or the right to rescind is otherwise lost. Where the promoter had sold the property to the company for an undisclosed profit, the remedy of account of profits is available only if it can be said that the promoter had acquired the property as trustee for the company or that the promoter was in a fiduciary position towards the company at the time when the promoter originally acquired the property. This issue depends on the question of when the promotion began. In *Re Cape Breton*,[174] a company was established to acquire some coal areas in which one of the promoters of the company was beneficially interested. The English Court of Appeal held that, while the promoter was in breach of fiduciary duty for non-disclosure of his interests in the transaction, the remedy of account of profits was not available. This was because, at the time when the promoter originally purchased the coal areas (over two years before the establishment of the company), the property was acquired for the promoter's own account and the promoter could not be regarded as a trustee or fiduciary *vis-à-vis* the company at the time of purchase.[175] In borderline cases, it may be difficult to determine whether the person was already a promoter of the company at the time of the original purchase of the property. In *Erlanger v New Sombrero Phosphate Co*,[176] the House of Lords seemed to accept that, at the time when the syndicate acquired the lease, it was likely that the members of the syndicate already had the intention of getting up a company which should buy it from them at an increased price. But the Law Lords considered that the syndicate did not acquire the lease as trustees nor were they fiduciaries towards the company at the time of the acquisition of the lease (and hence the remedy of account of profits would not have been available). However, as a matter of principle, if the evidence supports a finding that the person acquired property with an intention to resell it to a company which they propose to form, then the acquisition of the property must be regarded as being part of the promotion of the company, and the persons would be promoters and hence fiduciaries at that time. This approach was applied by the House of Lords in the later decision of *Gluckstein v Barnes*.[177] Also, where the promoter seeks to use funds of the company to discharge the payment obligations of the promoter under the original contract for purchase by the promoter, then it is likely that the property would be regarded as having been acquired by the promoter as trustee or fiduciary for the company.[178]

2.102 **Other grounds for compensation.** There could also be other grounds for obtaining compensation from the promoter, depending on the circumstances.[179] For example, if there has been a negligent or fraudulent misrepresentation by the promoter inducing the company to contract, then damages may be available under the common law in the tort of negligence or tort of deceit respectively.[180]

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[174] (1885) 29 Ch D 795.

[175] Where the promoters acquired the property before the commencement of the promotion, the courts refrain from allowing the remedy of an account of profits on the basis that they would not re-write the contract between the promoters and the company, and moreover, it is difficult for the court to account for accretions to value in the asset arising before and after promotion commenced.

[176] (1878) 3 App Cas 1218.

[177] [1900] AC 240. See, in particular, the judgment of Lord Robertson.

[178] *Re Olympia Ltd; Gluckstein v Barnes* [1898] 2 Ch 153, Eng CA. This point was not discussed in the judgment of the House of Lords which affirmed the Court of Appeal's decision.

[179] See also Mathew D J Conaglen, "Equitable Compensation for Breach of Fiduciary Dealing Rules" (2003) 119 LQR 246 as to the possibility of obtaining equitable compensation instead of an account of profits.

[180] *Re Leeds and Hanley Theatres of Varieties Ltd* [1902] 2 Ch 809, Eng CA.

CHAPTER 3

CORPORATE PERSONALITY

1. Doctrine of Separate Legal Entity

1.1 General

Company is a legal person different from its members. The doctrine of separate legal entity of a company constitutes one of the major conceptual foundations of company law. The powers and liabilities of a company and the rights of members, creditors and others dealing with a company are in fundamental respects determined by the separate entity doctrine. Under this doctrine, the company is a different person altogether from the members of the company.[1] The company itself is a legal person.[2] As a legal entity separate from its members, the company has its own rights and liabilities which are not regarded as the rights or liabilities of its members (nor of the company's directors). In earlier times, the company was not viewed in this way, as the company was seen as an entity identifiable with the members who, together, constitute the company.[3] However, this conception of the company had altered over time, and by the middle of the 19th century, there was clear recognition that the company was a separate legal person independent of the company's members.[4] 3.001

Salomon v Salomon. The House of Lords' decision in *Salomon v Salomon and Co Ltd*[5] is today regarded as the leading decision affirming the separate entity doctrine. The significance of the decision at the time, however, was the confirmation of the possibility for small businesses to take advantage of the benefits of incorporation under the companies' legislation that was originally created to facilitate fundraising for public companies.[6] The case concerned a Mr Salomon who originally operated his boot-making business as a sole proprietor. To extend his business and make provision for his family, he sold his business to a new company which he incorporated. At the time, the companies' legislation required a minimum of seven members, and the company was incorporated with Salomon and his family members as the seven subscribers, each subscribing for one share of par value of £1. The purchase price received by Salomon for the sale of the business consisted of £1,000 cash, £20,000 fully paid shares, and £10,000 debentures secured by a floating charge over the whole of the company's assets.[7] Subsequently, when the company entered into financial difficulties as a result of a depression in the boot and shoe trade, a Mr Broderip agreed to advance £5,000 to the company in return 3.002

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1 *Salomon v A Salomon and Co Ltd* [1897] AC 22, 51, *per* Lord Macnaghten.

2 See the definition of "person" in Interpretation and General Clauses Ordinance (Cap.1) s.3.

3 See Paddy Ireland, Ian Grigg-Spall and Dave Kelly, "The Conceptual Foundations of Modern Company Law" (1987) 14 *Journal of Law and Society* 149; Paddy Ireland, "Capitalism without the Capitalist: the Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality" (1996) 17 *Journal of Legal History* 41.

4 For an early case, see *R v Arnaud* (1846) 115 ER 1485.

5 [1897] AC 22.

6 Paddy Ireland, "The Rise of the Limited Liability Company" (1984) 12 *International Journal of the Sociology of Law* 239, 249–255.

7 That is, a further 20,000 shares were issued to Salomon, with the assets transferred to the company in the sale of the business being used as consideration paid to the company for the shares. The issue of the debentures meant that Salomon effectively provided a £10,000 loan to the company, but again Salomon did not advance cash to the company in the amount of £10,000. The issue of the debentures as part of the purchase price for the business was equivalent to a situation where the company paid £10,000 to Salomon as part of the purchase price, with Salomon immediately lending that sum back to the company in return for the issue of the debentures.

for Salomon transferring his secured debentures to Broderip. The company's fortunes could not be saved though, and the company entered into liquidation. As Broderip had a charge over the company's assets, he was entitled to payment first before the unsecured trade creditors. As the company did not have sufficient assets, the unsecured creditors would receive nothing in the liquidation.

The liquidator sought to set aside the transfer of the business from Salomon to the company and to have the debentures declared invalid. The liquidator's initial claim failed because no fraud was shown in relation to the transfer of the business and the issue of the debentures and so there was no basis for disputing the validity of those transactions. However, at first instance, the court held that the company was entitled to an indemnity against Salomon for the company's liabilities. The court held that the company was simply an agent of Salomon because the other shareholders were mere nominees of Salomon.[8] In substance, the business was still Salomon's, and the company was just a mere alias of Salomon. The Court of Appeal upheld Salomon's liabilities, but on the basis that the company was trustee for the shareholders. The Court of Appeal took the view that by requiring seven subscribers, the legislation envisaged a number of investors genuinely coming together to form a company. Thus, where Salomon used nominees to fill up the required numbers, he was attempting to do what the legislature intended not to be done. Accordingly, Salomon would be liable for the company's debts.

The House of Lords unanimously held in favour of Salomon. Lord Macnaghten noted:

> "The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act."[9]

3.003 **Company different person even if effectively operated by one person.** This is so, even if there is a controlling shareholder (with the others as nominees) and even if the company is effectively operated by a single person. The House of Lords rejected the view that the companies' legislation was not intended for small businesses. The Law Lords emphasised that there was nothing in the legislation requiring that the subscribers be independent from each other, and there were no requirements for subscribers to inject any minimum amount of capital beyond that needed to take up one share. The view that the company was simply an alias of Salomon or was a myth or fiction was firmly rejected. Once the formal requirements for incorporation under the legislation are complied with, then the company is legally incorporated and has a legal existence of its own, and with rights and liabilities of its own. Accordingly, Salomon was held not to have been liable for the debts of the company.

[8] A shareholder is regarded as a nominee for another where the shareholder holds the legal title to the shares on trust for the other (who is the beneficial owner).

[9] [1897] AC 22, 51.

1.2 Company's rights and powers

3.004 **Company has capacity of natural person.** A company has the capacity, rights, powers and privileges of a natural person.[10] Being a separate legal entity, the company can enter into contracts. Moreover, the separate entity doctrine means that the company can contract with its own members. For example, in the *Salomon* decision, Mr Salomon contracted with the company (controlled by him) in the sale of his business to the company. The principle is also illustrated by *Lee v Lee's Air Farming Ltd*.[11] Here, a Mr Lee was the controlling shareholder of a company he set up and was the company's governing director. Lee also worked as a chief pilot for the company's business operations and was paid wages for doing so. While piloting an aircraft for the company, the aircraft crashed and Lee was killed. Lee's wife sought to recover against the company on the basis of the company's statutory liability to pay compensation to its workers who suffered personal injury by accident in the course of employment. The issue was whether Lee was a "worker" within the meaning of the statute. The Privy Council (on appeal from the New Zealand Court of Appeal) held that he was. The Privy Council noted that the company was a separate entity to Lee, and held that it was possible for Lee to act in one capacity (as governing director) to cause the company to enter into an employment contract with himself in a different capacity (as a worker or employee).

3.005 **Can own property including land; members do not have legal or beneficial interest in property.** As a legal entity, the company can own property, including land.[12] Since the company is a separate entity to its members, the members do not have any legal nor equitable interest in the property of the company merely on the basis that they are members of the company. In *Macaura v Northern Assurance Co Ltd*,[13] where timber on land was owned by a company but was insured under a policy in the name of the controlling shareholder of the company, it was held that the shareholder could not claim on the policy by reason that he did not have any insurable interest[14] in the property. That is, under the separate entity principle, the shareholder did not have any proprietary interests in the property being insured. The property was owned by the company, and not the shareholders. Lord Buckmaster stated: "no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest therein".[15]

3.006 **Company does not hold property on trust for persons merely because they are members.** The above principles have been expressly applied in Hong Kong in a number of cases. In *Good Profit Development Ltd v Leung Hoi*,[16] the plaintiff brought an action against the two shareholders (and directors) of a company to enforce an agreement for the sale of all the shares in the company to the plaintiff. The company's sole substantial asset consisted of certain real property. The underlying intention of the plaintiff and

[10] Cap.622 s.115.

[11] [1961] AC 12.

[12] Cap.622 s.115(2).

[13] [1925] AC 619.

[14] Under insurance law, the insured is not entitled to claim under the insurance policy if he or she does not have an insurable interest in the property being insured.

[15] *Macaura v Northern Assurance Co Ltd* [1925] AC 619, 626.

[16] [1992] 2 HKC 539.

the two shareholders was for the plaintiff to acquire the real property. The plaintiff unsuccessfully sought to join the company as a defendant in the action. The plaintiff's argument that the company held the real property on trust for the shareholders was rejected on the basis of the separate entity doctrine.[17] Also, the mere fact that the shareholders had set up the company to hold property did not mean the company was an "alter ego" of the shareholders. However, the principle that the members do not own any legal or equitable interest in the company's property does not mean that the company can never be regarded as a trustee for its members. The company does not own its assets as trustee for its members merely because those persons are members, but it is possible for the specific circumstances of the case to give rise to a trust where the company holds on trust for one or more particular members.[18]

3.007 **Company's privilege against self-incrimination not available to directors.** The separate entity doctrine is also illustrated by the case of *Salt & Light Development Inc v SJTU Sunway Software Industry Ltd*.[19] Here, the Court of First Instance held that where the company is entitled to claim the privilege against self-incrimination, the privilege protects the company itself and not its directors. The court observed that the privilege is "personal to the company", and that "[a]s the company has a separate legal personality it is that separate personality that is protected".[20]

1.3 Company's obligations and liabilities

3.008 **Company liable in contract and tort.** A company can be subject to legal obligations and can incur legal liabilities. Thus a company is the entity liable on contracts entered into for the company. A company can also be liable in tort or under the criminal law. These principles are discussed in detail in Chapter 12.

2. Liability of Members

3.009 **Limited liability distinct from notion of separate legal entity.** The liability of members for the debts of the company can be limited, depending on the type of company formed under Companies Ordinance (Cap.622) s.66. The "limited liability doctrine" of company law refers to the limited liability of members of companies. The limited liability doctrine is a doctrine which is distinct from the notion of separate legal entity of a company. Incorporation does not necessarily mean that there is limited liability, as companies can be formed with the liabilities of its members either limited or unlimited.

3.010 **Limited by shares.** For companies limited by shares, the liability of shareholders is limited to any unpaid amounts on the shares held by the shareholders.[21] For example,

[17] See also *Terrian v Oriental Peer Co Ltd* [1988] 1 HKLR 246, 254, where the *Macaura* principle was applied.
[18] See *Pacific Electric Wire & Amp Cable Co Ltd v Texan Management Ltd* [2008] 4 HKLRD 349 (reversed on appeal on a different point of law: *Pacific Electric Wire & Cable Co Ltd v Harmutty Ltd* [2009] 3 HKLRD 94).
[19] [2006] 2 HKC 440.
[20] [2006] 2 HKC 440, [78].
[21] Cap.622 s.8. See also retitled Cap.32 s.170(1)(d).

where the issue price for a share is $2, and a shareholder has paid $2 for the shares upon subscription (i.e. the shares are fully paid), then the shareholder can lose that $2 if the company becomes insolvent, but the shareholder would not be required to contribute further amounts to pay the company's creditors on a winding-up. But if the shareholder had acquired partly paid shares (e.g. paying $1.50 for the $2 shares), then if the company does not have sufficient assets to satisfy the claims of creditors in a winding-up, then the shareholder can be called upon to contribute a further $0.50 to pay off the creditors.

3.011 **Limited by guarantee.** For companies limited by guarantee, the members are liable for the company's debts only up to the amount stated in the articles of association as the maximum amount for which members can be liable.[22]

3.012 **Unlimited liability.** Where a company is an unlimited company, then the members can be personally liable for all of the company's debts.[23]

3. Liability of Officers and Employees

3.013 **Separate entity doctrine and agency law mean that officers and employees are generally not liable on company's contracts.** Employees would act as agents of the company, and as such, would generally not be liable on contracts entered into by them on behalf of the company.[24] Similarly, when directors or other officers contract on behalf of the company as agents, they will not generally be personally liable pursuant to the law of agency.[25] It is the separate entity doctrine and the principles of agency law which together mean that officers and employees are generally not liable on the company's contracts. It should be noted that the doctrine of limited liability is not relevant in relation to officers or employees, as that doctrine relates to a company's members. Sections 7–10 of the Companies Ordinance (Cap.622), which provide for the possibility of "limited liability", are concerned with the liability of members.

3.014 **Agents still personally liable for their torts and other wrongs.** Agents can be personally liable to third parties for their torts or other wrongs even if acting under the authority of their principal.[26] Accordingly, employees can be so liable when acting for the company. Some cases and academic commentators have treated directors differently so as to confine the situations when directors would be liable in respect of their torts committed in the course of acting for the company.[27] However, it seems that the correct position is that directors are to be treated no differently to other employees

[22] Cap.622 s.9. See also retitled Cap.32 s.170(1)(e).
[23] See Cap.622 s.10. See also retitled Cap.32 s.170(1).
[24] *Montgomerie v UK Mutual SS Assn Ltd* [1891] QB 370, 371. See also *Yeung Kai Yung v Hong Kong and Shanghai Banking Corp* [1981] AC 787; and see generally Peter Watts and F M B Reynolds, *Bowstead and Reynolds on Agency* (19th edn, Sweet and Maxwell, London, 2010) [9-002].
[25] *Ferguson v Wilson* (1866-67) LR 2 Ch App 77.
[26] *Bennett v Bayes* (1860) 5 H & N 391; and see generally Peter Watts and F M B Reynolds, *Bowstead and Reynolds on Agency* (19th edn, Sweet and Maxwell, London, 2010) [9-116].
[27] E.g. *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517.

CHAPTER 8

DIRECTORS' DUTIES

1. Introduction

1.1 Nature of and rationales for duties

Duties ensure act properly in interests of company. The law of directors' duties regulates certain aspects of the conduct of directors to ensure that they act properly in the interests of the company when carrying out their functions and exercising their powers. 8.001

1.1.1 *Corporate governance*

Corporate scandals. The company, its shareholders and others can suffer a loss as a result of incompetence of directors in their management of the company or as a result of directors' abuse of power or fraudulent conduct. In recent decades, the topic of corporate governance has grown in prominence in corporate law scholarship.[1] The issue has also become topical in general public discourse outside the confines of academic debate. Major corporate collapses sear into the public consciousness the problem of corporate wrongdoing, prompting governments to implement legal or regulatory reforms in an attempt to address the problems. This is illustrated by the wave of high-profile corporate collapses in the United States in the early years of the new millennium (Enron,[2] Worldcom, Tyco etc.), which led to the enactment of the Sarbanes-Oxley Act 2002. More recently, the global financial crisis of 2007–2008 has again raised questions of whether existing regulatory schemes are adequate, including questions of corporate governance and risk management.[3] 8.002

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1 On corporate governance generally, see, e.g., Robert I Tricker (ed.), *Corporate Governance* (Ashgate, 2000); Kenneth A Kim, John R Nofsinger and Derek J Mohr, *Corporate Governance* (Prentice Hall, 3rd ed. 2010). On corporate governance in the Hong Kong context, see Janine Canham and Chris Southorn, "Protecting Shareholders of Hong Kong Companies" in Nick Ferguson (ed.), *Building Value in Asia: Corporate Governance and Compliance for a New Era* (Asia Law and Practice, 2000) 29–37; Simon S H Ho, *Corporate Governance in Hong Kong: Key Problems and Prospects* (Centre for Accounting Disclosure and Corporate Governance School of Accountancy Chinese University of Hong Kong, 2003); S H Goo and Anne Carver, *Corporate Governance: the Hong Kong Debate* (Sweet and Maxwell, 2003); Philip Lawton, "Berle and Means, Corporate Governance and the Chinese Family Firm" (1996) 6 *Australian Journal of Corporate Law* 348; Julieanne Doe, "Corporate Governance in Hong Kong" (1998) 9 *International Company and Commercial Law Review* 281; Alex Lau, John Nowland and Angus Young, "In Search of Good Governance for Asian Family Listed Companies: A Case Study on Hong Kong" (2007) 28 *Company Lawyer* 306; Simon S H Ho, "The Hong Kong System of Corporate Governance" in A Naciri (ed.), *Corporate Governance Around the World* (Routledge, 2008) 198–229; Gordon Jones, *Corporate Governance and Compliance in Hong Kong* (LexisNexis, 2012). See also SCCLR, "Corporate Governance Review: A Consultation Paper on Proposals Made in Phase I of the Review" (July 2001); SCCLR, "Corporate Governance Review: A Consultation Paper on Proposals Made in Phase II of the Review" (June 2003).

2 Enron was one of the major energy corporations in the world, and was one of the largest corporations in the United States (the seventh largest firm by market capitalisation in 2000: William W Bratton, "Enron and the Dark Side of Shareholder Value" (2002) 76 *Tulane Law Review* 1275, 1276). On the Enron saga and its aftermath, see, e.g., Jerry W Markham, *A Financial History of Modern US Corporate Scandals: From Enron to Reform* (M E Sharpe, 2006); Justin O'Brien (ed.), *Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets* (John Wiley and Sons, 2005).

3 See Grant Fitzpatrick, "The Corporate Governance Lessons from the Financial Crisis" (OECD Steering Group on Corporate Governance, February 2009) <http://www.oecd.org/dataoecd/32/1/42229620.pdf> [Accessed 24 November 2010]; Organisation for Economic Co-operation and Development, "Corporate Governance and the Financial Crisis: Key Findings and Main Messages" (June 2009) <http://www.oecd.org/dataoecd/3/10/43056196.pdf> [Accessed 24 November 2010]; Robert W Kolb (ed.), *Lessons from the Financial Crisis: Causes, Consequences and Our Economic Future* (Wiley, 2010).

8.003 **Peregrine case.** Hong Kong has not been immune to corporate scandals arising from mismanagement or fraud.[4] Peregrine was one of the major merchant banks in Hong Kong and its collapse following the 1997 Asian Financial Crisis led to an investigation under s.143 of the predecessor Companies Ordinance (Cap.32) (now s.841 of Companies Ordinance (Cap.622)).[5] Peregrine's failure in January 1998 was triggered by defaults in loans from Indonesian borrowers. But, while the proximate cause of the collapse was the crisis in the Asian markets, which few could have predicted, Peregrine was particularly vulnerable as it had sizeable long-term investments and illiquid trading assets. The underlying cause of the vulnerability of Peregrine was an inadequate infrastructure of reporting and accounting procedures, risk management and internal audit. Underlying these deficiencies were management failures. Peregrine was directed on a highly informal basis centred on one decision-maker (the chairman). Management had wide discretion to incur risk, subject only to the personal oversight of the chairman. The board failed to actively oversee management, and there was no formal governance structure to put in place a solid system of procedures and controls.

8.004 **Akai case.** Another high-profile example is the collapse, in 2000, of Akai Holdings, a listed company in a corporate group with businesses including the production of electronic goods and Singer sewing machines. The insolvency of Akai constituted Hong Kong's largest corporate collapse, with more than US$1.1 billion owed to creditors when the company entered into liquidation. Subsequent investigations by the liquidator and the police revealed major fraud by the company chairman in siphoning assets out of the company.[6]

8.005 **Directors' duties promote good corporate governance.** Problems of abuse of power by directors have been described under economic theories as problems arising from the separation of ownership and control of companies.[7] If a director is the sole shareholder and thus 100 per cent owner of the company, then the interests of the director and the company are aligned. If there are outside shareholders who are not involved in management, then there could be a divergence in the interests of the directors and the shareholders. As illustrated by the Akai case, directors can make personal gains at the expense of the company. Conflicts of interests between the directors and the shareholders can arise not only in public companies with dispersed shareholdings but also in companies where the directors are also the dominant or controlling shareholders — in the latter, the interests of the board-cum-majority owner may differ from the interests of the minority shareholders. In economic terms, the divergence in the interests of the managers and the owners of the company and the consequent need for mechanisms to curtail management conduct that is contrary to the owners' interests is said to give rise to "agency costs". The law of directors' duties provides one

[4] See Alan C W Tang, *Insolvency in China and Hong Kong* (Sweet and Maxwell, 2005) paras.4.18–4.72.

[5] Richard H Farrant, "Report: Peregrine Fixed Income Ltd (in liq) and Peregrine Investments Holdings Ltd (in liq)" (12 February 2000) <http://www.fstb.gov.hk/fsb/ppr/report/doc/report.pdf> [Accessed 24 November 2010].

[6] See "Akai Case Shows Need for Tighter Oversight" *South China Morning Post* (8 October 2009).

[7] See, e.g., Michael C Jensen and William H Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305; and see also Alex Lau, "The New Corporate Governance Code for Hong Kong Listed Companies – Part 2: Application of Corporate Governance Theories" (2005) 26 *Company Lawyer* 345, 345–346.

mechanism for reducing such agency costs by deterring directors from acting in their personal interests at the expense of the company's interests.[8]

8.006 **Need for enforcement mechanisms.** Directors' duties form part of the legal armoury in promoting good corporate governance. While proper corporate governance cannot be achieved solely through legal regulation, the law imposes minimum standards that need to be attained in all companies. Yet, notwithstanding the existence of laws on directors' duties, it is also critical that there be adequate enforcement mechanisms. In most corporate collapses in Hong Kong, it is up to the liquidator to attempt to seek recovery against delinquent officers, yet private liquidators are hampered by insufficient funding and resources.[9] Hong Kong does not have a full-fledged corporate regulator tasked with investigations of corporate misconduct generally.[10]

1.1.2 *Directors as fiduciaries*

8.007 **Fiduciary relationships involve trust and confidence.** From the early days in the development of company law, the courts already recognised the need to impose duties on directors similar to the duties imposed on trustees[11] or agents.[12] But while early cases did speak of directors as trustees or agents of the company, it is clear today that directors are not trustees of the company or of the shareholders simply by being directors,[13] nor are they agents when acting together as the board.[14] By analogy with trustees and agents, directors are treated as fiduciaries. In equity, persons who are in a fiduciary position are subject to fiduciary duties. A fiduciary relationship is one of trust and confidence that usually involves a person (the fiduciary) undertaking to act for or in the interests of another in the exercise of powers or discretions which affects the interests of the other person in a way where the latter would be in a position of vulnerability *vis-à-vis* the fiduciary.[15] There are established categories of fiduciary relationships under the law, such as director-company, trustee-beneficiary, agent-principal, and solicitor-client. Outside the established categories, a person might be regarded as a fiduciary *vis-à-vis* another pursuant to the general tests applied by the courts in determining whether there is a fiduciary relationship.[16] Fiduciary duties aim to ensure that the fiduciary exercises his or her powers in the interests of the person

[8] Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991) 90–93.

[9] Alan C W Tang, *Insolvency in China and Hong Kong* (Sweet and Maxwell, 2005) para.4.72.

[10] The Securities and Futures Commission is primarily a securities regulator rather than a corporate regulator: Gordon Jones, *Corporate Governance and Compliance in Hong Kong* (LexisNexis, 2012) 104. Compare, e.g., the functions of the Australian Securities and Investments Commission in Australia: see Jean J du Plessis, "Reverberations after the HIH and other Recent Australian Corporate Collapses: The Role of ASIC" (2003) 15 *Australian Journal of Corporate Law* 225.

[11] *Fraser v Whalley* (1864) 2 Hem & M 10, 71 ER 361.

[12] *Ferguson v Wilson* (1866–67) LR 2 Ch App 77.

[13] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL); *Chinese United Establishments Ltd v Cheung Siu Ki* [1997] 2 HKC 212, 220.

[14] *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34, 45 (Cozens-Hardy LJ) (Eng CA).

[15] *Kao Lee & Yip v Koo Hoi Yan Donald* [2003] 3 HKLRD 296, 311.

[16] See *Kao Lee & Yip v Koo Hoi Yan Donald* [2003] 3 HKLRD 296, 311; *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41, 96–97 (Mason J).

to whom the duties are owed. While different categories of fiduciaries are subject to similar duties, the precise content and scope of the duties can vary.[17]

1.2 Sources of law and categories of duties

8.008 **Equitable fiduciary duties.** Directors' duties in Hong Kong arise mainly from the general law (mainly equity). Traditionally, the following have been regarded as the main equitable fiduciary duties of directors:[18]

- duty to act in good faith in the interests of the company;
- duty to exercise powers for proper purposes;
- duty to avoid conflicts of interests;
- duty not to make secret profits; and
- duty not to misappropriate company assets.

8.009 **Proscriptive and non-proscriptive duties.** In Australia, a debate has arisen whether fiduciary duties are confined to proscriptive duties, namely duties which spell out what a fiduciary cannot do.[19] Proscriptive duties are contrasted with prescriptive or non-proscriptive duties, namely duties which mandate positive action.[20] In various decisions concerning fiduciaries in a different context, it was held by the High Court of Australia that the only fiduciary duties are the two proscriptive duties prohibiting fiduciaries from acting where there is a conflict of interest and from obtaining secret profits.[21] More recently, in *Westpac Banking Corporation v Bell Group Ltd (No 3)*,[22] the Western Australian Court of Appeal affirmed the traditional view in company law that fiduciary duties of directors also include the duties to act in the interests of the company and to exercise powers for proper purposes. The judges noted that the Australian High Court decisions restricting fiduciary duties to proscriptive duties did not deal with company directors. As stated by Drummond AJA: "[i]f the fiduciary obligations of directors to their company are limited to the two proscriptive ones, not to benefit and not to be in a conflict situation, an extensive revision of the law governing directors' duties must have taken place without any examination of that particular issue at the intermediate or final appellate level";[23] and furthermore, "until the High Court declares the law to be otherwise, long established authority requires the duties of company directors to act bona fide in the interests of the company and to exercise their powers for proper purposes to be accepted as fiduciary ones even

[17] *Henderson v Merrett Syndicates Ltd (No 1)* [1995] 2 AC 145, 206 (HL).
[18] See *Bristol and West Building Society v Mothew (t/a Stapley & Co)* [1998] Ch 1, 16 (Millett LJ); *Kao Lee & Yip v Koo Hoi Yan Donald* [2003] 3 HKLRD 296, 312–313; and see also Julian Svehla, 'Directors' Fiduciary Duties' (2006) 27 *Australian Bar Review* 192.
[19] Rosemary Teele Langford, 'The Fiduciary Nature of the Bona Fide and Proper Purposes Duties of Company Directors: *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* (2009) 31 *Australian Bar Review* 326, 327.
[20] *Ibid.*, 327–328.
[21] *Breen v Williams* (1996) 186 CLR 71; *Pilmer v The Duke Group Ltd (in liq)* (2001) 207 CLR 165.
[22] (2012) 89 ACSR 1, [897]–[933] (Lee AJA), [1947]–[1978] (Drummond AJA), [2714]–[2733] (Carr AJA).
[23] (2012) 89 ACSR 1, [1962].

though they may require the directors to take positive action." However, in the Hong Kong Court of Final Appeal decision of *Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei*,[24] Gummow NPJ (with whom the other judges agreed) spoke of the non-proscriptive duty of directors to act in the interests of the company as being an "equitable duty" only, contrasting it with proscriptive fiduciary duties in the "strict sense" of the term "fiduciary".[25] It appears that those comments were by way of *obiter* only, but they do suggest the possibility of the proscriptive model of fiduciary duties being applicable in the context of company directors as well. In the absence of a decision squarely dealing with the issue at the final appellate level, it seems that the position is not entirely settled. But in line with the approach adopted in the *Westpac Banking Corporation* decision, this Chapter proceeds on the traditional view that the duties to act in the interests of the company and for proper purposes are also fiduciary duties. Whether fiduciary duties are confined to the two proscriptive duties has implications on whether the principles on accessorial liability[26] for a director's breach of fiduciary duties are applicable in respect of breaches of non-proscriptive duties.[27]

8.010 **Companies Ordinance (Cap.622) s.465: statutory duty of care.** Apart from the above general law duties, directors are also under a duty to exercise due care, skill and diligence. This duty originally arose in equity (although it is not regarded as a fiduciary duty[28]) and under the common law in the tort of negligence (and where applicable, pursuant to contract). Under Cap.622, the duty of care of directors operates as a statutory duty in place of the general law: s.465.

8.011 **Can be breach of more than one duty.** The various duties, above, focus on different aspects of the responsibilities of directors in the exercise of their functions, but depending on the circumstances, particular conduct of a director can amount to breach of more than one of those duties.

8.012 **Cap.622: Pt.11.** Apart from s.465, the Ordinance also contains other provisions that supplement the general law duties, in particular in relation to conflicts of interests: Cap.622 Pt.11.[29]

8.013 **Listed companies.** For listed companies, there are also further restrictions that apply under the Listing Rules, including Chapter 14A dealing with connected transactions.

[24] (2014) 17 HKCFAR 466, [35]–[36].
[25] Gummow NPJ is a former Justice of the High Court of Australia and was a participant in the joint judgment in *Pilmer v The Duke Group Ltd (in liq)* (2001) 207 CLR 165 which affirmed the proscriptive model of fiduciary duties.
[26] See *Barnes v Addy* (1873–74) LR 9 Ch App 244 and paras.8.170 to 8.173 below.
[27] See Hon T F Bathurst and Sienna Merope, 'It Tolls for Thee: Accessorial Liability after *Bell v Westpac*' (2013) 87 *Australian Law Journal* 831.
[28] *Henderson v Merrett Syndicates Ltd (No 1)* [1995] 2 AC 145, 205 (HL); *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, 158.
[29] The Ordinance also imposes other obligations on directors such as obligations to ensure that proper accounts are kept or obligations to ensure that requisite documents are filed with the Registrar. These types of obligations are outside the scope of this Chapter.

8.014 **Guide on Directors' Duties.** The Companies Registry has issued a "Guide on Directors' Duties",[30] which sets out various duties of directors. The guide is not itself a law but is the Registry's summary of the legal duties of directors. The guide is intended to promote awareness among directors of their duties under the law.[31]

1.3 Persons subject to directors' duties

1.3.1 *De jure directors*

8.015 ***De jure* directors.** *De jure* directors[32] are of course subject to the general law duties and statutory provisions which apply to directors.

8.016 **Alternate directors.** Alternate directors[33] are regarded as *de jure* directors during the period when they act in place of their appointors and would also be subject to the duties of directors under the law in that period.

1.3.2 *De facto directors*

8.017 ***De facto* directors.** The concept of "*de facto* directors" was applied by the courts from the early days of company law in holding that such persons would be subject to the same duties of *de jure* directors,[34] for otherwise persons would be able to escape their legal obligations by avoiding formal appointment to the board. *De facto* directors are also covered by the provisions of the Companies Ordinance referring to "directors" due to the s.2 definition of "director".[35]

1.3.3 *Shadow directors*

8.018 **Shadow directors: better view that general law duties apply to them.** The s.2 definition of "director" does not refer to "shadow directors" and so references in the Companies Ordinance to "directors" will not generally cover shadow directors. But there are specific provisions in the Ordinance that expressly apply to shadow directors, including provisions which impose liabilities on "responsible persons" (as defined in Cap.622 s.3[36]) in connection with contraventions of the Ordinance. As to the general law duties, in *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2)*,[37] Toulson J considered that a shadow director who controlled the company's

[30] Available at the Companies Registry website: <http://www.cr.gov.hk>.

[31] In its review of corporate governance in 2001–2004, the SCCLR declined to recommend the statutory codification of directors' duties. Instead, the SCCLR recommended the publication of non-statutory guidelines to help directors better understand their responsibilities: see SCCLR, "Corporate Governance Review: A Consultation Paper on Proposals Made in Phase II of the Review" (June 2003) paras.7.01–7.12. For an earlier empirical study on the extent to which Hong Kong directors are aware of their legal duties, see Abdul Majid, Low Chee Keong and Krishnan Arjunan, "Company Directors' Perceptions of their Responsibilities and Duties: A Hong Kong Survey" (1998) 28 *HKLJ* 60.

[32] See Chapter 7.

[33] See Chapter 7.

[34] *Re Canadian Land Reclaiming and Colonizing Co (Coventry and Dixon's Case)* (1880) 14 Ch D 660; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638, [1257]; and see also the discussion in *Corporate Affairs Commission v Drysdale* (1978) 141 CLR 236.

[35] On *de facto* directors, see further Chapter 7.

[36] The concept of "responsible person" is adopted in Cap.622 instead of the concept of "officer in default" under Cap.32 s.351(2).

[37] [1998] 1 WLR 294, 311.

activities "undoubtedly" owed fiduciary duties to the company. However, in *Ultraframe (UK) Ltd v Fielding*,[38] Lewison J declined to follow that approach, taking the view that the facts in the *Yukong* case indicated that the person was more of a *de facto* director than a shadow director. Lewison J held that the mere fact that a person is a shadow director of a company does not mean that fiduciary duties will be imposed on him or her, although his Lordship accepted that where the shadow director takes on a role beyond indirect influence to assume control of a company asset, then fiduciary duties will be imposed in respect of the use of the asset.

The issue was raised again in *Vivendi SA v Richards*,[39] where Newey J held that shadow directors would owe fiduciary duties to the company in relation, at least, to the directions or instructions that they give to the *de jure* directors. This includes owing a duty of good faith to act in the interests of the company when giving such directions or instructions. Newey J took the view that Lewison J in the *Ultraframe* case had understated the extent to which shadow directors owe fiduciary duties. In *R v R*,[40] Munby P agreed with Newey J's analysis. However, as the UK Court of Appeal has subsequently noted, the law is not yet entirely settled.[41] The better view is that, because of the actual control and influence of a shadow director over the company, the general law duties of directors should apply to shadow directors to the extent of their control and involvement in the company's activities.[42]

8.019 **Cap.622: duty of care applies to shadow directors.** For the statutory duty of care, the Ordinance expressly applies the duty to shadow directors.[43]

1.3.4 *Corporate directors*

8.020 **Body corporate subject to same duties as natural persons.** A director which is a body corporate will also be subject to the same duties as directors who are natural persons. Bodies corporate can be *de facto*[44] or shadow directors,[45] and would also be subject to directors' duties to the extent that such duties apply to *de facto* or shadow directors, respectively. In some circumstances, the directors of a corporate director could also be regarded as *de facto* or shadow directors of the company in which the

[38] [2005] EWHC 1638, [1279]–[1290].

[39] [2013] BCC 771, [143].

[40] [2014] 2 FLR 699, [9]–[10].

[41] *Sukhoruchkin v Van Bekestein* [2014] EWCA Civ 399, [40]–[41].

[42] This view is supported in Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (Sweet and Maxwell, 8th ed. 2008) 485; John De Lacy, "The Concept of a Company Director: Time for a New Expanded and Unified Statutory Concept?" [2006] *Journal of Business Law* 267, 295. For a critique of *Ultraframe* on this question, see also D D Prentice and Jenny Payne, "Directors' Fiduciary Duties" (2006) 122 *Law Quarterly Review* 558. See also *Dairy Containers Ltd v NZI Bank Ltd* (1995) 13 ACLC 3211, 3238 where Thomas J of the New Zealand High Court held that a shadow director can owe a common law duty of care to the company. However, the relevant statutory definition of "director" in the New Zealand legislation included shadow directors (Companies Act 1955 (NZ) s.2, as amended by the Companies Amendment Act 1982; the 1955 Act is now repealed; *cf* Companies Act 1993 (NZ) s.126) and Thomas J's view that it would be appropriate to impose common law duties on shadow directors was made by way of analogy with the treatment of such persons as directors generally under the Companies Act.

[43] Cap.622 ss.465(5).

[44] See *Aktieselskabet Dansk Skibsfinansiering v Wheelock Marden & Co Ltd* [1998] 3 HKC 153; *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1.

[45] *Re Hydrodan (Corby) Ltd* [1994] BCC 161.

corporate director is a director,[46] and in this situation the first-mentioned director could be subject to duties owed to the last-mentioned company.

1.3.5 *Executive officers*

8.021 **Executive officers owe fiduciary duties.** Both executive and non-executive directors are subject to the duties of directors. Executive officers or senior managers who are not directors are arguably also subject to the fiduciary and common law duties similar to that of directors. Under the common law, employees of a company owe a duty of care to the company in carrying out their functions.[47] Employees might also owe fiduciary duties to the company, but the scope and nature of the duties of employees would not be coextensive with that of directors.[48] However, the situation is arguably different for employees who are executive officers. In the Canadian decision of *Canadian Aero Services Ltd v O'Malley*,[49] it was held that two persons appointed as president and executive vice-president of the company had responsibilities as senior officers and were in "top management" rather than "mere employees", and as such owed a more exacting duty to the company similar to that owed by directors to the company. Persons within the statutory definition of "manager"[50] could well be regarded as occupying a fiduciary position similar to directors, but in any particular case the extent to which a senior manager or officer would be subject to fiduciary duties comparable with a director will depend on the nature of the position held and the responsibilities attaching to the position in the company concerned. Imposition of fiduciary duties on senior executives similar to those of directors can be justified on the basis that such officers in large public companies may exercise greater management power than the non-executive directors who might only meet as a board a number of times per year.[51]

8.022 **Duty of care owed by officers.** Although the statutory duty of care in Cap.622 s.465 applies only to directors, executive officers would be under a common law duty of care, whether pursuant to contract or tort.

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[46] As for the tests to determine whether this would be the case, see Chapter 1.

[47] *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555 (HL).

[48] It is sometimes said that the employer-employee relationship is one of the established categories involving fiduciary relationships: see *Kao Lee & Yip v Koo Hoi Yan Donald* [2003] 3 HKLRD 296; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 96–97. However, it appears that the employee's duty of good faith or fidelity (which is an implied duty in the contract of employment) is different to fiduciary duties which are imposed in equity. The contractual obligations or functions of an employee may in the particular circumstances give rise to fiduciary duties as well, but the employment relationship does not of itself lead an employee to be a fiduciary: *Nottingham University v Fishel* [2000] IRLR 471; *Lonmar Global Risks Ltd v West* [2011] IRLR 138.

[49] [1974] SCR 592.

[50] Under Cap.622 s.2, "manager" means a person who, under the immediate authority of the board of directors, exercises managerial functions. Managers, so defined, are "officers" within s.2 of the Ordinance. Compare the definition of "officer" in s.9 of the Corporations Act 2001 (Aust) and the persons held to be officers in *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; *Australian Securities and Investments Commission v MacDonald (No 11)* (2009) 256 ALR 199 (general counsel and chief financial officer of company).

[51] E.g., see Melvin A Eisenberg, "The Duty of Corporate Directors and Officers" (1989–1990) 51 *University of Pittsburgh Law Review* 945, 949–950; John C Coffee, "Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response" (1977) 63 *Virginia Law Review* 1099, 1110, 1142. See also Corporations and Markets Advisory Committee, "Corporate Duties Below Board Level" (April 2006), available at the CAMAC website: <http://www.camac.gov.au>.

1.4 To whom are the duties owed?

8.023 **Owed to company.** Directors' fiduciary duties and the duty of care are owed to the company such that the company is the proper plaintiff to bring proceedings against a director for breach of duty.[52]

8.024 **Not owed to members except in special circumstances.** Directors' duties are not owed to the members individually,[53] but there may be special circumstances where directors will owe fiduciary duties to individual members directly pursuant to the general principles on fiduciary relationships.[54] This may be the case where directors act as the shareholders' agents in selling their shares.[55] It is also arguable that directors can owe fiduciary duties to individual shareholders when they act on behalf of the company in purchasing the shares of the shareholders.[56] Whether that is the case may depend on factors such as the shareholders' dependence on the directors for information and advice, the existence of a relationship of trust and confidence, the significance of the transaction for the parties, and the extent of any positive action taken by or on behalf of the directors to promote the transaction.[57]

8.025 **Take into account interest of creditors when company in vicinity of insolvency.** As will be discussed below,[58] directors have a duty to take into account the interests of creditors when the company is in the vicinity of insolvency, but it is clear that the duty is not owed to creditors directly such as to give creditors any direct cause of action under the general law for breach of the duty.[59]

2. Acting in Good Faith in the Interests of the Company

2.1 General

8.026 ***Akai* case: breach of duty where company obtained loan to discharge debt of another.** Directors must exercise their powers *bona fide* (in good faith) in what they consider is in the interests of the company.[60] For example, in *Akai Holdings Ltd (in liq) v Thanakharn Kasikorn Thai Chamkat (Mahachon)*,[61] Ting, the chairman and chief

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[52] *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189. See Chapter 10.

[53] *Percival v Wright* [1902] 2 Ch 421; *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258, 288.

[54] *Peskin v Anderson* [2001] 1 BCLC 372, 379.

[55] *Briess v Woolley* [1954] AC 333 (HL); *Allen v Hyett* (1914) 30 TLR 444 (PC).

[56] In *Percival v Wright* [1902] 2 Ch 421, the court declined to find that the directors owed fiduciary duties to shareholders in connection with the company's purchase of their shares. But the correctness of this approach has been doubted in later cases: *Coleman v Myers* [1977] 2 NZLR 225; *Re Chez Nico (Restaurants) Ltd* [1992] BCLC 192, 208; *Platt v Platt* [1999] 2 BCLC 745; *Brunninghausen v Glavanics* (1999) 46 NSWLR 538. See also *Peskin v Anderson* [2001] 1 BCLC 372.

[57] *Coleman v Myers* [1977] 2 NZLR 225.

[58] See para.8.038 below.

[59] E.g. *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2)* [1998] 1 WLR 294, 312; *Bilta (UK) Ltd v Nazir (No 2)* [2015] 2 WLR 1168, [125].

[60] *Re Smith & Fawcett Ltd* [1942] Ch 304.

[61] (unrep., HCCL 59/2004, [2008] HKEC 874).

6.4.3 *Removal*

11.147 **Removal of auditor by ordinary resolution.** The members in general meeting have power to remove an auditor from office by ordinary resolution: Cap.622 s.419. This power cannot be excluded by any agreement between the company and the auditor or by the company's articles: s.419(1). However, the removal from office does not deprive the auditor of any compensation or damages payable to him or her in respect of the termination of his or her appointment: s.420.

11.148 **Special notice of that meeting.** Special notice must be given to the company for the meeting.[295] On receipt of the notice, the company must send a copy of the notice to the auditor being removed.[296] The auditor has rights under Cap.622 s.422(3) to make representations, similar to the rights conferred on auditors in the case of resignation.[297] The auditor also has a right under Cap.622 s.411 to attend, and be heard at, the general meeting.

11.149 **Statement of circumstances.** Similar to the position for resigning or retiring auditors, an auditor removed from office before expiry must also give a statement to the company of any circumstances that should be brought to the attention of the members or creditors ("statement of circumstances"), or a statement that there are no such circumstances, as the case may be.[298]

6.4.4 *Disqualification*

11.150 **If disqualified, auditor immediately ceases to be auditor.** If an auditor of a company ceases to be eligible, or becomes disqualified, for appointment as auditor, the auditor immediately ceases to be auditor of the company: Cap.622 s.418.

[295] Cap.622 s.419(2). As to special notice, see s.578.
[296] Cap.622 s.419(3).
[297] See para.11.145 above.
[298] Cap.622 s.425.

Chapter 12

CORPORATE CONTRACTING AND LIABILITIES OF COMPANIES

1. Corporate Contracting

1.1 Introduction

Ways companies can enter into contract. Companies can enter into a contract through the methods as set out in s.121 of the Companies Ordinance (Cap.622), namely as follows: 12.001

- Contracts required by law to be in writing and under seal may be made by the company in writing under the company's common seal or executed in accordance with s.127(3): s.121(2).[1]
- Contracts required by law to be in writing may be made on behalf of the company in writing signed by any person acting with the company's authority: s.121(3).
- Oral contracts can be made orally on behalf of a company by any person acting with the company's authority: s.121(4).

Deeds required to be under seal. Deeds are required to be under seal and so may be executed by companies pursuant to s.121(2). The common seal is no longer compulsory under Cap.622, but companies may still use a seal if they wish.[2] If a company has a common seal, the seal can also be used for any written contract, even though the contract is not required by law to be executed as a deed. 12.002

For contract under seal, company entering into contract directly; and for other contracts, via an agent. Where the contract is executed under seal (or as if it was executed under seal pursuant to s.127(3)), the company is regarded as entering into the contract directly. The legal effect of the affixing of the common seal is similar to the legal effect of a signature of a natural person.[3] Where a company enters into a contract by the methods set out in ss.121(3) or 121(4), the company enters into the contract as a principal, with the agent signing the contract or verbally contracting for the company, as the case may be. Here, it is necessary to look to the general principles of agency law to see whether the person purportedly acting as agent has the requisite authority to bind the company to the contract. But even in the former scenario where the seal is used, principles of agency law are relevant as it is necessary to determine whether the persons affixing the seal (or executing the document as if under seal) are acting under the authority of the company to enter into the transaction and to affix the seal to the document (or to otherwise execute the document). 12.003

Articles determine which corporate organ has power to enter into contracts. The articles of a company will determine which corporate organ has the power to enter into contracts or other transactions on behalf of the company. Usually, the power to contract for the company is vested in the board of directors: see, e.g., Model Articles (private 12.004

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[1] See para.12.041 below.
[2] See para.12.041 below.
[3] *Northside Developments Pty Ltd v Registrar-General* (1990) 176 CLR 146, 156, 160.

companies) art.3.[4] Where the board acts pursuant to such authority in the articles, the board acts as a corporate organ and as the company itself (i.e., the board is not an agent of the company as such[5]). Where the board passes a resolution for the company to enter into a particular transaction, it is still necessary for one or more persons acting as agent of the company, with authority flowing from the board, to carry out the board resolution and to enter into the transaction (in one of the ways set out in s.121) on behalf of the company. Usually, only major contracts will come before the board. For day-to-day transactions of a company, the company's agents would be able to contract for the company within the scope of their authority. Potentially, an agent might be an officer of the company, an employee or any person appointed as agent for the company.

12.005 **Indoor management rule: enables third party to enforce transaction despite some defect in authority.** Where persons purportedly acting for the company do not have authority to do so, then *prima facie* the company is not bound to the transaction. Where a person has no authority whatsoever to contract, such as where the company has not even purported to grant any authority to that person, then, generally speaking,[6] the person cannot bind the company to the contract. Where the person acts pursuant to a power conferred by the articles, circumstances might arise where there is some defect in the authority because certain requirements of the articles have not been complied with. Also, where an agent acts pursuant to a grant of authority purportedly conferred on him, there might be some defect in the authority arising again from a lack of compliance with requisite procedures as set out in the articles or under statute. In these last two categories of situation, the indoor management rule could be relied on by the third party dealing with the company to enforce the transaction against the company. The indoor management rule is a rule which enables a third party to enforce a transaction with the company despite some defect in the authority of the person purportedly acting for the company: see Section 1.4 below.

12.006 **Agency principles and indoor management rule protect third parties and promote business convenience but cannot facilitate fraud.** The application of the agency law principles and the indoor management rule aims to strike a balance between two competing interests. Where an agent contracts for a company without proper authority, either the company or the third party dealing with the company may need to bear the consequences. Rules enabling the third party to enforce a transaction against the company despite the defects in authority are intended to protect and promote business convenience which would be at hazard if persons dealing with companies were under the necessity of investigating the companies' internal proceedings in order to satisfy themselves about the authority of agents. On the other hand, protections given to third parties must not go so far as to facilitate the commission of fraud against a company, with innocent shareholders and creditors suffering as a result of unscrupulous persons purportedly acting for the company.[7]

[4] Companies (Model Articles) Notice Sch.2. See also Sch.1 for Model Articles (public companies) art.2; and predecessor Cap.32 Table A reg.82 (repealed).

[5] *Automatic Self-Cleansing Filter Syndicate Co v Cunninghame* [1906] 2 Ch 34.

[6] There is some suggestion that the position may be different where the written contract is executed under seal: see para.12.062 below.

[7] See *Northside Developments Pty Ltd v Registrar-General* (1990) 176 CLR 146, 164, *per* Mason CJ; and see generally Andrew Griffiths, "The Economic Implications of Validating Unauthorised Contracts Made by Corporate Agents" [2003] *European Business Organization Law Review* 51.

1.2 Company contracting through agent

1.2.1 *General*

12.007 **General principles of agency law apply.** The general principles of agency law apply to determine whether a person has authority to enter into a transaction as agent for the company (the principal).[8] There are two broad categories of authority:

1. actual authority; and
2. apparent authority (or ostensible authority).

12.008 **Company bound if agent has either actual authority or apparent authority.** Actual authority and apparent authority can co-exist and may coincide, but either may exist without the other and their respective scope may be different.[9] A third party seeking to enforce the transaction against the company need only establish one or the other. If an agent has actual authority to contract, then the principal will be bound by the contract and it is unnecessary to consider the question of apparent authority. If the agent does not have actual authority, it is necessary to see if the circumstances give rise to apparent authority. If there is apparent authority, then the principal will also be bound, even though there is a lack of actual authority on the part of the agent.

12.009 **Authority not terminated because agent of unsound mind unless third party aware of this in which case voidable.** The Court of First Instance has held that where an agent has actual or apparent authority to contract for a company, that authority is not terminated merely because the agent becomes of unsound mind at the time of the contract.[10] The court took the view that to ensure commercial efficacy, where a third party deals with an agent in good faith without knowledge of the agent having gone insane, the third party should be able to treat the transaction as binding on the principal (the company). If the third party was aware that the agent was of unsound mind at the time of the transaction, then it seems that the transaction would be voidable at the election of the principal.[11]

1.2.2 *Actual authority*

12.010 **Types of actual authority.** An agent has actual authority where the principal has consented to the agent having such authority. Actual authority is a legal relationship between principal and agent created by a consensual agreement to which they alone are parties.[12] In the context of companies, actual authority can be conferred on an agent only by the corporate organ with the power to do the act or thing under the

[8] The ensuing discussion focuses on contracts and other transactions entered into by an agent for a company, but the principles are also applicable in respect of any act purportedly made by an agent for the company: see, e.g., *Attorney General v Herald Houseware Ltd* [1996] 4 HKC 787 (whether an admission made by an alleged agent was binding on the company).

[9] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 502.

[10] *Probus Ltd v Treble & Triple Ltd* (unrep., HCA 2723/2008, [2010] HKEC 1773), [131]–[142].

[11] *Probus Ltd v Treble & Triple Ltd* (unrep., HCA 2723/2008, [2010] HKEC 1773), [137]; *Imperial Loan Co Ltd v Stone* [1892] 1 QB 599.

[12] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 502; and see also *Attorney General v Herald Houseware Ltd* [1996] 4 HKC 787, 791.

articles or by persons who themselves have actual authority delegated from the proper corporate organ. Actual authority is of two types:

1. express actual authority; and
2. implied actual authority.[13]

Express actual authority

12.011 **Express vs implied actual authority.** An agent has express actual authority where the authority has been conferred expressly on the agent. For example, where the board of directors passes a resolution stating that a particular person is authorised to enter into a specified transaction on behalf of the company, then that person will have express actual authority to enter into that transaction on behalf of the company. Implied actual authority arises where the authority is inferred from the conduct of the parties and the circumstances of the case,[14] namely where the words or conduct of the principal indicate that a particular person is conferred with authority, even though the grant of authority is not explicitly stated. Whether there is actual authority is to be ascertained by applying ordinary principles of construction of contracts, including any proper implications from the express words used, the usages of the trade or the course of business between the parties.[15] These principles are applied to determine whether the principal has agreed with the agent to act on its behalf. To determine whether there is actual authority, it is necessary to focus on the relationship between the principal and agent and the agreement between these two parties. It is not necessary for the third party contractor to be aware of the agreement between the principal and agent. So long as there is actual authority, the agent's acts on behalf of the principal will create rights and liabilities between the principal and third party, even though the third party is ignorant of the existence of any authority on the part of the agent.[16]

Implied actual authority

12.012 **Can arise where board appoints person, person impliedly authorised to do things usually falling within scope of position.** Implied actual authority can arise where the board appoints a person to a particular office or position, with the person impliedly authorised to do all such things as fall within the usual scope of that position.[17] For example, the appointment of a person to the office of managing director would

[13] *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549, 583; *Akai Holdings Ltd (in liq) v Kasikorn Bank Plc* [2010] 3 HKC 153, 177–178, Court of Appeal.

[14] *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549, 583.

[15] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 502.

[16] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 502–503. The third party's ignorance of the actual authority of the agent in the present context does not necessarily mean that the third party is ignorant of the fact that the agent is purporting to act on behalf of a principal. However, even where the third party is unaware that the agent is contracting for a principal, the principal can enforce and be liable on the contract under the doctrine of undisclosed principal: see Peter Watts and F M B Reynolds, *Bowstead and Reynolds on Agency* (20th edn, Sweet and Maxwell 2014) [8-071].

[17] *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549, 583; *Zanda Investment Ltd v Bank of America National Trust and Savings Association* [1994] 2 HKC 409, 419.

impliedly confer on that person the usual authority of a managing director.[18] The scope of such usual or customary authority would be a matter of evidence of what is usual in the trade.

12.013 **Directors have powers when acting as board: a director on his own does not have implied or usual authority to enter into contracts.** Directors have power under provisions such as Model Articles (private companies) art.3 only when acting together as the board (i.e. via passing board resolutions). It is well established that the fact that a person holds office as a director does not confer on the director any implied or usual authority to enter into contracts on behalf of the company.[19] For example, in *Zanda Investment Ltd v Bank of America National Trust and Savings Association*,[20] Rhind J held that an alternate director, exercising the same powers of a director under the company's articles, did not have implied actual authority to exercise managerial functions such as endorsing cheques on the company's behalf.

12.014 **Position of chairman of board same.** The position of the chairman of the board appears to be no different to other directors. Although the chairman has particular responsibilities in presiding over the board,[21] such as in selection of matters and documents to be brought to the board's attention and for formulating board policy, as well as in promoting the position of the company and communicating with the outside world, the chairman's usual functions do not involve business operations or contracting for the company.[22]

12.015 **Usual authority of MD greater than ordinary individual director.** The courts have accepted that the scope of the usual authority of persons appointed as managing director is greater than that of the ordinary individual director. It has been said that the managing director's usual functions are "to deal with everyday matters, to supervise the other managers and indeed, generally, be in charge of the business of the company".[23] The courts have held the following to be within the usual authority of managing directors:

- borrow money and give security over the company's property in the course of normal trading activities;[24]
- give guarantees and indemnities on the company's behalf;[25] and
- employ staff or engage third parties to provide services for the company.[26]

[18] *Akai Holdings Ltd (in liq) v Kasikorn Bank Plc* [2010] 3 HKC 153, 178.

[19] *Re Marseilles Extension Railway Co* (1871) LR 7 Ch App 161, 168; *Mitchell and Hobbs (UK) Ltd v Mill* [1996] 2 BCLC 102; *Qualihold Investments Ltd v Bylax Investments Ltd* [1991] 2 HKC 589, 593.

[20] [1994] 2 HKC 409.

[21] *AWA Ltd v Daniels* (1992) 7 ACSR 759, 867.

[22] *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549, 586; *State Bank of Victoria v Parry* (1990) 2 ACSR 15, 29; *Hughes v NM Superannuation Board Pty Ltd* (1993) 29 NSWLR 653.

[23] *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 5 ACSR 424, 427.

[24] *Biggerstaff v Rowatt's Wharf Ltd* [1896] 2 Ch 93. But *cf. Re Tummon Investments Pty Ltd (in liq)* (1993) 11 ACSR 637 (principal executive officer does not have usual authority to borrow on behalf of company); and see also *Green v Meltzer* [1993] NZCLC 68, 393 (chief executive officer has usual authority to obtain temporary finance but not major or significant loans).

[25] *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549.

[26] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.

12.016 **MD would not have usual authority to sell company's undertaking.** The usual authority of the managing director is to carry on the company's business in the ordinary way and so a managing director would not have usual authority to sell the company's undertaking.[27]

12.017 **Usual authority of CEO comparable to that of MD.** The usual authority of the chief executive officer would be comparable to that of the managing director,[28] and this is likely to be the case even where the chief executive is not a director of the company. However, the particular circumstances of the company concerned could indicate that the company treats the office of managing director as being different to that of the chief executive officer such that the scope of the implied authority of the latter is lessened.[29] In *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd*,[30] the Court of Final Appeal took the view that, in the circumstances of the company in that case (a listed company), the usual authority of the chief executive officer of the company "would no doubt extend to entering into many types of contract, including … contracts which might involve [the company] incurring a US$30 m liability".

12.018 **Other executive officers or managers may also have usual authority to contract.** Other executive officers or managers of a company may also have usual authority to contract for the company within the scope of their area of responsibility. For example, the Court of Appeal has held that usual authority of a business manager could cover matters such as giving of discounts and settling of accounts.[31] It has been held in England that an employee with the title of sales director had authority to bind the company to contracts for the sale of products and to associated commission arrangements.[32] In Australia, it has been held that a person appointed as a money market manager and foreign exchange dealer had usual authority to enter into foreign currency contracts for the company.[33] Other employees will also have implied actual authority for entering into ordinary contracts of the company in its day-to-day business, such as sales staff in a company operating a retail store who would have usual authority to sell the company's goods to consumers in the store.

12.019 **Company secretary has usual authority to enter into contracts which come within day-to-day running of company's business of administrative nature.** The company secretary, as the company's administrative officer, will have usual authority to enter into contracts which come within the day-to-day running of the company's business of an administrative nature—e.g. employing staff or hiring cars for the company's use.[34] However, the usual authority of the company secretary would not extend to the company's commercial transactions,[35] nor the power to institute legal proceedings on the company's behalf.[36]

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27 *Re Qintex Ltd (No.2)* (1990) 2 ACSR 479.
28 See *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549.
29 *State Bank of Victoria v Parry* (1990) 2 ACSR 161.
30 (2010) 13 HKCFAR 479, [81].
31 *Yee Fat Development Ltd v Winline Knitting Factory Ltd* [2011] 3 HKLRD 511, [21].
32 *SMC Electronics Ltd v Akhter Computers Ltd* [2001] 1 BCLC 433.
33 *AWA Ltd v Daniels* (1992) 7 ACSR 759, 861.
34 *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971] 2 QB 711.
35 *Northside Developments Pty Ltd v Registrar-General* (1990) 176 CLR 146, 204.
36 *Club Flotilla (Pacific Palms) Ltd v Isherwood* (1987) 12 ACLR 387.

12.020 **Implied authority arising from conduct of company.** Apart from implied actual authority arising from the position to which the agent is appointed, implied authority can also arise from particular conduct of the company or those with authority in the company to delegate that authority, as illustrated in *Hely-Hutchison v Brayhead Ltd*.[37] In that case, a Mr Richards was the chairman of Brayhead Ltd. Brayhead was a major shareholder of Perdio Electronics Ltd. The plaintiff, Viscount Suirdale, guaranteed a loan provided by merchant bankers to Perdio and also agreed to inject loan funds himself into Perdio. In return, Brayhead would provide an indemnity to the plaintiff for his liabilities under the guarantee and also a guarantee for the plaintiff's loan. The indemnity and guarantee were provided in two letters signed by Richards as chairman of Brayhead. When Perdio entered into liquidation and the plaintiff sought to enforce the indemnity and guarantee, Brayhead denied liability on the basis that Richards was not authorised by the board of Brayhead to enter into those transactions.

12.021 **Implied actual authority when board allowed agent to act as de facto managing director.** The English Court of Appeal accepted that on the facts Richards did not have express actual authority, nor was there authority to provide the indemnity and guarantee arising from his position as chairman. However, the court held that there was implied actual authority. Richards was never formally appointed as managing director but he acted as if he was the managing director or chief executive. The other directors of Brayhead had acquiesced to Richards so acting and in committing the company to contracts without the board's prior sanction over many months before the provision of the indemnity and guarantee to the plaintiff. The court held that there was implied actual authority arising from the board's conduct in allowing the agent to act as a *de facto* managing director. The court accepted that a managing director would have usual authority to provide indemnities and guarantees on behalf of the company and accordingly Brayhead was bound to the transactions. However, for there to be implied actual authority in such circumstances, the board members must have communicated by words or conduct their respective consents to each another and to the agent.[38]

12.022 **Authority subject to restrictions under company's articles.** The actual authority of an agent, whether express or implied, would be subject to any restrictions under the company's articles (including any restrictions under an objects clause[39]). Moreover, where the actual authority is said to arise from a general delegation of authority or from the appointment to a particular position, the grant of authority would be subject to any limitations in relevant company documentation (such as staff manuals).[40]

12.023 **Authority subject to agent's duty to act honestly and in interest of company.** The actual authority of an agent is also subject to the agent's duty to act honestly and in the interest of the company.[41] In *Akai Holdings Ltd (in liq) v Kasikorn Bank PCL*,[42] the

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37 [1968] 1 QB 549.
38 *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 501.
39 *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246, 295.
40 See *Lo Suk Ling Villy v Methodist Church Hong Kong* [2001] 1 HKC 182.
41 *Akai Holdings Ltd (in liq) v Kasikorn Bank PCL* [2010] 3 HKC 153, 178 (CA); *Re Capitol Films Ltd* [2011] 2 BCLC 359.
42 [2010] 3 HKC 153. The question of actual authority was not in issue on appeal: *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd* (2010) 13 HKCFAR 479.

argument that a chief executive officer had actual authority to obtain loans on behalf of the company for the benefit of another company failed on the grounds that the director was acting in breach of fiduciary duty in the transactions.

1.2.3 *Apparent authority (or ostensible authority)*

12.024 **Apparent authority is authority of agent as it appears to others; elements of apparent authority.** An agent has apparent authority or ostensible authority where the third party dealing with the company relies on a representation by the company that the agent has authority. Apparent authority is the authority of an agent as it appears to others.[43] In *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*,[44] Diplock LJ set out the following elements which need to be established to give rise to apparent authority:

1. A representation is made to the third party that the agent had authority to enter on behalf of the company into a transaction of the kind sought to be enforced by the third party.
2. Such representation was made by a person who had actual authority to manage the business of the company either generally or in respect of those matters to which the transaction relates.
3. The third party was induced by such representation to enter into the transaction—that is the third party relied upon the representation.
4. Under the company's constitution, the company was not deprived of the capacity either to enter into a transaction of the kind sought to be enforced or to delegate authority to enter a transaction of that kind to the agent.[45]

12.025 **Legal relationship created by representation made by principal to third party.** As explained by Diplock LJ, apparent authority involves a legal relationship between the principal and the third party created by a representation, made by the principal to the third party.[46] The agent is a stranger to this relationship and need not be aware of the existence of the representation. This can be contrasted with the situation of actual authority where the relevant relationship creating the authority is the relationship between the principal and the agent. The concept of apparent authority is based on an estoppel, arising from the principal's representation, that prevents the principal from asserting that he is not bound by the transaction.[47]

[43] *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549, 583; *Re Moulin Global Eyecare Holdings Ltd* (unrep., HCCW 470/2005, [2008] HKEC 923), [119].

[44] [1964] 2 QB 480, 506; cited/applied in, e.g., *Re Moulin Global Eyecare Holdings Ltd* (unrep., HCCW 470/2005, [2008] HKEC 923), [120]; *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd* (2010) 13 HKCFAR 479, [43].

[45] This fourth element is no longer significant for Hong Kong companies due to the abolition of the *ultra vires* doctrine with respect to corporate capacity: see Chapter 5. Also, persons no longer have constructive notice with respect to restrictions in the company's constitution since the introduction of former s.5C in Cap.32 (see now Cap.622 s.120). Any restrictions on the exercise of powers under the constitution would only affect persons dealing with the company if they are aware of them.

[46] [1964] 2 QB 480, 503; and see also *Attorney General v Herald Houseware Ltd* [1996] 4 HKC 787, 791; *Re Moulin Global Eyecare Holdings Ltd* (unrep., HCCW 470/2005, [2008] HKEC 923), [119].

[47] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 503; *Northside Developments Pty Ltd v Registrar-General* (1990) 176 CLR 146, 172; *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd* (2010) 13 HKCFAR 479, [52].

Agent with apparent authority can authorise another to enter into transaction. 12.026 Where an agent has apparent authority to enter into a transaction, then it is possible for the agent to actually authorise another to enter into the transaction for the company so as to bind the company to the transaction, provided that the third party believed that the authority was being exercised by the former through the latter.[48]

Representation or holding out

Can be express representation; representation by conduct more common. The 12.027 representation which creates apparent authority may take a variety of forms. There could be an express representation by the principal to a third party that a particular person has authority to contract for the principal. However, more common would be representation by conduct. As stated by Diplock LJ in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*,[49] by permitting an agent to act in some way in the conduct of the principal's business with other persons, the principal implicitly represents to anyone who becomes aware that the agent is so acting that the agent has authority to enter on behalf of the principal into transactions with other persons of the kind which an agent so acting in the conduct of his principal's business has usually actual authority to enter into.

***Freeman & Lockyer* case.** 12.028 In the above case, Kapoor was one of the directors of a property development company. He was not formally appointed as managing director but acted in that capacity to the knowledge and acquiescence of the other directors. Kapoor purportedly acted for the company in engaging architects to provide services for the company. When the architects claimed payment against the company, the company refused payment. There was no express actual authority granted by the board to Kapoor to contract with the architects. However, the English Court of Appeal held that there was apparent authority. By allowing Kapoor to manage the affairs of the company akin to the usual conduct of a managing director, the board holds out to third parties dealing with the company that Kapoor has the authority within the usual ambit of a managing director. The usual authority of a managing director in a property development company would extend to the engaging of the services of architects to apply for planning permission and to develop the land. Accordingly, the company was bound to the contract and was liable to the architects. The court had held, however, that there was no implied actual authority, and so the outcome of this case was different to *Hely-Hutchison v Brayhead Ltd*[50] in that regard. The difference between the two cases is that where there is only silent acquiescence of the agent's conduct by the directors without communication of their consent to each other and the agent, there could be apparent authority only rather than implied actual authority.

Person appointed to position: apparent authority coincides with implied actual 12.029 **authority (both corresponding to usual authority of that position).** In the *Freeman & Lockyer* case above, the conduct amounting to a representation of the agent's

[48] See *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising Co Pty Ltd* (1975) 133 CLR 72, 79–80 (High Court of Australia).

[49] [1964] 2 QB 480, 503–504; and see also *Attorney General v Herald Houseware Ltd* [1996] 4 HKC 787, 791–792.

[50] [1968] 1 QB 549.

authority was conduct in permitting the agent to act in a particular position in the company notwithstanding the absence of formal appointment. Where there is formal appointment to a position, it also follows that the company makes a representation that the person has the usual authority attached to that position.[51] In this situation, the scope of the apparent authority of the agent would coincide with the implied actual authority of the agent (both corresponding to the usual authority of a person appointed to that position) unless the actual authority of the agent is narrowed or widened pursuant to the articles or pursuant to the company's grant of authority. Where the company allows a person to act for the company over a wide field of business beyond the ordinary functions attached to the particular job title held by the person, then the representation by the company to the outside world is that the person has authority within that wider field and not the authority usually attached to that job title only.[52]

12.030 **Representation of authority must be clear and unequivocal.** In order to give rise to apparent authority, the representation of authority must be clear and unequivocal, and what is clear and unequivocal would be judged by reference to the practical realities of the particular case.[53] In *Hua Rong Finance Ltd v Mega Capital Enterprises Ltd*,[54] the three directors of the company were also the three shareholders, holding equal shares. Unknown to the others, one of the directors purportedly acted on behalf of the company to obtain loans from the plaintiff on the security of a flat owned by the company. At issue was whether the plaintiff could enforce the loans and mortgage against the company. The plaintiff argued that the director had apparent authority on the basis that she was a director and one-third shareholder, that the articles permitted the directors to borrow and to delegate to one director to sign on the seal of the company, that the director was given custody of the seal and company chop, that the director could produce the deeds of the flat and that she had used the company's address. The Court of Appeal rejected the plaintiff's argument, holding that none of those factors, whether taken alone or in combination, amounted to a representation by the company that the director had authority to obtain the loans or to enter into the mortgage on behalf of the company.

12.031 ***Thanakharn Kasikorn Thai Chamkat* case.** In *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd*,[55] the chief executive officer (CEO) of a company (Akai) caused the company to obtain a loan and to grant security over the company's assets for the benefit of another company (Singer) having a common controlling shareholder. The loan funds were used to pay the liabilities of Singer which were owed to the same lender. Before the Court of Final Appeal, it was accepted that the CEO did not have actual authority, and the issue was whether the CEO had apparent authority to bind Akai to the transactions. The court accepted that the apparent authority of a person appointed as chief executive officer would be wide but held that there was no representation by the company of authority to enter into the transactions in the circumstances of the case.

[51] *Egyptian Intl Foreign Trade Co v Soplex Wholesale Supplies Ltd* [1985] 2 Lloyd's Rep 36, 41.
[52] See *Egyptian Intl Foreign Trade Co v Soplex Wholesale Supplies Ltd* [1985] 2 Lloyd's Rep 36.
[53] *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd* (2010) 13 HKCFAR 479, [71], [120].
[54] [2001] 3 HKLRD 623.
[55] (2010) 13 HKCFAR 479.

***Might* not be apparent authority if third party aware that transactions not for benefit of company.** It was significant that Akai received no benefit from the transactions (not even indirectly, as Akai did not have any equity interests in Singer), and also that the CEO was in a position of conflict, given his substantial interests in the common majority shareholder and his management positions in Akai and Singer. These facts were known to the lender, and in these circumstances, the court held that the mere fact that the alleged agent was the chief executive officer was insufficient to amount to a holding out by the company to the lender that he had authority to commit the company to the transactions.[56] The position might have been otherwise though if the lender was not aware that the CEO was acting for purposes other than the company's purposes. It has been held in England that a company holds out its directors as having apparent authority to bind the company to transactions falling within the powers conferred on it by its constitution, and that unless he is put on notice to the contrary, a person dealing in good faith with a company is entitled to assume that its directors are properly exercising such powers for the purposes of the company.[57] 12.032

Representation must be made for company by organ or person with actual authority. Under ordinary agency law, the representation giving rise to apparent authority is made by the principal. In the corporate context, this means that the representation must be made by the company. It is necessary, then, to identify the persons who can act for the company in making such a representation, and it is to this issue that the second element in Diplock LJ's formulation is directed: the representation must be made for the company by someone with actual authority. Where the board has power to enter into the transaction under the articles, then a representation from the board would suffice.[58] The members of a company would have the requisite power to make a binding representation within their areas of authority under the articles. For example, where there are no properly appointed directors, the members could represent on behalf of the company that particular persons have authority as the directors where the members are entitled to make the appointment of directors.[59] Also, under the doctrine of unanimous consent, it seems that a representation by the members acting unanimously could be effective to bind the company.[60] Any other person with actual authority to bind the company to the transaction would also be able to make a representation binding on the company.[61] 12.033

[56] (2010) 13 HKCFAR 479, [76]–[111].
[57] *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch 246, 295–296, *per* Slade LJ. See, e.g., *Re David Payne and Co Ltd* [1904] 2 Ch 608 (lender was not aware that loan was used to pay the personal debts of the controller and loan was enforceable against the company; the lender was not bound to enquire as to the purposes of the loan).
[58] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 506. It appears that the representation by the board must be one that is made by each of the directors of the board (or is one to which each of the directors has consented): see *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising Co Pty Ltd* (1975) 133 CLR 72, 80–81 (High Court of Australia).
[59] *Mahony v East Holyford Mining Co* (1875) LR 7 HL 869.
[60] *Brick & Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* [1992] 2 VR 279. On the scope of the doctrine, see Chapter 6.
[61] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 505; *Brick & Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* [1992] 2 VR 279; *Dolphin Advertising Ltd v Tronken Enterprises Ltd* (unrep., HCA 2409/2006, [2009] HKEC 1954), [20].

12.034 **Whether representation effective where authority to make representations but not actual authority to enter into transactions.** There is a suggestion in some English judgments that a person who does not have actual authority to enter into a particular transaction but who has actual or apparent authority to make representations as to who does have authority to enter into the transaction can effectively make a representation binding on the company that a particular person has authority.[62] On this view, a company secretary, for example, might be able to effectively bind the company to a representation that a particular person is a managing director and has authority to enter into a contract, with the effect being that the company is bound to the contract entered into by that latter person notwithstanding that neither the company secretary nor the other person has actual authority to contract.

12.035 **Different position whether actual or apparent authority to make representation.** There does not seem to be any difficulty in the above analysis where the person making the representation has actual authority, e.g. from the board, to make the particular representation. Here, it can simply be said that the representation is made by the board through the company secretary and so the entity making the representation is in fact the entity with actual authority to enter into the contract. However, it is not clear whether it would be correct to say that apparent authority on the part of a person to make the representation would be sufficient. Consistent with Diplock LJ's views in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*,[63] it has been held by the Australian High Court that there could not be apparent authority merely on the basis of a representation made by a person who only has apparent authority to enter into the transaction.[64] If a person having apparent authority to contract would not be able to make a binding representation as to another's authority to contract, it is difficult to see how a person, who only has apparent authority to represent who has authority to contract, can make a representation binding on the company.

12.036 **Where agent does not have authority to contract nor to represent who has authority, representation by agent not binding.** The principles in relation to a person having authority to represent who has authority to contract were discussed by the Court of Final Appeal in *Thanakharn Kasikorn Thai Chamkat (Akai Holdings Ltd*,[65] in the context of whether an agent could clothe himself with apparent authority to enter into the contract. It is clear that where the agent does not have actual authority to contract nor actual or apparent authority to make any representation as to who has authority to contract, then the agent's representation to the third party that he or she has authority cannot be binding on the company and will not be sufficient to confer on the agent apparent authority to contract.[66] As noted by Lord Neuberger NPJ in the *Akai Holdings*

[62] *Egyptian Intl Foreign Trade Co v Soplex Wholesale Supplies Ltd* [1985] 2 Lloyd's Rep 36, 42–43, *per* Browne-Wilkinson LJ; *First Energy (UK) Ltd v Hungarian Intl Bank Ltd* [1993] BCC 533; *ING Re (UK) Ltd v R&V Versicherung* [2007] 1 BCLC 108.

[63] [1964] 2 QB 480, 505; also approved in *Hely-Hutchison v Brayhead Ltd* [1968] 1 QB 549, 593, *per* Lord Pearson.

[64] *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising Co Pty Ltd* (1975) 133 CLR 72.

[65] (2010) 13 HKCFAR 479.

[66] *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 505; *Armagas Ltd v Mundogas SA* [1986] AC 717; *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising Co Pty Ltd* (1975) 133 CLR 72, 78; *Yip Lai Fong v Sin Tung Hing* (2004) 3 HKC 153, [25] (CA); *Re Moulin Global Eyecare Holdings Ltd* (unrep., CFI, HCCW 470/2005, 4 June 2008), [121]; *Dolphin Advertising Ltd v Tronken Enterprises Ltd* (unrep., HCA 2409/2006, [2009] HKEC 1954), [19].

case above, "apparent authority is based on a representation … as between the alleged principal and the third party as to the authority of the alleged agent, and if the third party could rely on some statement by the alleged agent, made without the authority of the principal, it would seem precious close to pulling up oneself by one's own bootstraps".[67]

12.037 **Scepticism as to person not having authority to contract having authority to represent that person (himself or another) has authority to contract.** Lord Neuberger was also sceptical of the view that a person, not having authority to contract, could have (apparent) authority to represent that a person (whether himself or herself or another person) would have authority to contract. Counsel argued why, if an agent could have given apparent authority to another to sign on behalf of the company, should he or she not be able to give himself or herself apparent authority to sign?[68] Lord Neuberger observed that counsel's argument seems to take matters little further. His Lordship noted that if the agent purports to give another authority, the question would still arise as to whether he or she had the company's authority to give the latter authority to bind the company. Similarly, if the agent purports to clothe himself or herself with authority, the question would still arise as to whether he or she has the authority to authorise himself or herself to bind the company, which is, at least normally, the same as asking whether he or she has apparent authority to bind the company.[69] Lord Neuberger approved[70] the view expressed by Robert Goff LJ in an earlier English Court of Appeal decision where his Lordship had stated:[71]

> "the effect of the judge's conclusion was that, although [the alleged agent] did not have ostensible authority to enter into the contract, he did have ostensible authority to tell [the third party] that he had obtained actual authority to do so. This is, on its face, a most surprising conclusion. It results in an extraordinary distinction between: (1) a case where an agent, having no ostensible authority to enter into the relevant contract, wrongly asserts that he is invested with actual authority to do so, in which event the principal is not bound; and (2) a case where an agent, having no ostensible authority, wrongly asserts after negotiations that he has gone back to his principal and obtained actual authority, in which event the principal is bound. As a matter of common sense, this is most unlikely to be the law."

12.038 **But rigid principle of law inadvisable.** Lord Neuberger observed that it is inadvisable to lay down any rigid principles of law in this area because of the difficulties in reconciling principle and predictability with commercial reality and fairness, but stated: "I find it very hard indeed to conceive of any circumstances in which an alleged agent, who does not have actual or apparent authority to bind the principal, can nevertheless acquire apparent authority to do so, simply by representing to the third party that he has such authority."[72]

[67] (2010) 13 HKCFAR 479, [64].

[68] (2010) 13 HKCFAR 479, [66].

[69] (2010) 13 HKCFAR 479, [66].

[70] (2010) 13 HKCFAR 479, [68], [70].

[71] *Armagas Ltd v Mundogas SA* [1986] AC 717, 730–731, approved also by Lord Keith on appeal to the House of Lords: see [1986] AC 717, 777–778.

[72] (2010) 13 HKCFAR 479, [70].