3 Non-Hong Kong Companies

A company incorporated outside Hong Kong which establishes a place of business in Hong Kong is termed a non-Hong Kong company. Such companies are required to register in Hong Kong. In November 2019, there were in total 12,368 such companies registered here. Such companies are now generally governed by Part 16 of Cap 622 and by the *Companies (Registered Non-Hong Kong Companies) Regulation* (Cap 622J).

Before 3 March 2014, non-Hong Kong companies were generally governed by Part XI of the former Cap 32. Its provisions were originally intended to deal with companies whose place of incorporation was overseas that established a place of business here. However, in the 1980s and 90s, a number of companies originally incorporated in Hong Kong decided to move their place of incorporation offshore to such jurisdictions as Bermuda and the Cayman Islands. In such a case, if the company maintained a place of business in Hong Kong, it fell within Part XI and was required to be registered as a non-Hong Kong company.

Many Hong Kong businesses also chose to incorporate in offshore jurisdictions as a means to gain tax advantages or to avoid disclosure requirements. If such a company maintained a place of business in Hong Kong it was also required to be registered under Part XI as a non-Hong Kong company.

In recent years the rationale for establishing a non-Hong Kong company is diverse and within a group of companies (*see* Ch 2.6) it is not unusual to find a 'local group' of companies comprising a holding company incorporated overseas with subsidiaries incorporated in various jurisdictions. Any company within the group that is not incorporated in Hong Kong will generally be governed by the law in its place of incorporation. If a company is required to register here because it has established a place of business then it will also be bound by certain provisions in Cap 622.

There is a need to understand what is meant by 'a non-Hong Kong company' from the outset of studying Hong Kong company law not only because of their significant number but also because of the need to carefully distinguish the various bodies that fall within the provisions of Cap 622. For example, the term 'company' if used as defined by Cap 622 does not include a non-Hong Kong company.

A 'company' means –

- a company formed and registered under Cap 622; or
- an existing company, meaning that it was formed and registered under the former Cap 32 or earlier *Companies Ordinances* (*see* s 2(1)).

A *non-Hong Kong company* does not fall within either arm of the definition because, although such a company may be required to register in Hong Kong, it is not 'formed' (i.e., incorporated) under Cap 622 or earlier *Companies Ordinances*. Such companies are formed in some other jurisdiction.

Certain Parts of the Ordinance do however extend the meaning of 'company' to include a 'non-Hong Kong company'. Part 14 (ss 722–743), which concerns remedies for the protection of a company's members, does so in its initial interpretation provision, s 722. These remedies will be explained further in Chapter 15.

Care also needs to be taken to distinguish a 'registered non-Hong Kong company' from a non-Hong Kong company that has failed to register in accordance with Cap 622. The requirement to register a non-Hong Kong company is explained in Ch 4.1 and 4.2.

Part 8 (ss 333–356) concerns charges. Most of the provisions in this Part refer to 'a company' but s 336 requires a registered non-Hong Kong company to register every specified charge created by the company on property in Hong Kong and s 339 requires such a company to register charges on existing property in Hong Kong that the company acquires. Within Part 8, the provisions that concern registration of the issue of debentures (Div 4 ss 341–343) apply to both a company and to a registered non-Hong Kong company. Debentures and charges will be explained in Chapter 10.

Certain Divisions and sections may also specifically apply or be extended to include a non-Hong Kong company. In Part 19, which concerns investigations and enquiries, the circumstances in which the Financial Secretary may appoint an inspector to investigate a company's affairs under s 840 apply to a 'registered non-Hong Kong company' while the circumstances under s 841 apply to a 'non-Hong Kong company' (whether or not it is registered). These provisions clearly illustrate the need to look very carefully at the interpretation provisions relevant to each Part and, in some cases, to each Division or even to each section of the Ordinance.

There are other terms employed in Cap 622 which also require careful consideration as to their inclusion, or otherwise, of a non-Hong Kong company. For example, a number of its provisions apply to a 'body corporate'. This term has been explained in the introduction to Chapter 1 but its significance may not have been fully understood. A *body corporate* is defined to include 'a company' (*see* above) and 'a company incorporated outside Hong Kong', s 2(1). So, *body corporate* in essence means a company wherever it is formed. The term therefore includes a non-Hong Kong company, whether or not it is registered. The provisions that apply to a *body corporate* very often require disclosure of dealings or interests and/or protection for minority shareholders. For example, the notion of an 'entity connected with a director' (connected entity) includes a *body corporate* with which a director is associated (*see* s 486 and Ch 13). These provisions will be explained in the relevant chapters.

In this chapter, we will first consider in Ch 3.1 what is entailed in a company incorporated overseas 'establishing a place of business in Hong Kong'. The registration of a non-Hong Kong company is considered in Ch 3.2 and the appointment of an authorised representative in Ch 3.3. The returns and accounts of such companies are outlined in Ch 3.4 and the publication of their name and other information and events in Ch 3.5. The last part of the chapter, Ch 3.6, is concerned with striking a registered non-Hong Kong company off the Companies Register. Other provisions affecting non-Hong Kong companies will be considered in the chapters where they are most relevant.

existence of an agent handling such matters as bills of lading constituted a place of business. ESL contended that the role played by the agent was not sufficient to constitute a place of business. The parties agreed that proving a place of business in Hong Kong was a question of fact to be established by the plaintiffs. It was held that, on the facts, the plaintiffs failed to establish that ESL had a place of business in Hong Kong and that the writ was not duly served.

England's Court of Appeal has more recently considered this issue. In *Adams v Cape Industries plc* (1990), Slade LJ proposed a number of tests, focusing on the role of the representatives (rep) operating within the jurisdiction, to determine whether or not a place of business has been established –

- whether or not the fixed place of business from which the rep operates was originally acquired for the purpose of enabling him/her to act on behalf of the overseas corporation;
- whether the overseas corporation has directly reimbursed him/her for the cost of the accommodation, at the fixed place of business, and/or the cost of his/her staff;
- what contributions, if any, the overseas corporation makes to the financing of the business carried on by the rep;
- whether the rep is remunerated by reference to transactions, e.g., by commission, or by fixed regular payments, or in some other way;
- what degree of control the overseas corporation exercises over the running of the business conducted by the rep;
- whether the rep reserves part of his/her accommodation, or part of his/her staff, for conducting business relating to the overseas corporation;
- whether the rep displays the overseas corporation's name at his/her premises or on his/her stationery and, if so, whether he/she does it in a way as to indicate that he/she is a rep of the overseas corporation;
- what business, if any, the rep transacts as principal exclusively on his/her own behalf;
- whether the rep makes contracts with customers, or other third parties, in the name of the overseas corporation, or otherwise in such manner as to bind it; and
- if so, whether the rep requires specific authority in advance before binding the overseas corporation to contractual obligations.

In *Rakusens Ltd v Baser Ambalaj Plastik Sanayi Ticaret AS* (2002) UK, a claim form was served on Baser at an address in the UK. Baser contended that the address was not their established place of business, merely the place from which P conducted an agency. P did not have authority to contract on behalf of Baser. The relevant UK provision permits service of documents at any place of business established by an overseas company which has failed to provide details of a person resident in the UK who is authorised to accept service.

The Court of Appeal held that in determining whether a company has established a place of business by the conduct of persons who are agents, a relevant factor is whether the agent is entitled to conclude contracts or merely passed on orders from customers to the foreign company. P did not decide which orders would be accepted or rejected by Baser, and he was

3.2 Registration of non-Hong Kong companies

Section 776 states that within one month after establishing a place of business here, a non-Hong Kong company is required to apply to the Registrar for registration as a *registered non-Hong Kong company*. Otherwise the company, every responsible person of the company, and every agent of the company who authorises or permits the contravention, commit an offence.

The application must –

- be in the specified form;
- contain the particulars and documents prescribed by the *Companies (Non-Hong Kong Companies) Regulation* (Cap 622J) (*see* below); and
- contain the required details of at least one person who is proposed to be an *authorised representative* of the company (*see* Ch 3.3).

If none of the company's domestic names, meaning the name(s) by which it is registered in its place of incorporation, is in Roman script or Chinese, a certified translation of one of the names into either English or Chinese, or both, must also be included in the application, s 776(5).

Sections 3 and 4 of Cap 622J essentially require the following information –

- if the company's domestic name is in Roman script or Chinese, its domestic name;
- the place of incorporation;
- the date when the company established its place of business in Hong Kong;
- with respect to each director and secretary –
  - the date of appointment;
  - in the case of a natural person, his/her present forename and surname, any former forename and surname (if any), any alias (if any), the address (i.e., usual residential address of director and correspondence address of the secretary), the number of the identity card (if any), otherwise, the number and issuing country of any passport held by him/her; and
  - in the case of a body corporate, its corporate name, registered number in Hong Kong and the address of its registered or principal office; and
- the address of the principal place of business of the company in Hong Kong and the address of its principal place of business (if any) and registered office (or equivalent) in the place where it is incorporated.

In relation to the company secretary, if all the partners in a firm are joint company secretaries, the name and principal office of the firm may be substituted for the details indicated above.

Certified copies of the following documents must also be delivered to the Registrar –

- its constitution (including articles, if any);
- its certificate of incorporation – if it is not the practice under the law in the place where the company is incorporated to issue a certificate, the Registrar may accept other evidence of incorporation; and

If a Registrar receives such a return, the Registrar must make a note in the Companies Register that there is a change, issue the company with a fresh certificate of registration containing the new name and register the return and accompanying documents, s 779.

The Registrar may serve notice on a registered non-Hong Kong company to change its name. These provisions will be considered in Ch 4.4 together with similar powers in respect of a company incorporated in Hong Kong.

Index of directors of registered non-Hong Kong companies

Section 802 requires the Registrar to keep an index of every person who is a director of a registered non-Hong Kong company. The particulars contained in the index are –

- the name and address of the director,
- the latest particulars sent to the Registrar in respect of the director (*see* s 791 in Ch 3.3 below), and
- the name of each company or registered non-Hong Kong company of which he/she can be identified as a director.

The index must be open to inspection by anyone on payment of the prescribed fee. However, the director's usual residential address and full ID card or passport number must not be open for inspection. But a correspondence address may be open for inspection even if it is the same as his/her usual address, s 802(4)–(5).

3.3 Authorised representatives of registered non-Hong Kong companies

You will recall that an application by a non-Hong Kong company for registration under s 776 must contain certain *required details* of at least one person who is proposed to be an *authorised representative*. Such a representative is authorised to accept service of any process (e.g., a writ) or notice required to be served on the company (*see* s 803) and must notify the Registrar if the company is dissolved (*see* s 793).

An authorised representative must be either –

- a natural person resident in Hong Kong;
- a solicitor corporation or a firm of solicitors;
- a corporate practice of professional accountants, or a firm of certified public accountants (practising), s 774(1).

The *required details* to be stated in the application to register a non-Hon Kong company are the name and address in Hong Kong of the authorised representative, the date on which the representative was authorised and in the case of a natural person the number of the representative's ID card. If the representative does not have an ID card, the number and issuing country of any passport held by him/her must be included, s 774(1).

8 Maintenance of Capital

This chapter is the last of 4 successive chapters concerned with a company's share capital. Its focus is on the funds raised by a company issuing shares. Shares are generally issued in return for payment. The term used to describe these payments/funds is 'issued share capital'. The issued share capital of the company is the fund to which creditors of the company look for payment of their debts. The amount of issued share capital is said to be the 'yardstick' by which the company's worth (i.e., its creditworthiness) may be ascertained.

In order to protect its creditors, a company's share capital must actually be raised. Thereafter its share capital will hopefully be employed to generate profits and enable growth. Shareholders will however be expecting a return on their investment. The most important concept then applying to a company is the general prohibition on returning share capital to its members. Capital will be returned to members if a solvent company is wound up. Being 'solvent' means that all of its creditors are paid. Otherwise share capital can only be returned to a member in strictly limited circumstances. Those strictly controlled circumstances all require that the company be solvent – if it is solvent, its creditors are unlikely to be adversely affected by the return.

Hence, in terms of maintenance of share capital, it is of vital importance that a company –

(1) receives value for each and every issued share (at the time of issue or in the future) and that the company does not in any way provide a member with the finance for the purchase of that share; and

(2) endeavours, having received value, not to diminish its share capital. The issued share capital provides the company with its assets and working capital. Whilst the profits derived from using the capital may be distributed to the shareholders, the capital itself must be maintained.

Cap 622 provides a certain amount of protection to meet these requirements. In respect of receiving value (point 1 above) –

- payment for shares in the form of non-cash consideration must be disclosed by the company in its return of allotment (*see* Ch 5.2);
- no commission may be given on subscription for shares unless it is within the limits imposed by Part 4, ss 147–149 (*see* Ch 6.3);
- a company may not acquire its own shares, except as provided by s 267 (*see* Ch 8.2); and
- no financial assistance may be given by a company for the purchase of its own shares except as provided by Part 5 (*see* Ch 8.3).

8.1 Reduction of capital

A company limited by shares can only reduce its capital in accordance with the procedures specified in s 211. As explained in the introduction to this chapter, the rules for maintaining the company's capital are strictly applied because a share capital is the fund to which creditors look for payment and on which they rely.

However, the company's issued share capital may cease to represent the assets of the company. If a company trades at a loss, the actual value of the capital may be reduced below the value of its issued shares. The issued share capital then misrepresents the fund available to pay the company's creditors. A company may also be *over-capitalised*, so that its assets exceed the value of its issued share capital or its capital exceeds its needs and can no longer be usefully employed in the company.

In either event, a company may want to reorganise its financial structure. A reduction of capital may reinstate the company's issued share capital as its capital 'yardstick' and thus constitute a more realistic measure of its worth.

Part 5 of Cap 622 provides a company with a right to reduce its capital, but the process is subject to a number of safeguards to ensure protection for both creditors and shareholders of the company. If a company reduces its share capital in contravention of Part 5 Div 3 ss 209–232, the company, and every responsible person of the company, commit an offence, s 212.

Types of reduction

A company limited by shares may reduce its share capital in accordance with the specified procedures (*see* below) in any way. But a reduction is subject to any provisions in the company's articles that prohibit or restrict a reduction. If the reduction would result in its member(s) holding only redeemable shares, the company cannot reduce its share capital, s 210.

Whilst a reduction may take any form, examples include a company –

- extinguishing or reducing the liability on any of its shares in respect of share capital not paid up;
- cancelling any paid up share capital that is lost or unrepresented by available assets; and
- repaying any paid up share capital which is in excess of the wants of the company.

In the cases of cancelling and repaying paid up share capital, the company may, or may not, also extinguish or reduce the liability on any of its shares.

If a company reduces its share capital, its members' liability in respect of a call or contribution (i.e., to a winding-up) will no longer be for the balance of the issue price but for the balance of the reduced amount, s 213. However, if a reduction is confirmed by the court under s 229 (*see* below), a member may still be liable to make a contribution up to the amount of the balance of the issue price. This will occur if a creditor who was entitled to object to the reduction but was omitted from the list of creditors subsequently seeks payment of a debt or makes a claim, and the company is then unable to pay. The reason for omission from the list must be either

- where the special resolution and solvency statement are available for inspection; and
- that a member of the company who did not consent or vote in favour of the special resolution, or a creditor of the company may, within 5 weeks after the date of the resolution, apply to the court for its cancellation, s 218(1).

The notice must be published in the Gazette on or before 'a date that falls on the last working day of the week after the week in which the special resolution is passed', or if that period is less than 4 business days (excluding the day of the resolution and that last working day), a date that falls on the last working day of the week next following. For these purposes, a black rainstorm day, a gale warning day, a general holiday and a Saturday are not business days; and a general holiday and a Saturday are not working days.

Before the end of the week after the week in which the special resolution is passed, the company must also either publish a notice with the same content in one Chinese language newspaper and one English language newspaper (these papers are specified by the Chief Secretary for Administration and published in the Gazette, s 203) or give written notice to that effect to each of its creditors. The company must also deliver a copy of the *solvency statement* to the Registrar no later than it publishes the notice in the Gazette or, if earlier, when it first publishes the notice in the newspapers or gives notice to its creditors. If a company fails to publish notices, give notice to creditors or deliver a copy of the *solvency statement*, the company and every responsible person of the company commit an offence, s 218.

The company must ensure that the resolution for reduction and the *solvency statement* are kept at its registered office (or a place prescribed by the regulations made under s 657; *see* Cap 622I) from the date it publishes the notice in the Gazette or, if earlier, when it first publishes the notice in the newspapers or gives notice to its creditors until 5 weeks after the date of the resolution. A member or creditor may inspect them without charge during business hours in that period. Otherwise, the company, and every responsible person of the company, commit an offence. If the company does not permit a member or creditor to inspect, the court may order immediate inspection, s 219.

Application to the court by members or creditors for cancellation of the resolution

A member or creditor may apply to the court within 5 weeks after the special resolution for it to be cancelled, but a member who consented to or voted in favour is not entitled to apply. One member may act as the applicant on behalf of the person(s) entitled to apply if appointed in writing by all of them, and he/she must, as soon as possible, serve the application on the company. The company must give the Registrar notice of the application within the following 7 days. Otherwise, the company, and every responsible person of the company, commit an offence, s 220.

The court may adjourn proceedings on such an application so that arrangements can be made to its satisfaction for the protection of the interests of dissentient members or dissentient creditors, s 221. The court may make an order confirming or cancelling the special resolution on any terms and conditions it thinks fit. It may extend dates and periods of time; provide for the company to buy back the shares of any member and for the consequent reduction of share capital; provide for the protection of the interests of members or creditors of the company; make

of the outside public who may become their creditors. In my opinion, the effect of these statutory restrictions is to prohibit every transaction between a company and a shareholder, by means of which the money already paid to the company in respect of his shares is returned to him, unless the court has sanctioned the transaction. Paid up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to, a limited company naturally rely on the fact that the company is trading with a certain amount of capital . . . and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.'

Section 267 states that a company must not acquire its own shares, whether by redemption, buy-back, subscription or otherwise, except as provided by Cap 622. Otherwise, the company, every responsible person of the company, and every *non-tendering member* (i.e., a member who gives notice of not responding to a buy-back offer, *see* s 705) who knowingly permits the contravention, commit an offence.

The exceptions to this general rule are in essence *permitted reductions of share capital*. Examples of these exceptions are as follows –

- A company may be ordered by the court to purchase the shares of dissentients if, for example, it is unlisted and provides financial assistance to acquire its own shares (*see* Ch 8.3), or in relation to a petition based upon unfairly prejudicial conduct under Part 14 s 724 (*see* Ch 15.3).
- A redemption of shares, which is in effect a purchase by the company of those shares, is permitted to a limited extent (*see* Ch 5.3 for the nature of such shares and below for the process of redemption).
- A purchase of the company's own shares in accordance with the buy-back provisions (*see* below).
- A reduction of capital that involves repaying its own paid up share capital (*see* Ch 8.1).

Furthermore, neither the rule in *Trevor v Whitworth* nor Cap 622 precludes a company from acquiring the entire shareholding of another company (e.g., X Ltd) where the sole asset of X Ltd is shares in the acquiring company: *Acatos & Hutcheson plc v Watson* (1995) UK. In coming to this decision, the court considered a number of Australian cases including *August Investments Pty Ltd v Poseidon Ltd and Samin Ltd* (1971) AUS where the court refused an injunction to prevent a similar transaction on the basis that the acquiring company was acquiring shares in X Ltd, not its own shares, and refused to lift the corporate veil to look at commercial realities.

In *Acatos & Hutcheson plc v Watson*, Lightman J did however add that: '. . . in view of the potential for abuse and for adverse consequences for shareholders and creditors, the court will look carefully at such transactions to see that the directors of the acquiring company have acted with an eye solely to the interests of the acquiring company (and not, for example, to the interests of the directors) and have fulfilled their fiduciary duties to safeguard the interests of shareholders and creditors alike.'

There are various reasons why a company may wish to buy back its own shares, including the following: to buy out a dissenting shareholder as a matter of compromise (as opposed to a court

resolution is proposed at a general meeting, a copy of the *solvency statement* must be made available for inspection of members at the meeting. If the *solvency statement* is not made available, the special resolution will not be effective, s 259.

Special resolution – voting restrictions

Section 260 provides that in the case of a written resolution for payment out of capital, a member holding shares to which the resolution relates is not an 'eligible member', i.e., is not entitled to vote (*see* Ch 14.1 and s 553). In the case of a resolution proposed at a meeting, the resolution is not effective if any member (or proxy) holding shares to which the resolution relates exercises the voting rights carried by those shares (on a show of hands or a poll), and if the resolution would not have been passed had the member not done so. Nonetheless, any member (or proxy) may demand a poll (*see* Ch 14.4), and a demand or a vote by a person as proxy is the same as a demand or vote by a member, whatever the restrictions in the company's articles. The special resolution will not be effective if a demand for a poll is refused.

These restrictions do not apply to a buy-back by a listed company under a general offer in accordance with s 238 (*see* below), s 260(5). But similar restrictions do apply to the special resolutions required in relation to a listed company and an unlisted company buying back shares under these provisions, i.e., Part 5 Div 4 ss 238–240 and ss 244–256 (*see* below).

Public notice of payment out of capital

If a special resolution for payment out of capital is passed, the company must publish a notice in the Gazette stating –

- that the company has approved the payment;
- the amount of the payment and the date of the resolution;
- where the resolution and solvency statement are available for inspection; and
- that a member of the company who did not consent to or vote in favour of the resolution or a creditor of the company may, within 5 weeks after the date of the resolution, apply to the court for cancellation of the resolution, s 261(1).

The notice must be published in the Gazette on or before 'a date that falls on the last working day of the week after the week in which the special resolution is passed', or, if that period is less than 4 business days (excluding the day of the resolution and the last working day), a date that falls on the last working day of the week next following. For these purposes, a black rainstorm day, a gale warning day, a general holiday and a Saturday are not business days; and a general holiday and a Saturday are not working days.

Before the end of the week after the week in which the special resolution for payment out of capital is passed, the company must also publish a notice with the same content in at least one Chinese language newspaper and one English language newspaper (these papers are specified by the Chief Secretary for Administration and published in the Gazette) or give written notice to each of its creditors. The company must also deliver a copy of the *solvency statement* to the Registrar no later than it publishes notice in the Gazette or, if earlier, when it first publishes the notice in the newspapers or gives notice to its creditors. If a company fails to publish notices,

Assignment and release

The rights of a listed company under a general offer, market buy-back or contract authorised under ss 238–240 are not capable of being assigned, s 242. Any attempt to release such rights will generally be void, but if the terms of the release agreement are authorised in advance by special resolution, the release will be valid. The notice requirements and voting provisions applicable to a contracted buy-back, as set out in s 240 (*see* above), apply to such release, s 243.

Unlisted companies – ss 244–256

An unlisted company may buy back its own shares under a contract authorised in advance by special resolution. Such a contract may be a contingent buy-back contract. The authorisation may be varied, revoked or, from time to time, renewed by special resolution, s 244.

Disclosure of contract details

A copy of the proposed contract, or a memorandum of its terms (if it is not in writing), must be available to members. In the case of a written resolution, it must be sent to every member at or before the time the resolution is sent. In the case of a resolution proposed at a general meeting, it must be available for inspection by members at the company's registered office, or a place prescribed under the regulations made under s 657; *see* Cap 622I, for at least 15 days prior to the meeting and at the meeting itself. The names of the members affected by the proposed contract must be included in the memorandum and, if the proposed contract does not reveal all of those members affected by the contract, their names must be annexed in a memorandum to the contract. Otherwise, the resolution will be ineffective, s 245.

Voting

A special resolution to confer, vary, revoke or renew the authorisation for a contract under s 244 (*see* above) is subject to restricted voting, s 246(1). These restrictions are identical with those applying in the event of a special resolution under s 260 for payment out of capital.

The restrictions in the event of authorising a buy-back are that –

- in the case of a written resolution, a member holding shares to which the resolution relates is not an 'eligible member', i.e., not entitled to vote (*see* Ch 14.1 and s 553).
- in the case of a resolution proposed at a meeting, the resolution is not effective if any member (or proxy) holding shares to which the resolution relates exercises the voting rights carried by those shares (on a show of hands or a poll), and if the resolution would not have been passed had the member not done so. Nonetheless, any member (or proxy) may demand a poll (*see* Ch 14), and a vote or a demand by a person as proxy is the same as a vote or demand by a member, whatever the restrictions in the company's articles. The special resolution will not be effective if a demand for a poll is refused, s 246.

Variation of authorised contract

Section 247 provides that a contract authorised under s 244 may be varied if the variation agreement is authorised in advance by special resolution. The authorisation for such an

13 Dealings by Directors

A variety of information concerning directors must be publicised in different ways. Who they are, the requirements for informing the Registrar, the Registrar's index and maintaining a company's own register have been considered in the previous chapter (*see* Ch 12.1).

This chapter focuses on the transactions and arrangements that typically involve a company's directors, and the provisions of Cap 622 that endeavour to ensure the fairness of those dealings. Loans to directors are one example. If a company grants a loan to a director, the issue of fairness arises *vis-à-vis* the company's members. The loan funds could otherwise have been utilised by the company to generate profits and to increase the dividend paid to its members. But granting a loan to a director may be part of a package of benefits that encourages a director to devote maximum time and effort to the company's success. In this context, and subject to limitations, a loan to a director may be regarded as fair.

Cap 622 Part 11 is entitled 'Fair Dealing by Directors'. It primarily concerns loans, quasi-loans and credit transactions (Div 2); payment to a director for loss of office (Div 3); a director's service contract (Div 4); and a director having a material interest in a company's transactions, arrangement and contracts (Div 5). The *Securities and Futures Ordinance* (SFO) (Cap 571) also concerns fair dealing by directors. It requires directors of listed companies to disclose their interests and dealings in shares or debentures in the company or other associated companies (including its holding and subsidiary companies, and other subsidiaries of its holding company). The disclosure required by Part XV of the SFO, affecting directors of listed companies, is considered in Chapter 17.

The provisions in Part 11 concerning fair dealings by directors are complex largely because they extend to a director's family and other entities connected with a director. Returning to the example of a loan to a director, if a particular loan transaction with a director is prohibited but there is no restriction on granting that loan to a member of the director's family or to a director's business partner, then the prohibition is probably easily avoided. Hence the notion of an 'entity connected with a director'. Many of the general prohibitions in Part 11 are extended to include these entities.

An *entity connected with a director* includes –

(a) a member of the director's family, defined by s 487 to include a spouse, a child (including a step-child, an illegitimate child and a child legally adopted) or a parent;

(b) a person cohabiting with the director (of the same or opposite sex), and a minor child (i.e., under 18) living with the director in that relationship;

(c) an *associated body corporate* (*see* below);

(d) a person acting as trustee of a specified trust where the beneficiaries, or the persons to benefit from the exercise of a power under the trust, include the director, his/her spouse

hard copy, by hand or by post, or, if the recipient has agreed, in electronic format and means, s 540.

Declarations in a one-member-one-director company

A company which has only one member who is also a director, and which enters into a contract with that member must ensure, unless the contract is in writing, that the terms of the contract are set out in a written memorandum within 15 days from entering into the contract. Such a memorandum must be kept with the minutes of the directors' meetings. This provision does not include the term 'material', and makes clear that it applies only to a contract not entered into in the ordinary course of the company's business, s 545.

Other restrictions on director's interests

Section 536 does not 'affect the operation of any other Ordinance or rule of law restricting a director of a company from having any interest in a transaction, arrangement or contract with the company', s 536(6).

At common law, a director has a duty to ensure that his/her personal interests do not conflict with the interests of the company (*see* Ch 12.3). Thus, even if a director complies with s 536, the contract in question is not thereby validated; it remains voidable for breach of the director's duty at the option of the general meeting: *Hely-Hutchinson v Brayhead Ltd* (*see* Ch 12.2).

Model articles

The Model Articles for public companies art 15 and those for private companies art 16 (*see* Cap 622H) generally reiterate the s 536 declaration requirements, adding that the director concerned must not vote in respect of any such transaction. If he/she does vote, his/her vote must not be counted, nor can the director be counted for quorum purposes in respect of the transaction. But these restrictions do not apply where the disclosure concerns an arrangement –

- for giving a director security or indemnity for money lent by the director, or obligation undertaken by the director, for the company's benefit;
- for giving security for the company's debt, or obligation, to a third party for which the director has assumed such responsibility;
- under which benefits are made available to employees and directors (or former employees and directors) of the company or of any of its subsidiaries, which do not provide special benefits for directors; or
- to subscribe for or underwrite shares or other securities of the company.

In the case of a public company, the duty to declare extends to an *entity connected with the director* and requires a director to declare the nature and extent of the entity's interest to the other directors, Model Articles for public companies art 15 (*see* Cap 622H). So, the interests of the director's family, persons living with the director, *associated companies*, certain trustees and business partners must all be disclosed (*see* the introduction to this chapter).

such a director, with funds to meet expenditure or to avoid expenditure. Such expenditure must be incurred for the purposes of the company or for the purposes of enabling them to properly perform duties as an officer of the company, s 506.

In *Wing Fai Construction Co Ltd (in liq) v Yip Kwong* (2009), YK, a director, claimed that his receiving HK$100,000 a month from the company for 17 months was to meet the expenses incurred in promoting its business in China. There was little documentary evidence to support this claim. The liquidators were successful in arguing that the payments were 'advances' because neither of the conditions set out in s 157HA(3) (i.e., of the former Cap 32; *see* now Cap 622 s 506(2)) were met, and that YK was liable to refund the company (less HK$450,000 proved as expended). YK appealed.

The Court of Final Appeal upheld the decision, but explained that the trial judge was wrong to consider the arrangement as a loan. YK was liable to refund the company because it was the company's money which had been placed in his hands for expenditure on the company's purposes. The payments were neither a loan nor YK's money.

Exception 3: Expenditure for defending proceedings – A company may enter into a transaction to provide a director of the company, or of a holding company, with funds (a) to meet expenditure incurred, or to be incurred, in defending any criminal or civil proceedings in connection with any alleged negligence, default, breach of duty or breach of trust by the director in relation to the company or an associated company, or in connection with an application for relief under the former Cap 32 s 358 or Cap 622 s 903 or 904, or (b) to enable the director to avoid incurring such expenditure.

Such a transaction must be entered into on the condition that the funds are to be repaid, or any liability the company incurred discharged, if the director is convicted in the proceedings, if judgement is given against the director, or if the Court refuses to grant the director relief under the provisions mentioned above; and that the funds are to be so repaid, or liability discharged, not later than the date when the conviction, judgement or refusal of relief becomes final. It is final when the periods for bringing an appeal end or when the appeal is abandoned or determined, s 507.

Exception 4: Expenditure in connection with investigation or regulatory action – A company may enter into a transaction to provide a director of the company, or of a holding company, with funds (a) to meet expenditure incurred, or to be incurred, in putting up a defence in an investigation, or against any action taken or proposed to be taken by a regulatory authority in connection with any alleged misconduct by the director in relation to the company or an associated company, or (b) to enable the director to avoid incurring such expenditure. 'Misconduct' in this provision means negligence, default, breach of duty or breach of trust.

Such a transaction must be entered into on the condition that the funds are to be repaid, or any liability the company incurred discharged, if the director is found to have committed the misconduct; and that the funds are to be so repaid, or liability discharged, not later than the date when the findings becomes final. The findings are final when the period for applying for review or appeal (if any, as the case may be) ends, or when the review or appeal is abandoned or determined. If there is no review or appeal, the findings are final when they are made, s 508.

without the 'prescribed approval' of certain members. These sections relate to particular circumstances –

- s 521 – Payment for loss of office to a director of the company or of its holding company.
- s 522 – Payment for loss of office to a director of the company, in connection with a transfer of the whole or any part of the undertaking or property of the company or of a subsidiary.
- s 523 – Payment for loss of office to a director in connection with a transfer of shares in the company, or in a subsidiary, resulting from a takeover offer.

Presumed payments

In the case of ss 522–523, a payment is presumed, except in so far as the contrary is shown, to be made in connection with a transfer of any undertaking or property, or with a transfer of shares (as the case may be), if it is made under an arrangement –

- entered into as part of the agreement for the transfer, or within one year before or 2 years after that agreement is entered into; and
- to which the company, or any person to whom the transfer is made, is privy, ss 522(3) and 523(2).

Prescribed approval of members

The prescribed approval of the members, or affected members, of a company must be obtained by a resolution that is passed before the payment for loss of office is made and that otherwise comply with s 518. We have previously met a very similar provision (s 496), regarding approval in relation to loans etc. to directors, in Ch 13.2 above. The requirements are restated here in the context of payments for loss of office, but some of the requirements should seem familiar –

- In the case of a written resolution, a memorandum setting out the particulars of the payment must be sent to every member (or affected member, as the case may be) at or before the time the proposed resolution is sent to the member.
- In the case of a resolution passed at a general meeting, a memorandum setting out the particulars of the payment must be sent to every member (or affected member, as the case may be) together with notice convening the meeting, s 518(2). An ordinary resolution is sufficient, but in the case of a public company, a resolution will only be regarded as passed after disregarding certain favourable votes (*see* below).

Disregarded votes

In the case of a resolution for the purposes of ss 521–522, the disregarded votes are those of a member who –

(a) is the director to whom the payment for loss of office is proposed to be made;
(b) is the proposed recipient of the payment and is not a director; or
(c) holds any shares in the company in trust for the director or recipient.

the payment. If the payment is made by or on behalf of a subsidiary, any director of the subsidiary that authorised the payment is similarly liable, s 528.

If payment is made in connection with a transfer of shares in a company, or in a subsidiary, resulting from a takeover offer in contravention of s 523, the payment is held by the recipient in trust for those who have sold their shares as a result of the offer made. The recipient must bear the expenses in distributing that sum amongst those who have sold their shares. If the payment is made by or on behalf of the company, any director who authorised the payment is jointly and severally liable to indemnify the company for any loss resulting from the payment. If the payment is made by or on behalf of a subsidiary, any director of the subsidiary that authorised the payment is similarly liable, s 529.

13.4 Director's service contract

Part 11 Div 4 (ss 530–535) concerns a director's service contract. This is defined by s 531 as a contract under which –

- (a) the director undertakes personally to perform services, as a director or otherwise, for the company or for a subsidiary, or (b) services that the director undertakes personally to perform, as a director or otherwise, are to be made available by a third party to the company or to a subsidiary; and
- includes the terms of a person's appointment as director of the company, s 531(1).

Such a contract is not restricted to a contract for the performance of services outside the scope of a director's ordinary duties as a director, s 531(2). So, even if a contract concerns the ordinary duties of a director, it will fall within these provisions.

The key section

The key section in Div 4 is s 534. A company must not agree to any provision under which the guaranteed term of the employment of a director exceeds, or may exceed, 3 years without the 'prescribed approval of its members'.

'Employment' here means any employment under a director's service contract. A 'guaranteed term' is reference to a period, during which the employment is to continue and cannot be terminated by the company by notice, or can be so terminated only in specified circumstances. In the case of employment terminable by notice, it is a reference to the period of notice required to be given. If, more than 6 months before the end of the guaranteed term, the company enters into a further service contract (other than pursuant of a right given in the original contract), the guaranteed term under the further contract is to be regarded as including the unexpired period under the original contract.

Prescribed approval of members

The prescribed approval of the members, or affected members, of a company must be obtained by a resolution that is passed before the payment for loss of office is made and that otherwise

accompanying the written resolution, it is regarded as having agreed that a response may be sent by electronic means to that address, unless indicated otherwise, s 560. If a member's agreement is signified, it cannot be revoked, s 556(4).

In the case of *an eligible member* who is a joint holder of shares, if any one of the holders signifies their agreement, all other holder(s) are to be regarded as having signified their approval. If, before the written resolution lapses, the company receives any objection from any other holder but that other holder is less senior than the holder who signified the agreement, all other holder(s) are still to be regarded as having signified their approval. Seniority is determined, for this purpose, by the order in which their names appear in the register of members, s 557. But this provision has effect subject to a company's articles.

Lapse

A proposed written resolution lapses if it is not passed before the end of the period specified in the company's articles or, if none is specified, 28 days beginning on the circulation date. The agreement of a member to a proposed written resolution is ineffective if signed after the end of that period, s 558.

Notification that a written resolution has been passed

That all members are required to agree to a written resolution means, in effect, that the shareholders' decision must be unanimous. If the resolution is passed, the company must then, within the next 15 days, send notice of this fact to every member of the company and each of its auditors, s 559. Otherwise the company and every responsible person of the company commit an offence.

Provisions of the company's articles

A provision of a company's articles that would have the effect of denying its members this written resolution process in relation to a resolution required, or provided for, in an Ordinance, is void. A company's articles may otherwise authorise the passing of a resolution without a meeting, but any such resolution must be agreed to by all members who are entitled to vote, s 561.

The Model Articles for public companies and private companies (*see* Cap 622H) do not make any provision for members' written resolutions.

14.2 Resolutions at general meetings

Resolutions are of 2 kinds: special and ordinary. The type of resolution required to be passed for the company to make a decision depends upon the requirements of Cap 622, Cap 32 and the company's articles.

A resolution is validly passed at a general meeting if notice of the meeting and of the resolution is given, if the meeting is held and conducted, and if the resolution is passed in accordance with Part 12 Div 1 (ss 562–616) and the company's articles. In the event of inconsistency between these provisions and a company's articles, the law prevails. If the law simply requires 'a

18 Investigations and Enquiries

The powers given to the Financial Secretary by Cap 622 Part 19 to appoint an inspector to investigate the affairs of a company have several purposes. For example, an investigation may be used to assist members where the management has failed to disclose information about the company. Alternatively, where the management is the majority shareholder and is abusing that situation, an investigation may be regarded as a device to protect minority shareholders. The Financial Secretary's powers may also deter the officers of a company from breaches of their duties and obligations. The investigation is a fact-finding exercise which may, ultimately, lead to prosecutions and/or civil actions. But this will depend upon what the inspector reveals.

There has been much criticism of the investigation process. *Palmer on Company Law* (*see* Ch 18.1 below) explains that: 'Since there is no right of appeal against such findings or opinions and no effective means of protesting, and since there is no certainty that proceedings will follow, in which a person referred to might defend his name, such investigation are not altogether satisfactory.' The revised provisions, now presented in Part 19, do however address some of these criticisms.

Part 19 also includes powers of *enquiring* into a company's affairs. The Financial Secretary and the Registrar of Companies are both vested with such powers. In practice, these provisions are likely to be employed far more often than the power of investigation.

The investigation and enquiry processes necessarily involve even more potentially sensitive issues than those identified in the quotation above. They include a power to require the production of documents, obtaining a search warrant, incriminating evidence, secrecy and the protection of informers. These issues are also dealt with in Part 19, and thereby add even more detail to what is already a very substantial and lengthy set of provisions – ss 838–894. These provisions are considered below but without reference to the provisions that concern offences for failing to comply – of which there are many.

Part 19 is divided into a number of Divisions and subdivisions, and their particular scope needs to be appreciated before looking at their application and requirements –

- Div 2 deals with ***Investigation*** by an inspector appointed by the Financial Secretary and begins with 2 key provisions, ss 840–841. 'Company' in s 840 includes a registered non-Hong Kong company and in s 841 includes a non-Hong Kong company (i.e., a company which has established a place of business in Hong Kong but has not registered under Part 16). The Financial Secretary may appoint an inspector under ss 840 and 841(2) in certain circumstances (*see* below), and must appoint under s 841(1) if ordered by the court.
- Div 3 deals with ***Enquiry*** by the Financial Secretary and begins with one key provision, s 868, which is divided into (a) and (b). 'Company' in (a) includes a registered non-Hong Kong company and in (b) includes a non-Hong Kong company (i.e., a company which has

Section 841(1) provides that the Financial Secretary **must** appoint an inspector to investigate a company's affairs if the court, by order, declares that the company's affairs ought to be so investigated, and **may** appoint if there are circumstances suggesting that –

- the company was formed for a fraudulent or unlawful purpose;
- the company's affairs are being or have been conducted –
  - (i) in a manner unfairly prejudicial to the interests of members generally or of one or more members;
  - (ii) with the intent to defraud its creditors or the creditors of any other person; or
  - (iii) for any other fraudulent or unlawful purpose; or
- the persons concerned with the formation or management of a company have engaged in fraud, misfeasance or other misconduct towards the company, its members or its creditors, s 841(2).

Before appointing an inspector under these circumstances, i.e., under bullets 1–3, the Financial Secretary must be satisfied that it is in the public interest to do so. But, if so satisfied, the Financial Secretary may make an appointment even if the company is in the course of winding-up, s 841(3)–(4).

A person appointed as an inspector under either of these provisions (i.e., ss 840–841) must deliver a notice of the appointment to the Registrar within 15 days after the appointment, s 842.

Some of the cases brought under the earlier provisions, i.e., the former Cap 32 s 143, may still be relevant. The last time the Financial Secretary appointed an inspector was in relation to Peregrine Investment Holdings in 1999 and in that case, Le Pichon J discussed the requirements for the court to order the Financial Secretary to make an appointment. She explained that evidence of misconduct or mismanagement was not required, but that the court had to be satisfied that a *prima facie* case has arisen for investigation, and that it also needed to consider whether the public interest would be served by the investigation. Applying the law to the facts, the court held that public interest would be served. The Judge explained that the shareholders and the public were entitled to know exactly what went wrong to cause the company's collapse, and said: 'It is undoubtedly in Hong Kong's interest, if it is to continue to flourish as an international financial centre, that the concerns as to the failure of Peregrine should not be left unaddressed. If improvements can be made to the regulatory system as a result, it can only advance Hong Kong's interest.'

Financial Secretary's powers

The Financial Secretary may give directions to an inspector regarding an investigation. Such directions may be given on the Financial Secretary's own initiative or at the request of the inspector, and they may subsequently be varied or revoked, s 843.

Such directions may include –

- the terms or subject matter of the investigation, i.e., a specified area of a company's operation, a specified transaction or a specified period of time;

Banks and other authorised institutions will only be required to produce documents and records, and to disclose information, relating to the affairs of a customer if the inspector has reasonable grounds to believe that the customer is able to provide information relevant to the investigation, if he/she is satisfied that the production or disclosure is necessary for the purpose of the investigation, and if he/she certifies the latter in writing, s 846(3).

If a director or former director maintains an account (sole, or joint with any other person) with a bank, deposit-taking company or similar financial institution (in Hong Kong or elsewhere), into or out of which there has been paid –

- any emolument, retirement payment or compensation in respect of the directorship, particulars of which are not contained in the notes to the financial statements (*see* s 383),
- any loan or quasi-loan in his/her favour, or dealings in his/her favour, which are not contained in the notes to the financial statements (*see* s 383), or
- any money that has been in any way connected with his/her misconduct (fraudulent or not) towards the company or its members,

then an inspector may, by notice in writing, require the director or former director, to produce all documents relating to the account that are in his/her possession or under his/her control, s 847.

If a person produces a record or document under these provisions (i.e., s 846 or 847), the inspector may make copies or otherwise record the details, and, by notice in writing, require the person to provide any information or explanation in this regard, and in regard of the inspector's general power under s 846, the inspector may require verification of the answer. Also, if a person does not give an answer or provide information because it is not within his/her knowledge or possession, the inspector may require verification of that reason or fact. In both cases, the required verification may be in the form of a statutory declaration taken by the inspector, s 848.

If a person fails to comply with ss 846–849 (*see* above), the inspector may, by originating summons, apply to the court for an inquiry into the failure. If the court is satisfied that the person has, without reasonable excuse, failed to comply with the requirement, it may –

- order the person to comply within a specified period; and/or
- punish the person, and any other person knowingly involved in the failure, in the same manner as if they had been guilty of contempt of court.

No such proceedings may however be instituted, if criminal proceedings have previously been instituted under s 863 in respect of the same conduct and remain pending or cannot be lawfully instituted, s 864.

The offences for failing to comply with the above requirements are stated in s 863.

Delegation of powers by inspector

An inspector may delegate, in writing, any or all of these powers to another person. Such delegation may relate to the company or an associate body corporate of the company. If 2 or more inspectors are appointed, this power is exercisable by each of them, s 850.

The offences for failing to comply with the above requirements are stated in s 875.

The Registrar may delegate, in writing, any or all of the powers under s 873 to any public officer, s 874.

18.4 Provisions supporting investigations and enquiries

As explained in the introduction to this chapter, a provision concerning the use of incriminating evidence is repeated in each of these 3 forms of investigation/enquiry (*see* Ch 18.1–18.3). This will be explained before we turn to consider the supplementary provisions contained in Part 19 Div 5.

Use of incriminating evidence

If an inspector, the Financial Secretary, the Registrar or a delegate requires a person to answer any question or to provide any information or explanation in respect of any record or document, he/she must ensure that the person has been informed or reminded of the following limitations in respect of the admissibility in evidence of the request and the answer. The limitations are that if –

- the answer, information or explanation might tend to incriminate the person, and
- the person so claims before giving the answer, or providing the information or explanation,

then, as a general rule, neither the inspector's request nor the response will be admissible in evidence against him/her in criminal proceedings. But, if a person is charged with an offence in respect of the response –

- under s 863, which concerns the provision of false or misleading evidence,
- under Part V of the *Crimes Ordinance* (Cap 200), or
- for perjury,

then the request and the response is admissible as evidence.

This provision is repeated in each of the 3 Divisions (i.e., Divs 2, 3 and 4) in ss 865, 872 and 876.

In *Re Pergamon Press Ltd* (1971) UK, the directors of a company which was the subject of an investigation had declined to answer questions unless they were first given assurances that, in effect, the proceedings would be conducted as if they were a judicial inquiry in a court of law. The inspectors referred this refusal to the court.

It was held that the directors were not entitled to the assurances. Lord Denning MR said: '... the inspectors are not a court of law. Their proceedings are not judicial proceedings ... They are not even quasi-judicial, for they decide nothing; they determine nothing. They only investigate and report. They sit in private and are not entitled to admit the public to their meetings ... They do not even decide if there is a *prima facie* case ... But ... they must act fairly ... The inspectors can obtain information in any way they think best, but before they condemn or criticise a man, they must give him a fair opportunity for correcting or contradicting what is said against him ...'

the company to be wound up and/or apply for a disqualification order. An application for a disqualification order also applies to a director or shadow director of an unregistered company (*see* s 326 of Cap 32) carrying business in Hong Kong that may be wound up under Cap 32, and to a registered non-Hong Kong company (*see* Ch 3 and 12.5).

In the case of a company or a non-Hong Kong company, if it appears to the Financial Secretary that its affairs are being, or have been, conducted in a manner unfairly prejudicial to the interests of the members generally, or of one or more of the members, or that an actual or proposed act or omission would be so prejudicial, then he/she may present a petition to the court under s 725, and apply for a remedy under s 729 (*see* Ch 15.3).

Preservation of secrecy

As a general rule, and except in the performance of any function or event under Cap 622 or Cap 32, a public officer, inspector, any employee/agent/consultant/adviser of the inspector or his/her delegate, any other person acting for the purposes of the investigation or enquiry, and any person receiving a copy of a report, must not permit any person to have access to any matter relating to the affairs of any person that comes to his/her knowledge in connection with the investigation. Also, he/she must not communicate any such matter to any person, other than the person concerned, s 880. But s 881 then proceeds to list permitted disclosure, including disclosure of information that has already been made available to the public, disclosure to a law enforcement agency with a view to bringing criminal proceedings, disclosure for the purposes of seeking advice from a professional adviser in connection with any matter arising under Cap 622 or Cap 32, and disclosure in accordance with the law, s 881(1).

The Financial Secretary may disclose information to a person such as the Chief Executive, Secretary for Justice, Commissioner of Police, Commissioner of the ICAC, Commissioner of Inland Revenue and the Registrar, and, in respect of a company whose affairs are the subject of an investigation or enquiry, the Official Receiver. He/she may also disclose information with the consent from the person providing the information and from the person to whom it relates. Information can be disclosed in summary form, so as to prevent particulars relating to any person from being ascertained, s 881(2). But such disclosure can be made only if the Financial Secretary is of the opinion that –

- the disclosure will enable or assist the recipient to perform his/her functions; and
- it is not contrary to the public interest that the information should be so disclosed, s 881(3).

The persons listed in s 881(2) are themselves subject to secrecy, except that they may disclose, with the consent of the Financial Secretary, under the circumstances in s 881(1) (*see* above).

Offences relating to a breach of secrecy are listed in s 882.

Provisions supporting all investigations/enquiries by the Financial Secretary and the Registrar

These provisions, ss 883–891, deal with 2 matters: firstly with the protection for the people who disclose information in the course of an investigation/enquiry, and secondly with the

20 The Assets of a Company Available for Distribution

In this chapter, we are concerned with the collection of money and property. The liquidator is under a duty to realise the assets of the company, and if those assets are insufficient to pay its debts, he/she may call upon the members of the company to contribute to the extent that their shares are not fully paid.

All references in this chapter are to Cap 32 unless stated otherwise.

In Ch 20.1, we shall consider the definition of a contributory, a contributory's liability, and the compiling of the lists of contributories, while the process of collecting the company's assets is discussed in Ch 20.2. Finally, the provisions dealing with 'onerous property' – property which is unsaleable – are considered in Ch 20.3.

20.1 Contributories

The term 'contributory' means every person liable to contribute to the assets of a company in the event of its being wound up, and includes any person deemed or alleged to be a contributory, s 171(1). Thus, the holder of fully paid shares is a contributory because all members are liable to contribute. There are, however, limits on that liability, and whether a person is in fact liable to contribute will be determined in the course of the winding-up.

Liability of a company's members

In the event of a company being wound up, every past and present member is liable to contribute to the assets of the company to an amount sufficient to pay –

- the company's debts and liabilities;
- the costs, charges and expenses of winding-up; and
- for the adjustment of rights between the members, s 170(1).

This statement of liability is qualified in relation to companies incorporated with limited liability –

- In a company limited by shares, no contribution is required, from any past or present member, which exceeds the amount, if any, that is unpaid on his/her shares, s 170(1)(d).
- In a company limited by guarantee, no contribution is required which exceeds the amount which was undertaken to be contributed in the event of the company being wound up, s 170(1)(e).
- Any sum due to a member by way of dividend is not a debt of the company in a case of competition between himself/herself and a creditor, but may be taken into account in the final adjustment of the rights of contributories among themselves, s 170(1)(g).

to make such further contribution if he/she ceased to hold office for one year or more before the commencement of the winding-up, or in respect of any debt or liability of the company contracted after he/she ceased to hold office. Subject to the company's articles, a director is not liable to make such further contribution unless the court deems it necessary, s 170(2)(c).

Where a company being wound up has made a payment out of capital in relation to a redemption or buyback of any of its shares within the year preceding the commencement of the winding-up, the directors who signed the solvency statement required by Cap 622, s 259 (*see* Ch 8.2) are liable to contribute. A director is excepted if he/she shows they had reasonable grounds for forming the opinion expressed in the statement, s 170A(2). The directors are jointly and severally liable with the past shareholder (*see* above) to contribute the amount to which the past shareholder is liable to contribute, s170A(3).

Liability of a contributory

The liability of the contributory creates a specialty debt due from the time when the liability commenced. Thus, any action for the debt may be commenced within 12 years of the liability commencing (as opposed to 6 years for a simple contract). But the debt only becomes payable when a call is made, s 172. Calls can only be made to raise a sum sufficient to pay the company's debts and liabilities, the costs, charges and expenses of the winding-up and for the adjustment of rights between contributories, s 213 (*see* below).

If a contributory dies before or after he/she has been placed on the list of contributories, his/her personal representative is liable in the course of administering the contributory's estate and is regarded as a contributory, s 173(1). If a contributory becomes bankrupt before or after being placed on the list of contributories, his/her trustee in bankruptcy will represent him/her for the purposes of the winding-up and will also be regarded as a contributory, s 174.

List of contributories

The list of contributories, which must be settled by the court, s 210, or by the liquidator, s 226, as soon as possible after the winding-up order is made, is in 2 parts: the A list and the B list. The A list consists of the members of the company at the commencement of the winding-up (i.e., present members). The B list consists of persons who were members within a year before the commencement of the winding-up, and is often not settled at all; it is only settled if it appears that the A list contributories are unable to satisfy their contributions. However, if it appears to the court that it will not be necessary to make calls or adjust the rights of contributories, it may dispense with this requirement.

The procedure for compiling the list of contributories is laid down in the *Companies (Winding-up) Rules* (Cap 32H). The liquidator must –

- with all convenient speed, settle the list, which must contain a statement of the address of, and the number of shares attributed to, each contributory, the amount called up, and the amount paid, r 68;

The fact that the company has paid one creditor knowing it could not pay all of its creditors may not amount to 'carrying on business with the intent to defraud', if the directors genuinely believe that the company will be able to satisfy all of its creditors in the future. In *Re WC Leitch Brothers Ltd* (1932) UK, the court clarified the meaning of 'carrying on business with intent to defraud'. Maugham J said: 'If a company continues to of carry on business when there is to the knowledge of the directors no reasonable prospect of the creditors receiving payment of their debts, it is, in general, a proper inference that the company is carrying on business with intent to defraud ...' However, in *Re Patrick and Lyon Ltd* (1933) UK, Maugham J said: 'I will express the opinion that the words "defraud" and "fraudulent purpose", where they appear in the section in question, are words which connote actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame.'

In *Re White and Osmond (Parkstone) Ltd* (1960) UK, Buckley J said in the course of his judgement: 'There is nothing wrong in the fact that directors incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that it is clear the company will never be able to satisfy its creditors. However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine on them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time.'

The Hong Kong courts have reviewed these and many other cases concerning s 275 in *ADS v Wheelock Marden & Co*. This case first came before the court in 1989 when Jones J held that, in order to succeed in a claim for fraudulent trading, actual dishonesty is an essential element. It must be shown that the persons involved in carrying on the company's business –

- actually intended to defraud creditors or to achieve a particular fraudulent purpose; or
- were reckless as to whether the carrying on of the business would result in the creditors being defrauded.

Wheelock Marden had argued that, on the facts, there was no case to answer, but the court held that ADS had established a cause of action. Wheelock Marden appealed (reported as *Wheelock Marden and Co Ltd v ADS* in 1990), but it was held that the points of claim appeared to establish a case inviting investigation under s 275. The case was eventually heard by the Court of First Instance in 1997.

In *ADS v Wheelock Marden & Co* (1997), ADS claimed that Wheelock Maritime International (WMI), a subsidiary of Wheelock Marden, obtained 2 loans from ADS at a time when the persons responsible for managing WMI knew that there was no reasonable prospect of the loans being repaid. This was denied largely on the grounds that Wheelock Marden (the holding company) would support WMI – it had done so in the past and there was genuine belief that it would continue to do so.

The Court of Appeal (1998) upheld the decision of the trial judge, agreeing that the persons responsible for managing WMI had not been fraudulent. But the decision was not unanimous. Le Pichon J, in her dissenting judgement, explained that the trial judge found 'an unjustified albeit honest chasing of the rainbow'. She added, 'I have some difficulty in understanding how

she may be compelled to repay or restore the money or property, or otherwise contribute towards the assets of the company by way of compensation, as the court thinks just, s 276(1). Such damages may be assessed against –

- a person who is or has been an officer of the company;
- a provisional liquidator or liquidator of the company;
- a receiver or manager of the property of the company; and
- a person who is or has been concerned or taken part in the promotion, formation, or management of the company, s 276(1A).

In *West Mercia Safetywear Ltd (in liquidation) v Dodd* (1988) UK, D, a director of D Ltd and its wholly owned subsidiary WMS, arranged for the transfer of £4,000 from WMS to D Ltd, in order to decrease D Ltd's indebtedness and so prevent the operation of his personal guarantee for the debts of D Ltd. The liquidator of WMS applied for a declaration that D was guilty of misfeasance and breach of trust. D was ordered to repay the £4,000.

In *American Express International Banking Corporation v Johnson* (1984), liquidators of A Ltd were accused of misfeasance and breach of duty as officers of the court, in relation to the procedure they had followed in pursuing claims in both New York and Hong Kong to recover payments owing to A Ltd.

It was held that the liquidators had taken legal advice and laid all relevant matters before the Hong Kong court, which then made the order complained of; there was no question of breach of duty or misfeasance.

The Court of Appeal has explained that the opening words of s 275 – 'if it appears' indicates the need for a threshold in determining whether such an action should be allowed to proceed, or be dismissed. In *Re Hun Kai Finance Co Ltd* (2015), the court upheld the decision to dismiss an action for misfeasance brought against a liquidator because there was 'no prospect of success' and failure to establish a prima facie case.

If misfeasance is proved and money ordered to be paid to the company, there is no right to set off debts which the company owes to the misfeasant: *Manson v Smith (liquidator of Thomas Christy Ltd)* (1997) UK.

An interesting question was presented to the UK's Supreme Court in *Re Paycheck Services 3 Ltd* (2010) UK, in relation to group of more than 40 trading companies that had paid dividends but then discovered that they were liable to pay a higher rate of corporation tax. They had insufficient reserves to pay the HM Revenue and Customs department and went into administration. The question concerned the fact that the director of the trading companies was a company. That company had just one director, Holland, and the court was required to determine whether he was a *'de facto'* director of the trading companies and so liable to contribute to the company's assets on the basis of misfeasance and breach of duty. By a majority of 3:2, the Supreme Court held that he was not a *de facto* director. The fact that he was the sole director of the trading companies' corporate director did not mean he was a *de facto* director for the trading companies.

Having control is defined by s 265C(5). A person has control of a company if all or any of its directors (and of any company which has control of it) are accustomed to act in accordance with that person's directions or instructions or that person is entitled to exercise (or control the exercise of) more than 30% of the voting power at its general meeting (or the GM of another company which has control of it). If 2 or more persons together satisfy either of these requirements, they have control.

It should be noted that in this section 'company' includes a body corporate, whether incorporated in Hong Kong or elsewhere, s 265C(6).

It should also be noted that in relation to a transaction at an undervalue or an unfair preference, the time periods mentioned below, namely 5 years, 6 months and 2 years, are only relevant if either the company is unable to pay its debts at that time of the transaction or the company becomes unable to pay its debts in consequence of the transaction. These conditions are presumed satisfied, unless the contrary is shown, to a transaction at an undervalue entered into by a company with a connected person (other than an employee), s 266B(2) and (3).

Transactions at an undervalue

Section 265D provides that if a company goes into liquidation and has within 5 years before the commencement day of its winding-up entered into a transaction with a person at an undervalue, the liquidator may apply to the court to restore the position to what it would have been if the company had not entered into that transaction. However, the court must not make such an order if it is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business, and at that time there were reasonable grounds for believing that the transaction would benefit the company.

A transaction is at an undervalue if it is a gift or is granted on terms that the company receives no consideration, or the value of the consideration (in money or money's worth) received by the company is significantly less than the value of the consideration (in money or money's worth) provided by the company, s 265E.

Unfair preference

In 2016, the former sections 266, 266A and 266B were repealed and replaced. Section 266 now provides that if a company goes into liquidation and has within 6 months before the day of commencement of winding-up given an unfair preference to a person, the liquidator may apply to the court for an order to restore the position to what it would have been if the company had not given the unfair preference. However, the court must not make such an order unless the company was influenced, in deciding to give that unfair preference, by a desire to produce such effect.

Section 266A provides that a company gives an unfair preference to a person if –

- that person is one of the company's creditors, or a surety or guarantor for any of the company's debts or other liabilities; and