from persons who ceased to be members no more than 12 months before the winding up (sec 170(1)(a) and (c), Cap 32). Such members are referred to as "contributories". Subscriptions from persons who have ceased to be members may only be used for the payment of debts which were incurred by the company while they were members (sec 170(1)(b), Cap 32).

Section 99(2) of Cap 622 provides that "a provision in the company's articles, or in any resolution of the company, purporting to give a person a right to participate in the company's divisible profits otherwise than as a member is void". Section 99(3) provides that "for the purposes of a provision of this Ordinance relating to the articles of a company limited by guarantee, a provision in the company's articles, or in any resolution of the company, purporting to divide the company's undertaking into shares or interests, is to be regarded as a provision for share capital".

A guarantee company is *sui generis* under Cap 622 but is to be treated as a public company for the purposes of the ordinance, *mutatis mutandis*.

Advantages and disadvantages

Membership of a guarantee company is open to individuals, partnerships and companies. As a company limited by guarantee cannot have a share capital, participation and power cannot be exercised or enjoyed in varying degrees by the members of the company. Each member is regarded as having only one vote. However, it is possible to have class shares and class rights.

Guarantee companies do not enjoy a base of subscribed, permanent share capital, and so are unsuitable for use where large sums of contributed capital may be required in order to commence activity. Furthermore, because the rights and obligations of membership of a guarantee company are entirely personal to members and incapable of being transferred, the guarantee company offers limited attraction to those desiring to participate in its success, unless, prior to 13 February 2004, it had been incorporated with a share capital (see below).

Accordingly, the guarantee company is a popular vehicle for charitable and professional bodies whose financial objectives do not require a permanent capital base and which focus principally on the need to maintain a sensible balance between income and expenditure. Indeed, it is common to refer to a guarantee company's "income and expenditure statements", rather than its "profit and loss accounts". The Registrar has developed a framework of regulation specifically designed to permit this type of company to dispense with using the word "Limited" in its name. This is dealt with at ¶2-500 and following.

The company is treated as a public company.

Guarantee company with share capital

Although rare, prior to 13 February 2004, it was possible to form a company limited by guarantee with share capital. Members of such companies are subject to liability to the extent of the guarantee as well as liability for the amount, if any,

unpaid on the shares held by them (see ¶2-150). A guarantee company with share capital normally would have been formed only if the company required initial capital for its operation or wished to provide for the distribution of incidental profits to its members. Now sec 99 of Cap 622 provides that

(a) the company may not give a person the right to participate in the company's divisible profits unless the person is a member, and

(b) a provision in the Articles or a resolution of the company, purporting to divide the undertaking into shares or interest is regarded as provision for share capital (sec 99).

The consequence of that division into shares or interests would be to alter the nature of the company, into a public company.

Note that for a company limited by guarantee with a share capital (that is a company formed prior to 13 February 2004), Division 3 of Part 5 (namely secs 209 to 234) applies to the reduction of that share capital.

[¶2-170] Unlimited companies

An unlimited company is a company in which there are no limits on the liability of members (sec 10). An unlimited company may have share capital and may be a public or a private company (sec 6).

For members of an unlimited company with share capital, shares in the company represent a valuable form of security comprising various rights and obligations which are capable of being transferred, pledged or charged. In the event of a winding up of a company which is solvent, share capital ranks for repayment to the extent of the sum subscribed, together with a proportionate sum of any surplus then remaining. However, where an unlimited company becomes insolvent, then those holding its shares are liable to contribute any amount unpaid on their shares, as well as any additional amount necessary to discharge the company's debts, and the costs of its winding up. Members are liable to contribute amounts proportionate to their shareholdings.

In the case of an unlimited company without share capital which becomes insolvent, the members are required to make unlimited, equal contributions to discharge the company's debts and expenses. If any members default in making contributions the other members will be liable to contribute additional amounts to account for the contributions not forthcoming from the defaulting members.

If the contributions of current members are not sufficient to discharge an unlimited company's debts and expenses upon winding up, the company may call for contributions from persons who ceased to be members no more than 12 months before the winding up (sec 170(1)(a) and (c), *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32)). Subscriptions from persons who have ceased to be members may only be used for the payment of debts which were incurred by the company while they were members (sec 170(1)(b), Cap 32).

[¶5-050] Fixed versus working capital

Creditors and shareholders are entitled to assume that no part of the capital which has been paid into the coffers of the company has been paid out except in the legitimate course of its business (*Trevor v Whitworth* (1887) 12 App Cas 409).

The capital which funds a company's business falls into two categories:

- *fixed* or *permanent* capital; and
- *working* capital.

The former is the permanent asset structure on which the company's business is based. Working capital is the amount needed to fund the company's business cycle (that is, the period beginning with the buying of materials, through production, sales and ending with the collection of payment for goods sold).

Working capital is defined in accounting rather than legal terms. It is the difference between a company's current assets and its current liabilities. Working capital is an important measure of liquidity and of short-term financial health. Inadequate working capital is a surprisingly common reason for business failure during expansionary times. The absolute amount of a company's working capital is only significant when considered in the context of that company's overall financial picture.

[¶5-060] Equity/share versus debt capital

A company may raise capital either by:

- *equity financing* — the issue of shares to new co-owners, who may be individuals or institutional investors;
- *debt financing* — the borrowing of longer-term finance, mainly from institutional investors who seek not just the capital growth offered by equities but the relatively stable income stream and lower risk from fixed income securities; or
- a combination of both — the hybrid financing which can represent a debt requirement (repayment of the loan, plus interest) or the issue of shares.

The choice between equity capital and debt capital for longer-term requirements depends on several factors. Raising equity capital involves a permanent sharing of the ownership and long-term profits of the business. Debt capital may be appropriate to fund projects which will allow profits to be used progressively to retire the debt. Though the cost of servicing debt capital is a deductible business expense, the amount raised must be repaid at some point. Furthermore, the cost of servicing debt will tend to rise at the point in the economic cycle when interest rates rise and general business conditions become more difficult.

In choosing between equity and debt finance, management must weigh the advantages and disadvantages of each, for example:

- the cost of financing debt can be determined with certainty, eg by fixing interest rates on bonds for years in advance; this is not the case with equity capital;
- debt cannot be borrowed forever; equity finance, once raised, is available to the company until it is wound up; indeed, company law began from the premise that, once subscribed, capital was inviolable and only reducible in the most exceptional of circumstances;
- debt finance does not involve sharing ownership; equity holders demand and are given participation in the power structure;
- debt finance does not involve sharing profits beyond a relatively fixed and steady income stream; equity finance does;
- the cost of debt finance is generally lower since servicing costs are most often tax deductible; and
- the inability to service equity may result in a temporary lowering of confidence in a company's prospects; inability to service debt, on the other hand, will often mean breach of loan conditions and constitute grounds for a winding-up petition, resulting in complete liquidation of the business.

In smaller companies owners tend to make maximum use of equity capital and retained earnings to fund new activities. In most of larger companies there will be a combination of equity and debt capital. Though tax treatment and the relatively secure position of debt providers as compared with equity providers generally results in debt capital being a cheaper source of long-term finance, the advantages of debt capital cannot be carried too far. If the proportion of debt to equity (known as *gearing*) becomes too high, the company may have difficulty in servicing the debt, in which case both debt *and* equity holders will demand a higher rate of return. The outstanding characteristic of equity capital is that it can be counted on to remain invested in times of adversity and can therefore be exposed to ventures and assets which involve the greatest risk. For this reason equity capital is sometimes known as risk capital.

Risk and reward are closely related. Up to a point, equity capital is more expensive to service than debt capital, which is more often made available at a fixed cost for the term of issue and whose servicing costs are tax-deductible. In addition, a properly balanced longer-term debt/equity combination can result in other advantages, such as avoidance of earnings dilution and the uncertainty of short-term swings in the interest rate cycle. But the operative word is *balanced*, for creditors will be less inclined to deal with companies whose funding is sourced primarily from third party lenders rather than the owners. Moreover, whereas reduction in or failure to pay dividends on shares will indicate financial difficulty, failure to service debt may trigger the winding up of the company, an event which is of course made more likely the higher the gearing.

But balance is not only achieved by looking at equity and debt relative to each other. Equally important is an examination of the type of business being

A similar procedure may be adopted to accommodate more than one purchaser in respect of shares represented by the same certificate.

The procedure for certification of share transfers is provided under sec 154 (for shares) and sec 320 (for debentures) of Cap 622.

[¶5-820] Transfers involving nominee shareholders

Shares in private companies are often held by nominee shareholders. A nominee shareholding arrangement is commonly used to achieve two things for a company's owners:

- 100% ownership — since the law requires a company to have at least two members, any person who wishes to retain 100% ownership cannot have all of the company's shares registered in his or her name; a nominee may hold at one or more shares on his or her behalf; and
- anonymity — whether he or she owns one or all of the shares in a company, a shareholder wishing to remain anonymous may use the services of one or more nominees.

The nominee (often a service company provided by a professional firm) is constituted as trustee and may be required to execute a brief form of declaration of trust as follows:

Declaration of Trust

We [name] of [address] do hereby declare as follows—

THAT the [number] shares bearing distinctive numbers [_____] now standing in our name in the books of [company name] do not belong to us but to [name of beneficial owner] of [address] (herein referred to as the Beneficial Owner, which expression shall include his personal representatives, successors and assigns).

THAT we hold the said shares upon trust for the said Beneficial Owner and we undertake to transfer, pay and deal with the said shares, together with any dividend and interest arising therefrom in such manner as the Beneficial Owner shall from time to time direct and we further undertake that we will at the request of the Beneficial Owner attend all meetings that we will be entitled to attend by virtue of being the registered holder of the said shares and will vote at any such meetings in such manner as directed by the Beneficial Owner.

In witness whereof the said [name] have executed this Declaration of Trust this [date]

For and on behalf of

[name]

Note that amendment was made to the *Trustee Ordinance* (Cap 29) from 1 December 2013. These amendments include the imposition of a statutory duty on the trustees (namely care and diligence reasonable in the circumstances), and restrictions on a trustee exemption clause.

Note that such declarations of trust may be submitted for adjudication to the Collector of Stamp Duties under sec 13 of the *Stamp Duty Ordinance* for an opinion as to whether or not duty is payable. Provided that documentation is in order, a declaration of trust will not normally be adjudicated as bearing any duty since it does not operate to transfer any beneficial interest in the shares in question. For a nominal HK$50 adjudication fee, however, this process provides an expedient means of obtaining evidence as to the currency of the declaration as the Stamp Office will officially date-stamp the declaration.

Nominee arrangements, on the surface, are an entirely private matter between beneficial and nominee owners. Indeed, a company is not permitted to recognise trusts on its register of members (sec 634, Cap 622). Therefore, the nominee is the only person recognised by the company as capable of exercising rights attached to the shares and a degree of confidentiality and anonymity may be obtained.

Note, however, that the use of nominee arrangements cannot provide complete confidentiality and anonymity. For example, if an individual is shown as owning 99 shares out of 100, it is relatively straightforward to suggest that the remaining share is held for him by a nominee. Furthermore, the broad application of Part XV of the *Securities and Futures Ordinance* can mean that the ownership of a private company may be required to be disclosed if it involves holdings of listed company shares on behalf of the company's directors, chief executives or substantial shareholders.

[¶5-830] Forged transfers

A forged transfer of shares is in legal terms a nullity. Where shares are transferred in a company's register following a forged transfer the real owner is entitled to have the register rectified and to have his name reinstated.

The *Companies Ordinance* provides every company with the power to make cash payments out of its funds to compensate purchasers for losses arising from forged transfers (sec 157, Cap 622). A company may maintain a fund through insurance, capital reserves, or the accumulation of income, to cover such compensation. Alternatively, a company may borrow on the security of its property to compensate purchasers.

Where compensation has been paid by the company out of such a fund the company then has the same rights as the purchaser and may take the same remedial action against the person who is liable for the loss as the purchaser could have taken.

[¶6-270] Redemption generally

If authorised by its articles, a company limited by shares may issue shares, the terms of which permit redemption either at the option of the shareholder or of the company (sec 234, Cap 622). A company may only issue redeemable shares if it has previously issued non-redeemable shares.

Redeemable shares may not be redeemed unless they are fully paid, and the terms of redemption must provide for payment on redemption. Redemption of shares must be carried out in accordance with the terms and procedure set out in a company's articles of association (sec 235, Cap 622).

Generally the redemption of redeemable shares must be financed by a company's distributable profits, or by the proceeds of a fresh share issue (sec 257, Cap 622). Only private companies are permitted to finance the redemption of shares out of capital (see further ¶6-310).

Redemption out of fresh share issue

Where redemption is funded from the proceeds of a new issue of shares made specifically for the purpose of the redemption, the capital issued or paid up on those shares replaces the redeemed capital. Redemption out of a new issue thus ensures that the company's share capital is maintained.

Section 257(2) of Cap 622 allows a company which is about to redeem shares to issue new shares up to the value of the redeemable shares, as if the redeemable shares had not been issued. That is, the redeemable issue will not rank for the purposes of computing the amount of the company's issued capital.

Where the proceeds of a new issue are less than the value of the shares redeemed, the amount of the difference must be transferred from the company's distributable profits to a capital redemption reserve (¶6-260).

Effect of redemption, failure to redeem

Once redeemed, shares are treated as cancelled and the company's issued share capital is accordingly diminished by their value. Where redemption has been financed by a new issue of shares, the final outcome is that the company's issued share capital is replenished. In other cases the capital redemption reserve ensures that the company's share capital base is maintained where redemption is financed out of the company's profits, or where a new issue does not fully replace a redeemed issue (see ¶6-260).

The sum of a company's authorised capital may be affected by the redemption of shares (sec 269, Cap 622).

It should be noted that if a company fails to redeem shares which have been issued as redeemable, the company is not liable in damages (sec 271(2), Cap 622). Nor will a court make an order for specific performance if the company can

demonstrate that it is unable to meet the costs of the redemption out of distributable profits (sec 271(4), Cap 622).

If, upon the winding up of the company, redeemable shares have not been redeemed the terms of redemption may be enforced against the company (sec 272, Cap 622). This does not apply, however, if the terms of redemption provide that redemption was to take place after the date on which the winding up commenced, or if the company could not have made a lawful distribution equal to the redemption value of the shares between the date on which the redemption was supposed to take place and the commencement of the winding up.

Notice of redemption

If a company having a share capital has redeemed any redeemable preference share, it must within one month after so doing give notice to the Registrar specifying the shares redeemed. Section 171 of Cap 622 requires such notice of redemption of shares to be given in a specified form. The prescribed form for this purpose is Form NSC11.

The company and every responsible person of the company who is in default in complying with sec 171 will be liable to a level 4 fine (HK$25,000) and, for continued default, to a daily default fine of HK$700 per day.

Repurchase of redeemable shares

The *Companies Ordinance* (Cap 622) specifically permits listed, unlisted and private companies to repurchase their redeemable shares (secs 233, 236, 257, 268 and 269, Cap 622; see also ¶6-290 and ¶6-300).

[¶6-280] Repurchase generally

If authorised by its articles, a company may buy-back its own shares, including redeemable shares, provided that this does not result in the company's capital comprising only redeemable shares (otherwise there would be nothing to stop a company from carrying out an informal liquidation of its assets by purchasing the whole of its then redeemable share capital).

A share buy-back is an offer made by or on behalf of the offeror company to purchase, redeem or otherwise acquire its own shares from any shareholder. Share repurchases can thus include schemes of arrangement, privatisation or reorganisation which consist of such offers.

The principles which apply in respect of redemption (set out in ¶6-270 above) also apply to repurchases, except that the terms and manner of repurchase need not be set out in the company's articles or in the terms of subscription of the shares. Therefore:

- shares to be bought-back must be fully paid up; and
- shares which have been bought-back are treated as cancelled.

Reduction of Share Capital

[¶6-400] General

The maintenance of share capital is a fundamental principle of the *Companies Ordinance* (see ¶6-170). Business conditions are not always favourable, however, and if a company trades at a loss for any period of time the real value of its capital may be reduced below the nominal value of issued shares; misrepresenting the company's real position to the public. On the other hand, a company may find itself over-capitalised with its assets exceeding the value of its issued share capital.

Seen from this perspective, a reduction in capital may serve as a positive measure to reorganise a company's capital structure so that it continues to provide a realistic measure of net worth. There are a number of safeguards in the *Companies Ordinance* to ensure that capital reductions are undertaken for the right reasons and to ensure that the interests of shareholders and creditors are protected. The *Companies Ordinance* specifically provides that a company may only purchase or subscribe for its own shares or reduce its capital in accordance with the provisions of the *Companies Ordinance* (secs 209-212, Cap 622).

[¶6-410] When reduction is permitted

A company limited by shares or limited by guarantee and having a share capital, may reduce its share capital (including its share premium account and capital redemption reserve fund) provided that the reduction is:

- permitted by the company's articles (sec 88 of Sch 1 of the *Companies (Model Articles) Notice* for public companies provides a general power to reduce share capital);
- authorised by a special resolution of members in general meeting; and
- confirmed by the High Court (sec 58).

It has not been possible to incorporate a company limited by guarantee having a share capital after 13 February 2004.

Section 58 allows a company to reduce its share capital in "any way". A non-exhaustive list of three alternatives is provided. A company may:

- extinguish or reduce the liability on any of its shares in respect of share capital not yet paid up;

- cancel any paid-up share capital which is lost or unrepresented by available assets (with or without extinguishing or reducing liability on shares); or
- pay off any paid-up share capital which is in excess of the needs of the company (with or without extinguishing or reducing liability on shares).

These three examples, albeit the most common, are not the only circumstance in which a court may sanction a reduction. In *British and American Trustee and Finance Corp v Couper* (1894) AC 399, the court approved a special resolution by which a company sought to sell its US assets and to apply the proceeds in repaying the US shareholders' shares so that the company's US business interests could be transferred to a new US company for whose shares the US shareholders would be given preferential subscription rights.

In *Re Thorn EMI plc* (1989) BCLC 612, a holding company wished to reduce its share premium account in order to make reserves available to write-off goodwill which arose in the accounts of its subsidiaries. It was held that the reduction was for a discernible purpose and it was confirmed. In *Re Ratners Group plc* [1988] BCLC 685 a reduction was requested in order to build up reserves for an anticipated need to write-off goodwill; it was held that this was a discernible purpose and the reduction was confirmed.

In *Re Everlight (Hong Kong) Ltd* [2006] 2 HKC 412, the directors of the company proposed a capital reduction (as provided for in the articles of association of the company) because the amount to be reduced is in excess of the wants of the company and could not be usefully employed in business. The court confirmed the reduction of share capital under sec 59 and 60 of the *Companies Ordinance* (Cap 32) and made an order to dispense with the settlement of a list of creditors on the basis that their interests would not be prejudiced by the capital reduction. There was no material change in the financial position of the company at the hearing of the petition in that the company appeared to have sufficient funds to make the proposed return of capital and to settle the debts owned to its creditors. In addition, the directions for advertisement of a notice of the petition for the reduction had been complied with as well.

[¶6-420] Confirmation of reduction by court

A reduction of share capital must be confirmed or sanctioned by the High Court. The requirements of the court vary from case to case and very much depend on whether the company's creditors are affected. The court will normally confirm a shareholders' resolution to reduce share capital provided that shareholders are to be treated *equitably* and have had the facts fully explained to them; and provided that creditors' interests are safeguarded. Shareholders need not necessarily be treated equally, provided that they are treated equitably. Note *Re Ratners Group plc* [1988] BCLC 685, where *Harman* J. stated:

> "... it may mean that some [shareholders] are treated equally save as to some who have consented to their being treated

Part 3 of the *Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance* gives "authorised persons" (ie a person authorised in writing by a "relevant authority" such as the HKMA for banking institutions) extensive powers of supervision and investigation, including the right to enter premises of a "financial institution" to inspect, make copies, etc, of documents. Offences can lead to imprisonment and/or fines.

Part 4 provides for a series of disciplinary powers for relevant authorities including a public reprimand of the financial institution, and a penalty.

Part 5 deals with a "money service institution".

Part 6 establishes a Review tribunal in respect of decision, defined in sec 54, of financial institutions under the ordinance.

The legislation is in keeping with the international Financial Action Task Force. It has similar effect to the current requirements for solicitors provided for under Practice Direction P of the Law Society requiring solicitors to comply with the *Drug Trafficking (Recovery of Proceeds) Ordinance* (Cap 405), the *Organised and Serious Crimes Ordinance* (Cap 455), and the *United Nations (Anti-Terrorism Measures) Ordinance* (Cap 575).

Listed company reports

From 1 January 2013, an issuer, whose financial year ended after 31 December 2012, should comply with the *Environmental, Social and Governance Reporting Guide*, detailing the issuer's involvement in various aspects of these matters in the report. From 1 January 2013, the Stock Exchange of Hong Kong Ltd decided to implement the Reporting Guide a "recommended practice" but it is anticipated that by 2015 these provisions will become "Guide provisions" in a manner similar to "Code provisions" in Appendix 14 of the *Listing Rules*, namely the provisions of the *Code of Corporate Governance Practice* which require compliance, or explanation on non-compliance.

The four subject areas of the Reporting Guide cover:

(i) workplace quality;

(ii) environmental protection;

(iii) operating practices; and

(iv) community involvement.

The Code will be inserted as Appendix 27 to the *Listing Rules for the Main Board* (and Appendix 20 for GEM). A new rule, r 13.91 will be inserted into Ch 13 of the *Listing rules for Main Board listings*, and r 17.103 for GEM.

Registered Office and Name

[¶20-050] Registered office

A company registered under the *Companies Ordinance* is required to have a registered office in Hong Kong to which communications and notices may be addressed or delivered. A company need not specify in its articles the precise location of its registered office, provided it is located within Hong Kong. A company may use a private residence as its registered office but, if it does so, it must allow the public to enter the premises for the inspection of any documents, registers and so forth which are kept there. A registered office facility may also be provided by the company's solicitors or accountants.

From 11 July 2008 details of the registered office of the company must be included in the incorporation form (secs 67-70 and Sch 2, Cap 622). Any change in the location of the office must be notified to the Registrar within 14 days. It is not sufficient merely to include the new address of the company's registered office in the company's annual return (sec 658, Cap 622).

A company's registered office is the official, legal address of the company at which the registers and books of the company are usually kept and may be inspected. If a company keeps its registers or books at a different location, the Registrar must be notified (secs 308-309, Cap 622).

A company which fails to notify the Registrar of the location of its registered office, or any change in the address of its registered office, within the 15 day time limit, is liable to a level 5 fine of HK$50,000 and a daily fine of HK$1,000 for continued default (see sec 658, Cap 622).

The location of the registered office is also required to be reported to the Inland Revenue Department when a company applies for a business registration certificate (see ¶20-200). Changes to the registered office are required to be reported and the certificate submitted for amendment and endorsement by the Inland Revenue Department.

Non-Hong Kong companies

To facilitate the delivery of notices and other communications, a company which is incorporated overseas and establishes a place of business in Hong Kong, is required to notify the Registrar of:

- the address of its place of business in Hong Kong;
- the address of its place of business in the country in which it was incorporated; and

[¶20-380] Register of directors

All companies are required to keep a register of directors containing the personal particulars of each director including, in the case of listed companies, particulars of other directorships held (sec 641). The requirements in relation to the register of directors are examined further at ¶21-500 and following.

Duties and responsibilities

[¶20-390] Common law duties

Fiduciary duty

Directors are considered to be trustees and agents of a company, albeit as quasi-trustees/agents. They are trustees of the company's money and property and agents in the transactions into which they enter on the company's behalf (*Charitable Corp v Sutton* (1742) 2 Atk 400; *Re Forest of Dean Coal Mining Co* (1878) 10 ChD 450; *Great Eastern Railway Co v Turner* (1872) 8 Ch App 149; *Re Sharpe, Bennett, Masonic and General Life Assurance Co v Sharpe* [1892] 1 Ch 154 (CA)). This relationship was described in *Law Wai Duen v Boldwin Construction Co Ltd* [2001] 4 HKC 403 as "being at least commercial trustees, or a position analogous to managing partners".

As "quasi-trustees" and "quasi-agents", directors have a fiduciary duty of loyalty and good faith. They must:

- act bona fide in the interests of the company
- exercise their powers for the purposes for which they are conferred and not for any collateral or improper purpose
- refrain from fettering the future exercise of directors' powers, and
- avoid being placed in a position of conflict of interest.

In *Peconic Industrial Development Ltd v Lau Kwok Fai* [2009] 5 HKC 135, it was noted in the Court of Final Appeal that in relation to sec 20 of the

Limitation Ordinance, in considering whether action was statute barred against directors:

> "The terms 'trust' and 'trustee' are defined to extend to constructive trusts: 2(1) and s 2 of the *Trustee Ordinance*. It is accepted that, within this extended definition, a director of a company is a trustee in relation to its assets. So the action against [one of the defendants] was an action by a beneficiary in respect of his fraudulent breach of trust and no limitation period applied." (para 18)

In considering the actions of another defendant, the question arose as to whether or not that defendant was a constructive trustee for the company, as a dishonest assister. Two categories of constructive trustees were referred to:

> "First, there are persons who, without any express trust, have assumed fiduciary obligations in relation to the trust property: for example as purchaser on behalf of another, trustee *de son tort*, company director or agent holding the property for a trustee. I shall call them fiduciaries. They are treated in the same way as express trustees, and no limitation period applied to their fraudulent breaches of trust. Then there are strangers to the trust who have not assumed any prior fiduciary liability but make themselves liable by dishonest acts of interference. I shall call them non-fiduciaries. They are also called constructive trustees but this … is a fiction: 'nothing more than a formula for equitable relief'. They are not constructive trustees within the meaning of the law of limitation." (para 19)

The question of applicability or otherwise of limitations was referred to then in *Akai Holdings Ltd (In Compulsory Liq) v Everwin Dynasty Ltd* [2012] 3 HKC 485 where the Court of Appeal found that, for the purposes of sec 20(1) of the *Limitation Ordinance* which provided in part that "no period of limitation prescribed by this Ordinance shall apply to an action by a beneficiary under a trust", applied as against a director in the same way as against a trustee. This equating of a director to that of a trustee because a director "has assumed fiduciary obligations" thus following the Court of Final Appeal in *Peconic*. So, in relation to action by the liquidators claiming recovery against fraud or fraudulent breach of trust, the Court of Appeal held that sec 20(1) applied and no limitation period applied to the claim.

The Court of Appeal had considered another matter involving the possibility of the application of limitations; but in regard to that matter it was said that the solution was "unsettled". This was the decision in *Hotung v Ho Yuen Ki* (No 4) [2011] 2 HKC 149. A bare, or passive, trust had been created by a mother for some of her children; the trust property consisted of shares in a company. The shares were held in the name of the trustee (a relative of the settlor). The company purchased land with some of the trust funds. One of the beneficiaries took action complaining about the sale of the land, the price obtained, and

Two hundred years ago, Lord *Eldon* said in the case of *Carlen v Drury* (1812) 1 Ves & B 154:

> "the court could not undertake the management of every brewhouse and playhouse in the kingdom."

That is a fundamental principle of the Company Law. Lord *Davey*, 110 years ago, referred in the case of *Burland v Earle* [1902] AC 83 at para 93,

> "It is an elementary principle of law relating [to] joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so."

> "I have considered in this judgment the Articles of the company and they make it perfectly clear that the choice of chairman and the choice of the executive directors is a matter for the board. In those circumstances, I have the gravest doubts as to whether this court would ever grant any injunctions, whether after a final trial or otherwise, that are sought in this case."

[¶20-510] Specific powers

In addition to general management powers (see ¶20-500), the articles of most companies provide specific powers to directors to facilitate the day to day operation of business. Legislation and case law also provide authority for the exercise of certain powers by directors.

The following are specific powers which are usually vested in, or which have been attributed to, directors:

- *Allotment and issue of shares and debentures*. Directors have the power to allot and issue shares, subject to the approval requirements prescribed by secs 140 and 141 of Cap 622, and sec 90 of Sch 1 of the *Companies (Model Articles) Notice* for public companies. An issue of shares motivated by self-interest is invalid (*Fraser v Whalley* (1864) 2 Hem & M 10). Directors may issue debentures at a discount (*Re Anglo-Danubian Steam Navigation and Colliery Co* (1875) LR 20 Eq 339).
- *Appointment of additional directors*. The power to appoint additional directors is usually vested in the directors by the company's articles (see sec 23(3) and (6) of Sch 1 of the *Companies (Model Articles) Notice* for public companies). If the articles vest this power in the directors, the company in general meeting cannot interfere (*Blair Open Hearth Furnace Co v Reigart* 108 LT 665) unless the directors are unable to exercise the power (*Foster v Foster* [1916] 1 Ch 532).
- *Appointment of attorneys*. Directors usually have the power to appoint an attorney by power of attorney under the articles (see sec 4 of Sch 1 of the *Companies (Model Articles) Notice* for public companies).

- *Appointment of managing director*. Power to appoint a managing director from among the directors, and to confer powers upon that managing director, is usually provided under the articles (see secs 33 and 34 of Sch 1 of the *Companies (Model Articles) Notice* for public companies).
- *Appointment of secretary*. Power to appoint a secretary for such term and on whatever conditions the directors think fit is usually provided under the articles (see sec 37 of Sch 1 of the *Companies (Model Articles) Notice*).
- *Bankruptcy proceedings*. Directors may petition in bankruptcy (*Re Tomkins & Co* (1901) 1 KB 476).
- *Books and accounts*. The articles usually provide directors with the power to determine whether, to what extent, when and where the accounts and books of the company are to be open for inspection by members. The directors are usually empowered also to inspect the accounts and books of the company at any time.
- *Borrowing*. Directors have a general power to borrow and give security for borrowings (the *Gibbs and West*'s case (1870) LR 10 Eq 312; *Re Pyle Works (No. 2)* [1891] 1 Ch 173; *General Auction Estate and Monetary Co v Smith* [1891] 3 Ch 432). The articles usually provide the directors with the specific power to exercise the company's powers to borrow, mortgage assets, issue debenture stock and so forth, subject to approval of the company in general meeting if the amount of the borrowings exceeds the nominal amount of the company's issued share capital (generally see sec 2, and Parts 7 and 8).
- *Branch register*. The directors may make and vary regulations with regard to the keeping of a branch register, subject to the provisions of secs 636 to 639 of the Ordinance.
- *Brokerage*. The directors may pay reasonable brokerage (*Metropolitan Coal Consumers' Association v Scrimgeour* (1895) 2 QB 604), provided it is lawful (see sec 147 (for prohibited commissions, etc) and sec 148 (for permitted commissions) and ¶5-660).
- *Calls*. The directors may make calls, subject to any limitations provided under the articles (*Ambergate, Nottingham and Boston and Eastern Junction Railway Co v Mitchell* (1849) 4 Exch 540; and see secs 70–79, Sch 1 of the *Companies (Model Articles) Notice*).
- *Capitalisation of profits*. Power to make recommendations as to the desirability of capitalising profits and to make appropriations of profits upon the resolution of the company is usually provided under the articles (sec 99, Sch 1 of the *Companies (Model Articles) Notice*). Usually, only the company in general meeting may resolve to capitalise profits.

The maximum disqualification period specified under a disqualification order may be as long as 15 years, depending upon the circumstances. Where a person is subject to more than one disqualification order, the orders run concurrently (sec 168D(3)). Note that the disqualification provisions contained in the Hong Kong *Companies Ordinance* are substantially similar to the UK *Company Directors Disqualification Act 1986*.

In *Official Receiver v Chan Hing To* [2008] 5 HKLRD 279, CA, the disqualified director sought to have the term of his disqualification reduced. Amongst the complaints made against him, giving rise to the order of disqualification, were those that he had failed to keep books and accounts, had not co-operated with the Official Receiver, had not complied with statutory filing requirements and had misused a bank account belonging to the company. The principles, the court adopted in reducing the term of disqualification from four years to three-and-a-half years, included:

- the rationale behind the disqualification;
- the delay in application for disqualification;
- the need for a flexible common sense and practical approach to case management, the operation of the statutory period of disqualification;
- relevant personal factors such as the general ability of the director or whether he is likely to offend again; and
- the conduct of the director in relation to other companies (for this factor the weight to be attached to the conduct differs from that relevant to the company in liquidation).

In summing up the relevant factors, the court referred to the fact that the director's misconduct "not only affected the internal management of the companies but also prejudiced creditors who were unable to recover their money from the companies".

Section 214(1) of the *Securities and Futures Ordinance* sets out the circumstances, in which the court will make various orders against the company or the directors. The section was considered in *Securities and Futures Commission v Fung Chiu* [2008] HCMP 2524/2006, where the Commission sought appropriate orders against the five directors of a company which was listed, until removed, on the Growth Enterprise Market (GEM). The order being sought was one to prevent the directors, without leave of the court, being or continuing to be directors, liquidators, receivers or managers of a company, or in any way directly or indirectly involved with a company for up to 15 years. One director had consented to the order being made against him by summary proceedings. The procedure was that referred to as the "Carecraft" procedure, following the decision in *Re Carecraft Construction Co Ltd* [1994] 1 WLR 172. This case had been followed in *Re Riverhill Holdings Ltd* [2007] 4 HKLRD 46.

In this case, the director had agreed to a disqualification period of six years. However, in considering the facts, and despite the SFC's case being based on

gross negligence, a period of disqualification of five years was apt. This was because there had been no allegation of fraud or dishonesty against the director, and there had been no suggestion that he had made any personal gain from loans advanced by the company.

Kwan J. (as she then was) pointed out two important factors relevant to exercise of the jurisdiction to make disqualification orders:

> "firstly, protection of the public against the future conduct of persons whose past records as directors of listed companies have shown them to be a danger to those who have dealt with the company, including creditors, shareholders, investors and consumers; and secondly, general deterrence in that the sentence must reflect the gravity of the conduct complained of so that members of the business community are given a clear message that if they breach the trust reposed in them they will receive proper punishment: [2009] 2 HKC 19, 23 at para 12." (per *Securities and Futures Commission v Fung Chiu* [2008] HCMP 2524 of 2006, para 55)

The question of deterrence rather than punishment of a criminal nature was referred to by *Yeun* J. in *The Official Receiver v Chan Min Simon* [2002] HKCU 1014 as:

> "7. It is now generally accepted as a matter of substantive law that disqualification is not a "punishment", and that even though its purpose is "to protect the public against the future conduct of companies by persons whose past records as directors of insolvent companies showed them to be a danger to creditors and others" (*Secretary of State for Trade and Industry v Griffiths* [1998] BCC 836, 843F), disqualification proceedings are civil proceedings, applying the civil standard of proof on the balance of probabilities (*Re Verby Print for Advertising Ltd, Fine & Anor v Secretary of State for Trade and Industry* [1998] 2 BCLC 23, 30-2) and adopting civil procedure."

This view was in keeping with the decision in *Carecraft* which provided that where the parties had agreed on certain facts, which were not opposed, the disqualification of the director could be dealt with summarily.

[¶20-920] Conviction of indictable offence

A court has the discretionary power to make a disqualification order against a person convicted of:

- an indictable offence in connection with the promotion, formation, management or liquidation of a company;

A requisition for an extraordinary general meeting must state the objects of the meeting. It must be signed by the requisitionists and deposited at the registered office of the company.

The requisition may consist of several documents in like form signed by one or more requisitionists. It has been acknowledged that a requisition constituted by several documents may make the date of deposit of the requisition uncertain. (The date of deposit is significant because it determines the time-frame within which directors must convene a meeting.) *Street* J, in *Dominion Mining (NL) v Hill* [1971] 2 NSWLR 259 ruled that while the several documents need not be deposited on the same day, if they are lodged on more than one day the lodging of the various documents must be able to be regarded "fairly as part of one identifiable and entire activity on the part of the requisitionists, or those acting in a coordinating capacity to bring the requisitionists together". If a series of requisition documents drift into the company's office over a lengthy period, the validity of the requisition may be uncertain.

If a requisitioner holds shares jointly with other persons, all of the joint holders must sign the requisition document (*Patent Wood Keg Syndicate v Pearse* [1906] WN 164).

Members may requisition meetings for the purpose of considering special resolutions. It must be noted, however, that the resolutions for which a general meeting is requisitioned must be resolutions which the company in general meeting has the power to pass.

Directors may decline to act on a requisition if the matter or matters in relation to which the meeting is to be convened cannot lawfully be dealt with at such a meeting. In *NRMA v Parker* (1986) 4 ACLC 609, for example, members tried to requisition a meeting to pass a resolution on a matter which was exclusively within the power of the directors. The Court held that the proposed resolution was one which could not be effectively passed by the members in general meeting so that the directors were not required to convene the requested meeting. Also see *Queensland Press Ltd v Academy Investments No. 3 Pty Ltd* [1987] 5 ACLC 175.

Directors' default; members' power to convene meeting

Section 566(1) imposes an obligation on directors, upon delivery of a members' requisition, to "forthwith proceed" to convene an extraordinary general meeting. This simply requires the directors to proceed to convene a meeting as soon as practicable (see *Re Windward Islands (Enterprises) UK Ltd* (1988) 4 BCC 158).

The specific time-frame within which a meeting must be convened and held is set out in sec. 561 which provides that, within 21 days of the deposit of a valid requisition, the directors of a company must convene a general meeting to be held within 28 days of the notice convening the meeting being given. If the directors default in complying with this time-frame the requisitioning members may convene the meeting themselves. The requirement that the meeting must be

held within 28 days of notice being given prevents directors from convening a meeting to be held maybe months after the members' requisition (as was the case in *Re Windward*).

Note that directors may be regarded as having defaulted if they convene a meeting which does not consider all of the matters set out in the members' requisition (*Isle of Wight Railway Co v Tahourdin* (1883) 25 ChD 320). On the other hand, in convening a meeting in response to a requisition, the directors may include for consideration matters other than those mentioned in the requisition provided that the notice for the meeting clearly indicates the sources of the different proposals (see *Leigo v Marra Developments Ltd* [1975-76] CLC 140-259).

If members requisition a meeting for the purpose of considering a special resolution, the directors must convene the meeting giving the amount of notice required for such a resolution under sec 566, that is, *at least 21 days* (see ¶22-180; ¶22-360). If they fail to do so they are deemed not to have duly convened the meeting as required under sec 567(1) and (2) and the meeting may be convened by the relevant members (sec 567).

A meeting convened by requisitioning members must be held within three months of the date of deposit of the requisition. The requisitionists must convene the meeting, as near as possible, in the same manner as that in which meetings are convened by the company's directors (sec 567(1) and (2)). The matters which may be considered at a meeting convened by requisitionists are limited to those which are set out in the requisition (*Ball v Metal Industries* [1957] SC 315).

Any reasonable expenses incurred by requisitionists due to the directors' failure to convene a meeting must be repaid by the company (sec 568). The company may deduct the expenses from any remuneration payable to the defaulting directors.

Alternative course for urgent matters

Although sec 566 provides that directors must proceed to convene an extraordinary general meeting upon the deposit of a members' requisition, the company has 21 days within which to convene the meeting and the meeting may not be held until 28 days after the date on which the notice convening the meeting is given. If the matters for which the meeting is requisitioned are urgent, and it is believed that the directors may not call a meeting as requisitioned, the requisitioning members may consider applying to the court under sec 570 to order a company meeting to be called. Note, however, the case of *Hong Kong Estates Ltd v San Imperial Corporation Ltd* (1980) HKLR 386 in which such an application was rejected. See ¶22-120.

[¶22-120] Power of court to order meeting

If, for any reason, it is impracticable for a meeting to be called in another manner, the court may order the calling of a general meeting under sec 570. The

Exceptions

A company meeting with a one-person quorum may be held in the following exceptional circumstances:

- where the company has only one member (*Re Johnstone, Dunster & Co* (1891) 17 VLR 100);
- where it is impracticable to obtain a quorum for a company meeting the court may order a meeting to be conducted in such manner as it thinks fit and may direct that one member of the company present in person or by proxy be deemed to constitute a quorum (see further ¶22-120);
- where one member holds all of the shares of a particular class of shares in a company, that member would constitute a quorum at a class meeting (*East v Bennett Bros* [1911] 1 Ch 163).

[¶22-470] Persons excluded from quorum

The following general principles regarding the quorum should be noted:

- A quorum of members means a quorum of *effective* members, that is, members qualified to take part in and decide upon questions before the meeting. Some articles, for example, prohibit members of certain classes voting on certain matters. Members under that sort of disqualification or incompetence may not be counted for quorum purposes (*Re Greymouth-Point Elizabeth Railway and Coal Co Ltd* (1904) 1 Ch 32).
- Proxies are not counted for quorum purposes unless a company's articles provide to the contrary. When the articles provide for a quorum "present in person or by proxy", proxies are counted. When the articles merely say "present in person", proxies are not counted. Under sec 43 of Sch 1 of the *Companies (Model Articles) Notice* proxies are included. When a member is represented by more than one proxy, only one person is deemed to be in attendance (*Donrob Enterprises Pty Ltd v Queensland Petroleum Management Ltd* [1987] 7 ACLC 255).

When the articles require members to be "present in person" in order to be included in a quorum, the individual members or company representatives (in the case of corporate members) must be physically present at the meeting (*Re Harris* [1956] SC 207; and *Clubb-Orville Leverne v Hong Kong Computer Society* (1990) HK No. MP 1106/1990).

- Bankruptcy does not necessarily debar a member from voting and accordingly being counted for quorum purposes. Provided that the bankrupt remains on the register, that there is nothing in the company's articles to the contrary and that the company is a going concern, he or she is entitled to attend and vote (*Morgan v Gray* [1953] 1 All E.R. 213).
- When the articles provide that a member cannot vote when any call is due on his shares (e.g. sec 43(2) of Sch 1 of the *Companies (Model*

Articles) Notice), the inclusion of members in arrears of calls to make up the quorum invalidates any resolution of the meeting.

- Not every member present (for quorum purposes) must vote. Provided a quorum is present it does not matter that those who vote are less than the number required for the quorum, provided the requisite majority is obtained.

[¶22-480] When is quorum required to be present?

It is generally accepted that the prescribed quorum for a meeting must be present throughout the whole meeting unless the articles provide otherwise (see *Henderson v Louttit* (1894) 21 R 674). Section 585 requires a quorum of members to be "present at the time when the meeting proceeds to business and [to continue] to be present until the conclusion of the meeting".

Section 584 further provides that if a quorum is not present within half an hour after the time appointed for a meeting, the meeting must either be dissolved, if it was convened at the requisition of members, or, in any other case, adjourned for one week. If a quorum is not present within half an hour at the adjourned meeting the members present (presumably at least two) are regarded as a quorum.

If a company's articles require that no business shall be transacted at any general meeting unless a quorum is present "when the meeting proceeds to business" (as per former UK Table A, reg. 53) it is not necessary that the quorum should be present when a vote is taken (*Re Hartley Baird Ltd* [1955] Ch 143). In the Hartley case a member left the meeting, before a vote was taken, thereby reducing the number of member present below that required for a quorum. Notwithstanding this, the passing of the relevant resolution was upheld as valid.

[¶22-490] Presumption that quorum was present

If the chairman of a meeting signs the minutes of a meeting which record that a particular resolution was passed, there is a presumption that what took place at the meeting was done lawfully, that is, among other things, that a quorum was present.

Per *Griffith* C.J. in *McLean Bros and Rigg Ltd v Grice* (1906) 4 CLR 835:

> "Now, what is the ordinary course of affairs in human nature when a meeting is held, and it is necessary that there should be a certain number of persons present? The first thing, whether in a legislative body or otherwise, is to ascertain the presence of a quorum of competent members, or, as it is sometimes called, to verify their powers, which is done before they proceed to business. *Prima facie*, then, in the ordinary course of business, when persons with specifically prescribed powers meet together, the first thing they would naturally do would be to verify their powers, and then proceed to act, and the fact of acting is *prima facie* evidence

- balance sheet (see secs 122(2) and 123 of Cap 32) and secs 430, 431, 379 and 380 of Cap 622);
- auditors' report (see sec 129C of Cap 32; and sec 436 of Cap 622); and
- directors' report (see sec 129D of Cap 32; and secs 288 to 391, sec 452(3) of Cap 622).

And see the *Companies (Directors' Reports) Regulation* and the *Companies (Disclosure of Information about Benefits of Directors) Regulation.*

[¶24-070] Profit and loss account

The matters to be included in the profit account are:

- sales or other operating revenues;
- net balance of profit or loss;
- amount of income received or due an receivable as dividends from quoted and unquoted investments in subsidiaries;
- profit or loss arising from the sale of assets;
- amount of extraordinary profit or loss;
- amount set aside for payment of profit tax attributable to any other financial period;
- amount charged or provided for depreciation, diminution in value or amortisation of assets;
- amount paid to directors as remuneration; and
- significant transactions with related companies.

On this see secs 122 and 123 of Cap 32, and also see secs 379, 380, and 420 of Cap 622.

[¶24-090] Balance sheet

The matters to be included in the balance sheet are:

- authorised and issued share capital, call in arrears and paid up share capital;
- current and long-terms liabilities;
- contingent liabilities; and
- fixed assets, current assets, investments and other assets.

On this see secs 122 and 123 of Cap 32, and also see secs 379, 380 and 429 of Cap 622.

[¶24-100] Directors' report

Matters to be included in a directors' report are:

(1) the principal activities (including any significant changes to these) of the company and its subsidiaries during the financial year;

(2) profit and loss for the year and the amount of dividend recommended by the directors to be paid to the members of the company;

(3) the amount proposed by the directors to be transferred to reserves;

(4) the total amount of charitable donations (exceeding HK$100,000 during the year) made by the company and its subsidiaries;

(5) where the company has issued shares or debentures during the financial year, the reason for the issue, the class and number of shares or debentures issued and the consideration received;

(6) significant changes in the company's or its subsidiaries' fixed assets during the year;

(7) names of directors during the year and, where applicable, any retirement of directors in accordance with the Articles;

(8) details of directors' interests in any significant contract with the company, any of its subsidiaries, its holding company, or any of its fellow subsidiaries during the year;

(9) names of the parties to the contract mentioned in (8) and names of directors involved;

(10) where directors are not parties to the contracts mentioned in (8), an indication of the nature of the contract and the directors' interest in it;

(11) details of any arrangement in which the company or any of its subsidiaries or its holding company or any of its fellow subsidiaries was a party to enabling any director to acquire shares in or debentures of the company or any other body corporate;

(12) particulars of matters which are material for the members' appreciation of the state of the company's affairs which, in the directors' opinion, if disclosed, will not be harmful to the business of the company or any of its subsidiaries; and

(13) a resolution for the appointment of auditors to be submitted at the next AGM.

On this see sec 129D of Cap 32, and secs 388-391 and 452 of Cap 622.

The report must be singed on behalf of the board either by the chairman of the meeting at which the report was approved or by the secretary of the meeting.

The abstract of receipts and payments must show:

- the receiver's or manager's receipts and payments for the relevant 12-month period (or, where the receiver or manager has ceased to act, for the period since the previous abstract to the date of his/her cessation); and
- the total amount of the receiver's or manager's receipts and payments since his/her appointment.

In addition to sending the abstract to the Registrar of Companies, the receiver or manager also must send a copy of the abstract to:

- any trustees for the debenture holders of the company on whose behalf he/she was appointed;
- the company; and
- the relevant debenture holders (to the extent that their addresses are known).

The form specified by the Companies Registry for the 12-monthly abstract of receipts and payments is Form NRC3.

Failure to submit 12-monthly accounts as required under sec 300A(2) of Cap 32 attracts a maximum level 3 fine of HK$10,000 and a daily fine of HK$300 for continued default (sec 300A(7); Sch 12 of Cap 32).

[¶30-840] Enforcement of receiver's duty to deliver accounts, etc

If a receiver or manager fails to file, deliver or make any return, account or other document, or fails to give any notice which is required by law, and fails to make good the default within 14 days after the service of a notice requiring him/her to do so, the court may order him/her to make good the default within a specified period of time (sec 302(1)(a), *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32)). All members and creditors of the company, as well as the Registrar of Companies, are eligible to apply for such a court order.

In the case of a receiver or manager appointed under the terms of a debenture or other similar instrument, a court order directing him or her to correct the default may be made if the receiver or manager fails to render proper accounts of receipts and payments as required by the liquidator of the company and to pay over the amount properly payable to the liquidator (sec 302(1)(b), Cap 32). The liquidator must apply for the court order.

The penalties normally applicable for failure to make and deliver accounts, etc, continue to apply notwithstanding that a court order is made under sec 302, Cap 32.

Scope of Liability

[¶30-900] General liability

A receiver is generally obliged to:

(i) account for money coming into has hands as receiver;

(ii) be responsible for loss attributable to his default (*Re Skerretts* (1829) 2 Hog 192), or through his having let funds go out of his control (*Salway v Salway* (1831) 2 Russ & M 214);

(iii) comply with statutory duties under the *Companies Ordinance* (Cap 622) and with those set out in the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) (failure to do so will attract liability for prescribed penalties); and

(iv) fulfil his obligations without misconduct.

In the case of a court-appointed receiver, who is the court's officer, the court will intervene where irregularity or misconduct are alleged. As stated in *Re Mayfair & General Property Trust Ltd* [1945] 2 All ER 523, "The principle that the court's officer will be controlled if he attempts to bring about a fraud or injustice is well established".

[¶30-910] Liability and indemnity under contracts entered into

The *Companies Ordinance* makes specific provision in sec 298A(2) of the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) regarding the liability of receivers and managers, who are appointed out of court, in relation to the contracts which they enter into in the performance of their functions. The extent of liability of a court-appointed receiver or manager also may be inferred from sec 298A of Cap 32 which indicates that a receiver or manager appointed under the powers contained in any instrument is, *to the same extent as if he had been appointed by order of a court*:

(i) personally liable on any contract entered into by him in the performance of his functions (except in so far as the contract otherwise provides); and

(ii) entitled in respect of that liability to indemnity out of the assets.

Section 298A(2) of Cap 32 does not limit any right of indemnity which the receiver or manager would have had, apart from that section. It also does not limit the receiver's or manager's liability on contracts which are entered into without authority, nor confer any right to indemnity in respect of that liability.

The court can make a call (and order payment of the call) on any contributory to the extent of his liability for the payment of the company's debts, liabilities and costs of the liquidation (sec 213(1), Cap 32). A call may be made even though the sufficiency of the company's assets may not have been ascertained.

When making such a call the court may take into account the possibility that some of the contributories may partly or wholly fail to pay the call (sec 213(2), Cap 32).

Any contributory, purchaser or any other person owing money to the company may be ordered by the court to pay that sum to the bank account of the liquidator rather than to him personally. An order under this section may be enforced as if the court had directed payment to the liquidator (sec 214(1), Cap 32). All monies and securities paid or delivered into any bank pursuant to Part V of the Ordinance are subject to order of the court (sec 214(2), Cap 32).

Once an order to pay a sum of money has been made that order shall, subject to any right of appeal, be conclusive evidence that the sum is due and owing (sec 215, Cap 32).

[¶40-790] Appointment of special manager

The court has power to appoint special manager on the application of the Official Receiver acting as the liquidator. The Official Receiver may apply for the appointment of a special manager where he or she is satisfied that:

- the nature of the estate;
- the interests of creditors and contributories; or
- other grounds

make the appointment necessary.

The court my appoint a special manager for such time and such powers, including any of the powers of a manager or receiver as the court considers (sec 216, Cap 32).

Where a special manager is appointed he must:

- give such security and account in such a manner as the court directs; and
- receive such remuneration as is fixed by the court.

[¶40-800] Claims of creditors and distribution of property

Section 217 of Cap 32 provides that the court may fix a date for the proving of debts or claims. If creditors fail to prove their debt or claim before the date they may be excluded from the benefit of any distribution.

The court must adjust the rights of the contributories among themselves and distribute any surplus amongst persons entitled to participate (sec 218, Cap 32).

Once a distribution has been made, a creditor who fails to file his proof within time is unable to recover from the contributories, to whom a distribution has been made (*Butler v Broadhead* [1974] 2 All ER 401).

In order to adjust the rights of the contributories the court may make a call on shares partly paid up for the purpose of adjusting the rights between those shares and shares paid up fully (*Re Anglo-Continental Corp of Western Australia* [1898] 1 Ch 327).

In *Re Alexandra Palace Co* (1883) 23 ChD 297 the equivalent of sec 218 was strictly construed. *Fry* J. considered that the court has jurisdiction to adjust the rights of contributories and not in respect of rights accruing in some other manner.

The Articles of Association are relevant for the purpose of ascertaining who is entitled to the "surplus" after a distribution (see *Liverpool & District Hospital for Diseases of the Heart v A-G* [1981] 1 All ER 994 where there was no provision in the Articles for the distribution of surplus assets to members. As the Memorandum of Association provided that surplus assets were to go to a similar charity, members were not entitled to participate in the surplus.

[¶40-810] Inspection of books by creditors and contributories

Section 219 of Cap 32 provides that the court may make such order for inspections of the books of the company by creditors and contributories as the court thinks fit. Any books, in the possession of the company, may be inspected by the creditors or contributories. Section 209 has been amended by Sch 9 of the *Companies Ordinance* (Cap 622) to add subsection 1A to the effect that:

> "(1A) Where an order for inspection is made under subsection (1), creditors or contributories may, in accordance with the order but not further or otherwise:
>
> (a) inspect any books or papers in the possession of the company; or
>
> (b) if the books or papers are kept by the company by recording the contents of the books or papers otherwise than in a legible form, inspect a reproduction of the recording or the relevant part of it in a legible form "

It would appear that persons (unless they are empowered by statute) other than creditors or contributories are not entitled to inspect the books of the company. In *Re North Brazilian Sugar Factories* (1887) 37 ChD 83, an order for inspection was refused because the persons seeking the order were attempting to establish a claim against the directors and the inspection was not for the beneficial purposes of the winding up.

Before an order of inspection will be made it must be shown that the books are in the company's possession (*Re North Brazilian Sugar Factories* (*supra*)).

be personally liable as a surety for the debt either to the extent of the charge or the value of his interest, whichever is the less (sec 266A(1)). The value of the person's interest will be determined as at the date of the fraudulent transaction (sec 266A(2)).

The court has the jurisdiction to determine any question with respect to the payment arising between the person to whom payment was made and the surety or guarantor and to grant relief in respect thereof (sec 266A(3)).

Section 60 of the Conveyancing and Property Ordinance

Section 60 of the Conveyancing and Property Ordinance provides:

> **Voidability of dispositions to defraud creditors**
>
> (1) Subject to subsections (2) and (3), every disposition of property made, whether before or after the commencement of this section, with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced.
>
> (2) This section does not affect the law of bankruptcy for the time being in force.
>
> (3) This section does not extend to any estate or interest in property disposed of for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the disposition, notice of the intent to defraud creditors.

It is to be noted that this section does not apply only to land, but refers to all forms of property in Hong Kong.

The section was considered by the Court of Final Appeal in *Tradepower (Holdings) Ltd (In Liq) v Tradepower (Hong Kong) Ltd* [2010] 1 HKC 380, where the court explained the procedure for establishing the requisite intention to defraud. It was said that when a disposition of property:

- is unsupported by consideration;
- is made by a disponor when insolvent, or who thereby renders himself/herself insolvent; and
- the result is that his/her creditors (including future creditors) were subjected to a significant risk of being unable to recover their debts in full,

the section applied because there was an inference of an intent to defraud creditors by the disponor. This accorded with the rule in *Freeman v Pope* (1870) LR 5 Ch App 538. However, where:

- the disposition was made for valuable consideration;
- the disponor was not insolvent; or

- the disposition did not deplete the fund potentially available to the creditors,

then an actual intent to defraud must be shown before sec 60 applied.

[¶46-280] Extortionate credit transactions

Section 264B of Cap 32, which came into effect on 10 February 1997, empowers the court, on application by the liquidator of a company being wound up, to declare that a credit transaction entered into by the company is or was extortionate and to direct that the transaction be set aside or varied, or to make such order as it thinks fit.

Section 264B is only applicable to transactions which were entered into in the period three years ending on:

(a) in the case of a winding up by court:

(i) where the company has by special resolution resolved that the company be wound up, the date of the resolution; and

(ii) in any other case, the date of the winding-up order; and

(b) in the case of a voluntary winding up, the commencement of the winding up.

Floating charge

[¶46-300] Effect of floating charge

Note: Part 8 of the *Companies Ordinance* (Cap 622) provides for registration of charges, and of the instrument creating the charge, and for other matters associated with charges, see sec 335.

Section 267 of the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) provides that any floating charge on a company's undertaking or property created within 12 months of the commencement of the winding up shall be invalid unless it can be shown that the company was solvent immediately after granting the charge. If the charge was given in consideration of the payment of an amount of cash at the time of or subsequent to such charge being given, it is not invalid to the extent of any such payment and interest thereon at 12% per annum.

The effect of the section is that the charge is void — the creditor remains an unsecured creditor who must prove for his debt the normal way. However, the