

number of recommendations made by the SCCLR,¹⁸⁵ which have since been implemented, including the statutory derivative action, members' rights to apply for inspection of company records, and the statutory injunction.¹⁸⁶

- 1.118 **2006 Companies Ordinance Rewrite.** Further study of wider reforms still needed to be undertaken, and in mid-2006, the Government launched the Companies Ordinance Rewrite.¹⁸⁷ The Rewrite was divided into two phases due to the complexity and length of the Companies Ordinance. Phase I was to cover the core company law provisions, while Phase II was to deal with the remaining provisions in the Ordinance.

5.2 Objectives of the Rewrite

- 1.119 **Objective of rewrite to modernise company law and enhance Hong Kong's appeal as financial centre.** The basic objective of the Rewrite was to modernise Hong Kong's company law and to further enhance Hong Kong's status as a major international business and financial centre.¹⁸⁸ The key guiding principles of the Rewrite were:¹⁸⁹

- Catering for SMEs—"think small first".¹⁹⁰ This principle is to ensure that the needs of private companies, particularly small and medium enterprises, are appropriately catered for. In particular, reduction of compliance costs was considered important.¹⁹¹
- Enhancing corporate governance. The Rewrite aimed to strengthen corporate governance, including enhancing regulation of public companies where appropriate.¹⁹²
- Complementing Hong Kong's role as an international business and financial centre. The Rewrite aimed to benchmark Hong Kong against other comparable jurisdictions such as the United Kingdom, Australia and Singapore.
- Encouraging the use of information technology. This principle was aimed at promoting the use of information technology, particularly in facilitating communications between companies and their shareholders and others.

¹⁸⁵ See SCCLR, *Corporate Governance Review – Phase I Consultation Paper* (July 2001); SCCLR, *Corporate Governance Review – Phase II Consultation Paper* (June 2003); SCCLR, "SCCLR issues final recommendations from Corporate Governance Review Phase II" (Press release, 20 January 2004).

¹⁸⁶ Companies (Amendment) Ordinance 2004 (30 of 2004).

¹⁸⁷ See FSTB, *CO Rewrite: Rewrite of the Companies Ordinance – Accounting and Auditing Provisions Consultation Paper* (March 2007) [1.4]–[1.6].

¹⁸⁸ FSTB, *CO Rewrite: Rewrite of the Companies Ordinance – Draft Companies Bill First Phase Consultation* (December 2009) [1.4].

¹⁸⁹ *Ibid.*, [1.5].

¹⁹⁰ *Ibid.*, Chs 3 and 4.

¹⁹¹ There is, however, no intention of introducing the United States' concept of "close corporations" (namely closely-held companies or small private companies where the shareholders are usually also the managers) and for close corporations to be regulated differently from other companies. See the earlier discussion of the SCCLR on this topic: *Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance* (February 2000) Ch 5.

¹⁹² See also FSTB, *CO Rewrite: Rewrite of the Companies Ordinance – Draft Companies Bill First Phase Consultation* (December 2009) Ch 2.

Rewrite to improve structure and clarity of the Ordinance. Apart from the above, the Rewrite also sought to improve the structure of the Ordinance and enhance the clarity of the provisions so as to make the law more accessible to users. Antiquated concepts in the law have also been changed, updated or simplified.¹⁹³

Aim of Rewrite to modernise and meet modern social and commercial needs. "Modernisation" of company law has also been the mantra for corporate law reform programmes undertaken in overseas jurisdictions in recent decades, including in the United Kingdom¹⁹⁴ and Australia.¹⁹⁵ At a basic level, this notion of modernisation involves reform to the law so that the law meets the needs of the modern social and commercial environment. For example, as noted above, both the structure and concepts of company law in the predecessor Companies Ordinance (Cap.32) date from the Victorian era in England. Some of these concepts (such as par value of shares) have become outdated and have little practical significance in the modern commercial environment. Modernisation therefore involves the updating of the law to remove antiquated concepts. At the level of law drafting, there is also an element of modernisation in using plain English and adoption of more modern terminology.¹⁹⁶

Purpose of modernising to cater for modern business enterprise. Fundamentally, modernisation aims to ensure that the law caters for and deals with the characteristics of the modern business enterprise.¹⁹⁷ It must be recognised, though, that the model corporate form in different countries might be different, and so there is not necessarily one model of modern company law that is suitable for all countries.¹⁹⁸ Modernisation can also embrace new theories of the company and corporate regulation. For example, a stream of corporate theory focuses on the interests of all stakeholders in a company (e.g. creditors, employees and customers etc., as well as members and directors)¹⁹⁹ and so in time it might be thought that a modern company law must ensure proper regard for the interests of all stakeholders. In this sense, modernisation is an open-ended project.²⁰⁰

5.3 The Rewrite process

Financial Services and Treasury Bureau led the Rewrite. The Government department responsible for driving the Rewrite was the Financial Services Branch

¹⁹³ *Ibid.*, [1.6].

¹⁹⁴ See Company Law Review Steering Group, *Modern Company Law: For a Competitive Economy – The Strategic Framework* (February 1999) [1.12].

¹⁹⁵ Corporate Law Economic Reform Programme ("CLERP"): see Roman Tomasic, "The Modernisation of Corporations Law: Corporate Law Reform in Australia and Beyond" (2006) 19 *Australian Journal of Corporate Law* 2, 29–31.

¹⁹⁶ See FSTB, *CO Rewrite: Rewrite of the Companies Ordinance – Draft Companies Bill First Phase Consultation* (December 2009) Ch 5.

¹⁹⁷ See H Hansmann and R Kraakman, "The End of History for Corporate Law" (2001) 89 *Georgetown Law Journal* 439, 439–440.

¹⁹⁸ In this respect, the social and cultural context of the firm must be taken into account in any law reform initiatives: see Philip Lawton, "Berle and Means, Corporate Governance and the Chinese Family Firm" (1996) 6 *Australian Journal of Corporate Law* 348.

¹⁹⁹ See para.1.213 below.

²⁰⁰ For a discussion of company law reform in the broader theoretical context of modernisation of law, see Roman Tomasic, "The Modernisation of Corporations Law: Corporate Law Reform in Australia and Beyond" (2006) 19 *Australian Journal of Corporate Law* 2.

articles) follows developments made overseas. For example, under the Corporations Act 2001 in Australia, there is just the one constitutional document referred to as the constitution of the company. In the United Kingdom, the memorandum is still required for incorporation but it has only a limited role as being a statement that the subscribers agree to form a company and to become members of the company.⁷ The memorandum is no longer treated as a part of the company's constitution in the United Kingdom, with the constitution now comprised of only the articles of association (and certain resolutions and agreements of the company).⁸

2.004 All new companies must register articles; must contain certain basic information. All new companies being formed under Cap.622 must have registered articles of association.⁹ There is certain basic information about the company which is required to be stated in the articles.

2.005 Compulsory provisions. The required or compulsory provisions to be included in the articles differ to some extent depending on the type of company being formed. For the most common type of company, companies limited by shares, the articles must state the following:

- The company name:¹⁰ see further para.2.084 below.
- That the liability of members is limited to any amount unpaid on the shares held by the members:¹¹ on the nature of limited liability, see para.2.042 below.
- Certain information about the company's initial shareholdings (namely the total number of shares to be issued and total share capital on the company's formation; total paid and unpaid amounts on the shares issued on formation; similar information as to the above for each class of shares if the company has shares of different classes; and in respect of each founder member,¹² the number of shares that the member is to hold upon the company's formation and the total amount of share capital to be subscribed by the founder member.¹³

2.006 Objects clause optional unless charitable company. Before 10 February 1997, it was compulsory for companies to have a clause in the memorandum setting out the company's objects.¹⁴ This was altered pursuant to amendments made to the predecessor Cap.32 in 1997. The position now under Cap.622 is the same as the position in the predecessor Cap.32 following the 1997 amendments in respect of whether an objects clause is needed (although under Cap.622, any objects clause

⁷ Companies Act 2006 (UK) s.8.

⁸ Companies Act 2006 (UK) s.17.

⁹ This can be contrasted with the position under predecessor Cap.32 where it was essentially optional for companies limited by shares to have registered articles: Cap.32 s.9. If the incorporators choose not to have their own articles registered under s.15, then the regulations in Table A in Sch.1 would apply as the company's articles: predecessor Cap.32 s.11(2).

¹⁰ Cap.622 s.81.

¹¹ Cap.622 ss.83(1) and 84(1).

¹² See para.2.017.

¹³ Cap.622 s. 68(2) and Sch.2.

¹⁴ On the significance of the objects clause, see Chapter 5.

would be stated in the articles). For charitable and other companies which seek to omit the word "Limited" from the company's name,¹⁵ it is compulsory for the company to have an objects clause.¹⁶ For all other companies, the objects clause is optional.¹⁷

Capital clause no longer required. Under the predecessor Cap.32, the memorandum was required to contain a capital clause; but with Cap.622 abolishing the concepts of authorised share capital and nominal or par value of shares, such a provision is no longer required in the constitution of new companies.¹⁸ 2.007

Company can set own regulations or rely on Model Articles. Beyond those details which must be included in the articles (as required by Cap.622 ss.81–85), it is up to the company whether to set out its own regulations in the registered articles or whether to rely on the default articles, which are referred to under Cap.622 as the model articles.¹⁹ The model articles which can be adopted by companies are set out in subsidiary legislation: Companies (Model Articles) Notice (Cap.622H).²⁰ For new companies, these model articles replace the standard articles contained in former Sch.1 to the predecessor Cap.32 (namely Table A articles etc.). The provisions in Table A which apply to existing companies will continue to apply to such companies unless and until they are altered by the company.²¹ Under the Companies (Model Articles) Notice (Cap.622H), there are three sets of model articles: for private companies limited by shares, public companies limited by shares and companies limited by guarantee. The applicable model articles will apply insofar as the company's registered articles do not exclude or modify the model articles.²² Whether the incorporators should rely on the model articles or should draft their own provisions will depend on whether the provisions in the model articles are appropriate for their particular circumstances and purposes. 2.008

Other requirements in respect of articles. Articles must be printed in English or Chinese, must be divided into paragraphs numbered consecutively and must be signed by each founder member.²³ 2.009

1.2.2 Incorporation form

Must contain name, address, founder members, details of who will become directors and company secretary and share capital. The incorporation form is required under Cap.622 s.67(1)(b), and must contain the information as specified in 2.010

¹⁵ Cap.622 s.103.

¹⁶ Cap.622 s.82(1).

¹⁷ Cap.622 s.82(2).

¹⁸ See Chapter 14.

¹⁹ Cap.622 ss.79–80.

²⁰ Made pursuant to Cap.622 s.78.

²¹ Cap.622 Sch.11, s.9.

²² Cap.622 s.80. This is similar to the position under the predecessor Cap.32: see former s.11(2) in respect of the application of the former Table A to companies limited by shares; and *Gaiman v National Association for Mental Health* [1971] Ch 317 in respect of the application of former Tables C, D or E to companies limited by guarantee and unlimited companies.

²³ Cap.622 ss.67(1)(a), 76–77.

3.034 Control seems to mean beneficial ownership and management. In the Court of First Instance decision of *Toptrans Ltd v Delta Resources Co Inc*,⁷⁶ Deputy Judge Carlson had also accepted that the two crucial ingredients that need to be present for the corporate veil to be pierced are control and improper motive. It seems that the element of “control” generally requires the wrongdoer to own beneficially all the shares in the company concerned as well as having managerial control of the company in respect of the relevant transactions. Thus, in *Nicholas v Nicholas*,⁷⁷ in matrimonial proceedings, the English Court of Appeal declined to treat the property of a company as the property of the husband, even though the husband owned 71 per cent of the shares in the company in circumstances where the minority shares were held by others who were not nominees of the husband. In *Dadourian Group Intl Inc v Simms*,⁷⁸ it was argued that the two controlling shareholders of a company should be liable for certain contractual debts of the company on the basis that the company was a mere façade concealing the true facts. However, the court declined to pierce the corporate veil. Although the two shareholders concerned owned beneficially all the shares in the company, the chairman and managing director of the company were independent persons who were not, on a day-to-day basis, acting as agents of the shareholders or acting under their direction. The shareholders were not in control of the company in the relevant sense when the company entered into the transactions concerned, and the court concluded that the company was used as a genuine company and not as a mere façade.

3.035 Toptrans case. In *Toptrans Ltd v Delta Resources Co Inc*,⁷⁹ the plaintiff contracted with a company (Delta), which was controlled by a Daniel Wong. Wong also controlled another company (Polo), and both companies were used to carry on a business operated by Wong. Delta was liable to the plaintiff for certain payments, and the plaintiff sued both Delta and Polo to recover the amounts. Although the contract was with Delta, both the companies were used interchangeably in communicating with the plaintiff, and the operation of the contract was performed interchangeably by both companies through common staff and Wong. On the facts, the parties accepted that Wong was the common controller of both companies. However, the court found that there was no improper motive. The court held that “some element of ‘shenanigans’ must be demonstrated to justify piercing of ‘the veil’”, and that none was present in this case, with there not being any “manipulation”.⁸⁰ It was merely out of convenience that Wong used both companies to perform the contract. Accordingly, the court refused to find that Polo would be liable to the plaintiff in respect of Delta’s debts.

3.036 Yui Tai Plywood case. The decision in *Toptrans Ltd* can be contrasted with that in the earlier case of *Yue Tai Plywood & Timber Co Ltd v Far East Wagner Construction Ltd*.⁸¹ In *Yue Tai Plywood*, the plaintiff supplied goods under a contract entered into

with a company, D1. There was a second company, D2, which had common directors and shareholders with D1, and which shared the same registered office and same place of business as D1. D2 drew cheques in favour of the plaintiff in purported payment for the goods, but the cheques were dishonoured. In an action brought by the plaintiff against D2 for payment, the court held that D2 was liable. The court accepted the evidence that both the plaintiff and the staff of D1 and D2 treated the two companies as a combined operation, and held that “there was a deliberate and obvious blurring of the edges in the operation of [the] transactions”.⁸² Regardless of whether the corporate veil was pierced, D2 would in any event have been liable on the cheques as drawer (as held by the court), although it appears from the judgment that the court was also prepared to treat D2 as being liable under the contract for the purchase of goods (independently of D2’s liability on the cheques).

Criticism of Yue Tai Plywood. However, it is not entirely clear from the judgment in *Yue Tai Plywood* what the precise basis for piercing of the corporate veil was. There is a possibility of the decision being justified on the basis of principles of agency.⁸³ Alternatively, if the decision is to be regarded as an application of the idea of a “mere façade”, there arises the question of what was the impropriety in the case. As suggested by the *Toptrans* decision, the mere fact that two companies are used to carry out the obligations under a contract does not amount to impropriety. Perhaps there was an element of intentional deception in *Yue Tai Plywood* that could justify the piercing of the veil in that case. The Court of Appeal in the more recent decision of *Winland Enterprises Group Inc v Wex Pharmaceuticals Inc*⁸⁴ has emphasised that the mere fact that two companies share common management, common directors and common staff is insufficient for the court to pierce the corporate veil in respect of the two companies. In that case, Acro Pharm was a wholly owned subsidiary of another company (WEX). The plaintiff alleged that Acro Pharm was in breach of contract and also sought to join WEX to the proceedings on the basis that corporate veil of Acro Pharm should be pierced, with any liability for breach of contract also imposed on WEX. The only basis for piercing the corporate veil in this case was that Acro Pharm was a wholly owned subsidiary and was under the control of WEX, and with the companies sharing the same offices and common staff. The Court of Appeal was emphatic in rejecting this as being sufficient for the piercing of the corporate veil.

“Impropriety” covers situations where company is used to evade existing legal obligations, or where used to perpetrate fraud or some other unlawful conduct. For the purposes of the test for piercing the corporate veil, “impropriety” covers situations where the company is used to evade existing legal obligations, or where the company is used to perpetrate fraud or some other unlawful conduct.⁸⁵ However, the notion of impropriety may be wider than these particular situations. The concept has also been described as one where a company is used in an unconscionable attempt to practise some other deception.⁸⁶

⁷⁶ [2005] 1 HKLRD 635.

⁷⁷ [1984] FLR 285.

⁷⁸ [2006] EWHC 2973 (Ch).

⁷⁹ [2005] 1 HKLRD 635.

⁸⁰ [2005] 1 HKLRD 635, 641.

⁸¹ [2001] 2 HKLRD 446.

⁸² [2001] 2 HKLRD 446, 450.

⁸³ See para.3.061 below.

⁸⁴ [2012] 2 HKLRD 757, [51].

⁸⁵ See para.3.039 below.

⁸⁶ *Re Polly Peck Intl Plc* [1996] BCC 486, 497, per Robert Walker J.

3.037

3.038

- (b) the contract had been entered into on the company's behalf by an agent acting without the company's authority."

4.045 **Ratification is retrospective under s.122.** Section 122(3) expressly equates the position with that which would arise in the ordinary case of an unauthorised agent (where the principal was in existence at the time of the purported transaction). Accordingly, it seems that in Hong Kong the ratification should have retrospective effect similar to the ordinary position under agency law (and consistent with the Australian court's views on the earlier Australian provision).

5.4 Communication

4.046 **Common law position that there is no requirement that ratification be communicated to third party for it to be effective.** Given that the company is only liable upon ratification of the contract under s.122, it is important for the third party contractor to be informed about the ratification in a timely manner. Where the ratification is effected through the conduct of a person directed to the third party contractor, the third party would be aware of the ratification by the conduct of the person acting on behalf of the company. However, an express act of ratification can be an internal act such as signing a board minute stating that the company ratifies the contract, and other parties to the contract, without more, will not be aware of the ratification. To determine the rights and obligations of the parties at a certain point in time, it may be necessary to determine whether the ratification takes place immediately after the internal ratification act is done or when the company's decision to ratify is communicated to other parties to the contract.⁹⁸ None of the case authorities appear to have provided a definite answer to this question in the context of the statutory provisions. The position under the common law appears to be that there is no legal requirement for the ratification to be communicated to the third party before it is effective.⁹⁹

6. LIABILITY OF THE PERSON WHO PURPORTED TO ACT FOR THE COMPANY

6.1 Where the company does not ratify the contract

4.047 **Where contract not ratified by company, person who made contract on behalf of company personally liable for contract.** If the company does not ratify the contract, then the person who purported to act for the company or as an agent for the company

⁹⁸ *Aztech Science Pty Ltd v Atlanta Aerospace (Woy Woy) Pty Ltd* (2005) 55 ACSR 1, [82], per Basten JA.

⁹⁹ *Harrisons & Crossfield v LNW Railway* [1917] 2 KB 755, 758; *Shell Co of Australia Ltd v Nat Shipping and Bagging Services Ltd* [1988] 2 Lloyd's Rep 1, 11, 14. Where the contract was one that was made subject to ratification, the third party must be informed about the ratification (*Watson v Davies* [1931] 1 Ch 455); but this is because in such a situation the issue is one of contract formation rather than simply ratification: *Warehousing & Forwarding Company of East Africa Ltd v Jafferli* [1964] AC 1, 9-10.

is treated as a party to the contract, and the person is personally liable for the contract and is entitled to enforce the contract: s.122(2).¹⁰⁰

Section 122 triggered as long as person purported to act for company. As long as the person purported to act for the company or as an agent for the company in respect of a contract purportedly entered into in the name of or on behalf of the company, then the provisions in s.122(1)-122(2) are triggered and the person will be personally liable. The issue does not turn on whether that person is regarded as a "promoter" of the company or not. For example, in *Bay v Illawarra Stationery Supplies Pty Ltd*,¹⁰¹ the agent of the promoters who executed the contract was regarded as the person who purported to act for the proposed company and who would therefore be liable on the contract.¹⁰² There are some uncertainties on the liabilities of the promoters in a *Bay* situation. The trial court in that case held all of the four promoters liable on the contract. On appeal, Grove J expressed a provisional view that:

"Section 81 [of New South Wales's Companies Code, the pre-incorporation provision under that Code] does not declare liability beyond the person or persons who execute on behalf of the non-existent company but nothing in its terms purports to exclude any rights or obligations flowing between that person or those persons and any principal nor does it otherwise impugn the doctrine of agency. ... The law to be applied can be no different if the plaintiff seeks a remedy directly against the principal."¹⁰³

Personal liability of person acting for company can be excluded by express agreement. The liability of the person acting for the company under s.122(2) is subject to "any express agreement to the contrary".¹⁰⁴ This means that it is possible for the person and the third party contractor to agree that the person would not be liable on the contract. However, for the person to avoid liability under s.122(2), there must be a clear exclusion of personal liability, and thus where the person simply signed "for and on behalf of" the proposed company, this would not be sufficient to constitute an express agreement that he or she is not to incur personal liability.¹⁰⁵ Where a release was given to the person and the company incorporated failed to ratify after incorporation, a third party contractor who has supplied goods or provided services to the company purportedly pursuant to the contract should have a *quasi* contractual remedy (namely, in restitution) against the company.¹⁰⁶

Personal liability of person acting for company can be avoided by obtaining assignable option from other party that will lapse if not exercised. An alternative

¹⁰⁰ See *Phonogram Ltd v Lane* [1982] QB 938.

¹⁰¹ (1986) 4 ACLC 429.

¹⁰² "In paraphrase, one aspect of this statutory provision facilitates making personally liable one who executes a contract on behalf of a non-existent company. In this case that person was Mr Dyke (the agent)": (1986) 4 ACLC 429, 431.

¹⁰³ (1986) 4 ACLC 429, 431.

¹⁰⁴ Companies Ordinance (Cap.622) s.122(2).

¹⁰⁵ *Phonogram Ltd v Lane* [1982] QB 938, 944.

¹⁰⁶ See J P Hambrook, "Promoters and Pre-registration contracts" in *Australian Corporation Law - Principles and Practice* (looseleaf, LexisNexis, Sydney), [2.5.0110].

directors cannot be traced;⁸ the circumstances in which the general meeting can exercise a power that is vested concurrently in the general meeting and the directors;⁹ the validity of shareholders' requisition for a meeting where the matters proposed to be deliberated in the meeting fall within the ambit of directors' management powers;¹⁰ whether the general meeting has the power to make regulations on the operation of the company's business, where such a power is confided exclusively to the directors;¹¹ or the effect of members' unanimous agreement achieved either at or outside of a meeting.¹²

- 6.004** **Prima facie solution lies in interpretation of articles.** The *prima facie* solution to a division of powers issue hinges on the courts' interpretation of the relevant clauses in the company's articles of association, the way in which the relationship between the two corporate organs and the sources of their powers is conceived, the level of majority and formality at which members' consent is obtained, and the existence of an unbiased, functional board of directors.

2. EARLY CONCEPTIONS ON THE LOCATION OF POWER OF CONTROL

- 6.005** **Historical view: directors were agents of shareholders.** The widely held view is that prior to the 20th century the board of directors was seen as agents of the shareholders. Originally, joint stock companies, whether incorporated or not, were seen as partnerships and the underlying assets belonged to the members in equity. Accordingly, the directors of those companies, who managed the assets for the shareholders' assets, could be seen as agents of the shareholders.¹³ The deeds of settlement companies, which emerged after the passage of the Bubble Act, were in essence constituted as partnerships or trusts.¹⁴ It is therefore possible to see the relationship between shareholders and directors in a deed of settlement company as one between principals and their agents. The provision in s.90 of the Companies Clauses Consolidation Act 1845, the predecessor of the division of powers provisions in Table A attached to subsequent company law legislation (now the Model Articles), was, *prima facie*, also consistent with an agency conception of the relationship between the directors and shareholders. Section 90 provided that:

"The directors shall have the management and superintendence of the affairs of the company except as to such matters as are directed by this or the special Act to be transacted by a general meeting of the company; but all the power so to be

⁸ *Re Frontsouth (Witham) Ltd* [2011] BCC 635.

⁹ *Worcester Corsetry Ltd v Witting* [1936] 1 Ch 640.

¹⁰ *NRMA v Parker* (1986) 6 NSWLR 517; *Credit Development Pte Ltd v IMO Pte Ltd* [1993] 2 SLR 370.

¹¹ *Black White and Grey Cabs Ltd v Fox* [1969] NZLR 824.

¹² *Re Express Engineering Works Ltd* [1920] 1 Ch 466; *Ox Operations Pty Ltd v Land Mark Property Developments (Vic) Pty Ltd* [2007] FCA 1221.

¹³ Sarah Worthington, "Shares and Shareholders: Property, Power and Entitlement: Part 1" (2001) 22(9) *Company Lawyer* 258, 260.

¹⁴ Paul L Davies, *Gower's Principles of Modern Company Law* (16th edn, Sweet & Maxwell 1997) 31.

exercised shall be exercised in accordance with and subject to the provision of this and the special Act; and the exercise of all such powers shall be subject also to the control and regulation of any general meeting specially convened for this purpose...." (emphasis added)

Whilst the above agency approach was the accepted historical view, there appears to be little case authority directly on point. In *Isle of Wight Rly Co v Tahourdin*,¹⁵ a case where the company was governed by the 1845 Act, Cotton LJ said that:

"[I]f a shareholder complains of the conduct of the directors while they keep within their powers, the Court says to him: "If you want to alter the management of the affairs of the company go to a general meeting, and, if they agree with you, they will pass a resolution obliging the directors to alter their course of proceeding."

It should be noted though that Cotton LJ's quoted comments were made in a context where the company was governed by the 1845 Act.¹⁶ As such, it may have been that the comments reflected an application of the alternative contractual approach that has been expressly accepted in the 20th century jurisprudence rather than necessarily an agency approach.

That said, in the context of directors' liabilities, there were some early cases expressly accepting that directors are agents of the company. In *Ferguson v Wilson*,¹⁷ Cairns LJ stated:

"What is the position of directors of a public company? They are merely agents of a company. The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent."

6.006 **Modern view: directors not agents of shareholders.** In any event, by the early 20th century, it became clear that the legal nature of the relationship between the directors and shareholders would no longer be conceived of as one of agency, as explained through a series of court decisions.¹⁸ In *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame*,¹⁹ Cozens-Hardy LJ stated:

"[I]f you once get clear of the view that the directors are mere agents of the company, I cannot see anything in principle to justify the contention that the directors are bound to comply with the votes or the resolutions of a simple

¹⁵ (1883) 23 Ch D 320 at 330–331.

¹⁶ See *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34, per Collins MR at 43 (although s.90 was not mentioned in the court's decision in *Isle of Wight Rly Co v Tahourdin*, as the case turned on the interpretation of, *inter alia*, ss.70 and 91).

¹⁷ LR 2 Ch App 77, 89–90. See also *Charitable Corporation v Sir Robert Sutton* (1742) 2 Atkyns 400; 26 ER 642, 644.

¹⁸ *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34; *Marshall's Valve Gear Co Ltd v Manning Wardle & Co Ltd* [1909] 1 Ch 267; *Quin & Axtens v Salmon* [1090] AC 442.

¹⁹ [1906] 2 Ch 34, 45.

- 7.032 Rejecting appointment of one director without having to reject others.** Where the company is a public company or a company limited by guarantee, no motion for the appointment of two or more persons as directors by a single resolution can be made, unless a resolution that such an appointment can be so made has first been passed at the meeting without any vote against it.⁶⁷ The rationale behind this prohibition on composite motions is to preserve the member's ability to refuse the appointment of a director without having to reject others.⁶⁸
- 7.033 Casual or additional vacancies can be filled by board or general meeting.** The power to appoint directors to fill casual vacancies or as an addition to existing directors can be vested in the board or the general meeting exclusively or granted concurrently to both corporate organs. The latter approach is adopted in the Model Articles.⁶⁹ However, any director appointed by the board only holds office until the next AGM.⁷⁰ If he or she is to continue in office after the AGM, it would be necessary for reappointment by the general meeting.
- 7.034 Notice to registrar of appointment.** Where a new director is appointed, the company must send notice to the Registrar of the appointment, with particulars specified in its register of directors (name, identification number and residential address) together with a statement signed by the director stating that he or she has accepted the appointment, and a statement that the appointee has attained the age of 18, if that person is a natural person, within 15 days from the appointment.⁷¹ The company must also enter the details of its directors in its own register of directors.⁷²
- 7.035 MD appointed by board.** The managing director is appointed by the board of directors for such period and on such terms as they think fit.⁷³ Where articles so provide, a director may appoint an alternate director to act in his absence.⁷⁴

4.4 Appointment by outsiders

- 7.036 Outsider, eg supplier of capital or debt finance, can acquire right to appoint.** It is possible for an outsider to acquire a right to appoint a director pursuant to contractual arrangements. The supplier of either capital or debt finance, for example, may be granted the right of appointing a director pursuant to a term in the company's articles⁷⁵ or of a contract.⁷⁶ Where the right to nominate is conferred under a contract, however, this may not be specifically enforceable, as the court may be reluctant to compel the

⁶⁷ Cap.622 s.460.

⁶⁸ Clive M Schmitthoff (ed.), *Palmer's Company Law* (Vol 1, 24th edn, Stevens & Sons 1987) 878.

⁶⁹ Model Articles (private companies) art.22; Model Articles (public companies) art.23. See also the discussion on this concurrent power in Chapter 6, section 3.3 (Concurrent powers).

⁷⁰ Model Articles (private companies) art.22(4); Model Articles (public companies) art.23(4).

⁷¹ Cap.622 s.645. The new requirement for notification of a correspondence address under ss.643(1)(a)(ii) and 645 has not yet commenced operation at the time of writing: see para.1.133 in Chapter 1.

⁷² Cap.622 ss.641 and 643.

⁷³ Model Articles (public companies) art.33; predecessor Cap.32 Table A reg.109 (repealed).

⁷⁴ Model Articles (private companies) art.28; Model Articles (public companies) art.30. Alternate directors would be within the Cap.622 s.2 definition of "director", and so notification of their appointment to the Registrar is required pursuant to Cap.622 s.645.

⁷⁵ *British Murac Syndicate Ltd v Alperston Rubber Co Ltd* [1915] 2 Ch 186.

⁷⁶ *Plantations Trust Ltd v Bila (Sumatra) Rubber Lands Ltd* (1915) 85 LJ Ch 801.

company to appoint the nominee where, for example, the nominee is unsuited for the office.⁷⁷ Directors may also delegate⁷⁸ their powers to appoint directors to enable the supplier of debt finance to nominate a director to protect the lender's interest.⁷⁹ Where the company is an incorporated joint venture, joint venturers may appoint nominee directors where such power is conferred under the terms of the shareholders' agreement.⁸⁰

4.5 Liabilities of under-age directors

Appointment void but under-age director can still be liable. A natural person director must be at least 18 years of age at the time of appointment.⁸¹ An appointment made in contravention of the statutory provision is void,⁸² but an under-age person who purports to act as director or shadow director can still be liable under any provision of the Companies Ordinance (Cap.622) or the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap.32) notwithstanding that the person could not be appointed director: Cap.622 s.459(3). This provision is modelled on s.157(5) of the Companies Act 2006 (UK). In the United Kingdom, the provision was introduced to deal with concerns that, notwithstanding the statutory provision, child directors were sometimes appointed in order to exploit their immunity from prosecution or the reluctance of enforcement authorities to pursue young persons.⁸³

4.6 Corporate directors

Prohibitions. There is an outright prohibition on public companies appointing a body corporate as director.⁸⁴ Corporate directors also cannot be appointed for companies limited by guarantee.⁸⁵ For private companies, there is an absolute prohibition on corporate directors for such companies which are members of a group of a company of which a listed company is member.⁸⁶ Other private companies can appoint corporate directors, but there is a requirement that the private company must have at least one director who is a natural person.⁸⁷

Issues with corporate directors regarding lack of transparency and accountability. The issue of corporate directorships had been the subject of public consultation in 2008,⁸⁸ with a suggestion being made that the prohibition on public companies having body corporate directors be extended to private companies as well. This was on the

⁷⁷ *Plantations Trust Ltd v Bila (Sumatra) Rubber Lands Ltd* (1915) 85 LJ Ch 801, 802, per Eve J.

⁷⁸ Pursuant to the directors' power of delegation as conferred under the articles: Model Articles (private companies) art.5; Model Articles (public companies) art.4; predecessor Cap.32 Table A reg.83 (repealed).

⁷⁹ Robert R Pennington, *Company Law* (8th edn, OUP 2001) 651.

⁸⁰ *Re Broadcasting Station 2GB Pty Ltd* [1964-1965] NSW 1648.

⁸¹ Cap.622 s.459(1).

⁸² Cap.622 s.459(2).

⁸³ *Hansard*, HL GC Day 2, Vol 678 col 167 (1 February 2006).

⁸⁴ Cap.622 s.456(1)(a).

⁸⁵ Cap.622 s.456(1)(c).

⁸⁶ Cap.622 s.456(1)(b).

⁸⁷ Cap.622 s.457.

⁸⁸ FSTB, *CO Rewrite - Company Names, Directors Duties, Corporate Directorship, Registration of Charges: Consultation Paper* (April 2008), [4.1]-[4.7], and *Consultation Conclusions* (December 2008), [25]-[30].

above principle. In *Passport Special Opportunities Master Fund LP v eSun Holdings Ltd*,¹¹⁶ Barma J observed that “the court should not set itself up as a tribunal to which disgruntled litigants can appeal against the commercial decisions of the board”, but held that if the board’s decision was reached with no consideration at all for a clearly relevant factor, then the decision is open to challenge. A breach of the duty to consider relevant factors and exclude from consideration irrelevant factors renders the exercise of the directors’ power voidable. In that case, the directors caused the company (eSun) to enter into a placement agreement with a broker. eSun indirectly held interests in itself through cross-holdings with another company (Lai Sun Development). The effect of the share allotments was to dilute the interests of Lai Sun Development in eSun, which resulted in a net reduction in the value of the assets of eSun. The court held that the failure of the board to consider the adverse financial impact on the company of the placements amounted to a breach of duty to take into account relevant factors. However, the court declined to set aside the allotments as innocent third parties (allottees) had already acquired property rights.

3. EXERCISE OF POWERS FOR PROPER PURPOSES

3.1 General

- 8.046 **Consider power, primary purpose for which it was exercised, and then whether that was permissible.** Directors, as fiduciaries, must exercise their powers for proper purposes.¹¹⁷ In *Howard Smith Ltd v Ampol Petroleum Ltd*,¹¹⁸ the Privy Council held that, to ascertain whether there is a breach of duty, it is necessary to start with a consideration of the power in question and to ascertain the nature of the power and the purposes for which the power was granted. The court must then determine as a matter of fact the primary purpose for which the power was exercised and whether that is within what is permissible.

3.2 The proper purposes of a power

- 8.047 **Determining purpose: generally look to articles.** Directors’ powers are generally conferred by the articles, and it is necessary to look at the particular provision in question to determine the purposes for which the power was granted. The particular power-conferring provision might not expressly set out the scope or purposes of the power, but the provision would be construed in the context of the articles as a whole,¹¹⁹ and in light of the nature of the company, and its objects and activities.¹²⁰ Some examples of directors’ powers are discussed below.¹²¹

¹¹⁶ [2011] 4 HKC 62, [142]–[156]. See also *Re Bank of East Asia Ltd* [2015] 4 HKC 137, [22]–[23] where Harris J expressed agreement with Barma J’s approach.

¹¹⁷ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Wong Kam San v Yeung Wing Keung* [2007] 2 HKLRD 267.

¹¹⁸ [1974] AC 821. See also *Re Bank of East Asia Ltd* [2015] 4 HKC 137, [15]–[20].

¹¹⁹ See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 837.

¹²⁰ See *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199, 217; and see also *Gaiman v National Association of Mental Health* [1971] Ch 317.

¹²¹ See also Chapter 14 in relation to the power to refuse registration of share transfers.

3.2.1 Power to deal with company’s assets

Assets of company must be used for corporate purposes. The funds and assets of the company must be used by directors for corporate purposes.¹²² Thus, for example, it would be an improper exercise of power by directors if they apply company assets for their own personal benefit rather than for the benefit of the company.¹²³

3.2.2 Power to allot shares

Power to allot shares primarily given to raise capital, not to destroy existing majority. The power to allot shares is primarily given to enable capital to be raised when required for the purposes of the company,¹²⁴ although there may be occasions when the directors may fairly and properly issue shares for other reasons.¹²⁵ But directors are ordinarily not entitled to allot shares for the purpose of destroying an existing majority (of shareholders in general meeting) or creating a new majority which did not exist previously.¹²⁶ The reason for this general principle has been said to lie in the distinction between the indirect proprietorship and ultimate control of the shareholders on the one hand and the powers of management entrusted to the directors on the other.¹²⁷ It is not part of the function of the directors to favour one group of shareholders over another.

In *Wong Kam San v Yeung Wing Keung*,¹²⁸ certain directors of the company purported to allot 9,900 shares to a new shareholder, effectively diluting the 100 per cent beneficial ownership of the existing controller of the shares in the company to 1 per cent beneficial ownership. The shares were issued at par value of \$1 per share. The Court of First Instance rejected the directors’ argument that the shares were allotted for the purpose of raising funds and found that there were no commercial justifications for the share allotment in circumstances where only \$9,900 were raised and where the 99 per cent interest in the company was worth a great deal more than that value (the company having assets with market value of RMB938 million). The court held that the purpose of the allotment was to replace the existing majority shareholder with a new majority created out of the allotment and that this was a breach of fiduciary duty.

Mere fact that company had considerable funds does not mean allotment not for proper purpose. In *Passport Special Opportunities Master Fund LP v eSun Holdings Ltd*,¹²⁹ where directors allotted shares pursuant to private placements, the court held that the mere fact that the company had considerable cash reserves and that there

¹²² See the principles set out by Eve J in *Re Lee, Nehrens & Co Ltd* [1932] 2 Ch 46, 51, which, although given in the context of the former *ultra vires* doctrine, have been said to be relevant in considering whether or not directors have abused their powers: *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1985] Ch 246, 287–290. See also *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1.

¹²³ E.g. *Primlake Ltd v Matthews Associates* [2007] 1 BCLC 666. Such conduct can also amount to breaches of other duties.

¹²⁴ *Re Bank of East Asia Ltd* [2015] 4 HKC 137, [14].

¹²⁵ *Harlowe’s Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co NL* (1968) 121 CLR 483, 493; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 836.

¹²⁶ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Wong Kam San v Yeung Wing Keung* [2007] 2 HKLRD 267.

¹²⁷ *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 (Mason, Deane and Dawson JJ).

¹²⁸ [2007] 2 HKLRD 267.

¹²⁹ [2011] 4 HKC 62. For the facts, see also para.8.045 above.

proper performance of directors' duties. Rogers VP (with whom the other members of the court agreed) followed the English decision of *Dorchester Finance Co Ltd v Stebbing*³⁵⁸ in holding that executive and non-executive directors have the same responsibility in law as to the management of the company's business. This implicitly accepts that there are minimum objective standards expected of all directors. Also, in *Re Copyright Ltd*,³⁵⁹ Kwan J accepted the principles set out in *Re Barings Plc, Secretary of State for Trade and Industry v Baker (No 5)*³⁶⁰ that directors have a duty to acquire and maintain a sufficient knowledge and understanding of the company's business and that, while directors can delegate, they must still supervise the discharge of the delegated functions. These views are consistent with the trend towards higher standards adopted by the courts overseas. Moreover, in *Securities and Futures Commission v Yin Yingneng Richard*,³⁶¹ Anthony Chan J accepted (the point not being in contention) the principles in *Re D'Jan of London Ltd, Copp v D'Jan*³⁶² and *Daniels v Anderson*.³⁶³ Having regard to developments in the law of negligence and to the greater role expected of directors in corporate governance today,³⁶⁴ the better view is that the Hong Kong courts would, if faced squarely with the issue, decide that the standard of care under the common law has minimum objective aspects as expounded by overseas decisions on the common law.³⁶⁵

- 8.139 **Under service or employment contract implied term that directors possesses reasonably competent skills.** In any event, for directors appointed under a service contract or employment contract (i.e., executive directors), there would (in the absence of any express term in the contract) be an implied term that the director possesses reasonably competent skills for the executive position appointed and would exercise reasonable care and skill in the performance of his or her duties.³⁶⁶ The standard would be what is objectively expected of a person appointed to the designated executive position.³⁶⁷ Where the director was appointed on the basis of particular skills, experience or qualifications, the contract may also expressly or impliedly require the director to meet the standards reasonably expected of a person having such skills, experience or qualifications.³⁶⁸

³⁵⁸ [1989] BCLC 498.

³⁵⁹ [2004] 2 HKLRD 113, 124. The case dealt with disqualification under Cap.32 Pt.IVA.

³⁶⁰ [1999] 1 BCLC 433, 489 (approved of on appeal: [2000] 1 BCLC 523).

³⁶¹ (unrep., HCMP 2502/2012, [2015] HKEC 86), [45]. The case dealt with a company incorporated in the Cayman Islands, but the court did not note any difference between Hong Kong and Cayman Islands law on directors' duties.

³⁶² [1994] 1 BCLC 561.

³⁶³ (1995) 16 ACSR 607.

³⁶⁴ See, e.g., Standing Committee on Company Law Reform, "Corporate Governance Review: Consultation Paper on Proposals in Phase 1 of the Review" (Hong Kong July 2001) paras.6.06–6.07, 6.13; Companies Registry, *A Guide on Directors' Duties* (Hong Kong March 2014); Stock Exchange Listing Rules r.3.08(f), App.14 (Corporate Governance Code and Corporate Governance Report).

³⁶⁵ For a contrary view, see I Tockley, "The AWA Decision in Hong Kong" (1995) 5(11) *Company Secretary* 36. Although Cap.622 s.465 now applies in relation to directors, the pre-existing common law is still relevant for events occurring before the commencement of s.465 (3 March 2014). Also, the common law principles continue to apply to officers who are not directors.

³⁶⁶ *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555.

³⁶⁷ *ASIC v Rich* (2009) 75 ACSR 1, [7206].

³⁶⁸ See *Daniels v Anderson* (1995) 16 ACSR 607, 667.

7.3.2 Statutory duty of care

Cap.622: new statutory duty replaces general law duty. The new statutory duty replaces the general law duty.³⁶⁹ Actions in respect of conduct which occurs after the commencement of Cap.622 need to be proceeded with via the statutory provision instead of under the general law. As noted above, the statutory provision was enacted to clarify that the dual objective or subjective standard of care is to apply for directors in Hong Kong companies.

Cap.622: standard of care. Under Cap.622 s.465(2),³⁷⁰ a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and (b) the general knowledge, skill and experience that the director has. Paragraph (a) sets out the minimum objective standards expected of all directors.³⁷¹ The standard is set with reference to the functions of the director in relation to the company, and so this takes into account the position held by the director and the responsibilities of the director, as well as the nature and type of the particular company concerned.³⁷² Where the director has special knowledge, skills or experience, then the standard of care expected of the director is raised, pursuant to para (b). The standard expected of a director cannot be lowered below the minimum objective standard under para (a) for directors who have poor knowledge, skills or experience, since a director must meet both the standards in paras (a) and (b). The dual objective or subjective standard in s.465 sets out in statutory form what is arguably the common law position in relation to the duty of care of directors.

Cases from general law relevant to statutory duty. The provision in Cap.622 does not have an equivalent of s.170(4) of the Companies Act 2006 (UK), which states that the statutory duties "shall be interpreted and applied in the same way as common law rules or equitable principles and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the [statutory] duties". The intention of the English provision is for the statutory duties to be interpreted and developed in an organic manner similar to the common law and consistently with developments in fiduciary and common law duties in other areas of the general law such as trusts and agency law.³⁷³ Without such a provision in Cap.622, s.465 would be interpreted pursuant to ordinary principles of statutory construction. The standard of care as set out in the statutory provisions has been accepted as codifying the existing common law in both England³⁷⁴ and Hong Kong.³⁷⁵ Accordingly, since the statutory duty is derived from the general law, the existing cases under the general law which apply the type of dual objective or subjective standard set out in s.465 would be relevant to interpretation of the

³⁶⁹ Cap.622 s.465(4).

³⁷⁰ The provision is modelled on Companies Act 2006 (UK) s.174.

³⁷¹ *Brumder v Motornet Service and Repairs Ltd* [2013] 3 All ER 412, [46].

³⁷² See also *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569; *Brumder v Motornet Service and Repairs Ltd* [2013] 3 All ER 412, [55].

³⁷³ Explanatory Notes to the Companies Act 2006 (UK), para.305.

³⁷⁴ *Gregson v HAE Trustees Ltd* [2009] 1 All ER (Comm) 457, [24].

³⁷⁵ *Securities and Futures Commission v Yin Yingneng Richard* (unrep., HCMP 2502/2012, [2015] HKEC 86), [45].

meeting in two situations. The first is where the members themselves requisition the meeting. Here, the members can include the text of a proposed resolution in their request for a meeting, and the notice of the meeting sent to members by the company must include notice of that resolution.¹⁴⁶ The second is where the meeting is an AGM. Here, the members may request the company to give to members notice of a proposed resolution where the request is made by members representing at least 2.5 percent of the total voting rights of the members having a right to vote, or by at least 50 members having the right to vote.¹⁴⁷ These rights in Cap.622 are similar to the rights previously conferred under the predecessor Cap.32.¹⁴⁸ However, under Cap.32 s.115A(4)(b) (repealed), the expenses associated with the circulation of a members' resolution at an AGM were borne by the members requesting circulation. To reinforce members' decision-making power, Cap.622 has reformed this cost aspect so that a resolution proposed by members will be circulated at the expense of the company.¹⁴⁹

- 9.064 **Members representing 2.5% of total voting rights or at least 50 members have right to request company to circulate statement prior to general meeting.** For any general meeting, members representing at least 2.5 percent of the total voting rights or at least 50 members who have a right to vote may request the company to circulate a statement of not more than 1,000 words relating to a proposed resolution or other business to be dealt with at the meeting.¹⁵⁰ It is thus possible for members to express opinions to all of the other members on matters to be deliberated upon at a general meeting. This right is again derived from provisions in the predecessor Cap.32,¹⁵¹ but the corresponding provision in Cap.622 requires the company to bear the expenses of circulating the members' statement in the case of AGMs (similar to the position for circulation of members' resolutions for AGMs).¹⁵² Where the meeting is not an AGM, the members requesting circulation are still required to pay for the expenses of circulation unless the company resolves otherwise.¹⁵³ A company is not required to circulate a statement if the members' rights to circulation are being abused or are being used to secure needless publicity for defamatory matter.¹⁵⁴ Whether a statement is "defamatory" depends on the common law meaning of the term, namely whether the meaning of the statement has a tendency to lower the plaintiff in the estimate of the ordinary reasonable reader.¹⁵⁵ The word defamatory for present purposes does not mean that the statement was one which, if it were the subject of a suit in defamation, would result in a win for the plaintiff. In deciding whether a statement is defamatory, one looks only to the meaning of the statement, not to the availability of the defences.¹⁵⁶

¹⁴⁶ Cap.622 ss.566(3)(b) and 567(3).

¹⁴⁷ Cap.622 s.615.

¹⁴⁸ See predecessor Cap.32 ss.113 and 115A (repealed).

¹⁴⁹ Cap.622 s.616(1).

¹⁵⁰ Cap.622 s.580.

¹⁵¹ Predecessor Cap.32 s.115A(1)(b) (repealed).

¹⁵² Cap.622 s.582(1). This changes the position compared with predecessor Cap.32 s.115A(4)(b) (repealed).

¹⁵³ Cap.622 s.582(2).

¹⁵⁴ Cap.622 s.583.

¹⁵⁵ *National Roads and Motorists' Association v Snodgrass* (2002) 42 ACSR 622, [10].

¹⁵⁶ *National Roads and Motorists' Association v Snodgrass* (2002) 42 ACSR 622, [11].

5. PROCEEDINGS

5.1 Quorum

5.1.1 The meaning of quorum

- Quorum minimum number of participants required to constitute valid meeting.** 9.065
A quorum is a minimum number of participants who must be present to constitute a valid meeting.

5.1.2 The requirement

- Quorum for general meeting two unless articles provide otherwise.** 9.066
Unless the articles provide otherwise, the quorum required for a general meeting is two members present in person or by proxy.¹⁵⁷ Where the company has only one member, the quorum is that member in person or by proxy.¹⁵⁸ If the only member of the company is itself a body corporate, that member present by its corporate representative also constitutes a quorum of a general meeting of the company.¹⁵⁹

- Cap.622 does not specify time after which meeting to be regarded as inquorate due to insufficient members but MA states half an hour from time appointed for meeting.** 9.067
Cap.622 does not specify the time after which the meeting is regarded as inquorate due to insufficient members arriving. Under the Model Articles, if a quorum is not present within half an hour from the time appointed for the meeting, then the meeting shall be dissolved where it was called through a members' requisition, and in all other cases the meeting is adjourned to the same day in the next week (or to another day that the directors determine).¹⁶⁰ If at the adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting, the member or members present are deemed to constitute a quorum.¹⁶¹

5.1.3 Loss of quorum

- Quorate meeting may lose quorum if one or more members leave before meeting concluded.** 9.068
An otherwise quorate meeting may lose its quorum when one or more of the members leave before the meeting is concluded. This possibility raises the question as to the validity of a resolution passed after the meeting has lost its quorum. The question will need to be answered by reference to the wording of the quorum regulations in the company's constitution. The common law rule is that for the meeting to be valid, a quorum must exist from the time when the meeting proceeds to business to the conclusion of the meeting.¹⁶² This common law rule has been incorporated in

¹⁵⁷ Cap.622 s.585(3).

¹⁵⁸ Cap.622 s.585(3).

¹⁵⁹ Cap.622 s.585(2).

¹⁶⁰ Model Articles (private companies) art.42(1); Model Articles (public companies) art.46(1) (Companies (Model Articles) Notice Schs.1 and 2); predecessor Cap.32 Table A reg.55 (repealed).

¹⁶¹ Model Articles (private companies) art.42(2); Model Articles (public companies) art.46(2). The equivalent provision in former Table A reg.56 refers to the "members" present being a quorum: see *Re China Star Enterprise Hong Kong Ltd* [2013] 5 HKLRD 271, discussed above at para.9.006.

¹⁶² *Henderson v Louttit* (1894) 21 R (Ct of Sess) 674; *Ball v Pearsall* (1987) 10 NSWLR 700.

common law or under the Companies Ordinance, the member is entitled to bring an action (in his own name). Here, the member's personal rights are infringed and the member has a personal remedy against the wrongdoer. The situation is not one where the proper plaintiff principle in *Foss v Harbottle* bites. The proper plaintiff principle only means that the company is the proper plaintiff to vindicate the company's rights, as opposed to individual members' personal rights. Members' personal rights of action are discussed at para.10.098.

2.2 Irregularity principle

- 10.014 **Irregularity principle: member cannot sue where mere irregularity can be cured by general meeting.** Under the irregularity principle, a member is not entitled to sue to complain of a mere informality or irregularity where the irregularity is one which can be cured by a vote of the company in general meeting and where the intention of the majority members is clear.¹⁵ For example, in *Re Hong Kong Sailing Federation*,¹⁶ a general meeting was held where certain motions put to the vote at the general meeting were defeated by an overwhelming majority. The plaintiff, a member who had supported the motions, brought an action to seek a declaration that the proceedings at the meeting were null and void due to breaches of the articles relating to the procedure for calling of a poll. The court held that the irregularities occurred but declined a remedy on the basis of the irregularity principle. The wishes of the majority, as reflected in the votes cast by poll paper, were clear. Although there was an irregularity, the majority could ratify the irregularity by ordinary resolution (since the motion considered by the meeting could be passed by ordinary resolution). Accordingly, there was little point in the court declaring the general meeting to have been invalid.

2.3 Rationales for the rule in *Foss v Harbottle*

- 10.015 **Rationales for rule in *Foss v Harbottle*.** The proper plaintiff principle follows logically from the separate entity principle.¹⁷ Both limbs of the rule in *Foss v Harbottle* have also been justified on the following policy grounds:

- The rule avoids a multiplicity of actions by a number of members over the same issue.¹⁸
- The company is in a better position to judge whether to take legal proceedings than an individual member,¹⁹ particularly in relation to internal disputes within the company.²⁰

¹⁵ *Burland v Earle* [1902] AC 83, 93–94; *Re Hong Kong Sailing Federation* [2010] 1 HKLRD 801; *Lim Jonathan v She Wai Hung* [2011] 1 HKLRD 305.

¹⁶ [2010] 1 HKLRD 801.

¹⁷ *Foss v Harbottle* (1843) 2 Hare 461, 490–491, 67 ER 189; *Prudential Assurance Co Ltd v Newman Industries Ltd (No.2)* [1982] Ch 204, 224 (Eng CA).

¹⁸ *Gray v Lewis* (1873) 8 Ch App 1035, 1051.

¹⁹ R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, Looseleaf edn), [11.240].

²⁰ *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9, 22–24.

- The courts should not intervene where a majority of the members do not support the legal proceedings (this reflects the majority rule doctrine). Where the complaint is of a procedural irregularity at a general meeting which the majority can cure, there is little point in invalidating the meeting where “the ultimate end ... is only that a meeting has to be called, and then ultimately the majority gets its wishes”.²¹

3. COMMON LAW DERIVATIVE ACTION

3.1 Introduction

Derivative action: brought by individual in name of company and for company. 10.016
The term “derivative action” refers to legal proceedings brought by an individual in the name of the company on behalf of the company. Where the wrong is done to the company, the proper plaintiff to bring proceedings is the company (with the decision made by the appropriate corporate organ).²² If the company does not institute the proceedings, then an individual member may bring a derivative action on behalf of the company pursuant to the common law exceptions to the rule in *Foss v Harbottle*.

Circumstances when derivative action can be brought. A common law derivative action can be brought in the following circumstances: 10.017

- in respect of *ultra vires* or illegal conduct (see para.10.018); or
- where there is fraud on the company (see para.10.019).²³

Some cases have suggested that there is also a further residual ground for a common law derivative action on the basis of the interests of justice (see para.10.028).

3.2 *Ultra vires* or illegal conduct

Derivative action for (i) *ultra vires* or illegal conduct. Where the company has engaged in conduct which is *ultra vires* in the sense that it is unlawful for the company to do the act (such as an unlawful return of capital to shareholders²⁴ or unlawful financial assistance for the acquisition of shares²⁵),²⁶ a member has standing to bring a derivative action on behalf of the company in respect of the conduct.²⁷ Where the member seeks to restrain the unlawful conduct, the member has a personal right to

²¹ *MacDougall v Gardiner* (1875) 1 Ch D 13, 25.

²² See para.10.010 above.

²³ *Edwards v Halliwell* [1950] 2 All ER 1064, 1067.

²⁴ Cap.622 s.212; *Devlin v Slough Estates Ltd* [1983] BCLC 497, 503.

²⁵ Cap.622 s.275; *Smith v Croft (No.2)* [1988] Ch 114, 165.

²⁶ The case law principles in the present context have also been applied to situations where the company acts *ultra vires* in the sense of acting outside of capacity. However, the question of lack of capacity no longer arises for Hong Kong companies as such companies now have full capacity: see Cap.622 s.115 and Chapter 5.

²⁷ *Smith v Croft (No.2)* [1988] Ch 114; *Nankivell v Benjamin* (1892) 18 VLR 543; *Hawkesbury Development Co Ltd v Landmark Finance Pty Ltd* (1969) 92 WN (NSW) 199.

may well find that the conduct is unfairly prejudicial. What amounts to serious mismanagement should be assessed objectively in line with the general objective test of unfair prejudice. Conduct that amounts to a breach of the duty to act with due care, skill and diligence could be unfairly prejudicial within ss.724–725 of Cap.622,⁵¹² for the same reason, it would seem, that breaches of fiduciary duties of directors are caught.

6.7.6 Breaches of understandings or promises that equity would uphold

10.188 Equitable considerations making it unfair. Aside from breaches of legal duties (whether arising under the Ordinance, the constitution or otherwise), the second broad category of situations of unfair prejudice recognised in *O'Neill v Phillips*⁵¹³ is where equitable considerations make it unfair for those conducting the affairs of the company to rely on their strict legal powers. One major example of the application of equitable considerations within this second category is where the letter of the articles does not fully reflect the promises made or understandings reached by the parties at the time when the company was formed and where it would be unfair for the parties to exercise their legal rights in a way that is contrary to the understanding of the parties.⁵¹⁴ Equitable considerations can apply to restrain the parties from breaching their promises or understandings even though such promises or understandings cannot be independently enforced as a matter of contract.⁵¹⁵ Moreover, apart from understandings reached at the time the company was formed or the association between the parties entered into, there may also be later promises made or understandings reached during the life of the company which it would be unfair to allow a member to ignore.⁵¹⁶

10.189 Necessary for there to be personal relationship or personal dealings. For equitable considerations (and hence the unfair prejudice remedy) to apply in relation to breaches of promises or undertakings not embodied in the articles or collateral shareholders' agreements, it is necessary for there to be a personal relationship or personal dealings of some kind between the party seeking to exercise the legal right and the party seeking to restrain such exercise, such as will affect the conscience of the former.⁵¹⁷ The mere fact that a company is a small one, or a private company, is not sufficient for the importing of equitable considerations in this context, as small private companies could be formed "where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles".⁵¹⁸ The association must be formed or continued on the basis of a personal relationship, involving mutual confidence, such as in a quasi-partnership company where the relationship between the parties is most closely analogous to that in a

partnership (for example, where a pre-existing partnership had been converted into the company to operate the same or substantially the same business).⁵¹⁹

10.190 Mere fact that small family company does not necessarily mean it is quasi-partnership or there is relationship of mutual trust and confidence. The mere fact that the company is a small family company does not necessarily mean that the company is a quasi-partnership or that there is a relationship of mutual trust and confidence in the operation of the company's business;⁵²⁰ it would be necessary to examine the actual relationships between the parties in the particular case. Moreover, although a company might have been in the nature of a quasi-partnership at the time it was established, it is possible for the relationship to subsequently change to a purely commercial footing so ending the appropriateness of equitable considerations giving rise to any legitimate expectations.⁵²¹

10.191 Where the company is not a quasi-partnership: generally personal relationship between parties still required. While quasi-partnership companies provide the classic example of situations where equitable constraints can be applied to restrain breaches of basic understandings that underpin the parties' association, the fact that a company is not a quasi-partnership is not necessarily fatal to the petitioner's case.⁵²² However, it has been said that there must still be some kind of personal relationship or personal dealings between the parties sufficient for equity to intervene.⁵²³ The Court of Appeal has held that there could not be a permanent personal relationship of mutual trust and confidence formed with a state entity that was a party to a joint venture company, as it is impossible for the state to exhibit those personal qualities, and any personal relationship with the individuals acting for the state entity could only be transient and could not be relied upon as the basis of the association since the positions held by those individuals for the state entity would only be temporary.⁵²⁴ Also, the element of a personal relationship would be difficult to establish in the context of a large public company, as the relationship between the parties would generally be a purely commercial one at arm's length.⁵²⁵

10.192 Luck Continent case: personal relationship not necessary where all shareholders privy to understanding. However, in *Luck Continent Ltd v Cheng Chee Tock Theodore*,⁵²⁶ the Court of Appeal held that there was unfair prejudice arising from a breach of an implied common understanding of the shareholders of a listed company that the company would maintain its listing status. On the facts, there was no express agreement or understanding between the shareholders as such, but investors acquired their shares on the premise and on the implicit agreement of the company that the

⁵¹² *Re Elgindata* [1991] BCLC 959, 994; *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354, cited with approval in *Re Tai Lap Investment Co Ltd* [1999] 1 HKLRD 384.

⁵¹³ *Re a Co (No.00709 of 1992)*, *O'Neill v Phillips* [1999] 1 WLR 1092.

⁵¹⁴ See *Re a Co (No.00709 of 1992)*, *O'Neill v Phillips* [1999] 1 WLR 1092, 1099–1102; *Re Taiwa Land Investment Co Ltd* [1981] HKLR 297; *Wong Man Yin v Ricacorp Properties Ltd* (2003) 6 HKCFAR 265, 88.

⁵¹⁵ *Re a Co (No.00709 of 1992)*, *O'Neill v Phillips* [1999] 1 WLR 1092.

⁵¹⁶ *Re a Co (No.00709 of 1992)*, *O'Neill v Phillips* [1999] 1 WLR 1092.

⁵¹⁷ *Re a Co (No.00709 of 1992)*, *O'Neill v Phillips* [1999] 1 WLR 1092, 1101, approving *Re Astec (BSR) plc* [1998] 2 BCLC 556, 588. But cf. *Luck Continent Ltd v Cheng Chee Tock Theodore* [2013] 4 HKLRD 181: see para.10.192 below.

⁵¹⁸ *Ebrahimi v Westbourne Galleries Ltd* [1964] AC 360, 379–380.

⁵¹⁹ *Ebrahimi v Westbourne Galleries Ltd* [1964] AC 360, 379–380; *Re a Company (No.00709 of 1992)*, *O'Neill v Phillips* [1999] 1 WLR 1092; *Croly v Good* [2010] 2 BCLC 569.

⁵²⁰ *Re Ching Hing Construction Co Ltd* (unrep., HCCW 889/1999, [2001] HKEC 1402).

⁵²¹ *Re a Co (No.005134 of 1986)*, *ex p Harries* [1989] BCLC 383.

⁵²² *Re Silver Bell Uniform Ltd* [2012] 1 HKLRD 719, 735–736 (CA).

⁵²³ *Re Astec (BSR) plc* [1998] 2 BCLC 556, 588–589.

⁵²⁴ *Ng Yat Chi v Max Share Ltd* [2001] 1 HKLRD 561; on appeal the issue was left open by the Court of Final Appeal: see (2001) 4 HKCFAR 299, 301–302.

⁵²⁵ See *Re Blue Arrow plc* [1987] BCLC 585, 590; *Re Astec (BSR) plc* [1998] 2 BCLC 556, 588–589.

⁵²⁶ [2013] 4 HKLRD 181. For discussion of the case, see also para.10.177 above.

audit properly.²⁴⁹ Likewise, in the case of wrongful payment of taxes for non-existent tax liability, the company's loss as a result of the payments is in principle recoverable from the negligent auditor.²⁵⁰ Generally, where the company's decision on the basis of the defective accounts (which led to the loss being suffered) is a decision which companies ordinarily take on the basis of the accounts, then the auditor is potentially liable for the loss.²⁵¹ Where the auditors are negligent in failing to report inadequacies in the company's books or systems or in failing to uncover misfeasance by company personnel, the auditors may be liable for the defalcations or other losses sustained by the company which the company would have prevented through remedial action had the auditor alerted the company to the problems.²⁵²

11.127 Limits to damages. There are limits to the damages recoverable from an auditor, which reflect the limitations in the scope of the auditors' role and the scope of their duty of care. In *Guang Xin Enterprises Ltd (in liq) v Kwan Wong Tan & Fong*,²⁵³ the Court of First Instance emphasised that the auditor is not a business adviser; that the auditor is not qualified to express a view as to how the business should be run, or what investments to make, or whether the company should continue to carry on business; and that the auditor is not engaged to steer the management into making better management decisions.²⁵⁴ In that case, the company entered into liquidation and the liquidator argued that by reason of incorrect reporting by the auditors (such as overvaluation of certain investments), the company continued trading thereby suffering loss, and that the auditors should be liable for those trading losses. The court, in striking out the claim, held that the auditors could not be liable for the trading losses. The court held that, in light of the role of the auditor as explained above, trading losses flowing from a decision to trade based on inaccurate financial information provided by the auditors are not a kind of damage from which the auditors promise to save the company harmless. On this basis, the trading losses should not be regarded as having been caused, in the legal sense, by the incorrect reporting.²⁵⁵

11.128 Whether scope of liability widening. However, in *Equitable Life Assurance Society v Ernst & Young*,²⁵⁶ the English Court of Appeal was not prepared to strike out a claim

²⁴⁹ *Leeds Estate, Building and Investment Co v Shepherd* (1887) 36 Ch D 787; *Re London and General Bank (No 2)* [1895] 2 Ch 673; *Equitable Life Assurance Society v Ernst & Young* [2003] 2 BCLC 603; *Extramoney Ltd v Chan, Lai Pang & Co (a firm)* [1994] HKLY 223; *Topping Chance Development Ltd v CCIF CPA Ltd* [2015] 3 HKC 71, 87.

²⁵⁰ *Topping Chance Development Ltd v CCIF CPA Ltd* [2015] 3 HKC 71, 87.

²⁵¹ See also *Johnson v Gore Wood & Co* [2003] EWCA Civ 1728, [98] where Arden LJ stated: "The scope of the duty of care as auditors must in principle encompass anything which the company in general meeting could, having regard to the statutory scheme for annual accounts and audit, be expected to do on the strength of those unqualified accounts."

²⁵² See *Daniels v Anderson* (1995) 37 NSWLR 438, 525–564; *Sasea Finance Ltd (in liq) v KPMG* [2000] 1 All ER 676; *Guang Xin Enterprises Ltd (in liq) v Kwan Wong Tan & Fong* [2002] 2 HKC 613, [41]. See also para.11.125 above.

²⁵³ [2002] 2 HKC 613.

²⁵⁴ [2002] 2 HKC 613, 622–625, citing *Caparo Industries Plc v Dickman* [1990] 2 AC 605; *Bank of Credit and Commerce Intl (Overseas) Ltd v Price Waterhouse* [1999] BCC 351.

²⁵⁵ The court applied *Alexander v Cambridge Credit Corp Ltd* (1987) 9 NSWLR 310; *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1361 (Eng CA); *Bank of Credit and Commerce Intl (Overseas) Ltd v Price Waterhouse* [1999] BCC 351. The case went on appeal, but there was no appeal on the point concerning the company's trading losses: see *Guang Xin Enterprises Ltd v Kwan Wong Tan* [2003] 3 HKLRD 527.

²⁵⁶ [2003] 2 BCLC 603.

for damages in respect of losses which the company could have averted by the directors selling the company's undertaking at an early stage had the auditors properly reported on the company's accounts. The approach adopted by the court in this case appears to widen the scope of auditors' liabilities compared with the more restrictive approach adopted in Hong Kong in the *Guang Xin Enterprise* case and in previous English cases (including an earlier decision of the English Court of Appeal²⁵⁷). The decision has been criticised. It has been said that if the auditors were engaged to provide an audit for the specified purpose of consideration of a potential sale, then the auditors would rightly be liable for the lost opportunity to sell resulting from the auditors' negligence. However, that was not the situation in the above case, and consistently with earlier case law, the auditors should not have been regarded as having undertaken to protect the company from losses flowing from the directors' decision to continue the company's existence.²⁵⁸

Company's contributory negligence or culpability

Company's contributory negligence or culpability. Where an auditor is liable to the company, the auditor can potentially seek to reduce the amount of damages payable on the basis of the company's contributory negligence.²⁵⁹ Where the company has, through its directors or senior managers, failed to take reasonable care for its own welfare—such as where the board or management failed to ensure that proper records were kept or proper internal controls put in place—then there will be contributory negligence on the part of the company.²⁶⁰ In *Daniels v Anderson*,²⁶¹ the NSW Court of Appeal held that, generally speaking, contributory negligence of any employee or other person whose acts for which the company would be vicariously liable would be regarded as the contributory negligence of the company. The general principles of attribution, and their exceptions, are relevant here.²⁶² For example, where the company's loss resulted from fraud of an employee, that fraud would not ordinarily be imputed to the company for the purposes of determining whether there was contributory negligence by the company.²⁶³

Sole shareholder source of fraud, company not entitled to sue on basis of *ex turpi causa non oritur actio*. Where the company's sole beneficial shareholder is the source of the fraud (e.g. in a sole director or shareholder company where that person perpetrated the fraud), the fraud will be regarded as the fraud of the company such that the company would not be entitled to sue the auditors on the basis of the principle of *ex turpi causa non oritur actio* (the court will not assist a plaintiff to recover a benefit from his or her own wrongdoing).²⁶⁴

²⁵⁷ *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1361.

²⁵⁸ Lee Roach, "Equitable Life and Auditor Liability: Part 1" (2006) 17 *International Company and Commercial Law Review* 201.

²⁵⁹ Law Amendment and Reform (Consolidation) Ordinance (Cap.23) s.21; and see *Daniels v Anderson* (1995) 37 NSWLR 438, 564–578. But cf. *Extramoney Ltd v Chan, Lai Pang & Co (a firm)* [1994] HKLY 223.

²⁶⁰ *Daniels v Anderson* (1995) 37 NSWLR 438; *Barings Plc v Coopers & Lybrand* [2003] EWHC 1319.

²⁶¹ (1995) 37 NSWLR 438, 570.

²⁶² See Chapter 12.

²⁶³ *Daniels v Anderson* (1995) 37 NSWLR 438, 568; and see Chapter 12.

²⁶⁴ *Stone & Rolls Ltd (in liq) v Moore Stephens* [2009] 1 AC 1391. For discussion of the case, see *Bilta (UK) Ltd v Nazir* [2015] 2 WLR 1168; Peter Watts, "Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm): Audit Contracts and Turpitude" (2010) 126 *Law Quarterly Review* 14.

similar defences available.²⁷⁰ However, it is not necessarily the case that a strict liability regulatory offence entails vicarious liability, nor is it the case that an offence requiring *mens rea* for the primary offender cannot lead to vicarious liability of the offender's principal without the need for *mens rea* on the part of the principal.²⁷¹ Whether a statutory offence imposes vicarious liability is a matter of statutory interpretation.²⁷²

Organisational fault

- 12.124 **Ineffectiveness of identification theory in case of large corporations.** The principles of corporate liability based on the identification theory have been much criticised as being ineffective and inappropriate for large companies where functions and responsibilities are spread diffusively within a complex corporate structure.²⁷³ While it may be easier to identify an individual or individuals as the company itself for small companies, it may be difficult to do so for large companies. For example, while a number of prosecutions have been brought in England against companies for manslaughter arising from gross negligence causing death (such as the 1987 Herald of Free Enterprise ferry disaster²⁷⁴ and the 1997 Southall rail crash²⁷⁵), few have been successful.²⁷⁶ In Hong Kong, there was a successful prosecution against a construction company Ajax Engineers and Surveyors Ltd for its fault where a site lift had fallen 17 floors, killing 12 building workers, but there, the company had pleaded guilty, and two individuals who were originally found guilty had their convictions quashed on appeal.²⁷⁷ The delegation of responsibilities via complex and diffuse management structures can mean that no single individual is culpable (and hence there is no guilty person who would be identified with the company), even though it might be thought that the company is responsible for the harm that has occurred and should be held to be criminally liable. A company might be regarded as being at fault because of corporate policies or a corporate culture that has facilitated the conduct leading to the harm, or there are deficiencies and failings at the organisational level, even though no single individual is fully responsible.²⁷⁸

²⁷⁰ See, e.g., *R v British Steel Plc* [1995] 1 WLR 1356; *Tesco Stores Ltd v Brent LBC* [1997] 1 WLR 1037; *R v Gateway Foodmarkets Ltd* [1997] IRLR 189.

²⁷¹ See *Mousell Bros Ltd v London and North-Western Railway Co* [1917] 2 KB 836, 845–846; *R v Australasian Films Ltd* (1921) 29 CLR 195. Cf. *Vane v Yiannopoulos* [1965] AC 486.

²⁷² *Mousell Bros Ltd v London and North-Western Railway Co* [1917] 2 KB 836, 845–846. For further examples, see *Pearks, Gunston and Tee Ltd v Ward* [1902] 2 KB 1; *National Rivers Authority v Alfred McAlpine Homes East Ltd* [1994] 4 All ER 286.

²⁷³ See generally Brent Fisse and John Braithwaite, *Corporations, Crime and Accountability* (Cambridge University Press 1993); Celia Wells, *Corporations and Criminal Responsibility* (Clarendon Press 2001); Eric Colvin, "Corporate Personality and Criminal Liability" (1995) 6 *Criminal Law Forum* 1; G R Sullivan, "The Attribution of Culpability to Limited Companies" (1996) 55 *Cambridge Law Journal* 515; Meaghan Wilkinson, "Corporate Criminal Responsibility – the Move Towards Recognising Genuine Corporate Fault" (2003) 9 *Canterbury Law Review* 142; Stephanie Earl, "Ascertaining the Criminal Liability of a Corporation" (2007) 13 *New Zealand Business Law Quarterly* 200.

²⁷⁴ *R v P&O European Ferries (Dover) Ltd* (1991) 93 Cr App R 72.

²⁷⁵ *Attorney-General's Reference (No. 2 of 1999)* [2000] QB 796.

²⁷⁶ For a summary, see Law Commission (UK), *Legislating the Criminal Code: Involuntary Manslaughter* (Law Com No 237, 1996), [1.11]–[1.18].

²⁷⁷ *R v Tam Ping Cheong* (unrep., CA, No 355 of 1995, 12 June 1996). See Melanie Pritchard, "Corporate Manslaughter: The Dawning of a New Era?" (1997) 27 *Hong Kong Law Journal* 40.

²⁷⁸ See further the references at note 273 above.

Dealing with difficulties of identification theory. The extension of strict or absolute liability could avoid some of the limitations of the identification theory, but this may not be appropriate for offences where some element of fault ought to be present before there is criminal liability. In some overseas jurisdictions, different approaches to determining corporate fault have been introduced to deal with the difficulties with the identification theory. In England, a statutory corporate manslaughter offence has been enacted which takes into account failures on the part of senior management without the need to identify a culpable individual who is the directing mind and will of the company.²⁷⁹ In Australia, for federal offences, the common law principles of corporate liability are replaced with rules which incorporate concepts of organisational blameworthiness and which expand the scope for corporate liability.²⁸⁰ Under these provisions, a corporation is regarded as having committed the physical elements of an offence if any employee, agent or officer acting within their actual or apparent authority has committed those physical elements. As for the mental elements of the offence, this can be established not only where directors or senior officers have the requisite state of mind, but also where there is a corporate culture that led to the proscribed conduct occurring.

2.2.2 Liabilities of individuals

Individual's own criminal liability. Individuals who have committed a criminal offence would be principal offenders and would be criminally liable notwithstanding that the acts were carried out on behalf of a company.²⁸¹ In addition, individuals could also be criminally liable as accessories where the company is itself the principal offender.²⁸² Furthermore, statutes might specifically provide for circumstances where directors or officers are to be liable in relation to offences committed by the company.²⁸³

²⁷⁹ See Corporate Manslaughter and Corporate Homicide Act 2007 (UK); and see, e.g., Sally Ramage, "Corporate Manslaughter and Corporate Homicide Act 2007 Explained" (2007) 175 *Criminal Lawyer* 5.

²⁸⁰ Criminal Code Act 1995 (Aust) Pt.2.5; and see, e.g., Jennifer Hill, "Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?" [2003] *Journal of Business Law* 1; T Woolf, "The Criminal Code Act 1995 (Cth) – Towards a Realist Vision of Corporate Criminal Liability" (1997) 21 *Criminal Law Journal* 257.

²⁸¹ See, e.g., *Dellow v Bushy* [1942] 2 All ER 439; *R v Ovenell* [1968] 1 All ER 933; *HKSAR v Otis Elevator Co (HK) Ltd* (unrep., HCMA 130/2011, [2011] HKEC 1320).

²⁸² See, e.g., *Hamilton v Whitehead* (1988) 166 CLR 121; *R v Judges of the Australian Industrial Court, Ex p CLM Holdings Pty Ltd* (1977) 136 CLR 235.

²⁸³ See, e.g., the provisions of the Companies Ordinance (Cap.622) on liability of "responsible persons" (defined in Cap.622 s.3) (cf. Cap.32 s.351 and liabilities for "officers in default"). See also Criminal Procedure Ordinance (Cap.221) s.101E.

3. Apply for a court order approving the scheme.²³⁴
4. Register the court order with the Registrar of Companies.²³⁵

14.146 Scheme binding on all members. Once the above requirements have been complied with in accordance with the Ordinance, the scheme is binding on all the members (or creditors, as the case may be), including those who did not vote in favour of the scheme.²³⁶

5.5.3 Class meetings

14.147 Approval for scheme required from each class of members. In the first application to the court under Cap.622 s.670 for meetings to be held, the company will need to determine whether class meetings are required. If class meetings are required, then the requisite approval for the scheme must be obtained at the meeting of each class of members (or class of creditors). In the case of a members' scheme, a single meeting of all the company's members would be held if class meetings are not required.

14.148 Circumstances in which class meetings required: *Argos* case. The following principles were set out by the Court of Final Appeal in *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin*²³⁷ as to when class meetings are required:

- Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings.
- Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting.
- The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights.
- The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.

²³⁴ Cap.622 s.673(2).

²³⁵ Cap.622 s.673(6).

²³⁶ Cap.622 s.673(5). Schemes involving a takeover, merger or share repurchase (including privatisations) of public companies also need to comply with requirements of the Codes on Takeovers and Mergers and Share Buy-backs. These Codes are made by the Securities and Futures Commission under s.399 of the Securities and Futures Ordinance (Cap.571). The Codes do not operate as laws, but non-compliance with the Codes may lead to a denial of the Hong Kong securities markets to the company.

²³⁷ (2001) 4 HKCFAR 358.

- The question is whether the rights which are to be released or varied under the scheme or the new rights which the scheme gives in their place are so different that the scheme must be treated as a compromise or arrangement with more than one class.

Whether class meetings held determined by shareholders' rights not interests. 14.149

In *Re Industrial Equity (Pacific) Ltd*,²³⁸ the scheme involved the privatisation of a listed company (IEP). Under the scheme, the IEP minority shareholders would receive shares in another company (BIL) in return for their shares in IEP. A single meeting of members was held, at which an overwhelming majority approved of the scheme. At the hearing for court sanction of the scheme, a minority shareholder who objected to the scheme argued that separate class meetings should have been held for members of IEP who already held shares in BIL and the members of IEP who did not own shares in BIL. His argument was on the basis that the IEP members who held BIL shares would be affected by their voting by the interests of BIL rather than simply in their interests as members of IEP. The court held against the minority shareholder, applying the principle that whether class meetings need to be held is determined with reference to the shareholders' rights rather than interests. As all the members at the single meeting had the same rights in IEP, it was unnecessary for separate class meetings to be held. (However, if the interests of the minority were overborne by a majority with extraneous interests, then that can be a factor leading the court to decline to sanction the scheme on separate grounds,²³⁹ discussed further below at para.14.156.)

Responsibility of company to determine whether class meetings required. It is the responsibility of the company putting forward the scheme to decide whether class meetings are required.²⁴⁰ If the requisite class meetings were not held, then the court does not have jurisdiction to sanction the scheme.²⁴¹ 14.150

5.5.4 Requisite approval at meetings

Headcount test and shareholder/ creditor value test. Under the predecessor Cap.32 s.166 (repealed), there must be approval at each meeting by a majority in number representing three-fourths in value of those present and voting at the meeting (whether in person or by proxy). The "majority in number" requirement is referred to as the "headcount test". The "three-fourths in value" is referred to as the "shareholder value" or "creditor value" test (as the case may be). 14.151

Controversy over appropriateness of headcount test. There has been much controversy in Hong Kong in recent years as to the appropriateness of that test. The 14.152

²³⁸ [1991] 2 HKLR 614.

²³⁹ [1991] 2 HKLR 614, 624-625.

²⁴⁰ *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358; *Re China Light and Power Co Ltd* [1998] 1 HKLRD 158.

²⁴¹ *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358.

Financial assistance with unanimous shareholder approval

15.116 Financial assistance can be given with solvency statement and unanimous shareholder approval. Under Cap.622 s.284, financial assistance can be given where the directors have made a solvency statement and all members approve the giving of the assistance by written resolution.²¹⁸ The requirement for a written resolution means that this provision will be more useful for smaller companies than larger companies. For larger companies, where it may be difficult to obtain approval of all the members, Cap.622 s.285 would be more relevant as that provision requires only an ordinary resolution. While s.284 sets a higher threshold in terms of member approval, the procedural requirements are simpler compared with s.285.

15.117 Requirements to be satisfied for giving financial assistance. The requirements that need to be met under s.284(1) for the assistance to be given are as follows:

- the board must, before the assistance is given, pass a resolution resolving that:
 - the company should give the assistance;
 - giving the assistance is in the best interest of the company; and
 - the terms and conditions under which the assistance is to be given are fair and reasonable to the company;²¹⁹
- a solvency statement must be made by the directors on the same day as the above board resolution; and
- all the members approve of the assistance by written resolution.²²⁰

15.118 Financial assistance to be given within 12 months of date of solvency statement. The financial assistance can be given only within the 12-month period after the day on which the solvency statement is made.²²¹

Financial assistance by ordinary resolution

15.119 Financial assistance can be given with solvency statement and ordinary resolution of members. Under Cap.622 s.285, financial assistance can be given where the directors have made a solvency statement and the giving of the assistance is approved by the members by an ordinary resolution.²²² The threshold for member approval

in s.285 is less stringent than that required under s.284, but s.285 contains further requirements for the protection of members.

Requirements to be satisfied before giving financial assistance. The following requirements need to be met under s.285(1): 15.120

- the board must, before the assistance is given, pass a resolution resolving that:
 - the company should give the assistance;
 - giving the assistance is in the best interest of the company and is of benefit to the members not receiving the assistance; and
 - the terms and conditions under which the assistance is to be given are fair and reasonable to the company and to the members not receiving the assistance;²²³
- a solvency statement must be made by the directors on the same day as the above board resolution; and
- the members approve of the assistance by ordinary resolution.

Company must send members financial assistance proposal before holding general meeting. Before the company holds a general meeting to seek member approval, the company must send to members details of the proposed financial assistance in accordance with Cap.622 s.285(1)(c) and 285(2). 15.121

Dissenting members can apply to court to restrain giving of financial assistance. If an ordinary resolution is passed, dissenting members holding at least 5 per cent of the voting rights may be entitled to apply to the court for an order restraining the giving of the assistance.²²⁴ An application can be made only if: 15.122

- the giving of the assistance is neither in the best interest of the company, nor of benefit to the members not receiving the assistance; or
- the terms and conditions under which the assistance is given are not fair and reasonable to the company, or to the members not receiving the assistance.²²⁵

Dissenting members must make application to court within 28 days of resolution. The application must be made within 28 days after the date of the resolution.²²⁶ The 15.123

²¹⁸ This provision is based on Companies Act 1993 (NZ) s.76.

²¹⁹ The directors need to provide the grounds for their conclusions on these matters in the board resolution: Cap.622 s.284(2).

²²⁰ For requirements on written resolutions generally, see Cap.622 Pt.12 Div.1 Subdiv.2 and Chapter 9.

²²¹ Cap.622 s.284(1)(d), and see para.15.115 above.

²²² The original proposal for the third exception was to provide along the lines of s.78 of the Companies Act 1993 (NZ), which allows financial assistance by approval of directors with notice given to members (and with members having a right to object). However, there was feedback in the public consultations on the draft Companies Bill provisions supporting a mid-way approach in terms of member approval: see cl.5.81 in the draft bill contained in FSTB's *Companies Bill: Consultation Draft – Parts 1, 3–9, 12 & 19–20* (May 2010) and FSTB, *CO Rewrite: Draft Companies Bill Second Phase Consultation – Consultation Conclusions* (October 2010) 4–9. A view was expressed that unanimous approval under the second exception may be too difficult to obtain, especially for larger companies, while the exception based on New Zealand's s.78 did not give sufficient protection to the shareholders. The third exception (now in Cap.622 s.285) was re-formulated in light of these views.

²²³ The directors need to provide the grounds for their conclusions on these matters in the board resolution: Cap.622 s.285(4).

²²⁴ Cap.622 s.286.

²²⁵ Cap.622 s.286(4). The grounds are derived from Companies Act 1993 (NZ) s.78(7). It seems that there is an anomaly in that while *prima facie* the company should provide the assistance only if the assistance is both in the interest of the company and in the interest of the members not receiving the assistance, a dissenting shareholder cannot apply to the court if only one of these requirements is unsatisfied. Similarly, in the case of the requirements for the terms and conditions to be both fair to the company and to the members.

²²⁶ To give members time to make an application, the company cannot provide the financial assistance within that 28-day period: Cap.622 s.285(1)(e)(i).

17.130 Charge on aircraft or share in aircraft registrable. Cap.622 introduced a head of registrable charge for charges on an aircraft or any share in an aircraft.²⁰⁸ Under the predecessor Cap.32 s.80(2)(c) (repealed), there was a possibility that such charges would be registrable as a bill of sale. The position is clarified under Cap.622 so that all charges over aircraft need to be registered, to align with the position for charges on ships.²⁰⁹

Goodwill and intellectual property

17.131 Charge on goodwill and intellectual property registrable. This head of charge covers charges on:

- (i) goodwill;
- (ii) a patent or a licence under a patent;
- (iii) a trademark; or
- (iv) a copyright or a licence under a copyright.²¹⁰

Floating charge

17.132 Floating charge on company's undertaking or property must be registered. A floating charge on the company's undertaking or property is registrable.²¹¹

3.3.3 Procedure for registration

17.133 Obligation to register imposed on company but chargee may also register charge. The obligation to register is imposed on the company.²¹² However, it is in the interests of the chargee to ensure that the charge is registered. Accordingly, the chargee (or any person interested in the charge) may effect registration.²¹³ Where a person other than the chargor company registers the charge, the person can recover from the company the fees paid to the Registrar for registration.²¹⁴

17.134 Formalities for registration. To effect registration, it is necessary to deliver a statement of the particulars of the charge, together with a certified copy²¹⁵ of the instrument (if any) creating or evidencing the charge, to the Registrar for registration.²¹⁶ A statement of particulars must be in the specified form²¹⁷ and be accompanied by the prescribed fee.²¹⁸

²⁰⁸ Cap.622 s.334(1)(h).

²⁰⁹ Financial Services and Treasury Bureau, *CO Rewrite – Company Names, Directors' Duties, Corporate Directorship, Registration of Charges: Consultation Conclusions* (December 2008), [37].

²¹⁰ Cap.622 s.334(1)(i).

²¹¹ Cap.622 s.334(1)(j). On floating charges, see para.17.071 above.

²¹² Cap.622 s.335(1).

²¹³ Cap.622 s.335(3).

²¹⁴ Cap.622 s.335(7).

²¹⁵ The copy must be certified as a true copy by a director or company secretary of the chargor company (or a person authorised by the company); or by any other person interested in the charge (or a person authorised by the first-mentioned person, or in the case of a company that is an interested person, a director or secretary of that company): Cap.622 s.333(4).

²¹⁶ Cap.622 s.335(1).

²¹⁷ Form NM1. See further para.17.139 below.

²¹⁸ Cap.622 s.335(6). For the amount of the fees, see the Companies (Fees) Regulation.

Cap.622: registration must be within one month of creation of charge. Under Cap.622, the time period for registration is one month after the date on which the charge is created.²¹⁹ This period is shortened from the period of five weeks as set out in the predecessor Cap.32 s.80(1) (repealed). A person inspecting the register of charges at any particular time will not necessarily find details of any registrable charge recently created by the company (in the last month under Cap.622, or in the last five weeks under predecessor Cap.32). As such, this period for registration has been referred to as the "invisibility period". While a longer period of time may be advantageous from the perspective of giving enough time for preparation of the materials for registration, a long "invisibility period" is disadvantageous to prospective creditors since, at the time when they take a charge from the company, they cannot be certain that the company has not granted any other charge (that might have priority) during the invisibility period. To reduce the latter problem, the period is shortened under Cap.622 to 1 month. The original proposal in the draft Companies Bill had been to shorten the period to 21 days,²²⁰ but this was subsequently changed to one month due to concerns by creditors that 21 days might be insufficient for preparation of the registration documents.

Cap.622: Statement of particulars of charge and copy of instrument creating charge must be registered. Under the predecessor Cap.32 s.83 (repealed), the Registrar was required to register only the particulars of charge set out in s.83(1)(B). The charge instrument was sent to the Registrar simply for the purpose of comparing the particulars in the specified form with the instrument of charge before the Registrar registers the particulars. Under Cap.622 s.344, both the statement of the particulars of the charge and a copy of the instrument creating or evidencing the charge (if any) are to be registered.²²¹ This was proposed to provide greater transparency so that more information on the charge is available for public inspection.²²² A significant legal effect is the impact on the rules on constructive notice of matters relating to the charge.²²³ In the public consultation responses on this proposal, there had been some concerns about confidential or commercially sensitive information in the charge instrument being made available for public inspection. However, the Government noted that such information can always be set out in an ancillary document instead of the charge instrument itself, in which case the information would not be on the register and cannot be inspected by the public.²²⁴

²¹⁹ Cap.622 s.335(5)(a)(i). If the charge is created outside Hong Kong and comprises property situated outside Hong Kong, the time period for registration is one month after the date on which a certified copy of the instrument of charge could, if dispatched with due diligence, have been received in Hong Kong in due course of post: Cap.622 s.335(5).

²²⁰ This is the period under Companies Act 2006 (UK) s.859A. See further Financial Services and Treasury Bureau, *CO Rewrite – Company Names, Directors' Duties, Corporate Directorship, Registration of Charges: Consultation Paper* (April 2008), [5.27], and *Consultation Conclusions* (December 2008), [55].

²²¹ This is now also the position in the UK: see Companies Act 2006 (UK) s.859A (introduced by the Companies Act 2006 (Amendment of Part 25) Regulations SI 2013/600).

²²² Financial Services and Treasury Bureau, *CO Rewrite – Company Names, Directors' Duties, Corporate Directorship, Registration of Charges: Consultation Paper* (April 2008), [5.22].

²²³ See para.17.204 below.

²²⁴ Financial Services and Treasury Bureau, *CO Rewrite – Second Phase Consultation on the Draft Companies Bill: Consultation Conclusions* (October 2010), Appendix III (p.29).