The main areas which are normally regulated by Articles of Association are:

- *Capital* – share capital, issue and allotment, variation of class rights, liens, calls, transfers, transmission, forfeiture, alteration of capital;
- *Members* – notice and constitution of meetings, proceedings at meetings, voting by members;
- *Officers* – appointment and removal of officers, notice and constitution of meetings, proceedings at meetings, voting by directors, delegation of authority to committees and managing directors, company secretary; and
- *Disclosure and distributions* – accounts and audit, treatment of dividends and reserves, capitalisation of profits.

A company may now incorporate the articles set out in the *Companies (Model Articles) Notice* (Cap 622H).

Documents required for incorporation

Progressive and substantial changes to the incorporation forms were made from 2004 onwards to 2011. See eg., the *Companies (Amendment) Ordinance 2004* (with effect from 11 July 2008); and further amendments have been made by the *Companies (Amendment) Ordinance 2010*.

In 2008, the incorporation forms, namely Form NC1 for a company limited by shares, and Form NCIG for registration of a non-Hong Kong company, were amended.

Further amendments have been made in 2011, in particular, to enable the delivery and signing of documents in the form of electronic records. The *Companies Ordinance* (Cap 622) has altered these forms (see the Forms set out in the website of the Companies Registry).

To form a company, the following documents have to be delivered to the Companies Registry:

(1) Articles of Association – under s 12, these must be signed by the founder member named in the form, or if two or more founder members, by any one of them (see s 69 of Cap 622 on signing of incorporation form, and Sch 2 on content of incorporation form). A company may draft its own Articles, or use the appropriate form in the *Companies (Model Articles) Notice* (Cap 622H) (see ss 75, 79 and 80).

(2) A statement of compliance with the requirements of incorporation under s 70 of Cap 622. The statement should certify that all requirements regarding matters precedent to incorporation have been complied with. These requirements include the address of the company, and it can include an email address for the company. The details of the first secretary and the directors of the company must be included. For the secretary a residential address is required and to facilitate electronic communication an email address may also be given. Previously, the HKID number or details of the passport of the secretary were required. Sections 47 to 52 of Cap 622 are not yet in force, but when they are in force it is expected that they will provide protection against disclosure of the residential address of directors, and others, and of their identity numbers.

Similar information is required for the first directors. In addition each director must state that he has consented to be a director, and sign the "Consent to Act as Director" section of the form, as well as signing Form NC3. Each director is also "advised" to read *A Guide on Directors' Duties* published by the Companies Registry.

(3) The appropriate fees. See the *Companies (Fees) Regulation* (Cap 622K).

(4) Since 21 February 2011, each application for incorporation must be accompanied by a Form IRBR1 which is a Notice to the Business Registration Office, together with the prescribed fee and levy pursuant to ss 5A(1) and 5D(2) of the *Business Registration Ordinance* (Cap 310) as application for incorporation is now taken to include the application for a business name registration.

For a non-Hong Kong Company seeking to be registered in Hong Kong, Form NN1 is required to be filed within one month of the company establishing a place of business in Hong Kong. The form is to be signed by a director, secretary, manager or an authorised representative, and accompanied by the correct registration fee. The email address of the authorised representative may be supplied to the registry to facilitate electronic communication. Email addresses of the secretary or director may also be provided for this purpose. The HKID number or passport number of the secretary or director should also be given. Copies of the Charter, Statute or Memorandum or other Document defining the constitution of the company should be provided, or a certified copy thereof. See the *Companies Registry Circular No 8 of 2014* dealing with *Requirements for Documents Delivered for Registration*.

The non-Hong Kong Company must also comply with ss 5B(1) and 5D(2) of the *Business Registration Ordinance* (Cap 310), and file Form IRBR2.

Since 18 March 2011, it has been possible to apply electronically for incorporation of a company, and to comply with the provisions of ss 5A(1) and 5D(2) of the *Business Registration Ordinance* (Cap 310). Applicants for incorporation can adopt one of three models of Memorandum and Articles of Association in the application process. Details to be provided include company name, details of share capital and founder members. The application can be signed electronically in line with the provisions of the *Electronic Transactions Ordinance* (Cap 553). See also *Companies Registry Circular No 9 of 2014* relating to the *Introduction of Electronic templates of Newly Specified Forms* at the e-Registry.

Certificate of incorporation

Upon submission of the required documents and fees, the Registrar of Companies will retain and, assuming that the proposed company name is in order, register the incorporation documents specified in s 67 of Cap 622, ie (i) an incorporation form in the specified form and (ii) a copy of the articles. Upon registration the Registrar issues a certificate of incorporation (ss 71 and 72).

By issuing a certificate of incorporation, the Registrar is in effect warranting to anyone dealing with the company that he has been satisfied with all requirements of registration and matters precedent.

As from the date of incorporation shown in the certificate of incorporation, the company is incorporated under the ordinance either as a limited or unlimited company, as appropriate, with a list of members in a register maintained by the company (s 627 of Cap 622). From the date of incorporation the company enjoys all the incidents of corporate status, namely:

- all the functions of a body corporate,
- the ability to sue and be sued,
- perpetual succession, and
- the right, but not the obligation, to have a common seal.

¶1-320 Raising finance

While the *traditional* limits on company borrowing were largely related to the purposes set out in the Memorandum, the question of *ultra vires* (see s 117 of Cap 622 on transaction or act binds company despite limitation in articles etc.) is now totally irrelevant, as there are no longer "purposes" for which the company was incorporated, unless restrictions on the activities of the company have been inserted into the Articles.

However, the concept of a loan requiring to comply with a corporate benefit remains relevant (see eg., *Kasikornbank v Akai Holdings (In Liq)* [2010] HKCFA 63, [2011] 1 HKC 357, where the chief executive officer of the company purporting to be authorised by forged minutes sought funds from the bank for the benefit of another company). In the circumstances the Court of Final Appeal said that while the other company and the bank received "substantial benefits" from the loan, the defendant company received "nothing". Due to the circumstances of the loan, it was held to be unenforceable and the value of the shares, deposited by the purported agent which had by then been sold, was recoverable by Akai in an action for conversion (see also *Re Moulin Global Eyecare Holdings* [2010] HKCA 119, [2010] 4 HKJR 2). The remedy given was that of "equitable compensation" on the basis that the money received from the sale of the shares was held by the bank as constructive trustee for the company; the contract of loan was void *ab initio* on the ground that the "agent" had no capacity to bind the company, and that until the shares were sold and the money detained by the bank, it would have been

possible to order specific restitution of the shares. But reviewing decisions on "constructive notice" received through "willful blindness", that is the failure of a party to ask appropriate questions because he does not want to receive the answer he would receive, or by the "irrationality" in the failure of the bank to do due diligence, it was said that the principle from *Royal Brunei Airlines Sdn Bhd v Tan* [1995] UKPC 4 to the effect that "knowing receipt" of trust property operated, thereby creating a constructive trust over the proceeds of the sale. Further the court was of the opinion that compound interest could be awarded.

A private company is not entitled to seek a loan from the public or to issue a debenture in favour of members of the public (s 11 of Cap 622). However, it has been held that a charging order may be given in support of a judgment debt against a private company; the order will then, as appropriate, enable the sale of the shares of the company presumably to the public. In *Ameritax Plus Ltd v DenIce Y Foster Harris* [2012] HKDC 1366, [2012] 11 HKJR 32, a charging order was awarded against a private company. On execution of that order, it was possible that any buyer of the shares would be a member of the public. However, the Court did add that any transfer of shares would only be registered in accordance with the articles of the company, and there would be – inevitably – a restriction on those articles from transferring shares to a non-member – especially if the effect was to elevate the number of members beyond the statutory number of 50.

See further at ¶18-000 "Raising Capital and Funds" and following.

A partnership is not restricted by an objects clause.

¶1-340 Procedure

Companies are subject to complex and detailed statutory rules governing their activities. The operation of a partnership is not as closely controlled but the partnership is subject to the *Partnership Ordinance* (Cap 38), and is required to comply with other Hong Kong legislation including the *Business Registration Ordinance* (Cap 310).

¶1-360 Dissolution

A company can generally be dissolved only by a formal liquidation. On this see the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32). A partnership, by contrast, can be dissolved by agreement of the partners.

¶1-380 Taxation

Companies pay profits tax on profits and gains. Partners in a firm pay income tax on any earnings.

Separate legal entity and corporate liability

¶1-480 Separate legal entity – the *Salomon's case*

A company and the individual or individuals forming that company are separate legal entities however complete the control might be by one or more of those individuals over the company. This principle was settled by the case of *Salomon v Salomon & Co Ltd* (1897) AC 22.

Briefly the facts in *Salomon's case* were as follows: S had a leather business which he operated together with his four sons. Under the English *Companies Act 1862*, he incorporated the business and set it up as A. Salomon Co Ltd. The Act required at least seven shareholders so S transferred one share to each of six relatives, but he was in reality the only substantial shareholder. S entered into an agreement with the company to sell his business to it for £38,782 and to apply the money for the purchase of £10,000 of debentures secured by a mortgage over the assets of the company, and with the rest to purchase £20,000 of share capital. All these transactions were carried out by deed and no money changed hands. After some time the company went into liquidation and creditors of the company found that there was a prior encumbrance of £10,000 secured by an unsecured mortgage. Upon the sale of the assets, the sum realised was less than the amount of the mortgage and the creditors were able to realise nothing. They then brought an action to have the transaction set aside.

The creditors claimed that:

- the company was a mere agent of S,
- the scheme was a fraud on the *Companies Act 1862*, since the Act required seven shareholders and there was in reality only one, and
- the business was sold in excess of its real value.

As to the first objection, the House of Lords held that the company was not an agent of S. The company was a distinct legal entity and owned the business. If the company was not a legal entity then there was no one to be an agent of S. Thus, it was made clear that *prima facie* there is no agent or trustee relation between a shareholder and the company.

As to the second claim, the House said in effect that it was not illegal to form a "one-man company". The Act required seven shareholders and did not specify the number of shares to be held by each. The Act, therefore, was

literally complied with. The only way to attack the incorporation for fraud was by proving fraud in becoming incorporated. This had not been done and while the incorporation stood the company had to be recognised as a separate and distinct legal entity. This enabled the concept of the corporate veil to disallow the court to go behind the incorporation to identify the members, except in exceptional cases, such as that of suspected fraud.

As to the third claim, the House of Lords replied that since the sale was completed before any money was advanced to the company, the creditors took the debtor as they found him. In addition, the creditors had notice of the limited liability by the use of the word "Limited" after the company name. The Act also required registration of the debentures and the creditors could have informed themselves as to the prior charge on the company's assets before advancing money.

Salomon's case established no new principle, but through this case the House of Lords affirmed that a company is separate from its shareholders; it is a principal, not an agent or trustee in contracts with or for its shareholders, in absence of facts showing an agency or trustee relation.

Lord *Halsbury* stated "once the company is legally corporated it must be treated like any other independent person with its rights and liabilities appropriate to itself".

Lord *Macnaghten* provided the classic description of the modern joint stock company:

> "When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate 'capable forthwith', to use the words of the enactment, 'of exercising all the functions of an incorporated company'. Those are strong words. The company attains maturity on its birth. There is no period of minority — no interval of incapacity. I cannot understand how a body corporate thus made 'capable' by statute can lose its individuality by issuing the bulk of its capital to one person, whether he be a subscriber to the memorandum or not. 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. That is, I think, the declared intention of the enactment. If the view of the learned Judge were sound, it would follow that no common law partnership could register as a company limited by shares without remaining subject to unlimited liability."

At the time when a company was required to have at least two shareholders (and in Hong Kong required at least seven members), it was said that the fact that substantially all shares are held by one person (as happened in *Salomon*)

In *Re Bank of East Asia Ltd* [2015] HKCFI 944, [2015] 6 HKJR 11, certain shareholders requested to inspect company records. It was said that:

> "[24] Section 740 gives the court a discretion on the application of 5 or more shareholders, or members representing 2.5% in value of the voting rights, to order inspection of a company's records or documents if it is satisfied that:
>
> (1) the application was made in good faith; and
>
> (2) the inspection was for a proper purpose.
>
> [25]....
>
> (5) In order to satisfy the 'proper purpose' criteria it is not necessary to satisfy the court that the applicant has a specific or personal right that can only be protected through the inspection of records... Generally, where the court is satisfied that the 'purpose' is germane to a shareholder's economic interest in the company, a 'proper purpose' will have been satisfied.
>
> [61]...[S]ection 740 does not provide a mechanism by which disgruntled shareholders can challenge a commercial decision of a board...
>
> [76]...[O]btaining documents in order to determine whether to commence proceedings for the purpose of advancing the protection of shareholder rights and maintaining appropriate standards of corporate governance... is...capable of constituting a 'proper purpose'."

¶6-120 Directors must not use powers for collateral purpose

The use of powers for a "collateral purpose" means utilisation of powers conferred under the Articles of Association for purposes other than those for which they were intended. In *Nicholas Timothy Cornforth Hill v Alvarez & Marsal Asia Ltd* [2009] HKCA 126, [2009] 3 HKC 41 the plaintiff as a director of a company sought a declaration under s 121 of the former *Companies Ordinance* (Cap 32) (now renamed as the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32); s 121 of Cap 32 is now s 375 of the *Companies Ordinance* (Cap 622)) that he was entitled at all times to inspect the books of account of the company. It was found that the purpose for the application was:

> "[T]hat he should be in a position to make sure that the monies, which had been agreed would be paid to him, would be paid and, if they were not paid, the plaintiff would be in a position to know exactly why." (as per *Rogers* VP at para 22)

In his judgment, *Lam* J referred to the suggested "collateral purpose" of the plaintiff in his application and found there was no explanation of a "purported fishing for information to build up a case regarding payments by the company to his former partners". Both judges referred to the fact that, as *Rogers* VP observed:

> "The question is thus raised as to what right is there to prevent a director having access to company records. I acknowledge that there must be power for a court to prevent abuse of a company's documents. So if there was evidence that a director was likely to misuse documents, whether by breaching confidence or in some other way, then it may be legitimate to control access to those documents by a director, even to the point, in extreme cases, of denying access. Nevertheless, even on that basis, the court would have to be very careful that in restricting access to company documents it did not prevent a director from carrying out his duties." (para 18)

Books of account should be available to the director *qua* director so that he will be in a position of knowing what is taking place within the company so he will have some power to alter various maters. This power must be exercise *bona fide*.

Examples of such abuse include:

- the issue of shares to maintain control of the board and not to raise capital (see *Piercy v S Mills* [1920] 1 Ch 77 and *Re Tai Ping Yeung Motors Ltd* [2001] 2 HKC 611, CACV1125/2000),
- the issue of shares with the immediate object of gaining control of the company (see *Punt v Symonss & Co Ltd* [1903] 2 Ch 506),
- the issue of shares for the purpose of diluting an existing majority shareholding (see *Howard Smith Ltd v Ampol Petroleum ltd* [1974] 1 All ER1126, PC), and
- the issue of shares to forestall a takeover bid despite the fact that the directors had acted in an honest belief that they were doing what was good for the company (see *Hogg v Cramphorn* [1966] 3 All ER 420 and *Tsang Wai Lun Wayland & Anor v Chu King Fai & Ors* [2009] HKCFI 685, [2009] 8 HKJR 9).

¶6-130 Duty to retain discretion

Directors are bound to exercise their powers for the benefit of the company. No constraints should be imposed on a director's discretion so as to influence and constrict his decision-making. A director must not fetter his discretion by contracting with an outsider to vote in a particular way at board meetings (see *Boulting v ACTAT* [1963] 2 QB 606). It is also unlawful for a director to bind himself to act in accordance with the instructions of another person or body. The *Boulting* decision was referred to in *Poon Ka Man Jason v Cheng Wai Tao & Ors* [2016] HKCFA 23, [2016] 4 HKJR 184, concerning breach of a fiduciary duty, where it was said that:

> "[T]he law would not interfere in the absence of evidence of a real possibility of breach of fiduciary duty, including of the no conflict rule. Such a rule had to be applied with common sense and applied realistically to a state of affairs, which disclosed a real conflict of duty and interest, and not to some theoretical or rhetorical conflict."

Possibility of conflict

The term "possibly may conflict" means that a reasonable man looking at the relevant facts and circumstances of a particular case would think that there was a real and sensible possibility of conflict (see *Boardman v Phipps* [1966] 3 All ER 721, at para 756).

In determining what will amount to a sufficient connection, the court will take into account a number of factors including the nature of the corporate opportunity, the circumstances in which it arose, and the nature and extent of the company's operations and future operations.

Liability for profit

A director is liable to account to the company for any profit which he derives from the breach of this duty notwithstanding that the company itself has made no loss. A director must disclose his interest in transactions, arrangements or contract significant to the company, whether express or indirect interests as soon as reasonably possible (see ss 536 and 537 of Cap 622). The company's articles may also spell out clearly that a director must not vote in respect of any contract or proposed contract with the company in which he is interested, or any matter arising therefrom (see *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407). Where the said director votes, his vote shall not be counted.

A director is not allowed to retain a profit that he has made by reason of opportunities that have arisen as a result of his position within the company. It is irrelevant even if the director had acted with complete probity and/or for the good of the company.

In *UDL Holdings Ltd & Anor v Leung Yuet Keung & Anor* [2008] HKCFI 903, [2008] 10 HKJR 13, a company owned and had mortgaged a dredger. On default of repayment, the mortgagee sold the dredger, under a judicial order for sale. The buyers were two non-executive directors of the mortgagor company. The question for the court was whether the sale to them "offended against a rule of equity in successfully bidding for, and thereafter reselling at a profit, a vessel, formerly owned by the second plaintiff". The court said that the fiduciary duty of these directors was fact dependent. Once an order for the sale of a ship owned by the defendant company had been made by the court, any attempt on the part of the directors to seek to sell constituted contempt of court.

On the other hand, the directors owned no duties to the plaintiff company in the judicial sale, and consequently there was no conflict of interest in their purchase of the vessel. On appeal (see *UDL Holdings Ltd & Anor v Leung Yuet Keung & Anor* [2008] HKCFI 903, [2008] 10 HKJR 13), the decision of the Court of First Instance was not upset; and on leave to appeal, [2010] HKCFA 33 did not upset the CFI judgment. In *UDL Holdings Ltd & Anor v Leung Yuet Keung & Anor* [2009] HKCA 323, [2009] 9 HKJR 2, the Court having looked at the decision of the High Court of Australia in *Kak Loui Chan v Zacharia* (1984) 154 CLR 178, HCtA, said that:

> "[14]...In that case Deane J referred to what he called 2 themes in relation to the law as to fiduciaries having to account for profits they have made. At page 198-9 he explained that in respect of the "no conflict" aspect, the fiduciary must account where a conflict or significant risk of conflict existed between fiduciary duty and personal interest. The "no profit" aspect of the rule is one which prevents the fiduciary receiving any benefit or gain by reason of or by use of the fiduciary position.
>
> [15] It was said that there was no conflict in this case because the judge held that there was no relevant duty, because there was no duty to bring the existence of the insurance claim to the attention of the bailiff. The benefit of the insurance claim belonged to Nippon Credit. The plaintiffs had, because of the event of default, no further interest in the insurance claims and there was no possibility of either of the plaintiffs benefiting from the insurance claims.
>
> [16] The "no profit" aspect prevents the fiduciary from misusing his position to gain a profit. In the present case, the defendants did not receive any information because of their position as directors or in connection with their duties as directors. The evidence from Y T Leung himself was that anything that he told the defendants about the insurance claims was not because they were directors. The profit arose outside the scope of the company's business; any information was not given to them as their capacity as directors. Furthermore, it could hardly be said that any information relating to the insurance claims was confidential information of the company. It might also be observed that there does not seem to have been any proper identification of what was confidential. The judge made clear that he did not accept the plaintiffs' evidence as to the information that was alleged to have been passed to the defendants."

The Court of Appeal considered the decision of the Court of Appeal (Eng) in *Bhullar v Bhullar* [2003] BCC 711 in which it was said:

> "The rule that a fiduciary was not allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict, with the interests of those whom he is bound to protect is universal and inflexible. The test is whether 'reasonable men looking at the facts would think there is a real sensible possibility of conflict' and where a fiduciary, such as the director of a company, exploits a commercial opportunity for his own benefit, the relevant question is not whether the party to whom the duty is owed (ie the company) has some kind of beneficial interest in the opportunity but whether the fiduciary's exploitation of the opportunity is such as to attract the application of the rule."

Bhullar was considered then in *Yifung Developments Ltd v Liu Chi Keung Ricky & Ors* [2017] HKCA 341, [2017] 8 HKJR 63, where the Court of Appeal held that the plaintiff's non-compliance concerned procedural requirements for the commencement of the action, and that the Court:

"...do not see why ratification cannot be applied to cure such an omission as long as the prescribed procedure is observed by the act of ratification. Non-compliance may take different forms due to different terms of the articles adopted by different companies and the result is that the action has no legal effect but nonetheless in an appropriate case ratification will come to aid and cure the omission... What is important is the application of the principle in a given situation rather than whether that situation has or has not been canvassed before in the precedents." (para 5.5)

Secret profits

Any secret profit made by a director is liable to be accounted to the company as company property. This is likened to the rule of equity that prohibits a trustee from making any profit directly or indirectly from his management position.

In the case of *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, the directors formed a subsidiary company with the intention that all its shares be held by Regal. When the landlord of two cinemas was not prepared to grant a lease to the subsidiary company, the directors of Regal decided to invest only £2,000 instead of £5,000. The balance of £3,000 was provided by the directors of Regal, and the Regal's solicitor invested £500. Thus, the directors of Regal and the solicitor became the owners of the subsidiary. These shares were sold at a profit. The House of Lords held that the directors had a fiduciary duty and they had made a profit on the shares in the course of the execution of their office as directors, and therefore were liable to account for the profit.

Although it was not a case of bad faith, the decision was based purely on the doctrine which insists that those, who by virtue of a fiduciary position make a profit, are liable to account for that profit.

Conflict of duty

The rule of conflict of interest seems strict, but statutory provisions have prescribed ways to overcome such a situation by more disclosure to the board at the first instance. The court will weigh such cases of conflict by examining among other things, the company's articles. If the company's articles exempt a director who has placed himself in a position in which his duty conflicts with his personal duty, then he is not automatically in breach of fiduciary duty. In other words, the director may enter into a conflict-of-interest situation, and then the transaction will be voidable at the option of the company if there is a breach of duty on his part. But if he has made full and proper disclosure, the company would be precluded from avoiding the transaction, at least according to the articles. Directors owe a statutory duty of disclosure as well as that contained in the company's articles, and they should not rely on the protection in the articles unless they can show that full disclosure has been made. In the case of *Movitex Ltd v Bulfield & Ors* (1996) 2 BCC 99,403, the directors had made the requisite disclosure and were not in breach of their duty merely because they had the prospect of a profitable investment.

In competition with his company

It will not be easy for a director to serve two masters and to act fairly towards each, so even if competing *per se* is not a breach it may place a director in a position which will lead him to commit breaches of duty.

It seems in order for a director of company A to be also a director of company B, which competes in business with company A, so long as the director does not divulge to or use, for the benefit of company B, any confidential information of company A, and he disclosures his interest in each company to the other.

In practice it is usual for directors of both companies in competition, when the activities of one is likely to affect the interest of the other, to be absent from any board room discussion of matters in which they have a conflict of interest or a conflicting duty.

As for executive directors this more general rule does not apply.

Director's own ideas

Although not every profit-making idea of a director belongs to the company, a possible complaint can result if for example, a director of an engineering company won a major construction contract on his own account as an engineer. But it would not have cause for complaint if the same director won a major contract to dealing in fruits and vegetables.

A good rule would be to ask if the business opportunity a director is considering is in the company's line of business. If it is, then the director should not take it up himself unless it is offered to and declined by the company.

Nominee director

A director nominated to sit on a board by a substantial shareholder, or a special class of shareholders, or a debenture, holder will have a conflicting role to play. Is the appointee to decide for the benefit of the company, or the shareholders or debenture-holders he represents? To expect a nominee or representative director to approach each company problem with a truly open mind is to ignore the realities of corporate organisation. Nominee directors are still subject to the same legal liabilities and obligations under the law, whatever the reason for their appointment. Company law does not recognise nominee directors to be trustees for those who appoint them.

Duties of care and diligence

A warning was given to directors in *Raithatha (as liquidator of Halal Monitoring Committee Ltd) v Baig & Ors* [2017] EWHC 2059 (Ch) where the Court held that where directors of a company had failed to register for, and pay VAT assessments until seven years after incorporation, and failing to charge or recover VAT for services provided to customers, they had breached their fiduciary duties to the company, or had failed to exercise reasonable care, skill and diligence, as required by s 174 of the *Companies Act 2016*. The company had been incorporated as a community project. The Court noted the company had 14 directors, and observed:

> "[35] In my judgment the duty of the directors to acquire and maintain sufficient knowledge and understanding of the company's business to enable them to discharge their duties as directors, is inescapable. It may seem harsh .... that an incoming, inexperienced director should acquire the necessary knowledge and understanding of the Company's operations, and ensure that it is compliant with issues as wide ranging as trading standards, health and safety and taxation. The standards required of a director to discharge the duties are higher perhaps than at any time in the past. It is not sufficient to simply delegate tasks in a small/medium sized enterprise. Neither is it sufficient to claim inexperience or lack of knowledge."

Accordingly the directors were liable for losses. The decision in *Re D'Jan* was referred to.

Where the refusal, of the company, to pursue the claim amounts to an unfairly prejudicial conduct on the minority shareholders, a remedy will be under the *Companies Ordinance* (Cap 622) (see s 724 on when the court may order remedies). Section 168BC of the former *Companies Ordinance* (Cap 32) (now s 724 of the *Companies Ordinance* (Cap 622)) was considered in *East Asia Satellite Television (Holdings) Ltd v New Cotai LLC & Ors* [2011] HKCA 127, [2011] 6 HKJR 23. Amendment to the section was made in 2010 to extend the scope of the statutory derivative action by permitting "multiple derivative action" which had been suggested by the Court of Final Appeal in *Waddington Ltd v Chan Chun Hoo* [2008] HKCFA 63, [2008] 9 HKJR 1. The extension allowed the plaintiff suing on behalf of the company to sue other companies within the group, even though the plaintiff was not a member of the other company.

Several issues were raised in the *East Asia* case concerning a joint venture set up to develop a hotel, retail and entertainment complex in Macau. Some of the actions were personal, while some were derivative; they included:

- damages for breach of the agreement, and for conspiracy: a personal action,
- damages for inducing a breach of the contract: a personal action in tort,

- a derivative action on behalf of the joint venture companies for damages or equitable compensation for dishonest assistance and for compensation, and
- a derivative action on behalf of the companies for damages or equitable compensation for breach of fiduciary duties and conspiracy.

In the Court of First Instance, parts of the claims were struck out because of the following reasons:

- the law of Macau did not recognise multiple derivative actions,
- the personal action of reflective loss was not available, and
- there was no reasonable cause of action for inducing breach.

The Court of Appeal held that:

> "(a) the cause of action for inducing breach should not be struck out, because a director who acted *bona fide* within the scope of his authority, and who procured or caused the breach of contract between the company and the third party, was not liable, in tort, for inducing breach under the exception found in *Said v Butt* [1920] 3 KB 497. The two requirements for the operation of the exceptions were that (a) the director acted *bona fide* and (b) in the course of his employment. So, if the director obtained the breach of the contract, *inter alia*, by making false representations without believing in their truth, the exception to *Said v Butt* could not operate to protect the director, and
>
> (b) the *lex incorporation* that is the law of the place of incorporation, governed the applicability of the derivative action. As multiple derivative actions were not available under Macau law or the BVI law, there could be no derivative action in Hong Kong against the companies."

Where the director's negligent acts (as opposed to acts that they negligently caused the company to do) have caused loss to the shareholders, the shareholders may attempt to recover from the directors if a duty of care and causation can be established (see *Heron International v Lord Grande* [1983] BCLC 244).

¶6-380 Director's duty of reasonable care, skill and diligence

In general, the degree of care, skill and diligence is subjective in that the director is not expected to possess any particular skills and his performance must be judged by the way he applies the skills that he already has. However, s 465(2) of Cap 622 provides that:

> "(2) Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with –

In *Re Duomatic Ltd* [1969] 2 Ch 365, it was held that directors may rely on the opinions of an outside expert, and if they do not obtain such an opinion in the appropriate circumstances, they may be negligent.

¶6-500 Remedies for breach of duty

The *Companies Ordinance* (Cap 622) provides remedies for breach of statutory obligations owed by directors to the company (see s 732 for the statutory derivative remedy and s 724 for relief for a shareholder suffering unfair prejudice under the former *Companies Ordinance* (Cap 32); now the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance*, the relevant section was s 168A). The company may, however, resort to various other remedies for breach of directors' duties, including those at common law and in equity.

Injunction

Based on the principle that intervention is better than cure, a company may obtain an injunction to restrain a director from committing a breach of duty.

An application for an injunction was made in *Re Silver Faith Holdings Ltd* [2014] HKCFI 1716. In commenting on the appropriateness or otherwise of this relief, it was said that:

> "[47] While the primary relief sought in the petition is a buyout, the basis of the petition was share dilution constituting unfair and prejudicial conduct. But evidence that emerged in response to the petition itself has given rise to other concerns mentioned above. In my view, these concerns cannot simply be dismissed because they have not yet been articulated by way of pleadings.
>
> [48] If what is sought is a buyout and the matters complained of can be taken into account in the valuation of shares, an injunction will *prima facie* not be necessary: *Re Wako Giken (HK) Co Ltd* [2010] 4 HKLRD 121 at §12. That *prima facie* rule can be displaced if circumstances so warrant as was the case on the facts of *Wako* itself. In that case there were concerns that given the claims against the 1st respondent and the value of the company that the 1st respondent might not be able to afford the buyout in which case there was a real possibility that the company would be wound up if the petition was successful at trial.
>
> [49] In the present case, Mr Ng was apparently willing to buyout Ms Chen's shares but the offer was withdrawn when Ms Chen insisted on the net proceeds being held by stakeholders. Now that the financial position of Tronken as at 31 March 2013 has been disclosed, a buyout may not be meaningful. More importantly, the present case is complicated by a real possibility of a winding up order having to be made at the end of the day. If there are circumstances that require investigation, a buyout may not be the appropriate relief."

See also on costs:

- *Re Silver Faith Holdings Ltd* [2017] HKCFI 1837, [2017] 10 HKJR 45; and
- *Re Silver Faith Holdings Ltd* [2018] HKCFI 403, [2018] 2 HKJR 4.

Restoration of company property

A company may recover property which is rightfully its own from its directors or those who purchased property from the directors (and were not innocent while doing so). This is only possible if the property can be traced. However, restitution does not render the misappropriation lawful. The director may still be convicted for the offence (see *Morgan v Flavel* [1983] 1 ACLC 831). That case was referred to in *Chew v R* (1992) 7 ACSR 481, HCtA, where it was said:

> "in requiring a director to act honestly, s. 124(1) imposed the common law obligation to act bona fide in the interests of the company, making it an offence to fail to do so. However, he expressed the view that for there to be a breach of this obligation imposed by s. 124(1) there had to be 'a consciousness that what is being done is not in the interests of the company, and deliberate conduct in disregard of that knowledge'. He added that '[t]his constitutes the element of *mens rea* in the criminal offence created by the statute'."

See also a decision of the Court of Final Appeal in *Choi Wai Lun v HKSAR* [2018] HKCFA 18 in relation to a statutory offence and presumptions of *mens rea* and *actus reus*.

Further, if directors allot shares in breach of their duties, the allotment may be set aside unless the allottee had no notice of the breach (see *Howard Smith Ltd v Ampol Petroleum Ltd* [1984] AC 821).

Rescission of contract

A company may rescind a contract with a director unless the company has given its consent in a general meeting to affirm the contract despite the director's breach of duty.

Account of profits

A company is entitled to recover any profit derived by a director from a breach of duty, for example, through availing of corporate opportunities or information to his own advantage. Where misappropriated company funds are pooled with other moneys, the account for profits may extend to the whole of the profits without any proportionate allowance for the other moneys pooled (see *Paul A Davies (Australia) Pty Ltd (In Liq) v PA Davies & Anor* [1983] 1 ACLC 1091).

In *Poon Ka Man Jason v Cheng Wai Tao & Ors* [2015] HKCA 28, [2015] 1 HKJR 13 (and see [2016] HKCFA 23, [2016] 4 HKJR 184, on another point), the modern remedy of "equitable compensation" was referred to as an alternative to (a) damages or (b) account of profits.

- every person who was a director at the time the prospectus was issued;
- every person who authorised himself to be named as director or agreed to become a director after a particular period of time;
- every person who was a promoter of the company; and
- every person who authorised the issue of the prospectus.

Experts who give their consent to the issue of a prospectus are only liable in respect of untrue statements made in their capacity as experts. Experts, together with the Securities and Futures Commission, the SEHK and the Registrar of Companies are not regarded as persons who authorised the issue of the prospectus.

Civil liability under s 40 extends to persons responsible for untrue statements contained in prospectuses which offer subscriptions for shares in, or debentures of, companies which are incorporated outside Hong Kong (see s 342E).

Defences against civil liability under s 40 of the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32)

A director, promoter, or any other person involved in the issue of a prospectus containing untrue statements, will not be liable to pay compensation under s 40 if it is proven (see s 40(2)):

- that having consented to become a director he withdrew his consent to the issue of the prospectus prior to its issue, and it was subsequently issued without his authority or consent;
- that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue he gave reasonable public notice that he had not consented to, or had no knowledge of its issue;
- that after the issue of the prospectus, and before allotment of shares, he withdrew his consent on becoming aware of an untrue statement in the prospectus and gave reasonable public notice of the withdrawal and of his reasons for the withdrawal;
- that he had reasonable grounds to believe that a particular statement was true and did so believe up to the time of allotment;
- in the case of an untrue statement by an expert – that he had reasonable grounds to believe the expert's statement, that the expert was competent to make his statement and that the expert's consent had been given and not withdrawn; or
- in the case of an untrue statement made by a public official or extracted from an official public document – that it was a correct and fair representation of the statement or document.

An expert will not be liable for untrue statements if (see s 40(3)):

- he gave written notice of withdrawal of consent before the prospectus was delivered for registration;
- he withdrew consent after registration but before allotment of shares and gave reasonable public notice of his reasons; or
- he was competent to make a particular statement and had reasonable grounds to believe, and did believe up to the time of allotment of shares, that the statement was true.

Shareholders not excluded from obtaining compensation

The *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) provides that a person is not debarred from obtaining damages or compensation from a company (e.g., for losses suffered due to untrue statements made in the company's prospectus) simply because he or she holds shares or is entitled to subscribe for shares in the company (see s 40B).

Extensive amendment was made to Cap 32 by the *Companies (Winding-Up and Miscellaneous Provisions) (Amendment) Ordinance* (Order No 14 of 2016), with effect from 13 February 2016.

¶18-420 Criminal liability for misstatements

The *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) provides that where a prospectus contains untrue statements any person who authorised the issue of the prospectus may be imprisoned for up to three years and fined up to HK$700,000 (see s 40A and Sch 12). Such criminal liability also extends to any person who has authorised the issue, circulation or distribution in Hong Kong of a prospectus for shares in or debentures of a company incorporated outside Hong Kong which contains untrue statements (see s 342F of Cap 32 on criminal liability for misstatements in prospectus). Criminal liability does not extend to experts.

Defences against criminal liability for untrue statements are:

- that the untrue statement was immaterial; or
- that the person had reasonable grounds to believe and did believe that the statement was true.

Where a statement in lieu of a prospectus is issued and contains untrue statements, any person who authorised the delivery of the statement may be imprisoned for up to two years and fined up to HK$350,000 (see s 43(5) and Sch 12). The same defences apply.

Section 107 of the *Securities and Futures Ordinance* (Cap 571) imposes criminal liability upon any person who fraudulently, or by reckless misrepresentation, induces another to subscribe for shares (see s 108 of Cap 571). The person on conviction is subject to a fine of HK$1 million and imprisonment for seven years (on indictment), or a level 6 fine and imprisonment for six months (on

summary conviction). A level 6 fine is HK$100,000 (see Sch 8 to the *Criminal Proceedings Ordinance* (Cap 221)). Section 108 of the *Securities and Futures Ordinance* (Cap 571) provides that on fraudulent, reckless, or negligent misrepresentation the person responsible for inducing another to invest, will be liable to pay damages as compensation for the investor's loss (see s 107 of Cap 571).

¶18-440 Statement in lieu of prospectus

Subject to exemptions in the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) (see s 38AA for a Hong Kong company, and s 342AA for a company incorporated outside Hong Kong), a prospectus (under Cap 32) is not required to be issued by a company unless shares or debentures are actually offered to the public. The statement in lieu of prospectus provides protection to members of the public who may acquire shares of a public company (e.g., through share transfers) before the company issues a prospectus or before public issue of securities has been made. A statement in lieu of prospectus is required to be registered in the following circumstances:

- A public company with share capital which has not previously issued a prospectus or which has issued a prospectus but has not allotted any of the shares offered for public subscription (e.g., because of a failure to raise a minimum subscription) must register a statement in lieu of prospectus before allotting any of its shares or debentures for the first time; and
- A company which ceases to be a private company and becomes a public company is required to register a statement in lieu of a prospectus within 15 days of becoming a public company. (Alternatively, a company may immediately register a prospectus upon becoming a public company.)

A company which has registered a statement in lieu of prospectus is not exempted from issuing a prospectus in accordance with the requirements of the Ordinance if it subsequently makes a public offer of its shares or debentures.

A statement in lieu of prospectus is not required to be generally distributed by the company but may be inspected by members of the public at the Companies Registry.

Initial public offers

¶18-640 New listing application under the Listing Rules

In the case of a new applicant, the following documents must be lodged with the SEHK for review by a sponsor according to Ch 9.11 of the *Listing Rules:*

- Documents to be lodged at the time of submission of the Form A1 (Advance Booking Form):
  - proof of the Listing Document in a reasonably advanced state; and
  - copies of the audited profit and loss accounts and balance sheets for the first two years out of the three financial years comprising its track record.
- Documents to be lodged for initial review at least 15 business days prior to the expected hearing date:
  - a copy of the board's draft profit forecast memorandum where the listing document contains a profit forecast, covering 12 months from the expected date of publication of the listing document; and
  - where the listing document does not contain a profit forecast, two copies of a draft of the board's profit forecast memorandum covering the period up to the forthcoming financial year end date after the date of listing, together with a cash flow forecast memorandum covering at least 12 months from the expected date of publication of the listing document.
- Documents to be lodged at least four business days prior to the date of the hearing of the application by the Listing Committee:
  (a) a formal application for listing (Form C1);
  (b) the final proof of the Listing Document;
  (c) the final proof of any application form(s) (including any excess or preferential application form(s)) to subscribe for or purchase the securities for which listing is sought;
  (d) a written submission to the SEHK in the prescribed form in support of the application for listing;
  (e) the annual report and accounts for each of the three completed financial years of the issuer immediately preceding the issue of the Listing Document;

(f) in the case of listing of depositary receipts, a certified copy of the signed deposit agreement and any other agreements or documents as the Exchange may require;

(g) copies of all executed requests for waiver from the requirements of the Listing Rules and the provisions; and

(h) where the Listing Document must contain a statement by the directors as to the sufficiency of working capital, a draft letter from the sponsor confirming that they are satisfied that the statement in the Listing Document as to the sufficiency of working capital has been made by the directors after due and careful enquiry, and that persons or institutions providing finance have stated in writing that such facilities exist.

- Documents to be lodged as soon as practicable after the hearing of the application by the Listing Committee but on or before the date of issue of the Listing Document:

(a) four copies of the Listing Document, dated and signed by every person who is named therein as a director or proposed director of the issuer or by his agent authorised in writing (and a certified copy of such authorisation) and by the Company Secretary;

(b) one copy of the formal notice, where applicable;

(c) a copy of the written notification issued by Hong Kong Securities Clearing Company Ltd stating the securities will be Eligible Securities. Eligible securities are those able to be dealt within the Central Clearing and Settlement System (the "CCASS") – that is the deposit, the clearance and the settlement in the clearing system;

(d) every written undertaking from the applicant, its shareholders and/or other relevant parties to the Exchange referred to in the Listing Document; and

(e) the original signed sponsor declaration required by r 3A.13.

- Documents to be lodged by no later than 11am on the intended date of authorisation of the prospectus where the Listing Document constitutes a prospectus under the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32):

(a) an application for authorisation of registration of the prospectus (s 38D(3) or s 342C(3) of the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) as appropriate);

(b) two printed copies of the prospectus duly signed in accordance with the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) with copies of all documents stipulated by the *Companies (Winding-Up and Miscellaneous Provisions) Ordinance* (Cap 32) to be endorsed thereon or annexed thereto; and

(c) in respect of the Chinese translation of the prospectus, a certificate issued by the translator certifying the accuracy of the translation and a certificate as to the competence of the translator.

- Documents to be lodged as soon as practicable after the issue of the Listing Document but before dealings commence:

(a) a copy of the relevant page(s) of each newspaper at which the Listing Document and/or formal notice was published and, if applicable, the newspaper in which the announcement of the results was published, together with a list containing details of each successful applicant;

(b) the Sponsor's Declaration in the prescribed form (Form E of Appendix 5 of the *Listing Rules*);

(c) a declaration substantially in the form set out in the *Listing Rules* (Form F of Appendix 5), duly signed, in accordance with s 38D(3) or s 342C(3), having endorsed thereon or annexed thereto. The documents stipulated in the relevant section; and

(d) for every Chinese translation of the prospectus a certificate certifying the Chinese translation of the English version is true and accurate.

After the issue of the listing document but before dealings commence, then as a condition for granting listing approval, the SEHK will require a certified copy of the resolution of the new applicant at a general meeting authorising the issue of all securities for which listing is sought. A certified copy of Form A1 of Appendix 5 is required where the board has properly delegated powers for the issue and allotment of such securities, the application for listing, the arrangements for the securities to be admitted into the CCASS and the signing of the Listing Document.

Form D of Appendix 5 of the *Listing Rules* is required in the case of placing of securities signed by the lead broker, any distributors and any Exchange Participant.

Drafting listing particulars

A company seeking listing must submit two copies of the new listing application to the SEHK. The issue manager appointed by the company for the listing is responsible for drafting and submitting the listing particulars on behalf of the company. The listing application must contain the information required in Ch 9 of the *Main Board Listing Rules*. Sufficient detail must be given to enable the SEHK to have a full and proper understanding of the applicant's business, financial conditions and prospects and it may sometimes be necessary to include information not specifically mentioned in the *Main Board Listing Rules*.

According to Appendix 1A of the *Main Board Listing Rules*, a summary of the information that the new listing application must at a minimum contain, is as follows:

- General information about the issuer, its advisers and the Listing Document:
  - (a) name of issuer;
  - (b) date and place of incorporation;
  - (c) address of the principal registered office;
  - (d) a statement that the directors are responsible for the accuracy of the Listing Document;
  - (e) names and addresses of the issuer's auditors, promoters, principal bankers, sponsors, authorised representatives, solicitors, registrars and trustees;
  - (f) summary of the provisions of the articles of association with regard to directors' powers, changes in capital, dividend and transfer of the securities;
  - (g) where the listing document includes a statement purporting to be made by an expert, a statement specifying:
    - the expert's qualifications and shareholding in the issuer's group of companies;
    - that the expert has given and has not withdrawn his written consent to the issue of his statement; and
    - date of the expert's statement,
  - (h) particulars of any other stock exchange which the equity or debt securities of the issuer is listed;
  - (i) particulars of any future dividends arrangements; and
  - (j) particulars of any special terms granted within the two years immediately preceding the issue of the listing document in connection with the issue or sale of any capital of any member of the group and the names of directors, promoters or experts who received such payments.
- Terms and conditions of the issue and distribution of the securities:
  - (a) statements that application has been or will be made to the SEHK for listing of and permission to deal in the securities and whether or not that all necessary arrangements have been made enabling the securities to be admitted into the CCASS;
  - (b) nature and amount of the issue including the number of securities which have been or will be created and/or issued and a full description of the securities for which listing is sought;
  - (c) information concerning the terms and conditions of the issue and distribution, public or private, of the securities for listing is made where such issue or distribution is being effected in conjunction

with the issue of the listing document or has been affected within the 12 months preceding the issue of the listing document;
  - (d) where listing is sought for securities with a fixed dividend, particulars of the profits cover for dividend;
  - (e) a statement of net proceeds of cash issues within the two years and how such proceeds were or are intended to be applied;
  - (f) where listing is sought for options, warrants or convertible equity securities, the terms and conditions of such issues;
  - (g) particulars of any preliminary expenses incurred or proposed to be incurred;
  - (h) a statement of net tangible asset backing for each class of security for which listing is sought; and
  - (i) if known, the date on which dealings will commence.
- Information about the issuer's capital:
  - (a) the authorised and issued share capital of the issuer, the amount paid up, the nominal value and a description of the share;
  - (b) the amount of any outstanding convertible debt securities and particulars of the conditions governing and the procedures for conversion, exchange or subscription of such securities. The voting rights of shareholders and if there is more than one class of shares, the rights of each class of shares and a summary of the consents necessary for the variation of such rights;
  - (c) particulars of any alterations in the capital of any member of the group within the two years preceding the issue of the listing document; and
  - (d) particulars of the capital of any member of the group which is under option or agreed conditionally or unconditionally to be put under option.
- Information about the group's activities:
  - (a) the general nature of the business of the group;
  - (b) information in respect of major customers and suppliers;
  - (c) description of the group's structure;
  - (d) particulars of any contracts for the hire or hire purchase of plant to or by any member of the group for a period over one year which are substantial in relation to the group's business;
  - (e) particulars of any trademarks or other intellectual rights which are material in relation to the group's business;
  - (f) number of people employed by the group and any material changes therein in the last financial year;

(g) particulars of any material interruptions in the business of the group on research and development of new products and processes over the past five financial years; and

(h) particulars of any restrictions affecting the remittance of profits or repatriation of capital into Hong Kong from outside Hong Kong.

- Financial information about the group:

(a) a statement on a consolidated basis on:

- the total amount of any debt securities of the group issued and outstanding;
- the total amount of all other borrowings or indebtedness in the nature of borrowing of the group;
- all mortgages and charges; and
- the total amount of any contingent liabilities or guarantees;

(b) a commentary on the group's liquidity and financial resources and its capital structure;

(c) a statement showing the sales turnover figures or gross trading income of the group in the preceding three financial years;

(d) information and particulars in respect of directors' emoluments;

(e) general information on the trend of business since the last audited accounts and a current statement as to the group's financial and trading prospects;

(f) an accountants' report and a statement whether or not the report is qualified by the accountants;

(g) directors' statement on the sufficiency of the group's working capital and any material adverse change in the financial or trading position;

(h) valuation report on the issuer's interest in land or buildings; and

(i) particulars of any material claims or litigation threatened against any member of the group.

- Information about the issuer's management:

(a) the full name, residential or business address and brief biographical details of every director and senior manager or proposed director and senior manager;

(b) the full name and professional qualification of the secretary;

(c) the location of the registered office and the head office and transfer office;

(d) details of any share schemes;

(e) a statement showing the interests of each director and chief executive in the equity or debt securities;

(f) a statement showing the name, other than of a director or chief executive, of anyone who is interested in 10% or more of the nominal value of any class of capital carrying rights to vote at general meetings;

(g) full particulars of the nature and extent of the interest of every director or proposed director or expert, within the two years preceding the issue of the listing document; and

(h) particulars of directors' service contracts with any member of the group including the remuneration paid and payable.

- Information about the use of proceeds:

(a) details of the intended use of the proceeds of the issue;

(b) where relevant, as respects any property:

- the names and addresses of the vendors;
- the amount payable in cash, shares or debentures to the vendor(s);
- brief particulars of any transaction relating to the property completed within the two preceding years; and
- property purchased or acquired or to be purchased or acquired for which the consideration is to be paid out of the proceeds of the issue, other than where the property purchased or acquired was entered into in the ordinary course of business or the amount is not material; and

(c) the amount, if any, paid or payable as purchase money in cash, shares or debentures for any property, specifying the amount, if any, payable for goodwill.

- Material contracts and documents for inspection:

(a) the dates of and parties to all material contracts (not being contracts entered into in the ordinary course of business) entered into by any member of the group within the two years together with a summary of the principal contents of such contracts and particulars of any consideration passing to or from any member of the group;

(b) details of a reasonable period of time (being not less than 14 days) during which and a place in Hong Kong at which the following documents where applicable may be inspected:

- the Articles of Association of the issuer;
- each contract disclosed in the case of a contract not reduced into writing, a memorandum giving full particulars thereof;

A friendly takeover occurs when the directors of the target company welcome the bid. A hostile takeover is when there is opposition from the directors, and the company may seek to take defensive action to prevent the takeover; for example, by application to the Takeover Panel.

The reasons for a takeover include:

(a) acquisition of a competitor. Note the operation of the *Competition Ordinance* (Cap 619) with effect from 14 December 2015, which contains three competition rules, namely, the *First Conduct Rule* and the *Second Conduct Rule* (applying to anti-competitive agreements and abuse of market powder in all sectors of the Hong Kong economy), and the Merger Rules (applying only to anti-competitive mergers involving carrier licence holders within the meaning of the *Telecommunications Ordinance* (Cap 106));

(b) to enable expansion into a new area or to diversify; or

(c) to take advantage of a favourable share price or surplus cash of the company or to acquire a valuable asset. For example, the target company in the *Shanghai Land's* case (see *Vivien Fan & Ors v HKSAR* FACC6-8/2010 and FACC10-12/2010) where the target company was described as a "cash rich" entity and the acquisition was to obtain a wealthy company.

Takeovers of target companies are usually conducted in one of the following manners:

- by way of a private treaty;
- by acquisition of shares in the market;
- a combination of the above; or
- making a mandatory offer to all shareholders of the target company.

Where the takeover is that of a private company, then it is commonly referred to as a merger and acquisition ("M&A"). However, where the transaction involves a public company, whether or not listed (and the relevant listing here is that it is a primary listing in Hong Kong), then it is referred to as a takeover. An M&A involves observance of the terms of the *Companies Ordinance* (Cap 622), in particular the sections relating to "financial assistance". A takeover also involves the *Companies Ordinance* (Cap 622) and the *Takeovers Code*; if the target is a listed company, then provisions of the *Securities and Futures Ordinance* (Cap 571) will also be relevant; in particular see clauses 4.1 to 4.5 of the "Introduction to the Takeovers Code".

The documentation for an M&A usually includes:

- a confidentiality agreement, perhaps limited to the duration of the negotiations; this will be followed by certain confidentiality terms in the contract (the "SPA");

- an exclusivity agreement under which the target company covenants to deal only with the current, potential purchaser, usually for a limited time;
- sometimes a separate agreement containing a non-compete covenant to protect the value of the asset being purchaser; and
- the formal SPA containing several Schedules (which are expressly provided to be part of the contract) and often Appendices.

These general documents will be used whether the purchaser is seeking to buy the share capital of the target, or only selected assets (and perhaps liabilities) of the target under an Asset Purchase Agreement. Other aspects of the transaction include due diligence, a disclosure letter from the target (supported by an "entire agreement" clause in the SPA), a share transfer, notice under the *Transfer of Businesses Ordinance (Protection of Creditors) Ordinance* (Cap 49), and relevant documents. For an Asset Purchase Agreement, various transfers, notices and others will be relevant, including notices to third parties with whom the target had contracted where those contracts are now being assigned to the purchaser.

A takeover must follow the requirements of the *Takeover Code*; these provisions are commented on below, and the terms of the Code are referred to in the Appendices. The regulations are designed to ensure that there is a fair and informed market. Informal guidelines are provided by the Takeover Executive to provide assistance in the interpretation of the Takeovers Code. The underlying factors for the regulation of a takeover are:

(a) the identity of the offeror which should be openly disclosed;

(b) adequate time given to shareholders and directors of the target company to consider the offer and alternatives;

(c) equal opportunity for every shareholder to participate in the benefits of the scheme;

(d) detailed disclosure to enable shareholders and directors of the target company to form a judgment on the merits of the scheme; and

(e) confidentiality.

In general, a takeover typically involves:

(a) the approach and recommendation to consider the offer;

(b) an irrevocable announcement of the offer;

(c) the offer document; and

(d) the closing of the offer and the compulsory acquisition. Questions of acting in concert will be relevant to the transaction.

Economic assumptions

In general, the term of "takeover" is when one company acquires control of another smaller company. "Merger" is understood to be a marriage between two companies of roughly equal size, although the word has often been taken to mean a takeover as well. It may also be defined as an arrangement whereby assets of one or more companies become vested in, or under the control of, one company. Therefore, in broad terms, a takeover is:

- the acquisition or holding of, or entitlement to exercise or control the exercise of, more than 30% of the voting shares in a public company (and designated company) by a person (or company) or a group of such persons acting in concert; or
- the entering into of an agreement, arrangement or understanding by two or more persons to co-operate to act jointly or severally (e.g., consolidate their voting power) for the purpose of exercising control over a company.

From the point of view of a free enterprise economy, allowing people to pursue their own economic advantage will result in the best use of limited resources. It follows from this theory that, as in the case of takeover bids, a person of substantial means who feels that the value of the assets of a company is greater than the value placed upon those assets by its existing shareholders, should be free to attempt to persuade those shareholders to transfer control to the person with substantial means. From the economic point of view the person of substantial means will put these assets to more efficient use.

Similarly, in a merger, the two business enterprises, by merging, will be regarded as the best judges of a business advantage. Nevertheless, the theory on free enterprise also recognises that a resulting enterprise may become monopolistic and abuse its position by charging higher prices, and operate with less efficiency than under competitive conditions. Further, a takeover bid may override certain considerations of public interest, particularly in industries providing public services and utilities.

There are various categories of takeovers and mergers which can be classified in the manner set out below:

- *Horizontal* – A horizontal takeover or merger involves two companies producing essentially the same products or services (or products or services competing with each other) joining together. The objective of the exercise is to reduce the number of competing firms in an industry and eliminate duplicate facilities thus giving rise to a greater scope for the economies of scale.
- *Vertical* – A vertical takeover or merger involves a firm engaged in the manufacturing of a certain product taking over the other firms engaged in the manufacture of the same product at a different stage. The takeover is called a vertical one if one of the two companies is a potential supplier of goods and services to the other so that the two companies that merge contribute to the final product manufactured. For example, a car manufacturer taking over a sheet metal maker or a car distributing firm.
- *Conglomerate* – This mode of takeover or merger involves the joining of two companies in different industries not related to each other horizontally. The objective is to merge the same or competing products of the two companies, thus bringing together common factors in marketing, manufacturing, research and development or technology into a big group of business activities. Sometimes, such an action is also called diversification with a view to:
  (a) achieve greater stability of earnings through the spreading of activities;
  (b) employ spare resources of capital and management;
  (c) reap the benefits of economies of scale for financial advantages;
  (d) defend itself against being an object of takeover; and
  (e) strengthen its ability to withstand economic cycles.

A leverage buy-out (also known as "LBO") has also qualified as a distinct form of takeover. It is a takeover where a substantial proportion of the acquisition price has been financed by borrowings. The bidder is usually a company formed by a consortium with the intention of acquiring control of a conglomerate. The borrowings are then repaid partly or wholly out of the proceeds of selling off parts of the group acquired.

A management buy-out (also known as "MBO") is a type of leverage buy-out popularly carried out in the 1980s. In this case, part or all of the existing management of the target company forms a prominent part of the consortium set up to acquire it. It is funded by financiers who expect that members of the management invest substantially their own net worth in the project as a show of earnestness of their commitment to the venture.

The *Competition Ordinance* (Cap 619) is designed to prohibit conduct that prevents, restricts or distorts competition in Hong Kong. It also prohibits mergers that have the effect of substantially lessening competition in Hong Kong (see *Competition Commission v Nutanix Hong Kong Ltd & Ors (No 2)* [2018] HKCT 1; [2018] 3 HKC 173).

¶30-020 Source and purpose of Codes

The Takeovers Code has been issued by the Securities and Futures Commission (the "SFC") in consultation with the Takeovers Panel and its predecessor, the Committee on Takeovers and Mergers.

The Code comprises General Principles and Rules. The General Principles apply to supplement any areas not covered expressly by the Rules.

The General Principles represent statements of good conduct in relation to takeovers and mergers. The *Share Buy-backs Code* also contained General Principles which have the same object as those in the *Takeovers Code*.

Despite not being binding, the spirit and the terms of both are to be observed. However, in exceptional circumstances, the Executive and the Panel may modify or relax the application of the Rules.

The Takeovers Panel and the Executive administer the Codes.

The primary purpose of the takeover codes is to ensure fair treatment for shareholders who are affected by takeover and merger transactions. In essence, the Code seeks to achieve fair treatment by requiring equality of treatment of shareholders, mandating disclosure of timely and adequate information to enable shareholders to make an informed decision as to the merits of an offer, and ensuring there is a fair and informed market in the shares of companies affected by takeover and merger transactions. It also provides an orderly framework with which all takeover and merger transactions take place.

The Codes do not have the force of law. They are written so far as possible non-technical language and should not be interpreted as statute. However, the Listing Rules of the Stock Exchange in Hong Kong expressly require compliance with the Codes.

The Rules in each of the Codes contain detailed information about the manner of observing the terms. They are to be interpreted to achieve their underlying purpose of affording fair treatment for shareholders who are affected by takeover and merger transaction, and share repurchases.

Both the *Takeovers Code* and *the Share Buy-backs Code* share common definitions and general principles. The General Principles are essentially statements of good standards of conduct to be observed in takeovers, mergers and share repurchases.

Each of the Codes contains a series of rules. Although the rules are expressed in more detail, they are to be interpreted to achieve their underlying purpose.

The *Code on Real Estate Investment Trusts* ("REIT"), applies to one form of a collective investment scheme under Pt 4 of the *Securities and Futures Ordinance* (Cap 571). The Code together with Practice Notes provides guidelines for the conduct of REITs.

Definitions

¶30-080 Takeover offer

A "takeover offer" in relation to a company means an offer made to acquire all or part of its voting shares, or all the shares of any class or classes of its voting shares. Section 689(1) of the *Companies Ordinance* (Cap 622) defines "takeover" (see also ss 690 and 691, and see the definitions in the *Takeovers Codes*).

¶30-090 Acquirer

A "acquirer" means:

- a person (either a body corporate or an individual) who acquires or proposes to acquire control in a company by himself or through an agent; or
- two or more persons, who acting in concert with one another, acquire or propose to acquire control in a company by themselves or through an agent.

¶30-100 Persons acting in concert

"Persons acting in concert" are defined as persons who, pursuant to an agreement arrangement or understanding actively co-operate to obtain or consolidate "control" of a company through the acquisition by any of them of the voting rights of the company (see definition under the *Takeovers Code*).

An agreement, arrangement or understanding means an agreement, arrangement or understanding whether formal or informal, written or oral, express or implied or whether or not having legal or equitable force.

Based on the above definition of "persons acting in concert", there can be a takeover by parties acting in concert regardless of whether there is an acquisition of shares. A takeover situation arises when an agreement, arrangement or understanding exists between two or more persons to co-operate to act jointly or severally for the purpose of exercising control over a company.

The following persons are presumed to be acting in concert unless the contrary is established:

- A company, its parent, subsidiaries, fellow subsidiaries, associated companies of any of the foregoing, and companies of which such companies are associated companies.
- A company with any of its directors (together with their close relatives, related trusts and companies controlled by any of the directors, their close relatives and related trusts).
- A company with any of its pension funds, provident funds and employee share schemes.

- A fund manager (including an exempt fund manager) with any investment company, mutual fund, unit trust or other person, whose investments such fund manager manages on a discretionary basis, in respect of the relevant investment accounts.
- A financial or other professional adviser, (including a stockbroker), with its client in respect of the shareholdings of the adviser and persons controlling, controlled by or under the same control as the adviser except in the capacity of an exempt principal trader.
- Directors of a company (together with their close relatives, related trusts and companies controlled by such directors, their close relatives and related trusts) which is subject to an offer or where the directors have reason to believe a *bona fide* offer for their company may be imminent.
- Partners.
- An individual (including any person who is accustomed to act in accordance with the instructions of the individual) with his close relatives, related trusts and companies controlled by him, his close relatives or related trusts.
- A person, other than an authorised institution within the meaning of the *Banking Ordinance* (Cap 155), lending money in the ordinary course of business, providing finance or financial assistance (directly or indirectly) to any person (or a person acting in concert with such a person) in connection with an acquisition of voting rights (including any direct or indirect refinancing of the funding of the acquisition).

¶30-160 The *Codes on Takeovers and Mergers*

In Hong Kong, the scheme for a takeover bid is not governed by the *Companies Ordinance* (Cap 622) but by the *Codes on Takeovers and Mergers and Share Buy-backs*. The Code applies to all takeovers and mergers affecting public companies in Hong Kong and listed companies with a primary listing of their equity shares. The Code is concerned with offers for and takeovers and mergers of, all relevant companies however effected. These include partial offers, offers by parent company for shares in its subsidiary and certain other transactions where control of a company is to be obtained or consolidated. It however does not include the offers for non-voting, non-equity capital unless required by r 13 and r 14 of the *Takeovers Code*. The Code seeks to ensure that minority shareholders are given a fair opportunity to consider the merits and demerits of an offer and to enable them to decide whether they should retain or dispose of their shares. The Code also requires offer documents, board of directors' circulars and independent advice circulars to include all relevant information required by shareholders and their professional advisers to make informed assessments of the merits and risks of accepting or rejecting a takeover offer.

The policy of the SFC is to keep the Code under regular review, aiming to ensure that it is kept up to date with the changes in the market and with developments in international practice. See in particular:

- Practice Notes No 5 on post-vetting of certain documents under r 12.1;
- Practice Note No 9 on exempt fund for merger and exempt principal trader under rr 21, 22, 23, 26 and 35; and
- Practice Note No 15 on confirmation of financial resources in cash offers under r 3.5 (with effect from 5 July 2011)).

Offers

¶30-220 Mandatory offers

Rule 26 of the *Takeovers Code* applies to the following persons:

- an acquirer who has obtained control of a company; or
- an acquirer who holds more than 30% but less than 50% of the voting shares of a company and such acquirer acquires in any period of 12 months more than 2% of the voting shares of the company.

The Rule also applies to parties acting in concert including those who collectively hold less than 30% of the voting rights, and those who acquire voting rights thereby increasing their collective holding of voting rights to 30% or more of the voting rights of the company. The Rule also applies to those acting in concert who hold not less than 30% but not more than 50%, and where the acquisition of additional voting rights increase their collective voting rights by more than 2% from the lowest collective percentage holding of such person in 12 months as provided for in the Rule.

An acquirer described above must extend an offer to the offeree shareholders in accordance with the requirements of the Code.

Before an offer document is sent to the offeree shareholders, the said acquirer cannot:

- appoint a director to the board of directors of the offeree; or
- exercise the voting rights attached to the voting shares which have been acquired by the acquirer.

Condition of offer

Mandatory offers cannot include any other condition other than that specified under the Code (see r 5.1 of the *Share Buy-backs Code*, and Sch 1, Form 1 and Form 3).

The offer document, where it is not a partial offer, should state that the offer is subject to the offeror having received acceptances which will result in the offeror and all persons acting in concert with the offeror holding in total more than 50% of the voting shares to which the offer relates. This does not apply where the offeror and persons acting in concert with the offeror have already acquired or held or are entitled to acquire or hold 50% in total of the voting shares at the time of the posting of the offer document.

A firm offer cannot be withdrawn without the consent of the Panel.

Consideration: Rule 23 of the *Takeovers Code*

The offeror must provide the consideration for the offer in the following manner:

- cash sum; or
- where there is more than one consideration, one of it must consist solely of a cash sum (see note 5 to r 23).

¶30-230 Partial offers: Rule 28 of the *Takeovers Code*

Partial offers can only be made when approved by the Securities and Futures Commission. The offeror must:

- offer to buy a precise number of shares, and the offer may not be declared unconditional as to acceptances unless acceptances are received for not less than that number;
- offer to acquire the same percentage of voting shares from all offeree shareholders to which the takeover offer relates; and
- accept all acceptances from all offeree shareholders who wish to accept the takeover offer up to the percentage of voting shares proposed to be acquired by the offeror (see r 28.1).

¶30-240 Announcements: Rule 3 of the *Takeovers Code*

Prior to formal appointment to the board of the offeree company, the offeror is responsible to keep a close watch on the offeree company's share price and volume of transacted shares for any undue movement.

The offeror must make an announcement when:

- before the formal approach made to the offeree, the offeree company is the subject of rumour or speculation concerning a possible takeover which has led to undue movements of the share price or volume of share turnover, and there are reasonable grounds for concluding that it is the potential offeror's action which has led to the situation;
- there has been an acquisition of shares by the offeror which gives rise to an obligation to make an offer under the conditions which call for a mandatory offer (see r 29 and r 3.1(c)); and

- negotiations or discussions are about to be extended to include more than a very restricted number of people.

The offeree must make an announcement when:

- when the attention of an offer is made to the board from a serious and reliable source, irrespective of the attitude of the board to the offer; when the company becomes the subject of rumour and speculation of a possible offer after the approach is made by a potential offeror;
- when negotiation or discussion between the offeror and the offeree is about to be extended to include more than a very restricted number of people (i.e., those who need to know in the companies concerned and their immediate advisers); and
- when the board is aware that there are negotiations or discussions between a potential offeror and the holder or holders of shares carrying 30% or more of the voting shares of the company or when the board is seeking a potential offeror (see r 3.3).

A potential offeror must make an announcement when:

- the potential offeror is having negotiation or discussion with the holder or holders of shares carrying 30% or more of the voting shares of the company prior to a formal approach made to the board, and the company is subject to rumour and speculation of a possible offer which has led to undue movement of the company's share price and volume of share turnover.

Content of written notice

The written notice referred to above must include the following:

- the identity of the proposed offeror and all persons acting in concert with the proposed offeror;
- the terms and conditions of the takeover offer;
- details of any existing holding of voting rights of the offeror and any persons in the offeree company acting in concert with the offeror;
- details of any outstanding derivative in respect of securities in the offeree company entered into by the offeror or any person acting in concert with it;
- the details of any existing or proposed agreement, arrangement or understanding relating to the relevant voting shares between the proposed offeror or any person acting in concert with the proposed offeror and the holders of the voting shares to which the takeover relates; and
- the conditions of the takeover offer, including conditions relating to acceptances, listing and increase of capital (see r 3.5).

of votes cast by shareholders in attendance in person or by proxy (see r 3 of the *Share Buy-backs Code*, and s 275 of the *Companies Ordinance* (Cap 622)).

The offer will lapse if the shareholders do not approve of the share repurchase. The offeror should also consult the Executive at an early stage to determine the applicability of the rules of the Codes to the proposed share repurchase by general offer.

In the case of share repurchase by this method of a general offer seeking to privatise or delist the company, all rules of *Takeover Code* will normally apply. However, in all other share repurchases by a general offer, only a number of the rules of the *Takeover Code* apply.

A general offer shall be made on the same terms to all holders of shares of the class of shares that is the subject of the general offer.

Where an offer is made for less than all of the outstanding shares of a class, arrangements must be made for those who wish to do so to accept in full for the relevant percentage of their holdings. Where shares tendered are in excess of this percentage, the offeror must accept in the same proportion from each offeree to the extent necessary to enable the offeror to obtain the total number of shares for which he has offered.

¶30-660 Methods of share buy-back

A company may engage in the following types of share buy-back:

- an on-market share buy-back;
- an off-market share buy-back in accordance with r 2;
- an exempt share buy-back; and
- a share repurchase by general offer in accordance with the General Principles and rules of the Codes.

¶30-680 Offer document: Schedule III

The offer document must be submitted to the Executive Director of the Corporate Finance division of SFC for comment. The offeror must obtain the confirmation from SFC that there is no further comment thereon before he can despatch it to the offeree.

The offeror must disclose in the offer document all such information as the offeree shareholders would reasonably require in an offer document for the purpose of making an informed assessment as to the merits of the offer and the extent of the risks involved in doing so.

Information which must be excluded in the offer document are:

- Information which is within the knowledge of:
  (a) an offeror and all persons acting in consent with the offeror;
  (b) if the person is a corporation, its officers and associates; or

  (c) an expert appointed by such person referred in relation to the takeover offer; and
- information which the persons referred to above could be able to obtain by making such enquires as were reasonable in the circumstances.

Schedule III of the Codes sets out the information and statements required to be included in the offer document.

¶30-700 Shareholders' approval

An offeror may not take up shares tendered to a general offer unless and until the general offer has been approved by a majority of votes cast by shareholders in attendance in persons or by proxy at a general meeting of shareholders duly convened and held to consider the proposed share repurchase.

For the purpose of convening a general meeting to consider a general offer for the purpose of share repurchase, an offeror shall include the following documents together with the notice of the general meeting (see ss 238-241 of the *Companies Ordinance* (Cap 622)).

- a copy of the document containing the proposed general offer; and
- a statement, signed by the directors of the company containing such particulars as would enable a reasonable person to form as a result thereof a valid and justifiable opinion as to the merits of the proposed offer.

¶30-720 Terms of offer

For a general offer approved by shareholders, it shall continue to remain open at least until the close of business on the tenth day immediately following the date of the meeting.

An acceptor of an offer could withdraw his acceptance prior to the later of the date when the offer is approved by the shareholders and the date the offer becomes or is declared unconditional.

If the offer is conditional, it must specify the latest date when the offeror could declare the offer unconditional. If an offer becomes unconditional, it should remain open for acceptance for not less than ten days thereafter.

¶30-740 General offer in excess of 10% of outstanding shares

Where a general offer is made for in excess of 10% of the outstanding shares of a class of shares of an offeror, the offeror should also include in the offer document the following:

- an independent financial adviser's opinion on whether the proposed share repurchase is fair, reasonable and the reason therefore; and

- a summary of an updated independent valuation of the offeror's property assets, if any. In case the value assessed is considered not to be appropriate by the board of directors, the offeror should also include a statement to this effect and provide the reasons therefor.

¶30-760 Compelled share repurchases

In the event that the shareholders of an offeror is compelled, either legally or economically to dispose of their interests in any shares of the offeror, the offeror is normally required to agree with the Executive Director of the Corporate Finance Division of SFC concerning the appropriate steps that need to be taken to protect the interests of the shareholders. Such steps will normally include the appointment of an independent committee of the offeror board of directors to advise such shareholders on the merits of the offer, the appointment of an independent financial adviser to advise the independent committee and the approval of the proposed share repurchase by at least three quarters of such shareholders in attendance or by proxy at a general meeting of shareholders of such class of shares duly convened and held to consider the share repurchase.

¶30-780 Announcement

Once the board of directors of an offeror decides to make an offer, the offeror shall publish an announcement of the material terms of the offer. The announcement shall specify the number of shares that have been acquired by the offeror pursuant to the share repurchase and the number of shares in respect of which acceptances of the offer have been received.

In the case of a partial offer, the announcement shall also disclose the way in which the individual shareholder's entitlement is determined.

All announcements must be filed with the executive director of the Corporate Finance Division of SFC for comment prior to release or publication.

All announcements must be published as a paid announcement in at least one leading English language newspaper and one leading Chinese newspaper, both of which should be published daily and circulated generally in Hong Kong.

¶30-800 Secrecy

Prior to announcement, all persons who have access to the offer information must treat the information as confidential and may only pass it to another person if the offer requires so.

The board of directors has a responsibility to keep a close watch on the share price and volume of share turnover of the offerors' shares, and if there is any undue movement in either or both, the board should make an immediate announcement, accompanied by such comment as may be appropriate.

¶30-820 Declaration of due case and responsibility

On all documents and advertisements addressed to an offeree, the board has to make a written declaration stating that the board has taken all reasonable care to ensure the facts stated are accurate, the opinion expressed has been arrived at after due and careful consideration, and no material information has been omitted. In addition, it must also state that all the directors accept full responsibility jointly and severally for the contents of the document.

¶30-840 Withdrawal or lapse of an offer

Once an offer is made, the offeror shall proceed with the offer unless the posting of the offer document is subject to the prior fulfilment of a specific condition and that condition has not been fulfilled.

In the event of the non-fulfilment of a pre-stated condition, the offeror must make an announcement giving reasons for not proceeding with the offer.

¶30-860 General waiver

With reference to all requirements under the *Code of Share Buy-backs*, the executive director of the Corporate Finance Division of SFC, upon application of an offeror or any other person with an interest in a share repurchase, can waive compliance with one or more of the provisions of the Code.

¶33-460 Wages

The *Employment Ordinance* (Cap 57) defines wages and the period in relation to which wages may be calculated, and the manner in which wages may be paid (ss 22-28). Unless otherwise proven, the period in respect of which wages are payable is one month. The *Minimum Wage Ordinance* (Cap 608) amended the hourly rate of the minimum wage to HK$32.50 per hour from 1 May 2015. The *Minimum Wage Ordinance* (Cap 608) increases the hourly wage from HK$32.50 to HK$37.50 per hour from 1 May 2019.

The *Employment Ordinance* also restricts deductions which can lawfully be made by an employer from wages (s 32).

¶33-470 Hours of work

Although there are restrictions on the hours which may be worked by children and young persons in industry, the *Employment Ordinance* (Cap 57) contains no restrictions on the maximum hours which an employee may be required to work.

¶33-480 End-of-year payments

Although there is no legal obligation upon an employer to include an end-of-year payment as part of the contract, if he does so the *Employment Ordinance* (Cap 57) will govern such a payment (ss 11D, 11E and 11F). If no payment period is specified, it is deemed to be the Chinese Lunar Year. If the amount is not specified it will be one month's wages and payment will become due on the last day of the payment period.

¶33-490 Rest days

An employee is entitled to one rest day in every period of seven days. Rest days shall be in addition to any statutory, alternative or substituted holiday (ss 17 and 18).

¶33-500 Public holidays

An employee is entitled under the *Employment Ordinance* (Cap 57) to 12 public holidays each calendar year.

Subject to ss 39(1A), (2) and (3), an employee shall be granted a statutory holiday by his employer on each of the following days:

- Lunar New Year's Day or, if that day falls on a Sunday, then the fourth day of Lunar New Year;
- the second day of Lunar New Year or, if that day falls on a Sunday, then the fourth day of Lunar New Year;
- the third day of Lunar New Year or, if that day falls on a Sunday, then the fourth day of Lunar New Year;

- Ching Ming Festival;
- Labour Day, being the first day of May;
- Tuen Ng Festival;
- the day following the Chinese Mid-Autumn Festival or, if that day falls on a Sunday, the Chinese Mid-Autumn Festival Day;
- Chung Yeung Festival;
- the Chinese Winter Solstice Festival or Christmas Day, at the option of the employer;
- the first day of January;
- Hong Kong Special Administrative Region Establishment Day, being the first day of July; and
- National Day, being the first day of October.

¶33-510 Annual leave

The *Employment Ordinance* (Cap 57) prescribes between seven and 14 days annual leave for every 12 months of continuous service, depending on the number of years of service of the employee.

An employee must have accrued at least 12 months' service in order to qualify for statutory annual leave (s 41AA).

¶33-520 Sickness allowance

An employee who has been employed under a continuous contract for at least one month accrues sickness allowance at the rate of two paid sickness days for each completed calendar month during the first 12 months of employment and at a rate of four paid sickness days for each such month thereafter. The allowance may be accumulated up to a maximum of 120 paid sickness days. An employee who takes less than four consecutive days as sickness days shall not (except in the case of pregnancy or post-natal sickness) be entitled to sickness allowance in respect thereof (s 33 of Cap 57).

¶33-530 Maternity leave

An employee who is employed under a continuous contract immediately before the expected date of commencement of maternity leave is entitled to a continuous period of ten weeks maternity leave. To qualify for paid maternity leave the employee must have been employed for a period of not less than 40 weeks immediately before the expected date of commencement of maternity leave.

Termination

¶33-580 Right to terminate

A contract of service can be terminated either by the employer or the employee. Dismissal is a form of termination of employment at the initiative of the employer. Resignation is a form of termination of employment at the initiative of the employee.

The right of an employer to dismiss or "fire" an employee is qualified. The law generally requires that employment should not be terminated without due notice or payment in lieu of notice, except in the case of misconduct which warrants summary dismissal. The employee is equally obliged to give due notice of resignation in most circumstances although an employee may terminate his employment contract without notice or payment in lieu in circumstances such as danger of violence or disease not contemplated by the contract or where the employer breaches the contract so that the employee may resign and claim constructive dismissal.

An employer is prohibited from terminating a pregnant employee's continuous contract, after she has served notice of pregnancy, except for reasons stated in s 9 of the *Employment Ordinance* (Cap 57). However, if the pregnant employee served such notice after being informed of her termination, the employer should immediately withdraw the termination or notice of it.

An employee may be granted remedies against his employer if the employer, intending to reduce any protection conferred by the Ordinance, dismisses an employee who has been employed under a continuous contract for a period of not less than 24 months. The law also prohibits an employer from dismissing an employee whilst pregnant, on maternity leave or sick leave, where dismissal is as a result of union membership or as a result of an employee having given any evidence or information against his employer in relation to a safety at work claim or a claim in relation to the enforcement of any provisions of the *Employment Ordinance* (Cap 57).

¶33-590 Notice

In accordance with the *Employment Ordinance* (Cap 57) either party to a contract of employment may at any time terminate the contract by giving notice to the other either orally or in writing.

Contracts of service should specify the length of notice of termination required by either party and may also specify the method by which notice is to be given.

If the contract of service does not specify a notice period the *Employment Ordinance* (Cap 57) sets out certain minimum notice requirements and also provides that in the absence of an express agreement to the contrary every continuous contract shall be deemed to be a contract for one month, renewable from month to month.

The *Employment Ordinance* (Cap 57) provides that the services of an employee on probation may be terminated by the employer or the employee without notice during the first month and by any notice period agreed in the contract, but not less than seven days' notice thereafter.

In all other cases the employee is entitled to:

- not less than one month's notice of termination where the contract is for one month renewable from month to month and the contract does not otherwise provide for the length of notice required to terminate the contract; or
- seven days or the agreed period, whichever is the longer, where the contract is for one month renewable from month to month and the length of notice of termination is provided for in the contract; or
- the agreed period, but not less than seven days in the case of a continuous contract, in every other case.

Annual leave and maternity leave to which an employee is entitled shall not be included in the length of notice required to terminate a contract of employment.

Alternatively, an employment contract can be terminated without notice by either party agreeing to make to the other payment in lieu of notice, equal to the amount of wages which would have accrued to the employee during the requisite period of notice. The parties may of course give longer notice than that required by the contract or the *Employment Ordinance* (Cap 57).

¶33-600 Cessation of employment

The law requires that when an employee is about to leave his employment, his employer must notify the Commissioner of the Inland Revenue not later than one month before such individual ceases to be employed.

This also applies to employees who are leaving Hong Kong and are expected to be away for any period exceeding one month. In such circumstances a company is obliged to retain any moneys due to an employee until it has had clearance from the Inland Revenue regarding the tax liabilities of the employee. The Inland Revenue can recover the taxes of an employee directly from an employer if the employer has failed to give notice of the employee's cessation of employment.

¶33-610 Termination payments

An employee who has been employed under a continuous contract for not less than 24 months is entitled to a severance payment if dismissed by

reason of redundancy or if the employee is laid off (s 31B of the *Employment Ordinance* Cap 57). The amount of severance payment for a monthly-rated employee is, subject to certain maximum limits, two-thirds of his last full month's wages, or two-thirds of HK$22,500, whichever is less for each complete year of service and pro rata with respect to an incomplete year of employment (s 31G of Cap 57).

In order to qualify for a long-service payment an employee must have been employed under a continuous contract for not less than five years and have been dismissed for reasons other than summary dismissal or redundancy. The amount of the entitlement is calculated by reference to the employee's wages, age and years of service at the date of termination or dismissal (ss 31V and 31W of Cap 57).

¶33-680 Employment protection

An employee may be granted remedies against his employer if the employer, intending to reduce any protection conferred by the *Employment Ordinance* (Cap 57) either dismisses an employee who has been employed under a continuous contract for a period of not less than 24 months or, at any time, unilaterally varies the terms of employment of an employee employed under a continuous contract. Any such dismissal or variation by the employer is deemed to be for the intention of reducing the protection conferred by the Ordinance unless the employer can show that he had a valid reason, as defined by the Ordinance, for so doing.

The valid reasons for dismissal or for the variation of the terms of employment are:

- the employee's conduct;
- the capability or qualifications of the employee for performing work of the kind which he was employed to do;
- redundancy or other genuine operational requirements of the employer's business;
- where failure to dismiss the employee or vary the terms of his employment contract would be in contravention of the law; or
- some other reasons of substance which, in the opinion of the court or the Labour Tribunal, was sufficient cause to warrant the dismissal or contract variation.

Remedies

Where the employer is found to be in breach of these provisions the court or Labour Tribunal has wide discretion in determining the sanction it can apply. An order for re-instatement or re-engagement of the employee may be made on terms which it considers just and appropriate if both the employee and the employer consent. Alternatively, the employer can be ordered to pay to the employee terminal payments, being a sum of money representing what the employee was entitled to on termination of the contract or what the

employee might reasonably have been entitled to upon the termination of the contract had he been allowed to continue his employment to obtain the minimum qualifying length of service required for the entitlements under the Ordinance, particularly for a severance or long-service payment.

Compensatory awards

Where an employee is dismissed, other than for one of the valid reasons, he may, if he has been dismissed in contravention of one of the following specified provisions of the Ordinance, also claim an additional award of compensation. The specific circumstances in which an employee can claim the additional compensatory award are where the employee is dismissed:

- while pregnant, on maternity leave or sick leave;
- as a result of union membership;
- as a result of an employee having given any evidence or information against his employer in relation to a safety at work claim or a claim in relation to the enforcement of any provisions of the Ordinance;
- in breach of the *Factories and Industrial Undertakings Ordinance* (Cap 59); or
- in breach of the *Employees' Compensation Ordinance* (Cap 282).

Where there has been no order for re-instatement or re-engagement the court or Labour Tribunal may, whether or not it has made an award of terminal payments, make an award of compensation to the employee as it considers just and appropriate in the circumstances up to a maximum of HK$150,000. In determining the amount of the award, consideration will be given to, *inter alia*:

- the manner of the dismissal,
- the length and circumstances of the employment,
- the loss sustained by the employee,
- the possibility of obtaining new employment, and
- any contributory fault borne by the employee.

Health and safety

Occupational Safety and Health Ordinance provisions

¶34-040 Scope of Ordinance

The *Occupational Safety and Health Ordinance* (Cap 509) took full effect on 1 June 1998. It applies to almost all workplaces in Hong Kong, including offices and government departments. The Ordinance imposes wide-ranging obligations on employers, occupiers and employees to take care of the health and safety of persons employed in workplaces. The Ordinance also applies to independent contractors and self-employed persons but only in respect of their capacity as employers or as occupiers of premises where workplaces are located. It does not apply to domestic premises (ss 3 and 4 of Cap 509).

The stated purposes of the Ordinance are as follows (s 2 of Cap 509):

- to ensure the health and safety of employees while they are at work;
- to prescribe measures that will contribute to making the workplaces of employees safer and healthier for them;
- to improve the safety and health standards applicable to certain hazardous processes, plant and substances used or kept in workplaces; and
- to generally improve the safety and health aspects of the working environment of employees.

A regulation or code of practice made or issued under the *Occupational Safety and Health Ordinance* (Cap 509) will prevail over regulations or codes of practice issued under the *Factories and Industrial Undertakings Ordinance* (Cap 59) (see s 46 of Cap 509).

¶34-050 Employer's or occupier's duties

The *Occupational Safety and Health Ordinance* (Cap 509) imposes certain obligations on those persons who are the employers or occupiers of premises in respect of the health and safety of those persons working at a workplace. Employer and occupier are defined in s 3 of the Ordinance. An employer is a person who employs natural persons under contracts of employment or apprenticeship. An occupier includes a person who has any degree of control over any premises or workplace. A person under a contract or lease who has an obligation for the maintenance of the premises or safety of the plant and any substances on the premises is taken to be an occupier. A person under a contract or lease who has an obligation to provide, maintain or repair a means of access to or egress from the premises is also taken to be an occupier.

Sections 6 and 7 of the Ordinance impose obligations on employers and occupiers respectively to ensure the safety and health of employees and persons employed at the premises. Employers are required to ensure, as far as reasonably practicable, the safety and health of all their employees. Specifically, as far as reasonably practicable, they are required to:

- maintain plant and systems of work that are safe and without risks to health;
- ensure the safety and absence of risk to health in connection with the use, handling, storage or transport of plant or substances;
- maintain the workplace in a condition that is safe and without risks to health; and
- provide means of access to and egress from the workplace that are safe and without risk and maintain a working environment that is safe and without risks to health.

Occupiers are required to ensure that means of access to and egress from the premises and any plant and substances kept at the premises are, as far as reasonably practicable, safe and without risks to health. Failure of the employer or occupier to meet these requirements is an offence.

Directors, secretaries, managers or other officers of companies which are convicted of an offence under the Ordinance are also liable if it is established that the offence was committed with their consent or attributable to their neglect (s 33 of Cap 509).

Under the Ordinance, the person responsible for the workplace (i.e. the employer of the employees who work there, or, where the employer does not exercise any control over the workplace, the occupier), is required to notify an occupational safety officer of the Labour Department in the event of an accident which causes the death of or serious injury to an employee. Only accidents which occur at the workplace need be reported under the Ordinance. If an accident occurs while the employee is out of the workplace no report need be made under the Ordinance. The report must be made in accordance with s 13 of the Ordinance (ss 3(2) and 13 of Cap 509).

¶34-060 Penalties for contravening the Ordinance

Various penalties are prescribed in the Ordinance for certain offences. The main offences include the following.

- *Employers failing to ensure, as far as reasonably practicable, the health or safety of their employees.* Any employer who fails to ensure the health and safety at work of all their employees as required commits an offence and will be liable to a fine of HK$200,000 on conviction. If the offence was committed intentionally, knowingly or recklessly the penalty, on conviction, will be HK$200,000 and six months' imprisonment (s 6 of Cap 509).