture capital funds, commonly known as an FIEVC. The governing rule is the Foreign Invested Venture Investment Enterprise Administrative Regulations, ("FIEVC Regulations") which various authorities issued on 30 January 2003[133] replacing its predecessor, the 2001 Provisional Regulations Governing the Establishment of Foreign-invested Venture Investment Enterprises ("Provisional Regulations").[134] **13.029**

Unlike the Provisional Regulations which encouraged long-term strategic investments rather than short-term PE investments, the vaguely enacted FIEVC Regulations are more attractive in that they signify a departure from the rather stringent and impractical minimum capital rule and investor qualification threshold

[129] Interim Provisions on Investment Companies Established with Foreign Investment 1995, Article 2(1).

[130] Provisions on Investment Companies Established with Foreign Investment 2004, Art.3.

[131] *Ibid*., Article 2(1).

[132] Provisions on Investment Companies Established with Foreign Investment 2004, Art.22.

[133] The Ministry of Foreign Trade and Economic Cooperation, the predecessor of MOFCOM, the Ministry of Science and Technology, the State Administration of Taxation and the State Administration of Foreign Exchange jointly issued the FIEVC Regulations in an attempt to attract foreign venture capital and PE investments into China.

[134] The Interim Provisions Concerning the Establishment of Foreign Venture Capital Investment Enterprises were issued jointly by MOFTEC, SAIC and the Ministry of Science and Technology on 28 August 2001 and effective as of 1 September 2001.