association and articles of association. The incorporation form includes much of the information that is required to be stated in the memorandum of association. Also, that information can be stated in a single constitutional document (now composed of just the articles of association under Cap.622) without the need for two separate documents. The abolition of the memorandum of association as a constitutional document is consistent with the practice in the UK[3] and a number of other Commonwealth jurisdictions, notably Australia and New Zealand, of having a single constitutional document.[4]

5.005 **Objects clause and *ultra vires* doctrine.** The discussion below focuses on the objects clause in the company's constitution, and on the legislative reform and jurisprudence relating to the objects clause and the *ultra vires* doctrine. These matters can be important for resolving disputes between the company and parties dealing with the company.

2.2 Objects clause

2.2.1 *The purpose of the objects clause and the ultra vires doctrine*

5.006 **Historically aimed at protecting shareholders from uncontemplated business activities.** Under the common law, a company does not enjoy full legal capacity. The capacity of a company is defined by the objects clause in the company's constitution. The original requirement for an objects clause in the constitution was aimed at protecting company investors and creditors against unauthorised use of funds. A shareholder needs to assess the risks associated with the acquisition of shares in a particular company. It was assumed that that assessment could be accomplished through a careful perusal of the company's objects.[5] Inserting objects clauses in a company's constitution was thought to be an effective way of protecting shareholders from losses that might result from business activities that were never contemplated by the shareholders when they acquired their investments. In the 19th century, a company's assets were conceptualised as a trust fund "dedicated to the defined and limited objects which would, hopefully, generate fairly stable annual profits for the benefit of those who supplied the company's capital".[6] The objects clause would ensure that the company only engages in business activities the risks of which the shareholders could have assessed at the time of their acquisition of the shares.

5.007 **Aimed at protecting company's creditors who could ascertain scope of business.** An objects clause can also function to protect the interests of the company's creditors. It was thought that creditors would rely on the objects clause to ascertain the scope of

[3] See Companies Act 2006 (UK) s.17. The memorandum of association is retained in the UK but its nature is different to the "old-style memorandum". The provisions in the old-style memorandum of existing companies became part of the articles from 1 October 2009 (s.28). The memorandum of association now required for formation of a company in the UK is no longer part of the company's constitution and merely states that the subscribers wish to form a company and agree to become members of the company (and to take up at least one share, in the case of companies having share capital): s.8.

[4] Corporations Act 2001 (Aust.) s.136; Companies Act 1993 (N.Z.), Pt 5.

[5] Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia* (2nd edn, the Federation Press, Sydney, 2002) 209.

[6] Robert Pennington, "Reform of the Ultra Vires Rule" (1987) 8 *Company Lawyer* 103, 104.

business of the company and to use that information for assessing the creditworthiness of the company. Limiting the company's capacity to what was permitted by the objects clause would therefore help ensure that the company did not depart from the basis on which creditors provided funds to the company.

5.008 ***Ultra vires* doctrine: act not authorised by constitution *ultra vires*.** Under the *ultra vires* doctrine,[7] a company registered under the companies legislation only had the power to do acts authorised by the company's constitution. The classic version of the *ultra vires* doctrine was enunciated by the House of Lords in *Ashbury Railway Carriage and Iron Co Ltd v Riche*.[8] In that case, a company's contract to provide finance to another party for the construction of a railway was wholly ineffective, since provision of finance was not authorised by the company's memorandum of association. It was held that an act done by the company unauthorised by its constitution was *ultra vires* the company and void. The act could not be ratified by the members, even with unanimous consent, since the act was something that the company was incapable of doing at all.

5.009 **Harsh effect of *ultra vires* doctrine.** The House of Lords soon realised the harsh effect of a strict application of the *ultra vires* rule it enunciated in *Ashbury*.[9] It stated in a subsequent case, *A-G v Great Eastern Rly Co*,[10] that the *ultra vires* principle did not require that each type of transaction that the company was capable of entering into be particularised in its memorandum and the company had implied power to enter into transactions incidental or ancillary to the achievement of its stated objects.

2.3 Reform of the *ultra vires* doctrine in Hong Kong

2.3.1 *The need for reform*

5.010 **Commercial unreality of doctrine for those dealing with company.** The *Ashbury*[11] version of the *ultra vires* doctrine, even after having been relaxed in *A-G v Great Eastern Rly Co*,[12] was still too draconian for the business community, especially from the perspective of those who dealt with the company.[13] In *Re Jon Beauforte (London) Ltd*,[14] for example, a sale of goods contract was held to be void because the goods delivered were for the purpose of the company's new line of business, which was outside the company objects. This can be harsh from the perspective of the party dealing with the company — the seller in the above case. While the *ultra vires* doctrine is premised on third parties having knowledge of the restrictions in the objects clause

[7] Some care needs to be taken in the use of the term *ultra vires*. For the purposes of this chapter, *ultra vires* is used to refer to acts which are outside the "capacity" of a company. In other contexts, it might be said that an act of a company is *ultra vires* if the act is prohibited by statute or the general law. Even more widely, it is sometimes said that directors act *ultra vires* when they act outside the scope of their authority. However, to avoid confusion, it is preferable in the context of company law not to refer to the latter situation as *ultra vires* conduct, but only as conduct which is outside the directors' authority or which is in breach of the directors' duties.

[8] (1875) LR 7 HL 653.

[9] (1875) LR 7 HL 653.

[10] (1880) 5 App Cas 473.

[11] (1875) LR 7 HL 653.

[12] (1880) 5 App Cas 473.

[13] J H Farrar, *Farrar's Company Law* (3rd edn, Butterworths, London, 1991) 104.

[14] [1953] Ch 131.

when dealing with the company, this is unrealistic in practice. From the commercial perspective, it is often impractical for traders or others dealing with the company to inspect the company's constitution before contracting.

5.011 **Prejudicing interests of company.** A mechanistic application of the *ultra vires* rule may also prejudice the interests of the company itself. This may happen when a third-party seeks to take advantage of the *ultra vires* doctrine to retain the benefit of the company's performance without discharging its own obligation under the contract.[15] In the meantime, a strict application of the *ultra vires* doctrine may expose company directors to unwarranted liability, the exposure of which may increase the cost of running the company and the difficulty for finding suitable candidates for the directorial office. In *Cullerne v London and Suburban General Permanent Building Society*,[16] Mathew J held that directors who acted beyond the power of the company are personally liable for the consequential loss, even if they had acted with reasonable care and in good faith with the approval of the majority of the shareholders.[17] Imposing absolute liability on the directors on the basis of *ultra vires* in this situation is arguably unwarranted.[18]

5.012 **Practice of extending scope of company's objects evolved.** To avoid the types of problems outlined above, the practice grew of extending the scope of the company's capacity through the use of various techniques. One of these was to include more and more objects in the objects clause to enable the company to have the capacity to do whatever the directors considered profitable.[19] Another technique was to state that each sub-clause shall be treated as a substantive clause and not auxiliary to the primary object stated in the clause.[20] This technique helped prevent a restrictive interpretation of each clause, which had the effect of enlarging the scope of the company's capacity.

5.013 **Proliferation of objects clauses meant doctrine had ceased to protect anybody.** An effect of the proliferation of objects clauses was that the *ultra vires* doctrine had ceased to protect anybody.[21] This was because the compendious objects clause did not delimit the company's business any more: "it seeks to avoid definition by including everything".[22]

2.3.2 *The 1997 reforms in Hong Kong*

5.014 **Comparison with reform in UK.** The reform of the *ultra vires* doctrine in Hong Kong may be compared with the reform that has taken place in the United Kingdom. The reform in the United Kingdom started in 1972 when the European Communities Act (ECA) was enacted. Section 9(1) of ECA, which was later consolidated as s.35 of the Companies Act 1985, provided that in certain circumstances a third-party dealing

[15] *Bell Houses v City Wall Properties* [1966] 2 QB 656 (although in this case the court held the contract in dispute was *intra vires*). It seems that it is rare for third parties to invoke the doctrine of *ultra vires* against the company who has contracted with them: Andrew Griffiths, *Contracting with Companies* (Hart, Oxford, 2005) 167.

[16] (1890) 25 QBD 485.

[17] (1890) 25 QBD 485, 490.

[18] See Robert R Pennington, "Reform of the Ultra Vires Rule" (1987) 8(3) *Company Lawyer* 103, 104–105.

[19] L S Sealy, *Company Law and Commercial Reality* (Sweet & Maxwell, London, 1984) 43.

[20] *Cotman v Brougham* [1918] AC 514; *Stable Investment Ltd (in liq) v Chang Shin Chuen* [1982] HKLR 79.

[21] Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (18th edn, Thomson Sweet & Maxwell, London, 2008) 153.

[22] Robert R Pennington, "Reform of the Ultra Vires Rule" (1987) 8(3) *Company Lawyer* 103.

with the company would not be adversely affected by any limitation on the company's capacity stated in the company's constitutional documents. In 1989, s.35(1) of the Companies Act 1985 was recast to state that:

> "…the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum".[23]

5.015 **UK: company's objects now unrestricted unless it chooses otherwise.** The *ultra vires* doctrine was further reformed under Companies Act 2006. As it stands now, the company's objects (and hence capacity) are unrestricted, unless it chooses otherwise by specifically restricting the company's objects.[24] Even if the company chooses to adopt restrictions in its objects, those restrictions will not affect the validity of the company's act.[25]

5.016 **HK: reforms in 1997.** In Hong Kong, no steps had been taken to reform the *ultra vires* doctrine until amendments were introduced by the Companies (Amendment) Ordinance 1997. The steps taken include: (i) removing the requirement that a limited liability company must state its objects in its constitution (with the exception of a certain category of companies, such as charitable companies) (predecessor CO, s.5(1A) (repealed); now Cap.622, ss.82 and 103(2)); (ii) conferring on a company the same powers as a natural person (predecessor CO, s.5A (repealed); now Cap.622, s.115); (iii) where a company states its objects in its constitution, its powers to carry on business will be restrained accordingly (predecessor CO, s.5B(1) (repealed); now Cap.622 ss.116(1) and 116(2)); (iv) where a company has stated its objects in its constitution, no act of the company is invalid merely because it has acted outside the stated objects (predecessor CO, s.5B(3) (repealed); now Cap.622, s.116(5)); and (v) a member has the power to bring proceedings to restrain the doing of an act that contravenes the stated objects (predecessor CO, s.5B(2) (repealed); now Cap.622 s.116(3)).

2.3.3 *The significance of the reform: full corporate capacity*

5.017 **HK: companies now have full capacity; same capacity as natural person.** Following the 1997 amendments, the rules in the Companies Ordinance on corporate capacity help ensure the security of transactions with companies. Importantly, under what is now Cap.622, s.115(1), a company: "has the capacity, rights, powers and privileges of a natural person of full age". This provision aims to give companies full capacity. In this respect, there has been an abolition of the doctrine of *ultra vires* in Hong Kong so far as the doctrine relates to a company's capacity under its constitution.[26] However, notwithstanding the apparent breadth of s.115(1), certain inherent characteristics of

[23] Companies Act 1985, s.35 (1). Note that this provision was recast as s.39 in the Companies Act 2006. The 1989 reform was based on the recommendations made by Professor Dan Prentice, who was commissioned by the Department of Trade and Industry to review the *ultra vires* rule: Paul L Davies, *Principles of Modern Company Law* (18th edn, Thomson Sweet & Maxwell, 2008) 154.

[24] Companies Act 2006, s.31(1).

[25] Companies Act 2006, s.39.

[26] The abolition of the *ultra vires* doctrine applies to "companies" only under the Companies Ordinance (namely companies incorporated under the current Cap.622 or its predecessors). Thus, for example, the *ultra vires* doctrine still applies in relation to statutory corporations which are formed under their own Ordinances: see, e.g., *Standard Chartered Bank v Ceylon Petroleum Corp* [2011] EWHC 1785.

a company would prevent the company from having capacity to do all things that a natural person could do. For example, a company could not enter into a contract for marriage.[27] Leaving aside such exceptions, a company would largely have the same capacity as a natural person within the sphere of commercial activity.

5.018 **Effect of having capacity to do all things natural person can do.** The effect of Cap.622, s.115(1) is illustrated by the different outcomes in the cases of *Re Estate of Leung Wai Jing*[28] and *Re Estate of Tang Muk Kwai*.[29] Both cases deal with the question of whether a company has capacity to take a grant of probate. In the former case, it was held that a church (which was not a company to which the Companies Ordinance applied) did not have capacity to take a grant of probate since the objects clause in its memorandum of association did not confer on it power to "take a grant". On the other hand, the latter case dealt with a company under the Companies Ordinance (which did not have any objects clause in its memorandum). In that case, the court held that the predecessor provision of Cap.622, s.115 had the effect that the company would have the same capacity as a natural person to take up a grant of probate, and that there could be no question of lack of power to seek a grant on account of such act being *ultra vires*.

5.019 **Position where company has objects clause.** In *Re Estate of Tang Muk Kwai*,[30] the court expressly left open the position where the company has an objects clause. However, the better view is that the same consequences apply in respect of the question of the company's capacity and the scope of application of the *ultra vires* doctrine, whether or not the company has an objects clause.

5.020 **Where objects clause, company must not do act not authorised; but act not rendered void by *ultra vires* doctrine.** Where the company's articles do contain an objects clause, the company must not do any act that its articles have not authorised it to do; and if any power of a company is expressly modified or excluded by its articles, the company must not exercise the power contrary to that modification or exclusion: Cap.622, ss.116(1) and 116(2). However, an act by the company (including a transfer of property to or by the company) is not invalid only because the company does the act in contravention of ss.116(1) or 116(2): see also Cap.622, s.116(5). In other words, in respect of the external effects of a company's acts, there is no scope for application of the *ultra vires* doctrine even if the company's articles restrict the company's objects. The act is not rendered void by the *ultra vires* doctrine.

5.021 **Might be circumstances where act contravening objects clause is invalid: third-party has notice that act in contravention of objects clause.** That said, there may be some circumstances where an act that contravenes the objects clause would be invalid. It seems that where the third-party dealing with the company is aware that the company is entering into the transaction in contravention of the objects clause, the transaction can be voidable at the election of the company. This is because the directors of the company would not have actual authority to enter into the transaction for the company

[27] R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edn, LexisNexis Butterworths, Sydney, 2013) 886.
[28] [2004] 1 HKLRD B25.
[29] [2011] 1 HKLRD 858.
[30] [2011] 1 HKLRD 858.

in breach of the objects clause (due to the restriction in the articles and the effect of ss.116(1)–116(2) of Cap.622). The third-party can enforce the transaction against the company on the basis of apparent authority of the directors though, so long as the third-party did not have notice of the contravention of the objects clause.[31] However, if the third-party has notice, the third-party cannot rely on any apparent authority of the agents. Accordingly, on this basis, the company can rescind the transaction on the basis of absence of authority of the agents purportedly transacting on behalf of the company.

5.022 **Partial abolition of constructive notice doctrine.** In the foregoing analysis, it is also important to have regard to Cap.622, s.120. That section provides that a person is not to be regarded as having notice of any matter merely because the matter is disclosed in the articles of a company kept by the Registrar or a return or resolution kept by the Registrar. Section 120 abolishes the common law doctrine of constructive notice with respect to the articles and returns and resolutions lodged with and kept by the Registrar in the public Companies Register. This ensures that a third-party would not be treated as having constructive notice of any restrictions in the objects clause in the company's constitution merely on the basis of the information being available on the public register. Accordingly, third parties without actual notice of the restrictions would generally be entitled to enforce a transaction against the company notwithstanding that there was a breach of the objects clause.[32]

5.023 **Any restrictions in objects clause remain important to internal governance.** Although a company now has full capacity despite any restrictions in objects clauses in the company's constitution, such restrictions remain important in relation to the internal governance of the company. Under Cap.622, s.116(3), where the company's constitution does state the objects of the company, the members have power to restrain the controllers of the company from exercising their powers for a purpose that is outside the stated objects. However, proceedings must not be brought under s.116(3) in respect of any act to be done in fulfilment of a legal obligation arising from a previous act of the company: see also Cap.622, s.116(4). For example, if the company has already entered into a contract which is outside the scope of the objects clause, it is too late for a member of the company to restrain performance of the contract.

5.024 **Director who acts contrary to constitution can breach fiduciary duty.** The directors can still be liable to the company for the breach of the constitution though. Generally, a director who acts contrary to the company's constitution can be in breach of fiduciary duty.[33] In particular, it has been held under the common law that a director will be in breach of his or her duty to the company where he or she enters into an *ultra vires* transaction.[34] Such principles should also be applicable to breaches of the objects clause and breaches of Cap.622, ss.116(1)–116(2), such that the director would be in breach of fiduciary duty and can be liable to compensate

[31] On the concept of apparent authority, see Chapter 12. See also Cap.622, s.117.
[32] Each case needs to be looked at in the context of its own facts though. The particular circumstances of the case could still give rise to constructive notice, even though there would not be constructive notice merely on the basis of the objects clause being shown on the public register.
[33] *Re Samuel Sherman plc* [1991] 1 WLR 1070. See further Chapter 8.
[34] *Cullerne v London and Suburban General Permanent Building Society* (1890) 25 QBD 485.

the company for any losses suffered or to return property to the company received by the director as a result of the breach.

3. Rules on Internal Governance: Articles of Association

3.1 The legal nature of articles of association

5.025 **Company's regulations on internal governance.** Traditionally, the articles of association have constituted the company's "rule book". As such, the articles set out regulations on the internal governance of the company. The purpose of the articles is to provide for the allocation of profit, risk, and control within the company.[35] The articles determine the ways in which the powers of the company are exercised, including allocation of powers to particular corporate organs.[36] The articles may deal with members' rights in relation to the distribution of the company's profits. Under Cap.622, the articles of association still perform this role, although in addition the articles now also perform the role of the former memorandum of association in setting out basic information about the company for outsiders (as discussed in the previous section).[37]

5.026 **Statutory contract between members *inter se* and member and company.** In Hong Kong, as in the United Kingdom and some other jurisdictions of British extraction, a company's constitution is a statutory contract between individual members *inter se* and between individual members and the company. This is made clear by Cap.622, s.86:

> "(1) Subject to this Ordinance, a company's articles, once registered under this Ordinance or a former Companies Ordinance –
>
> (a) have effect as a contract under seal –
> (i) between the company and each member; and
> (ii) between a member and each other member; and
>
> (b) are to be regarded as containing covenants on the part of the company and of each member to observe all the provisions of the articles.
>
> (2) Without limiting subsection (1), the articles are enforceable –
>
> (a) by the company against each member;
> (b) by a member against the company; and
> (c) by a member against each other member.
>
> (3) Money payable by a member to the company under the articles –
>
> (a) is a debt due from the member of the company; and
> (b) is of the nature of a specialty debt."

[35] J H Farrar, *Farrar's Company Law* (3rd edn, Butterworths, London, 1991) 95.
[36] E.g., Model Articles arts.3, 4 (private companies): Companies (Model Articles) Notice (Cap.622H) Sch.2.
[37] See also Chapter 3 in relation to the contents of articles of association.

5.027 **Reasons for contractual approach.** There are some historical and practical reasons for the adoption of the contractual approach to the company constitution. In the 19th century, the contract was a favourite analytical tool. Also, making a contract had been the only way of forming or joining any company under the common law.[38] The constitution of the deed of settlement companies in the 19th century was the deed, which was a contract among members. The Joint Stock Companies Act 1844 (UK) provided, for the first time, for the registration of deed of settlement companies. The constitution of a company registered under the 1844 Act was still the deed, which was an actual contract.[39] The memorandum of association and articles of association were introduced to replace the deed under ss.7 and 10 of the Joint Stock Companies Act 1856. Sections 7 and 10 herein made it clear that both the memorandum and the articles bound the company and shareholders contractually.

3.2 The enforcement of articles of association

3.2.1 *Who can enforce the constitution?*

The company and its members

5.028 **Company, members.** Section 86 of Cap.622 states in clear terms that the constitution is enforceable between the company and each individual member and among each member *inter se*. Thus, the company could enforce a provision of the articles that required disputes between the company and its members to be referred to arbitration,[40] and a shareholder was able to enforce a provision in the articles on dividend payments against the company.[41] An example of enforcement by a member of his rights under the articles against a fellow member is *Rayfield v Hands*.[42] There, reg.11 [of the articles of association] provided that a member who intended to transfer shares should inform the directors, "who will take the shares equally between them at a fair value". The directors were also members, as the articles required them to hold shares in the company. The plaintiff wished to transfer his shares and sought a declaration that the three directors were bound to purchase his shares because of the effect of reg.11. Vaisey J granted the declaration, holding that reg.11 was binding on the directors in their capacity as members.[43]

5.029 **Not all clauses can be enforced by company against members and vice versa, eg clause only applies to members *inter se*.** It should be noted that not all clauses in

[38] L S Sealy, "The Enforcement of Partnership Agreements, Articles of Association and Shareholder Agreement" in P D Finn (ed.), *Equity and Commercial Relationships* (LBC, Sydney, 1987) 89, 93.
[39] Companies Act 1844, ss.7, 26. J H Farrar, *Farrar's Company Law* (3rd edn, Butterworths, London, 1991) 121.
[40] *Hickman v Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch 881.
[41] *Wood v Odessa Waterworks Co* (1889) 42 Ch D 636.
[42] [1960] Ch 1.
[43] Note that directors are not parties to the statutory contract, but the case of *Rayfield v Hands* illustrates that directors can be bound to the contract in their capacity as members if they also hold shares. However, as discussed below, the constitution is only binding on members in their capacity as members. This restriction was not an obstacle in *Rayfield v Hands*, where the court regarded reg.11 in the articles as involving a relationship between the members and the directors not in their capacity as directors but in their capacity as members of the company (the directors being referred to as "working members" in that context): see [1960] Ch 1, 6. See also para.5.030 below.

the articles can be enforced by the company against its members and *vice versa*.[44] For example, where a provision in the articles only applies to matters between members *inter se*, the provision may not be invoked by the company in relation to a matter between itself and a member. In *Ng Kin Kenneth v HK Football Association Ltd*,[45] reg.49 of the articles of the association of a sports association provided that, *inter alia*: (i) all members should refer all differences and questions coming within the provisions of the Laws of the Game and the Rules of the Association to the Council, and (ii) the membership of the association: "shall constitute an agreement to refer all such differences and questions in accordance with the Rules of the Association and shall be enforceable as an agreement under the Arbitration Ordinance". A member aggrieved by a decision of the Council of the Association (which was the Association's governing organ) that he was un-welcome to take part in their activities, etc., sought, *inter alia*, a declaration that the decision of the Council was null and void and in breach of the rules of the Association. The defendant Association sought to stay the plaintiff's proceeding on the basis that there should be arbitration of the matter pursuant to reg.49. Kaplan J of the Hong Kong High Court held that judging from the wording in reg.49, the arbitration clause in that article envisaged disputes between members concerning the Rules or the Laws of the Game and made no provisions for arbitration of disputes between the defendant itself and its members.

External capacity

5.030 **Members bound and entitled under constitution in capacity as members.** There appears to be an established rule that members are only bound and entitled under the corporate constitution in their capacity as members. This rule was set out in *Hickman v Kent or Romney Marsh Sheep-Breeders' Association*.[46] Astbury J said in that case that:

> "An outsider to whom rights purport to be given by the articles in his capacity as such outsider, whether he is or subsequently becomes a member, cannot sue on those articles treating them as contracts between himself and the company to enforce those rights."[47]

5.031 ***Eley* case.** Astbury J formed this view after reviewing a number of case authorities, including *Eley v The Positive Government Security Life Assurance Co Ltd*.[48] In the *Eley*[49] case, the Court of Appeal held that the plaintiff, one Eley, was not entitled to enforce a provision of the articles (reg.118 of the articles of association) which provided that he should be the permanent solicitor of the company and should not be removed unless for misconduct. Eley reached an agreement to this effect with one Baylis, who was a promoter, before the formation of the company. Eley, who was involved in the preparation of the articles of association, inserted reg.118 in the articles. Eley became a member subsequently. Lord Cairns held that the provision was "*res inter alios acta*

[44] For limitations on the ability of minority members to enforce the articles, see Chapter 10.
[45] [1994] 1 HKC 734.
[46] [1915] 1 Ch 881.
[47] [1915] 1 Ch 881, 897.
[48] (1876) 1 Ex D 88.
[49] (1876) 1 Ex D 88.

(a thing done between others)", to which Eley was not privy. His Lordship explained that the regulation was either a stipulation binding on members or a mandate to the directors. His Lordship also said that there appeared to be a grave question "whether a contract under which a solicitor is not bound to give any particular services, but the company, on the other hand, are bound to employ him for all their business, and to continue to do so, however incompetent he may prove to be in point of physical health or otherwise, until they can convict him of some positive misconduct, is a contract which the Courts would enforce."[50]

5.032 **Rights given to outsiders enforceable by members.** On the other hand, there are authorities showing that an article giving rights to an outsider can be enforced by members. In *Ramkissendas Dhanuka v Satya Charan Law*,[51] a shareholder successfully challenged a resolution purporting to terminate the appointment of managing agents in contravention of an article stipulating the term of the managing agents' office. The basis of the challenge was that under the relevant articles, a decision to terminate the employment of the managing agents must be made by a special resolution whereas the decision under challenge was made through an ordinary resolution.

5.033 **Permissible even though enforcement of member's right incidentally also enforces right in capacity other than member.** The difference between *Eley*[52] and *Dhanuka*,[53] it is submitted, can be reconciled by Goldberg's view that:

> "[a] member of a company has under section 20(1) of the (1948) Act [equivalent to Cap.622 s.86] a contractual right to have any of the affairs of the company conducted by the particular organ of the company specified in the Act or the company's memorandum or articles, even though the enforcement of that right (and the correlative obligation) may incidentally enforce also a right or power bestowed by the memorandum or articles on a person in a capacity otherwise than as a member of the company, be that person in fact a member or not".[54]

5.034 **Reconciling *Eley* and *Dhanuka*.** In *Eley*,[55] an enforcement of his right enshrined in reg.118 would not be incidental but contrary to the conduct of the company's affairs by the directors, who must have the powers to appoint agents for the company. In *Dhanuka*,[56] the enforcement of the right of the managing agents in question was incidental to the conduct of the relevant affairs by the general meeting. The member's right enforced in that case was one to have certain affairs of the company, namely termination of the employment of managing agents, conducted by a particular organ of the company specified in the company's articles. The general meeting had the power to conduct the relevant affair by special resolution only.

[50] (1876) 1 Ex D 88, 89.
[51] (1949) LR 77 IA 128.
[52] (1949) LR 77 IA 128.
[53] (1949) LR 77 IA 128.
[54] G D Goldberg, "The Enforcement of Outsider-Rights under Section 20 (1) of the Companies Act 1948" (1972) 35 *Mod L Rev* 362, 364.
[55] (1876) 1 Ex D 88.
[56] (1949) LR 77 IA 128, PC.

5.035 **Enforcing constitution: 2003 amendments.** To widen the circumstances where members can enforce the constitution, s.23(1A) was inserted in the predecessor CO in 2003. Section 23(1A) has now been re-enacted under Cap.622, s.86(2), which stipulates that, *inter alia*, "the articles are enforceable — (a) by the company against each member; (b) by a member against the company; and (c) by a member against each other member". While this provision was intended to overcome restrictions on the proper plaintiff principle in *Foss v Harbottle*,[57] it is unlikely that the previous law, as discussed above, has been altered.[58]

5.036 **Statutory reform of privity doctrine does not confer right on third-party to enforce constitutional documents.** The privity doctrine in contract law has been reformed so that it is possible for a third-party on whom the contract confers a benefit to enforce that contract in stated circumstances.[59] Section 3(2)(g) of the Contracts (Rights of Third Parties) Ordinance (Cap.623), however, expressly excludes the application of the Ordinance to company's articles having effect as a contract under seal under Cap.622, s.86. The exclusion was recommended by the Law Reform Commission of Hong Kong in its 2005 report on privity of contract,[60] and also follows the position under the equivalent United Kingdom legislation reforming the law on privity of contract.[61] In Australia, the doctrine of privity has been somewhat modified under the common law through cases such as *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*.[62] It is, however, unlikely that this type of case would enable an outsider to enforce a provision of a company's constitution conferring rights on him in that country. Nor is it likely that the beneficiaries under a trust of shares would have standing to enforce the statutory contract.[63]

Directors

5.037 **Directors' lack of standing to enforce constitution.** At times, issues can also arise as to the rights, powers or obligations of a director provided in the constitution. Section 86 of Cap.622 does not say that a company's constitutional documents also constitute a contract between the company and its directors. The UK Court of Appeal held in *Beattie v E & F Beattie Ltd* [64] that a director was unable to enforce the arbitration clause in the articles as he was suing in his capacity as a director rather than a shareholder. Regulation 133 of the company's articles provided that:

> "...whenever any doubt, difference, or dispute shall arise between any members of the company or between the company and any member or members, ... the members of the company respectively, shall not take proceedings at law... but the same shall be referred to two arbitrators or their umpire...".

[57] (1843) 2 Hare 461.
[58] See further Chapter 10.
[59] Contracts (Rights of Third Parties) Ordinance (Cap.623), s.4. The Ordinance came into operation on 1 January 2016.
[60] The Law Reform Commission of Hong Kong Report: *Privity of Contract*, September 2005, para.4.178, available at http://www.hkreform.gov.hk.
[61] See Contracts (Rights of Third Parties) Act 1999 (UK) s.6(2); and see further Edwin Peel, *The Law of Contract* (12th edn, Sweet & Maxwell, London, 2007) 691ff.
[62] (1988) 165 CLR 107.
[63] R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edn, LexisNexis Butterworths, Sydney, 2013) 886, 202.
[64] [1938] Ch 708.

5.038 **Directors who are members can enforce constitution in capacity of member.** Notwithstanding authorities on the lack of standing on the part of directors to enforce articles, directors who are also members may be able to enforce the company's constitution in their capacity as member. In the *Rayfield* [65] case considered above (at para.5.028), the court upheld the directors' obligation to comply with the shareholders' request for a purchase of their shares in accordance with the articles. Vaisey J did so, as mentioned above, by ruling that the directors were obliged to take the transfer because they were also shareholders. His Lordship, however, did not consider a situation where the directors are not shareholders.

5.039 **Relevant provision in article treated as incorporated into director's employment contract.** Where rights are conferred in the constitution on directors in their capacity as director, one way of enabling them to enforce such rights is by treating the provision in the relevant article as having been incorporated into the contract between the director and the employer company. The directors to whom the companies owed salaries in *Re New British Iron Co Ex p Beckwith*[66] and *Swabey v Port Dawin Gold Mining Co*[67] were able to recover the amounts owed on this basis.

5.040 **Australia: constitution has effect as contract between company and each director and company secretary.** Under Australia's Corporations Act 2001, s.140(1)(b), the company constitution has effect as a contract between, *inter alia*, "the company and each director and company secretary". Section 140(1)(b) helps remove the uncertainty on the directors' right to enforce constitutional provisions. A case example on s.140(1)(b) is *Jones v Money Mining NL*.[68] In that case, Jones retired by rotation as a director under the company's articles and offered himself for re-election. He was not re-elected at the general meeting but no other persons were elected in his place. Regulation 84 of the company's articles provided that if at any meeting at which the election of directors "ought to take place" the company did not fill the position of a director retiring by rotation, the director should remain in office, unless the company decides to reduce the number of directors. By virtue of reg.84, Jones was successful in obtaining a declaration that he would remain in office as a director.[69]

5.041 **No reason not to treat director as party to statutory contract.** There is much to commend in the Australian provision as regards the directors' power to enforce the articles. Apart from the historical origin of the memorandum and articles, there does not appear to be any policy reason not to treat directors as a party to the statutory contract.

[65] [1960] Ch 1.
[66] [1898] 1 Ch 324.
[67] (1889) 1 Meg 385.
[68] (1995) 17 ACSR 531.
[69] This decision was made under s.180(1) of the Corporations Law, which was the predecessor of s.140(1)(b), Corporations Act 2001.

3.3 Alteration of articles

5.042 Reasons why articles may need to be altered. The company's ability to adapt in the business environment depends, to a certain extent, on the alterability of the terms of the company's constitution.[70] This is especially so where the original terms of the constitutional documents restrict the company's freedom in taking action that is, in the view of the corporators, in the interest of the company. A need for altering the articles can arise, for example, where there is a need for relaxing stringent restrictions on share transfers in the existing articles;[71] to rid the company of a shareholder who is competing against it through conferral of a power on the directors or the majority shareholders to buy out, at a fair price, the shares of the competing member[72] or for the purpose of maximising the company's profits;[73] or to give the company the power to remove a delinquent director whose term of office is entrenched under the existing articles.[74]

5.043 **Other examples where alterations required.** The issue of alteration of articles may also arise where there is a need for reconciling inconsistent articles which lead to different treatment of members, to advance the interests of the company[75] or to ensure an equitable distribution of profits.[76]

5.044 **Restrictions on majority to change articles.** As the majority members' power to alter the constitution can be easily misused for self-interested purposes, it is necessary for the law to chart a limit within which that power may be legitimately exercised. The following sections consider the mechanics for effecting an alteration of articles and common law restrictions on the majority's power to alter constitutional rules.

3.3.1 *The mechanics*

Special resolution

5.045 **Special resolution.** Section 87 of Cap.622 empowers a company to alter its articles. Subsequent s.88 of Cap.622 provides that articles may be altered or added by special resolution, subject to that s.88(3) and any other provisions of Cap.622. Section 88(3) provides that an alteration in articles to the maximum number of shares that the company may issue may be made by ordinary resolution. Within 15 days after the date on which an alteration to the articles takes effect, the company must deliver to

[70] Paul L Davies and Sarah Worthington, *Gower and Davies' Principles of Modern Company Law* (19th edn, Thomson Sweet & Maxwell, London, 2012) 77.

[71] *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286.

[72] *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154. See also *Dafen Tinplate Co v Llanelly Steel Co* [1920] 2 Ch 124 (where the resolution inserting a new article empowering the majority to compulsorily acquire shares from any shareholder as they thought proper was invalidated on the ground that the terms of the article were too wide — although it was in the interest of the company to require a defaulting shareholder to sell his shares to the company, albeit at a fair price).

[73] *Gambotto v WCP Ltd* (1995) 182 CLR 432. See also *Brown v British Abrasive Wheel Co Ltd* [1919] 1 Ch 290, where the article was inserted by the 98% majority to buy out the minority members as a condition for the majority shareholders to make the much needed capital injection.

[74] *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9. Note, however, that entrenchment of directors in the articles may be less of a problem nowadays in light of Cap.622 s.462 (see Chapter 7).

[75] *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656.

[76] *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457.

the Registrar for registration a notice of the alteration and a certified copy of the altered articles: see also Cap.622, s.88(5).

Informal alteration

5.046 **Informal alteration where unanimous consent.** It is possible to achieve an alteration of the articles in the absence of a formal resolution provided that there is unanimous consent of the members. In *Ho Tung v Man On Insurance Co Ltd*,[77] the articles were not signed by members in accordance with the relevant requirement in the Companies Ordinance, but were registered by the Registrar, who overlooked the members' failure to sign. The Privy Council held that the articles had been adopted by the members. In *Cane v Jones*,[78] Deputy Judge Wheeler QC held that an amendment of the articles can be effected in the absence of a formal resolution as long as all of the corporators agreed with the alteration and the proposed amendment is not otherwise unlawful. Informal agreement can be inferred from conduct, such as acquiescence in circumstances where the members knew that their assent was being sought. But where conduct alone is relied upon, that conduct must lead to the conclusion that on the balance of probabilities the members intended to amend the articles and, further, intended to make the particular amendment contended for.[79]

3.3.2 *Statutory limitations*

Complying with the companies legislation

5.047 **Must be consistent with mandatory rules in Companies Ordinance.** A proposed alteration must be consistent with the mandatory rules in the Companies Ordinance. A company limited by shares is thus unable to alter its constitution to give itself the power to return share capital to members otherwise than as permitted under the Ordinance. Nor can a company modify its constitution to deprive members of their right to petition for the winding-up of the company.[80] Also, a modification to restrict the company's power to alter its articles or constitution will likewise be invalid.[81]

No alterations increasing members' liability to contribute to share capital

5.048 **Cap.622 s.92: no alterations increasing members' liability to contribute to share capital.** A protection afforded to members against an amendment affecting their rights is Cap.622, s.92. That provision provides that no member shall be bound by an alteration of the company's constitutional documents after the date on which he or she became a member, if and so far as the alteration requires him or her to take or subscribe for more shares than the number held by him or her at the date on which the alteration is made, or in any way increase his or her liability to contribute to the share capital or to otherwise pay money to the company, unless the member agrees in

[77] [1902] AC 232.

[78] [1981] 1 All ER 533.

[79] *Re the Sherlock Holmes International Society Ltd (No.2)* [2017] 2 BCLC 14, [72].

[80] *Re Peveril Gold Mines Ltd* [1898] 1 Ch 122; R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edn, LexisNexis Butterworths, Sydney, 2013) 210.

[81] *Walker v London Tramways* (1879) 12 Ch D 705.

writing either before or after the alteration is made. The significance of this protection is illustrated in *Ding v Sylvania Waterways Ltd.*[82] In that case, shareholders of the company consisted of owners of blocks of land. The original version of the constitution provided for the charge of a once-only membership fee in exchange for a right to moor boats in the waterway. The court held, on the basis of a provision equivalent to s.92, that an amendment giving the company the power to charge a membership fee as an annual levy for a right to moor was not binding on members.

Class rights

5.049 **Cap.622 contains provisions on manner in which change of class rights can be effected.** Where share capital is divided into different classes and special rights are attached to such classes of shares, an alteration of articles may change members' class rights. To protect minority shareholders from an improper exercise of power on the part of the majority to alter articles resulting in a change of the former's class rights, Cap.622 sets out provisions on the manner in which a change of class rights is to be effected. The procedures under Cap.622, ss.180–184 (for companies with a share capital) and ss.185–192 (for companies without a share capital) vary depending on whether the company's constitution provides for procedures on variation of class rights. These procedures are considered in detail in Chapter 14.

Members' remedies

5.050 **Unfairly prejudicial conduct.** Cap.622, ss.723–725 give a member the right to apply for a court order where the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members (including the individual member himself). There is a widely held view that it is possible for a member aggrieved by an alteration of the company's articles to seek a court order through these provisions, at least in cases of conflicts between or among groups of members, where the interest of the company itself is not engaged and where the modification or repeal is unfairly prejudicial.[83] This view seems to command some judicial support.[84]

Abolition of the entrenchment provisions

5.051 **Abolition of entrenchment provisions under Companies Ordinance (Cap.622).** In the United Kingdom and Australia, it is possible to add additional conditions for altering the company's constitution or particular provisions in the constitution through inserting an "entrenching provision".[85] Examples of an entrenching provision include

[82] (1999) 46 NSWLR 424.

[83] See, for example, Paul L Davies and Sarah Worthington, *Gower and Davies' Principles of Modern Company Law* (19th edn, Thomson Sweet & Maxwell, London, 2012) 700; R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (15th edn, LexisNexis Butterworths, Sydney, 2013) 212; Philip Smart, Katherine Lynch and Anna Tam, *Hong Kong Company Law: Cases, Materials and Comments* (Butterworths Asia, Hong Kong, 1997) 92; Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia* (2nd end, Federation Press, Sydney, 2002) 201 (the authors believe that Pt.2F.1 of the Corporations Act 2001 constitutes a statutory limit on the alteration of a corporate constitution).

[84] *Shears v Phosphate* (1988) 14 ACLR 747; *Re a Company Ex p Schwarz* [1989] BCLC 427, 450–451. See further Chapter 10.

[85] Companies Act 2006 (UK) s.22; Companies Act 2001 (Aust), s.136(3).

a majority that is higher than 75 percent or requiring the consent of a particular person. An entrenching provision can be used to help ensure control by the founders of the company after its incorporation.[86] Under the predecessor CO, entrenchment could be achieved by providing additional conditions for altering articles in the memorandum.[87] Under Cap.622, s.89, the power to alter the articles by special resolution is no longer subject to any conditions in the memorandum as the memorandum is abolished and the constitution is composed of the articles only. However, s.89 does not make the power of alteration of the articles subject to any restrictions contained in the articles. Accordingly, it would not be possible for the company to deprive or restrict the power of the general meeting to amend the articles by special resolution.[88] The Government's policy intention was not to provide for the possibility of having entrenchment provisions in the constitution. Yet, one would have thought that, in a jurisdiction such as Hong Kong, where family companies play a significant role in the economy, there would be a need for permitting the company founder to maintain control through restrictions on the ability of other shareholders to alter the company's internal management rules.

3.3.3 *Common law limitation on the power to alter the company's constitution*

The traditional common law position

5.052 **Proposed amendment might affect rights and obligations between company and members; or redistribute members' rights.** A proposed amendment of the constitution might aim at or has the consequence of altering the rights and obligations between the company as a commercial entity and the members.[89] A constitutional amendment might also alter or redistribute members' rights without affecting the interest of the company.[90] Since the principles in adjudicating different types of cases involving constitutional amendment may not be identical, the abovementioned categories of cases are considered separately.

Where the company's interest is engaged

5.053 ***Allen v Gold Reefs* test: alteration must be bona fide for benefit of company as whole.** The seminal case of this type is *Allen v Gold Reefs West Africa Ltd*,[91] wherein the original common law position on the company's power to alter its articles was expounded by Lindley MR. In that case, reg.29 of the company's articles of association

[86] Philip Lipton, Abe Herzberg and Michelle Welsh, *Understanding Company Law* (15th edn, Thomson Reuters LBC, Sydney, 2010) 96.

[87] Predecessor CO, s.13(1) (repealed).

[88] See also *Ayre v Skelsey's Adamant Cement Co* (1904) 20 TLR 587, affd (1905) 21 TLR 464; and see para.5.047 above.

[89] *Allen v Gold Reefs West Africa Ltd* [1900] 1 Ch 656; *Sidebottom v Kershaw Leese and Co Ltd* [1920] 1 Ch 154; *Dafen Tinplate Co v Llanelly Steel Co* [1920] 2 Ch 124; *Shuttleworth v Cox Brothers & Co (Maidenhead)* [1927] 2 KB 9.

[90] *American Delicacy Co Ltd v Heath* (1939) 61 CLR 457; *Greenhalgh v Ardene Cinemas Ltd* [1951] Ch 286. An alteration having the effect of altering the rights of a section of the members may, however, be dictated by the interest of the company: *Citco Banking Corp NV v Pusser's Ltd* [2007] Bus LR 960 (where the company's ability to secure, *inter alia*, equity and loan finance hinges on the obtaining of a control power by the chairman of the board).

[91] [1900] 1 Ch 656.

it unconscionable for him or her to retain the benefit of the receipt. This test has been applied by the Court of First Instance in Hong Kong.[480] In *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No.2)*,[481] the approach in *Akindele* was accepted to be correct by the parties and so the Court of Final Appeal was prepared to assume, without deciding the point, that the *Akindele* test was correct. In that case, apart from its claim for common law damages for conversion, the company also argued that it was entitled to recover against the lender on the basis of knowing receipt. The court had found that the belief by the lender that the director had authority to act for the company was irrational.[482] In these circumstances, the court accepted in *obiter* that it would be unconscionable for the lender to retain the benefit of any assets received from the company under the impugned transaction.[483]

8.178 **Where knowing receipt, proprietary claim.** Where knowing receipt is established, the company has a proprietary claim for its assets or its proceeds against the third party. However, even if the third party no longer holds the asset or its traceable proceeds, the company has a personal claim against the third party for equitable compensation.[484]

8.6.3 *Dishonest assistance*

8.179 **Dishonest assistance.** Third parties can also be liable on the basis of being an accessory to the breach of fiduciary duty, namely dishonestly procuring or assisting in the breach of fiduciary duty[485] (or what was previously referred to as "knowing assistance"[486]). For liability to be imposed on this basis, it is unnecessary to establish that the fiduciary was in breach of trust or that there was any misapplication or misappropriation of property.[487] In *Royal Brunei Airlines Sdn Bhd v Tan,*[488] the Privy Council also emphasized that it is the state of mind of the third party that is critical and not the state of mind of the fiduciary. That is, it is not necessary to show that the fiduciary was dishonest, although this would usually be so where the third party who is assisting him is acting dishonestly.[489] The liability of a person for dishonest assistance is to compensate the company for losses resulting from the breach of fiduciary duty,[490] and possibly also to account for profits as a result of his or her assistance.[491]

[480] *High Fashion Garments Co Ltd v Ng Siu Tong* [2004] 1 HKLRD 928.
[481] (2010) 13 HKCFAR 479, [127]–[128].
[482] For the facts, see para.8.026 above, and see also Chapter 12.
[483] (2010) 13 HKCFAR 479, [137].
[484] See John McGhee (ed.), *Snell's Equity* (32nd edn., Sweet and Maxwell 2010) para.30-070; *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No.2)* (2010) 13 HKCFAR 479.
[485] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC).
[486] *Barnes v Addy* (1873–74) LR 9 Ch App 244.
[487] *Goldtrail Travel Ltd (in liq) v Aydin* [2015] 1 BCLC 89, [125]–[129].
[488] [1995] 2 AC 378.
[489] [1995] 2 AC 378, 385, 392. However, the position is different in Australia: *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89; *Re Waterfront Investments Group Pty Ltd (in liq)* (2015) 105 ACSR 280, [126].
[490] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378.
[491] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638; *Novoship (UK) Ltd v Mikhaylyuk* [2015] QB 499; and see further John McGhee (ed.), *Snell's Equity* (32nd edn., Sweet and Maxwell 2010) [30-079]–[30-081]; Hon. William Gummow, "Dishonest Assistance and Account of Profits" (2015) 74 *Cambridge Law Journal* 405.

8.180 **Objective standard of honesty.** In *Barlow Clowes Intl Ltd v Eurotrust Intl Ltd*,[492] Lord Hoffmann, in giving the advice of the Privy Council, accepted as correct the trial judge's statement of the test of dishonesty that although a dishonest state of mind is a subjective mental state, the standard by which the law determines whether it is dishonest is objective; and that if by ordinary standards a defendant's state of mind would be characterised as dishonest, it is irrelevant that the defendant judges by different standards. This test is regarded as an objective test of dishonesty and has been applied in Hong Kong.[493] Although the standard of honesty is objective, whether a person is dishonest also depends on the circumstances actually known to the person in question, as distinct from what a reasonable person would have known or appreciated.[494]

8.181 **Case example.** In *Breitenfeld UK Ltd v Harrison*,[495] discussed at para.8.075 above, the son and daughter-in-law (who were also employees of the claimant company at the time when they set up the rival company) were held to have dishonestly assisted the managing director in the latter's breach of fiduciary duty. There was assistance as they participated in, and provided the very opportunity for, the managing director's breach of duty.[496] As to dishonesty, the evidence was that all three parties cloaked their activities (in establishing and operating the rival company) in secrecy and concealed it from the claimant company. The court held that they did not act as honest people would act; and their consciences told them that they were engaged in transactions in which they could not honestly participate, so they acted secretly.[497]

8.7 Breach of duty of care

8.182 **Cap.622: statutory duty of care; for remedies general law applies.** Although the duty of care is now set out under Cap.622, s.465, the principles on the remedies for breach of duty under the general law apply for breaches of the statutory duty of care.[498]

8.7.1 *Compensation for losses*

8.183 **For negligence company can recover compensation: common law principles of causation, remoteness and measure of damages likely to apply.** Where a director

[492] [2006] 1 WLR 1476 (PC). For an example, see *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd* [2017] 1 BCLC 625, [2017] EWHC 257 (Ch) (where a director was in breach of fiduciary duty by requesting the bank to pay the company's funds to entities controlled by the director, the bank was held not to have acted dishonestly in the circumstances of the case).
[493] *Peconic Industrial Development Ltd v Chio Ho Cheong* (unrep., HCA 16255/1999, [2006] HKEC 957). The test was not in issue on appeal: *Peconic Industrial Development Ltd v Lau Kwok Fai* [2008] 4 HKLRD 473 (CA); (2009) 12 HKCFAR 139 (CFA). See also *UBS AG v Stand Ford Intl Enterprises Ltd* [2002] 3 HKC 621, 627–628; *Li Shiu To v Cheung Pik Ng* [2018] 2 HKC 381, [47]–[49] Matthew Conaglen and Amy Goymour, "Dishonesty in the Context of Assistance – Again" (2006) 65 *Cambridge Law Journal* 18.
[494] *Li Shiu To v Cheung Pik Ng* [2018] 2 HKC 381, [50]–[52].
[495] [2015] 2 BCLC 275, [2015] EWHC 399 (Ch).
[496] [2015] 2 BCLC 275, [2015] EWHC 399 (Ch), [80].
[497] [2015] 2 BCLC 275, [2015] EWHC 399 (Ch), [84]. The rival company was also liable (at [86]). A company's liability depends on attribution of the acts and dishonest state of mind of persons (*eg.* its directors) to the company: *e.g.*, see *BCI Finances Pty Ltd v Binetter (No.4)* (2016) 117 ACSR 18, [308]–[313], [980]–[983]; *Australian Careers Institute Pty Ltd v Australian Institute of Fitness Pty Ltd* (2016) 116 ACSR 566.
[498] Cap.622, s.466

is negligent, the company can recover compensation for its losses. Compensation for losses for breach of an equitable duty is obtained by way of the remedy of equitable compensation in the court's equitable jurisdiction, while compensation in tort is obtained via damages under the common law. Generally, common law principles on damages such as remoteness and measure of damages do not apply to the assessment of equitable compensation. However, it may be otherwise in the case of the equitable duty of care. The English Court of Appeal has expressed the view that the aim of compensation for breach of the duty in equity is the same as under the common law.[499] The remedy is to compensate for loss suffered and is different to equitable compensation for breach of fiduciary duty which is restitutionary or restorative[500] rather than compensatory. Accordingly, the court took the view that common law rules of causation, remoteness and measure of damages can be applied by analogy when assessing the amount of equitable compensation for breach of the duty of care. There are *obiter* comments in Hong Kong decisions accepting such an approach,[501] but doubts have been expressed on its correctness by the Australian High Court.[502]

8.7.2 *Causation*

8.184 **Causation: as matter of ordinary common sense whether defendant's act cause of loss.** The company can only recover compensation from a director if the breach of the duty of care by the director was the cause of the company's loss. Under common law principles of negligence, it is necessary to examine whether the negligent act or omission of the defendant was so connected with the plaintiff's loss that as a matter of ordinary common sense, it should be regarded as a cause of it.[503]

8.185 **"But for" test of causation.** In *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers*,[504] a moneylending company suffered losses after a number of borrowers defaulted under their loan agreements which led to the company entering into liquidation. Certain of the directors acted fraudulently in the obtaining of the loans from the company, but the company also failed to comply with accepted lending practices. The appellant was a non-executive director who was, together with the other directors, found to be in breach of duty by failing to ensure such compliance. However, the Queensland Court of Appeal held that the appellant's breach of duty was not the cause of the company's loss. The crucial question was whether the appellant's omissions in terms of the collective governance of the company contributed to the outcome of the decision-making process of the company that resulted in the improvident loans being made.[505] The Court of

[499] *Bristol and West Building Society v Mothew* [1998] Ch 1; and see also *Permanent Building Society v Wheeler* (1994) 14 ACSR 109; *Henderson v Merrett Syndicate Ltd* [1995] 2 AC 145, 205; John Mowbray et al., *Lewin on Trusts* (18th edn., Sweet & Maxwell 2008) para.39-15.

[500] In the case of "substitutive compensation": see para.8.174 above.

[501] *Kao Lee & Yip v Koo Hoi Yan Donald* [2003] 3 HKLRD 296, 312–313; *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No.2)* (2010) 13 HKCFAR 479, [155]; *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681, [77]. This approach has been approved of in New Zealand (*Bank of New Zealand v New Zealand Guardian Trust Ltd* [1999] 1 NZLR 664, 681).

[502] *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 196 ALR 482, [39].

[503] *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, 161. On Hong Kong cases generally which apply the common-sense test of causation in the tort of negligence, see, e.g., *World Wide Stationary Manufacturing Co Ltd v Fong Chi Leung* [1994] 2 HKC 449, 454.

[504] [2006] QCA 335.

[505] [2006] QCA 335, [273].

Appeal applied the "but for" test of causation,[506] and held that, on the evidence, it was not possible to conclude that the improvident loans would not have been made but for the absence of the proper loan assessment procedures that should have been in place.[507] If proper lending procedures were in place, there would have been an increased prospect of exposing irregular or fraudulent loan applications, but that was not sufficient to establish that the loans would not have been made but for the appellant's breach of duty.[508]

9. Relief from Liability

9.1 Ratification by company

8.186 **Unless articles provide that board can do so, ratification is by general meeting.** *Prima facie*, a company can authorise conduct by a director in advance to avoid the conduct being regarded as a breach of duty, or the company can ratify a breach of duty that has already occurred so as to relieve the director from liability to the company.[509] Unless the articles provide otherwise, the board does not have the power to ratify breaches of duties by directors—ratification must be done by the members in general meeting.[510] An ordinary resolution will suffice, but this is subject to restrictions, discussed below. Ratification is only effective if there is adequate disclosure of material facts to the general meeting.[511]

8.187 **Cap.622: interested directors and associated persons not entitled to vote.** Under Cap.622, s.473, interested directors and associated persons are not entitled to vote where ratification is sought from the members to relieve directors from breaches of duties.[512] Votes of the director, entities connected with the director,[513] and persons (i.e., nominees) holding shares on trust for the director or connected entity are disregarded in the vote on the motion for ratifying the director's breach of duty. Section 473 was introduced when Cap.622 was enacted. The provision is an improvement on the previous law as, under the common law, the director or associated persons are not prevented from voting to ratify the director's own breach of duty,[514] and the resolution passed on the strength of the director's votes could only be set aside if there is fraud

[506] [2006] QCA 335, [272].

[507] [2006] QCA 335, [323].

[508] [2006] QCA 335, [282].

[509] *Hogg v Cramphorn Ltd* [1967] Ch 254; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 150; *Bamford v Bamford* [1970] Ch 212. There is a difference between "authorisation" and "ratification" as the former refers to consent of the company given prior to the conduct occurring, while the latter refers to consent given after a breach has occurred. However, for simplicity, the term "ratification" will be used in this section to cover both terms unless the context indicates otherwise. Note also that ratification in the present context involves a release of the director from liability. It is not sufficient if there is only ratification in the sense of the company adopting (an being bound by) a transaction entered into by a director without authority and in breach of duty; see *Lam Kin Chung v Soka Gakkai International of Hong Kong Ltd (No.2)* [2018] 747, [2018] 2 HKLRD 769.

[510] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; *Man Luen Corp v Sun King Electronic Printed Circuit Board Factory Ltd* [1981] HKC 407.

[511] *Phosphate of Lime Co v Green* (1871–72) LR 7 CP 43, 56–57.

[512] *cf* Companies Act 2006 (UK) s.239.

[513] For the definition of connected entity, see Cap.622, s.486.

[514] *North-West Transportation Co v Beatty* (1887) 12 App Cas 589.

on the company. However, s.473 applies only in respect of "ratification" of conduct and so it may not apply in the case of authorisation of future conduct as opposed to ratification of conduct that has already occurred.

8.188 **Cannot ratify act which is unlawful.** There are limits to the circumstances where the members can effectively ratify director's conduct so as to relieve the director from liability. Where directors cause the company to do an act which the company cannot lawfully do (because of a prohibition under either statute law or the general law), it would not be possible for the company to ratify the conduct. For example, there cannot be effective ratification of a breach of duty involving disposals of assets to the company's shareholders in contravention of the maintenance of capital doctrine under the common law or the Companies Ordinance (Cap.622).[515] The court may also hold the ratification (even if given unanimously by the members) to be ineffective where the transaction is dishonest and illegal, such as opening of letters of credit, purportedly for payment of goods under non-existent sale and purchase transactions, which amounted to a fraud on the issuing bank.[516]

8.189 **Cannot ratify breach of duty to take into account creditors' interests.** Where the directors' breach of duty has caused the company to enter into insolvency or has caused further losses of assets when the company is already insolvent, the members will not be able to ratify any breaches of duties as the creditors' interests are paramount in those circumstances.[517]

8.190 **Whether non-ratifiable breaches such as misappropriation of company's assets.** Subject to the above restrictions, the company, through the members as the corporate organ, can in principle ratify any breach of fiduciary duty or breach of the duty of care. It is sometimes said that there are further categories of non-ratifiable breaches, such as misappropriation of company's assets. However, such statements are apt to mislead. For example, as long as there is no infringement of the capital maintenance rules and creditors' interests are not prejudiced, there is nothing to stop the members from unanimously agreeing to make a gift of the company's assets.[518] This would be consistent with the general principle that a beneficiary can release a fiduciary from breach of duties owed to the beneficiary.[519] In *Tam Po Kei v Tam Bo Kin*,[520] Harris J accepted that the doctrine of unanimous consent of shareholders can be applied to relieve a director from breaches of duties. The case dealt with a petition under the

[515] See, e.g., *Re Exchange Banking Co, Flitcroft's Case* (1882) 21 Ch D 519; *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016.

[516] *Liquidator of Wing Fai Construction Co Ltd (in liq) v Yip Kwong Robert* [2018] 1 HKC 472, [269]–[271].

[517] *Chintung Futures Ltd v Arthur Lai Cheuk Kwan* [1994] 1 HKLR 95; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722; *Re PV Solar Solutions Ltd (in liq)* [2018] 1 BCLC 58; and see para.8.038 above.

[518] See *Re Horsley & Weight Ltd* [1982] Ch 442, 454; *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258, 289–290; *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch 246, 296. See also *Tam Po Kei v Tam Bo Kin (No.1)* [2011] 1 HKLRD 537, [67]; *cf Liquidator of Wing Fai Construction Co Ltd (in liq) v Yip Kwong Robert* [2018] 1 HKC 472, [271].

[519] See further Stefan Lo, "The Continuing Role of Equity in Restraining Majority Shareholder Power" (2004) 16 *Australian Journal of Corporate Law* 96.

[520] [2011] 1 HKLRD 537, [67], [108]. See also *Re Styland Holdings Ltd (No.2)* [2012] 2 HKLRD 325 where Burma J. accepted in obiter that misappropriation of company property is capable of ratification.

predecessor CO, s.168A (repealed) (see now Cap.622, ss.724–725), and the director concerned was found to have made improper distributions of the assets of a family-owned company. However, the court held that there was no breach of duty in respect of remuneration paid to an executive director which was agreed to by the permanent managing director who was the patriarch of the family. At the time, the patriarch had ultimate authority over the affairs of the company which he had set up, and all the shareholders (who were family members) had acquiesced to his authority and control. In those circumstances, the court was prepared to infer unanimous approval of the shareholders for the payment of the remuneration.[521]

8.191 **Ratification might require special resolution and be subject to minority remedies.** The ability of members to effectively ratify *via* less than unanimous agreement is restricted in particular circumstances. First, if the conduct sought to be ratified is something which the members can only do *via* a special resolution under the articles or the Companies Ordinance, then an ordinary resolution will not be effective.[522] Secondly, any ratification by a majority of the members is still subject to minority remedies, including statutory remedies of members, or remedies under the doctrine of fraud on the minority under the general law.[523]

9.2 Indemnities and provisions exempting liability

9.2.1 *The basic restriction*

8.192 **Companies ought not give directors blanket exemptions from liability for breaches under articles.** In the absence of statutory restriction, it may be possible for the articles to give blanket exemptions from liability for directors who breach their duties. To avoid giving over-extensive protections to directors, the Greene Committee in 1925 had recommended a statutory prohibition.[524] While it might be thought that the members should be able to agree amongst themselves on the scope of directors' liabilities to the company, the Greene Committee observed that:

> "[i]t is … fallacious to say that the shareholders must be taken to have agreed that their directors should be placed in this remarkable position. The articles are drafted on the instructions of those concerned in the formation of the company, and it is obviously a matter of great difficulty and delicacy for shareholders to attempt to alter such an article as that under consideration".[525]

[521] A similar argument could not be made in respect of other distributions in the case which the court had found to be improper: (a) dividends paid in breach of requirements of the Companies Ordinance cannot be ratified; (b) certain withdrawals of company funds were not proved to have been approved of by the family patriarch; and (c) a loan to a director was not approved by all the shareholders but only by a majority.

[522] *Young v South African and Australian Exploration and Development Syndicate* [1896] 2 Ch 268; *Edwards v Halliwell* [1950] 2 All ER 1064 (Eng CA).

[523] See Chapter 10.

[524] "Report of the Company Law Amendment Committee" (Cmd 2657, 1925) (Greene Committee Report), paras.46–47.

[525] Greene Committee Report, para.46.

8.193 **Cap.622: prohibitions against exemption.** Sections 467–469 of Cap.622 are the current Hong Kong provisions equivalent to those enacted in England as a result of the above recommendations. Section 468 renders void any "provision contained in a company's articles, or in a contract entered into by a company, or otherwise":

- which "purports to exempt a director of the company from any liability that would otherwise attach to the director in connection with any negligence, default, breach of duty or breach of trust in relation to the company"; or
- which "directly or indirectly provides an indemnity for a director of the company, or a director of an associated company[526] of the company, against any liability attaching to the director in connection with any negligence, default, breach of duty or breach of trust in relation to the company or associated company (as the case may be)".

8.194 **Better view that Cap.622, ss.467-469 do not invalidate ratification.** Despite concerns on the possibility of the statutory provisions extending to invalidate a company's ratification of breaches,[527] the better view is that they do not. Resolutions of a general meeting and informal unanimous approval of the members should be outside the scope of the meaning of "provision", read in the context of the section, which deals primarily with provisions in the articles or in a contract. Moreover, it has been said that clear words would be required to interpret the section as overriding established principles of the common law on ratification.[528]

8.195 **Construction of Cap.622, s.468.** Section 468 only covers provisions where the company purports to exempt the director from liability. The words "or otherwise" are to be construed *ejusdem generis* with the preceding words, and would cover non-contractual arrangements with the company under which the company agrees to exempt a director or to indemnify him.[529] The provision does not, for example, prevent a director from obtaining his or her own insurance from a third party insurance company.

9.2.2 *Insurance*

8.196 **Company can purchase insurance for director.** The company can purchase insurance for a director for liabilities to the company (or any other person) except where the liability arises from the director's fraud: Cap.622, s.468(4)(a). The company can also purchase insurance for the director for any liabilities incurred by the officer in defending proceedings: Cap.622, s.468(4)(b). The latter provision covers, for example, legal costs, and the company can purchase the insurance whether or not the director is found liable, and whether or not the conduct involves fraud. In practice, however, insurance companies will often exclude coverage under the policy where there is fraud.

[526] "Associated company" is defined in Cap.622, s.2 (i.e. a holding company and all its subsidiaries are associated companies with each other).

[527] See, e.g., Rani John, "Relieving Directors from the Liabilities of Office: the Case for Reform of Section 241, Corporations Law" (1992) 10 *Company and Securities Law Journal* 6, 8.

[528] Ross Cranston, "Limiting Directors' Liability: Ratification, Exemption and Indemnification" [1992] *Journal of Business Law* 197, 206.

[529] *Burgoine v London Borough of Waltham Forest* [1997] 2 BCLC 612.

9.2.3 *Permitted indemnity provisions*

8.197 **Cap.622: company can indemnify director for liability to third party.** Cap.622, s.469 expressly allows a company to indemnify a director for the director's liabilities to third parties (i.e., the "permitted indemnity provisions").[530] However, there are exceptions. The company cannot provide indemnities in respect of a director's liability to pay criminal fines or regulatory penalties, nor can the company pay for the costs of defending criminal proceedings in which the director is convicted.[531] Also, in relation to proceedings brought by the company against the director,[532] the company is prohibited from paying the director's costs in defending the proceedings where the director is unsuccessful.[533]

9.2.4 *Effect of articles which modify duty to avoid conflicts of interests*

8.198 **Modifications of duties under articles not inconsistent with statutory restriction on indemnities.** There has been debate as to whether the statutory restriction on indemnities is inconsistent with provisions in the articles which modify or relax directors' duties in relation to conflicts of interests.[534] It is not uncommon for articles to require disclosure of conflicts to the board in place of the general law requirement for disclosure to the members.[535] In *Movitex Ltd v Bulfield*,[536] Vinelott J held that such provisions are not invalidated by the statutory provision on the basis that the no-conflict rule does not impose a duty on directors but only a disability. On this analysis, since infringement of the no-conflict rule does not of itself mean that there is a breach of duty, a provision in the articles modifying the rule does not fall foul of Cap.622, s.468. However, as discussed above,[537] the better view is that breach of the no-conflict rule ought properly to be regarded as a breach of duty. Even on this latter approach, it is still possible to reconcile s.468 with particular provisions in the articles that modify the no-conflict rule. In the *Movitex* case, Vinelott J rejected the view that it would be possible to reduce or abrogate the scope of a duty in the articles without infringement of the statutory provision, essentially on the basis that a reduction or abrogation of a duty leads, in substance, to exemption of the director from liability that would otherwise arise and would fly in the face of the purpose of the statutory provision. This is arguably correct. However, a modification of the scope of a duty does not necessarily mean that there is a reduction or abrogation of the duty. It should be open to the courts to characterise particular modifications of duties as altering the parameters of the duty rather than as reducing the requirements of a duty. For example, the constitution could, to an extent, legitimately determine what conduct would be in the interests of a company[538] or what would be the legitimate purposes for the exercise

[530] Section 469 was newly introduced in Cap.622 and did not have an equivalent in the predecessor CO.

[531] Cap.622, ss.469(2)(a) and 469(2)(b)(i).

[532] Including derivative actions: Cap.622, ss.469(2)(b)(iii) and 469(2)(b)(iv).

[533] Cap.622, s.469(2)(b)(ii).

[534] See, e.g., John Birds, "The Permissible Scope of Articles Excluding the Duties of Company Directors" (1976) 39 *Modern Law Review* 394; and see also Ian M Ramsay, "Liability of Directors for Breach of Duty and the Scope of Indemnification and Insurance" (1987) 5 *Company and Securities Law Journal* 129, 134–135.

[535] See para.8.081 above.

[536] [1988] BCLC 104.

[537] See para.8.070.

[538] There can, for example, be legitimate differences for a charitable company compared with a commercial company, with the scope of legitimate activities being determined by the constitution.

of a power by directors.[539] It should also be legitimate, for example, for the articles to require disclosure of conflicts of interests to the board in place of the members. Despite Vinelott J's reservations in *Movitex*, such a provision arguably should not be seen as reducing the scope of the duty but only replaces one corporate organ with another in relation to the power to authorise the conduct that would otherwise lead to a breach of duty.[540] Granted, the distinction between a modification of a duty and a reduction of a duty does not provide a bright line test, and there will be borderline cases which may not be easy to resolve. Nonetheless, s.468 speaks of exemption and indemnification of liabilities and not of modifications of duties. The two notions are conceptually distinct. The fact that a duty can potentially be modified to such an extent that in substance a director is effectively relieved from the duty does not mean that every modification achieves that result.

9.3 Court's power to grant relief

8.199 **Court can relieve director of liability.** Under Cap.622, ss.902–904, the court can relieve a director wholly or partly from liability in any proceedings for negligence, default, breach of duty or breach of trust, if the officer acted honestly and reasonably, and the court is of the view that the officer ought fairly to be excused, having regard to all the circumstances of the case (including those connected with the officer's appointment). These provisions enable company officers to be excused from liability in situations where it would be unjust and oppressive not to do so, recognising that such officers are businesspersons who act in an environment involving risk in commercial decision-making.[541]

9.3.1 *Proceedings within ss.902–904*

8.200 **Scope of coverage of Cap.622, ss.902-904.** In *Customs and Excise Commissioners v Hedon Alpha Ltd*,[542] the English Court of Appeal held that the English equivalent of ss.902–904 is confined to claims by the company or its liquidator against officers for breaches of their duties owed to the company and for officer's liabilities under the Companies Act,[543] but does not extend to actions brought by third parties nor officers' liabilities under other

[539] For the latter point in relation to the duty to exercise powers for proper purposes, see John Birds, "The Permissible Scope of Articles Excluding the Duties of Company Directors" (1976) 39 *Modern Law Review* 394, 400.

[540] Also, any provisions in the former Table A articles which modify the general law requirements (e.g. regs.86(3) and 86(5)) must be regarded as valid, on the basis of their statutory footing and the need to interpret the predecessor CO, s.165 in the context of the whole of the Ordinance, including Table A: see also John Birds, "The Permissible Scope of Articles Excluding the Duties of Company Directors" (1976) 39 *Modern Law Review* 394, 400–401. The current Model Articles, which replaced Table A, are contained in subsidiary legislation. Although subsidiary legislation cannot be inconsistent with the primary legislation, the legislative history of the Model Articles (being derived from Table A) should indicate that the provisions on conflicts of interest in the Model Articles are effective despite Cap.622, s.468.

[541] *Daniels v Anderson* (1995) 16 ACSR 607, 685–686, citing the Report of the UK Company Law Amendment Committee 1906 (Reid Committee Report) para.24, which recommended the introduction of the provision.

[542] [1981] QB 818; applied, for example, in *Re Produce Marketing Consortium Ltd* [1989] 1 WLR 745; *First Independent Factors & Finance Ltd v Mountford* [2008] 2 BCLC 297.

[543] Civil liabilities to the company under the Act would be covered: *Re Duckwari plc (No.2)* [1998] 2 BCLC 315 (Eng CA). There is acceptance that at least certain criminal provisions for the enforcement of particular duties imposed on directors under the Act are covered: *Re Barry and Staines Linoleum Ltd* [1934] Ch 227; *Customs and Excise Commissioners v Hedon Alpha Ltd* [1981] QB 818 (Ackner LJ). However, this view was regarded as incorrect by the Victorian Supreme Court in *Lawson v Mitchell* [1975] VR 579 after careful consideration of the legislative history of the English provision (from which the Australian provision is also derived).

legislation. Relief can be granted for liabilities not only in respect of compensation for the company's losses but also for an account of profits.[544] In Australia, the view that relief is unavailable where proceedings are brought by third parties has been rejected, although the relevant decisions were given in respect of liabilities relating to directors' breaches of duties owed to the company.[545] The question of whether an officer can be relieved from liability under the provision in respect of default under other legislation apart from the Corporations Act in Australia has not been finally resolved, with differences of opinion given in *Deputy Commissioner of Taxation v Dick*.[546] Spigelman CJ adopted a narrow view, consistent with the English authorities. Santow JA was prepared to accept that relief is available in respect of breaches or defaults under other legislation where the relevant statutory provision has a sufficient connection with the subject matter of corporations and directors' duties in the Corporations Act context.[547]

9.3.2 *Honesty*

8.201 **Precondition is that officer acted honestly.** A precondition for the grant of relief is that the officer acted honestly. For example, in *Bairstow v Queens Moat Houses plc*,[548] the directors sought relief from liability to in respect of unlawful dividends. The English Court of Appeal held that where the trial judge had made findings that the directors had dishonestly prepared accounts in order to deceive the market into the belief that the company was much more profitable that it actually was, then it would not be open for the court to regard the directors as having acted honestly and reasonably in paying dividends on the strength of those accounts.

8.202 **Subjective test.** Whether a person has acted honestly or not is assessed under a subjective test.[549] A subjective test of dishonesty does not mean that individuals are free to set their own standards of honesty and are to be assessed with reference to their personal standard;[550] but a person is not to be regarded as being subjectively dishonest simply because the person falls below the objective standards of a hypothetical honest person.[551] A person can still be regarded as subjectively dishonest if the person acts in a way in which he or she knows to be dishonest according to the standards of reasonable

[544] *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749.

[545] *Daniels v Anderson* (1995) 16 ACSR 607, 685–686 (NSWCA) (proceedings by third party auditor seeking contributory negligence against director on basis of director's breach of duty of care owed to the company); *Edwards v Attorney General (NSW)* (2004) 50 ACSR 122 (NSWCA) (personal liabilities to tort creditors arising from directors' decision for company to make payments to existing claimants).

[546] (2007) 64 ACSR 61 (NSWCA).

[547] The third judge, Basten JA, did not decide the issue.

[548] [2001] 2 BCLC 531.

[549] *Re Produce Marketing Consortium Ltd* [1989] 1 WLR 745; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749. Australian courts have stated that a person acts honestly for the purposes of the statutory provision if the person's conduct is without moral turpitude in the sense that it is without deceit or conscious impropriety, without intent to gain improper benefit or advantage and without carelessness or imprudence at a level that negates the performance of the duty in question: see, e.g., *ASIC v MacDonald (No.12)* (2009) 259 ALR 116, [11]–[22].

[550] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, 389; and see *Bairstow v Queens Moat Houses plc* [2001] 2 BCLC 531, [58].

[551] On the concept of subjective dishonesty generally, see *Aktieselskabet Dansk Skibsfinansiering v Brothers* (2000) 3 HKCFAR 70; *Twinsectra Ltd v Yardley* [2002] 2 AC 164; *Barlow Clowes Intl Ltd v Eurotrust Intl Ltd* [2006] 1 WLR 1476 (PC).

and honest people, even though he or she feels personally that the conduct is not dishonest (measured against his or her own standards).[552]

9.3.3 *Reasonableness*

8.203 **Officer must have acted reasonably.** To obtain relief, the officer must also show that he or she acted reasonably. The test of reasonableness has been described as "acting in the way in which a man of affairs dealing with his own affairs with reasonable care and circumspection could reasonably be expected to act in such a case".[553] For example, relief was granted in *Re Claridge's Patent Asphalte Co Ltd*,[554] where the directors had caused the company to enter into an *ultra vires* transaction in circumstances where the directors had acted honestly and had relied, reasonably, on legal advice before entering into the transaction.

8.204 **Even if negligent director might have acted reasonably under Cap.622, ss.902–904.** Sections 902–904 of Cap.622 contemplate that officers who are negligent can still be regarded as having acted reasonably for the purposes of seeking relief under the provision.[555] It has been said that relief can be granted if the negligence was technical or minor in character, and not "pervasive and compelling".[556] Wider considerations can be taken into account and not only the nature of the fault of the officer concerned.[557] In *Re Simmon Box (Diamonds) Ltd*,[558] the court was prepared to grant a director partial relief from liability for negligence in failing to properly insure major company assets. The court took into account the fact that the director was appointed as director in his father's company in name only as he was still a student with no business experience, and felt it understandable why he would have been reluctant to question his father's business acumen in an area where his father had many decades of business experience with apparently no difficulties at all and where he had no experience. It was also significant that it was his father who was primarily at fault.[559]

8.205 **Considerations: each case depends on its own facts.** Each case depends on its own facts though, and the mere fact that a director was a non-executive director or was not expected to be involved in the running of the business does not mean that relief would be granted. For example, in *Queensway Systems Ltd v Walker*,[560] relief was denied where there were breaches of duties in connection with unlawful loans and misappropriation of company assets in a husband and wife company. The wife was

[552] *cf R v Lockwood* [1986]1 WLR 125.

[553] *Re Duomatic Ltd* [1969] 2 Ch 365, 376–377; applied in *Re Brian D Pierson (Contractors) Ltd* [2001] 1 BCLC 275; *PNC Telecom plc v Thomas (No.2)* [2008] 2 BCLC 95.

[554] [1921] 1 Ch 543. For another example where relief was granted, see *Re Duomatic Ltd* [1969] 2 Ch 365; and see also *PNC Telecom plc v Thomas (No.2)* [2008] 2 BCLC 95, [27]–[33].

[555] *Re D'Jan of London Ltd* [1994] 1 BCLC 561; *Re Simmon Box (Diamonds) Ltd* [2000] BCC 275; *Barings plc v Coopers & Lybrand* [2003] EWHC 1319, [1133]–[1134]; *Equitable Life Assurance Society v Bowley* [2004] 1 BCLC 180, [45]; *PNC Telecom plc v Thomas (No.2)* [2008] 2 BCLC 95, [94].

[556] *Barings plc v Coopers & Lybrand* [2003] EWHC 1319 (Ch) [1133].

[557] *Barings plc v Coopers & Lybrand* [2003] EWHC 1319 (Ch) [1133].

[558] [2000] BCC 275. The decision was reversed on appeal on other grounds: *Cohen v Selby* [2001] 1 BCLC 176.

[559] See also *Re D'Jan of London Ltd* [1994] 1 BCLC 561 where partial relief was granted.

[560] [2007] 2 BCLC 577.

not involved in the business and was ignorant of her duties as director, but the court was not prepared to grant relief in circumstances where she was a recipient of the significant funds which she knew was paid out of the company.

8.206 **Examples.** Other examples where relief was not given include *Chintung Futures Ltd (in liq) v Lai Cheuk Kwan Arthur*[561] and *Dorchester Finance Co Ltd v Stebbing*,[562] discussed earlier.

9.3.4 *Ought fairly to be excused*

8.207 **Court has wide discretion in deciding whether officer should be excused.** The court has a wide discretion in deciding whether the officer ought to be excused. For example, even if an officer is regarded as having acted honestly and reasonably in relation to misapplication of company assets, the court is likely to refuse to grant relief where the officer has received company assets or funds to the detriment of creditors.[563] Avoiding a windfall for a shareholder might be a valid factor to be taken into account.[564]

[561] [1994] 1 HKLR 95.

[562] [1989] BCLC 498. Relief was also denied in the following cases: *Guinness plc v Saunders* [1990] 2 AC 663 (receipt of unauthorised remuneration and clear conflict of interest); *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749 (misuse of confidential information and obtaining secret profits); *Re Loquitur Ltd* [2003] 2 BCLC 442 (unlawful dividends); *PNC Telecom plc v Thomas (No.2)* [2008] 2 BCLC 95 (clear conflict of interest and secret profits).

[563] *Guinness plc v Saunders* [1990] 2 AC 663; *Inn Spirit Ltd v Burns* [2002] 2 BCLC 780; *Queensway Systems Ltd v Walker* [2007] 2 BCLC 577, [70].

[564] See *Circle Petroleum (Qld) P/L v Greenslade* (1998) 16 ACLC 1577 (Qld SC).

against the company on the basis that the rule does not apply to forgeries and further that the director did not have any authority from the company to enter into the transactions. On appeal, the Court of Appeal affirmed that the director did not have any apparent authority, and accordingly the company was not bound. While the decision is sometimes cited as an example of the application of *Ruben*, the decision is best interpreted as one that is based on the question of authority rather than forgery. The resolution was a forgery in the narrow sense (as the signatures of the other directors on the resolution were forged), but the mortgage document was not forged (in the narrow sense). The resolution was a nullity not only because of the forged signatures but because there was in fact no resolution passed. The real issue was whether the mortgage was binding on the company, and the court correctly held that it was not because the director had neither actual nor apparent authority to contract. This is a situation where the indoor management rule is not relevant in the first place because of the absence of authority.

Insiders

12.081 **Insiders cannot rely on Rule.** A third exception to *Turquand's* rule is that "insiders" cannot rely on the rule. In *Morris v Kansenn*,[165] the board purportedly allotted shares to a director, but none of the persons acting as directors were duly holding office as such at the time. The House of Lords held that the director who took the shares could not rely on *Turquand's* rule on the basis that it is the duty of the directors (whether *de jure* or *de facto*) to see that the company's transactions are regular. To allow directors the benefit of the presumption of regularity where it was their duty to be aware of the correct procedures would be to encourage ignorance and condone dereliction of duty.[166] However, the "insiders" exception applies only where the director is purporting to act on behalf of the company in the transaction with himself or herself.[167]

1.4.3 *Statutory indoor management rule*

12.082 **Statutory indoor management rule in Cap.622.** Sections 117 to 119 of Cap.622 set out a new statutory indoor management rule, largely based on ss. 40–42 of the Companies Act 2006 (UK). Under s.117(1):

> "... in favour of a person dealing with a company in good faith, the power of the company's directors to bind the company, or authorise others to do so, is to be regarded as free of any limitation under any relevant document of the company".

12.083 **Person dealing with a company.** Under s.117(2)(a) of Cap.622, a person deals with a company if the person is a party to any transaction or any other act to which the company is a party. Under the corresponding English provision, it was held in *EIC Services Ltd v Phipps*[168] that "the section contemplates a bilateral transaction between the company and the person dealing with the company or an act to which both are

[165] [1946] AC 459.
[166] [1946] AC 459, 476.
[167] See *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549.
[168] [2004] 2 BCLC 589, [35].

parties such as will bind the company ... if the section applies" and that the issue of bonus shares to members does not constitute the members "dealing with" the company. This is on the basis that there is no bilateral transaction or act where the company's issue of bonus shares is an internal arrangement of the company with no action required from the members receiving the shares.[169]

The specific wording of s.117(2)(a) of Cap.622 has, in the UK in respect of the equivalent provision in Companies Act 2006 s 40, been said to give rise to circularity:

> "In cases where section 40(1) is needed to enforce a transaction there is no enforceable transaction unless the third party contractor is 'dealing with' the company, yet dealing with the company depends on a person being a party to the transaction".[170]

To avoid circularity and to give effect to the statutory intention, that s.117(2)(a) must be read as requiring the person to be a party to any transaction or act to which the company is "purportedly" a party.[171]

12.084 **Good faith.** A person is presumed to have acted in good faith unless the contrary is proved.[172] *Prima facie*, a person is not obliged to inspect the company's articles or otherwise enquire as to the limitations on the directors' powers[173] and so ordinarily, a failure to make such enquiries will not amount to bad faith. Also, a person is not to be regarded as acting in bad faith by reason only of the person's knowing that an act is beyond the directors' powers.[174] For example, where the directors were not improperly exercising their powers in the transaction, albeit there was some procedural irregularity at the board meeting, the outsider dealing with the company could still be regarded as having acted in good faith even if he or she was aware of the irregularity.[175] However, knowledge of the irregularities or a failure to make enquiries can in particular circumstances constitute a lack of good faith. For instance, if a director was in breach of fiduciary duty in causing the company to enter into the transaction, an outsider who is aware of the circumstances of the breach of duty (or who is put on enquiry) could be regarded as acting in bad faith.[176] Even where there is no actual notice of the irregularities, the statutory provision does not entirely absolve outsiders from making investigations when the circumstances are such that they ought reasonably to

[169] But for the view that a gift or unilateral act is within the statutory provision, see *Gore-Browne on Companies*, para 8[15] (issue 138); Christian Twigg-Flesner, "Sections 35A and 322 Revisited: Who is a 'Person Dealing with a Company'?" (2005) 26 *Company Lawyer* 195, 199. On this view, a person is still a party to the transaction or act as the person is a recipient of the gift under the transaction or pursuant to the act.
[170] David Kershaw, *Company Law in Context* (2nd edn, Oxford University Press 2012) 131.
[171] Cf. David Kershaw, *Company Law in Context* (2nd edn, Oxford University Press 2012) 131; *TCB Ltd v Gray* [1986] 1 All ER 587, 596; *Story v Advance Bank of Australia Ltd* (1993) 31 NSWLR 722, 733.
[172] Cap.622, s.117(1)(b).
[173] Cap.622, s.117(2)(d).
[174] Cap.622, s.117(2)(c).
[175] See *Ford v Polymer Vision Ltd* [2009] 2 BCLC 160.
[176] See *Wrexham Association Football Club Ltd v Crucialmove Ltd* [2008] 1 BCLC 508 (director failed to disclose conflict of interest in the transaction; and outsider held to have acted in bad faith where he acted closely with the director to procure the relevant transactions and was aware of director's conflict of interest and failed to enquire whether board authorised transaction with full knowledge of the conflict); and see also *Ford v Polymer Vision Ltd* [2009] 2 BCLC 160.

make investigations.[177] It has been suggested in England that the test of "good faith" in the present context is the same as the test adopted in *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd*[178] for preventing an outsider from being able to rely on the apparent authority of the purported agent; namely that good faith means a belief in the validity of the transactions which was not irrational or dishonest.[179]

12.085 **Dealing under the directors' powers.** Section 117 of Cap.622 applies only where the transaction is entered into by the board or through an agent acting under the authority of the board.[180] The better view is that the irregularities covered by the provision include a lack of quorum at a board meeting, although the provision would not apply to decisions made by persons who cannot on substantial grounds claim to be the board.[181]

12.086 **Whether s.117 applies if agent has neither actual nor apparent authority.** Section 117 of Cap.622 provides that only the directors' powers are to be regarded as free of constitutional limitations. It seems that the provision does not confer authority on persons who have no authority (actual or apparent) flowing from the board under agency law.[182] There is an alternative view that the provision should be capable of applying "if a document is put forward as a decision of the board by someone appearing to act on behalf of the company, in circumstances where there is no reason to doubt its authenticity".[183] This suggests that the statutory provision can be relied upon even if the person purportedly acting for the company does not have any actual nor apparent authority. However, the difficulty with this view is that s.117 only removes limitations on the directors' powers in the company's articles and other "relevant documents" that might otherwise restrict the ability of the directors to bind the company or to authorise others to do so. An example of such a limitation is a provision in the articles limiting the power of the directors to borrow over a certain amount without approval of the members in general meeting.[184] Section 117 can operate to enable the company to be bound to a loan transaction entered into by the directors or under their authority even

[177] See *Wrexham Association Football Club Ltd v Crucialmove Ltd* [2008] 1 BCLC 508, [46]–[47] (English CA).

[178] (2010) 13 HKCFAR 479; see para.12.040 above.

[179] *Bass Jarrington Ltd v The Royal Bank of Scotland plc* (unrep., HC13C02505, 7 November 2014) (Ch D), [117], citing *LNOC Ltd v Watford Association Football Club Ltd* [2013] EWHC 3615 (Comm). As to the latter case, see para.12.097 below.

[180] *Palmer's Company Law* (Vol.1), para.3.329.

[181] See *Smith v Henniker-Major & Co (a firm)* [2003] Ch 182, [41], *per* Robert Walker LJ; *Ford v Polymer Vision Ltd* [2009] 2 BCLC 160, [77].

[182] See *Bass Jarrington Ltd v The Royal Bank of Scotland plc* (unrep., HC13C02505, 7 November 2014) (Ch D), [117], where it was stated that if the transactions were entered into without authority, then s.40 of the Companies Act 2006 (UK) could not be relied upon to enable the outsider to enforce the transactions against the company.

[183] *Smith v Henniker-Major & Co (a firm)* [2003] Ch 182, [108], *per* Carnwarth LJ; Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French and Ryan on Company Law* (32nd edn, Oxford University Press 2015) para.19.5.5.3. Compare also the differently worded Australian provisions (Corporations Act 2001 ss.128 and 129) in respect of which the Australian courts have held that it is not necessary that the person representing the company have authority from the company to commit the company to the relevant transactions or execute the relevant documents, so long as the person has authority to undertake some negotiation or other steps in relation to the contemplated transaction: *Soyfer v Earlmaze Pty Ltd* [2000] NSWCA 1068, [82] *per* Hodgson CJ; *Australia and New Zealand Banking Group Ltd v Frenmast Pty Ltd* (2013) 282 FLR 351; *Esperance Cattle Company Pty Ltd v Granite Hill Pty Ltd* (2014) 47 WAR 318.

[184] Predecessor CO, First Schedule, Table A reg.81 (repealed).

though the general meeting approval was not obtained. In this sense, s.117 operatives "negatively", but the provision does not confer any power on the directors other than by removing the specified restrictions.[185] Nor could the provision confer power or authority on other persons other than removing the limitations on the directors' powers in the relevant documents.

12.087 **Limitations under the company's relevant documents.** "Relevant documents" means the company's articles, and any resolutions of the members (or any class of members), and any agreements between the members (or members of a class).[186] Accordingly, the provision also applies to limitations on directors' powers under a shareholders' agreement.

12.088 **Transaction between company and director.** Where the transaction[187] is between the company and a director,[188] then Cap.622, s.118 applies. Although s.117 might *prima facie* enable the director to enforce the transaction against the company, s.118 operates to enable the company to rescind the transaction. The right to rescission is lost in the circumstances set out in s.118(3), such as where the company has already affirmed the transaction or where there is intervention of third party's rights acquired in good faith and for value.[189]

12.089 **Restriction in respect of charitable companies.** Cap.622, s.119 restricts the application of s.117 in respect of charitable companies.[190] A person dealing with a charitable company will be entitled to rely on s.117 only if: (a) the person did not know that the company was a charitable company; or (b) gave full consideration and did not know that the transaction was beyond the directors' powers. Accordingly, the provision gives a greater measure of protection for the funds of charities.

12.090 **Overlap with common law Rule.** The statutory indoor management rule overlaps to a large extent with the common law rule. The exception to the statutory rule based on the absence of good faith is narrower than the "notice" exception under the common law, and so the statutory provision gives greater protection to outsiders in this respect. However, the common law rule still has an area of operation, such as where the outsider deals with the company not through the directors but through the members in general meeting (e.g. decision made by the members) or where the restriction on the directors' powers is not derived from the articles (or other "relevant document"), although these circumstances may be rare. Also, the common law rule applies in respect of charitable companies even if s.117 does not apply by reason of s.119.

[185] *Palmer's Company Law* (Vol.1), para.3.307.

[186] Cap.622, s.117(6).

[187] "Transaction" includes any act: Cap.622, s.118(10).

[188] Cap.622, s.118 also covers transactions between a company and a director of the company's holding company or with an entity connected with the director of the company or director of the holding company. Section 486 defines "entity connected with a director": s.118(9).

[189] However, the provision does not prevent the operation of other rules of law which might invalidate the transaction: Cap.622, s.118(8). Also, whether or not the transaction is rescinded, the director or other persons as specified in s.118(4) are required to indemnify the company for its losses or to account to the company for any gains made: Cap.622, s.118(4).

[190] Referred to in the section as "exempt companies". These are companies which are entitled to dispense with the word "Limited" in their names under Cap.622, s.103 and which are charitable bodies exempt from tax under s.88 of the Inland Revenue Ordinance (Cap.112): see also Cap.622, s.118(4).

1.4.4 *Validity of acts of directors*

12.091 **Acts of director valid despite subsequent discovery of defect in appointment under Cap.622 s.461.** Section 461[191] of Cap.622 has replaced predecessor CO, s.157 (repealed). Under ss.461(1)(a)–461(1)(b), the acts of a director are valid despite the fact that it is discovered afterwards that there was a defect in his or her appointment or that he or she is not qualified to hold office.[192] In *Morris v Kanssen*,[193] it was held that the English equivalent of predecessor CO, s.157 applied to defective appointments only, and not where there was no appointment made at all or where a director ceases to hold office but continues to act as a (*de facto*) director. Cap.622, s.461 is wider than the predecessor provision in s.157, and also validates the acts of a person acting as director despite the person having ceased to hold office as director or despite the person not being entitled to vote on the matter in question: Cap.622, ss.461(1)(c)–461(1)(d). Section 461 overturns *Morris v Kanssen* to the extent that the acts of a person who had ceased to hold office can be validated, but *Morris v Kanssen* would still be good law in respect of situations where no attempt had been made to appoint the person as director at all. Section 461(2)(a) also makes it clear that the acts of a person purporting to act as director can be valid notwithstanding that the appointment was made in contravention of the restrictions on bodies corporate or under-age persons acting as director.

12.092 **Circumstances where persons not entitled to rely on Cap.622, s.461.** A person who had notice of the defects in the appointment or qualifications etc. before the time of the relevant act is not entitled to rely on the statutory provision.[194] It has also been held by the Court of First Instance that s.461 is aimed at providing protection to third parties, and if, as in the case at hand, the members are challenging the appointment of the directors, the directors cannot rely on s.461 to justify their appointment and the lawfulness of their conduct vis-à-vis members.[195] The court observed that otherwise, the directors can rely on their own wrongdoing to obtain directorship and to conduct the business of the company to the detriment of its members, which cannot be right. Similarly, the English court has held that the statutory provision validates unauthorised actions in favour of those dealing with a company and does not validate hostile actions which persons dealing with the company do not want to be validated, such as litigation against them.[196] Furthermore, a director cannot invoke the statutory provision to validate, in his or her favour, a transaction which was invalid because of some defect caused by a breach of his duty to see that the affairs of the company are properly conducted.[197]

[191] Modelled on Companies Act 2006 (UK) s.161.

[192] For example, directors might be required by their articles to hold shares in the company in order to be eligible or qualified to be appointed as director: see predecessor CO, Table A reg.79 (repealed); and see, e.g., *British Asbestos Company Ltd v Boyd* [1903] 2 Ch 439l; *Channel Collieries Trust Ltd v Dover, St Margaret's and Martin Mill Light Railway Co* [1914] 2 Ch 506; *Qualihold Investments Ltd v Bylax Investments Ltd* [1991] 2 HKC 589, 591.

[193] [1946] AC 459.

[194] *Morris v Kanssen* [1946] AC 459; *Re the Sherlock Holmes International Society Ltd (No 2)* [2017] 2 BCLC 14, [113], appeal dismissed [2018] 1 BCLC 188.

[195] *Re Kam Lan Koon* [2015] 5 HKLRD 79, [93].

[196] *Re the Sherlock Holmes International Society Ltd (No.3)* [2017] 2 BCLC 38, [61].

[197] *Re the Sherlock Holmes International Society Ltd (No.3)* [2017] 2 BCLC 38, [59]–[60].

1.4.5 *Conveyancing and Property Ordinance*

12.093 **Section 20 rebuttable presumption that deed duly executed if seal affixed in presence of two directors or secretary/director.** Section 20(1) of the Conveyancing and Property Ordinance (Cap.219) (CPO) deals with the execution of deeds by corporations. The section provides that in favour of a person dealing with a corporation in good faith, a deed shall be deemed to have been duly executed by the corporation if the deed purports to bear the seal of the corporation affixed in the presence of and attested by its secretary or other permanent officer of the corporation and a member of the board or other governing body, or by two members of that board or body. The provision was originally enacted to avoid the need for persons to enquire as to the formalities for execution under a corporation's constitution.[198] The provision deems due execution in the sense that a person can assume there to be due execution under s.20 of the CPO notwithstanding different requirements in the constitution. It is generally accepted that the deeming only operates to give rise to a rebuttable presumption of due execution, and so for example a person who knows that the affixing of the seal does not comply with the corporation's constitution will not be entitled to rely on the provision as the person would not be dealing with the corporation in good faith within the statutory provision.[199] In *Re Moulin Global Eyecare Holdings Ltd*,[200] the deed on its face complied with CPO, s.20, but the third party was not entitled to enforce the transaction against the company where the third party had constructive notice of irregularities in the conferral of authority by the company for entering into the transaction.

12.094 **Section 23 instrument appearing to be duly executed shall be presumed to have been duly executed.** Section 23 of the CPO deals with instruments generally and provides that an instrument appearing to be duly executed shall be presumed, until the contrary is proved, to have been duly executed.[201] For the presumption to apply, the document must on its face appear to have been duly executed in accordance with any requirements in the articles[202] or in accordance with CPO, s.20.

12.095 **Reliance on ss.20 and 23 in conveyancing.** CPO, ss.20 and 23 are often relied upon in the conveyancing context with respect to the question of what would be sufficient for a vendor to discharge its obligations to show good title to the property to be conveyed under the agreement for sale and purchase before completion.

1.4.6 *Validity of documents executed as if under seal*

12.096 **Executed as if under seal.** Sections 127(3)–127(5) of Cap.622 provides for the execution of a document by signatures of the specified officers in a manner that would be treated as equivalent to execution under seal: see para.12.045 above. Section 127(6) of Cap.622 then provides that in favour of a purchaser in good faith for value, a document is regarded

[198] *Bolton Metropolitan Borough Council v Torkington* [2004] Ch 66, [31].

[199] See, e.g., Michael Wilkinson, "The Continuing Saga of Defective Execution of Conveyancing Documents: Statutory Intervention" (2003) 33 *Hong Kong Law Journal* 347, 354–355; Judith Sihombing and Michael Wilkinson, *Hong Kong Conveyancing* (Vol 1(A), LexisNexis looseleaf) VI[157].

[200] (2009) 12 HKCFAR 621. See also *Excelling Profit Investments Ltd v Sera Ltd* [1992] 2 HKC 262 (CA).

[201] See, e.g., *Excelling Profit Investments Ltd v Sera Ltd* [1992] 2 HKC 262 (CA); *Leung Kwai Lin v Wu Wing Kuen* (2001) 4 HKCFAR 55.

[202] See *Grand Trade Development Ltd v Bonance Intl Ltd* [2001] 3 HKC 137 (CA). But see CPO s.23A(1) in respect of deeds executed before 9 May 2003.

as having been executed by a company if the document purports to have been signed in accordance with s.127(3). Following the equivalent English provisions, s.127(6) appears to be intended to provide for a presumption of validity, where signatures are used, that is equivalent to the presumption that applies, where the seal is used, pursuant to the conveyancing legislation (CPO, s.20(1), discussed at para.12.093 above).[203]

12.097 **Presumption of validity.** The presumption in Cap.622, s.127(6) applies in favour of a purchaser in good faith for valuable consideration: see also Cap.622, s.127(7). This refers to a person acting in good faith who acquires a proprietary interest for valuable consideration.[204] The concept of a purchaser in good faith for value is derived from the equitable concept of a bona fide purchaser for value without notice. In the latter context, it has been said that questions of the bona fides or good faith of a person requires enquiry not only as to whether there is a genuine and honest absence of notice but also enquiry into the whole conscience of the person.[205] In a decision dealing with the English equivalent of s.127(7) itself, it was suggested that the requirement of "good faith" should follow the test for negating apparent authority under the common law, as set out in *Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd,*[206] namely whether the person was acting dishonestly or irrationally.[207] The test in *Thanakharn* was applied on the basis that the statutory provision provides in effect a statutory presumption of apparent authority and that therefore a similar test to the common law should be applied to promote clarity and consistency in the law.

12.098 **Meaning of "purports".** Section 127(6) of Cap.622 can apply where the document "purports" to have been signed in accordance with s.127(6). The word "purports" refers to the impression a document conveys.[208] For example, where there are signatures of persons stated in the document to be directors, the document would "purport" to be signed by the directors even if they were not in fact directors. If, for example, those persons had apparent authority to enter into the transaction, then s.127(6) could be relied upon to cure the formal invalidity of the document, and the transaction can be enforced against the company under a document treated as being duly executed.

12.099 **Better view is that Cap.622, s.127(6) not applicable to validate transaction if total absence of authority.** In *Lovett v Carson Country Homes Ltd*,[209] the English court favoured the view that the provision can also be relied upon by a third party even where there is a lack of actual or apparent authority on the part of the persons signing and even in the case of forged signatures, although the court expressly stated that no conclusive views were being laid down. However, the better view is that s.127(6) would not apply to validate a transaction if there was a total absence of authority on the part of the persons signing or if a signature is forged. It seems that the provision provides only a counterpart to CPO s.20(1), and as the general understanding of the CPO provision is that it only

[203] For the English provisions, see Companies Act 2006, s.44(5) and the Law of Property Act 1925, s.74.
[204] See *Lovett v Carson Country Homes Ltd* [2009] 2 BCLC 196, [73]. "Purchaser" also includes a lessee, mortgagee or other person who acquires a property interest: see s.127(7).
[205] *Midland Bank Trust Co Ltd v Green* [1981] AC 513; *Cheung Pik-wan v Tong Sau-ping* [1986] HKLR 921.
[206] (2010) 13 HKCFAR 479; see para.12.040 above.
[207] *LNOC Ltd v Watford Association Football Club Ltd* [2013] EWHC 3615 (Comm), [91].
[208] *Lovett v Carson Country Homes Ltd* [2009] 2 BCLC 196, [79].
[209] [2009] 2 BCLC 196, [80], [98]–[102], *per* Davis J (Chancery Division).

sets out a rebuttable presumption of validity and does not apply to cure forgeries,[210] then s.127(6) would also be limited in such manner. Section 127 deals only with formal validity in the execution of documents and was introduced because the seal is no longer compulsory under Cap.622. It does not appear that the Hong Kong legislature intended s.127(6) to effect a radical change by sidewind to the existing law on agents' authority or the law in respect of forgeries and the indoor management rule.

1.5 Ratification

12.100 **Where no authority, for company to enforce transaction against third party it must be ratified under agency principles.** It has been seen above that where a transaction is entered into by a person purportedly for the company without actual authority, the principles of apparent authority and the indoor management rule can enable the third party dealing with the company to enforce the transaction against the company. However, those principles do not enable the company to enforce the transaction against the third party.[211] Where, for example, a director has given notice to a third party purportedly on behalf of the company, although the outsider may presume regularity of the notice under the indoor management rule, the company cannot rely on that rule to compel the latter to accept the validity, and hence the consequence, of the notice.[212] For an irregular transaction to be enforceable by the company, the company needs to ratify or affirm the transaction pursuant to ordinary agency law principles. The transaction can be ratified by the company through a person or persons having actual authority to enter into the transaction. Where the board could have authorised the transaction, then the board can ratify by passing a resolution to that effect.[213] Where the matter is within the authority of the general meeting, then the general meeting can ratify by an ordinary resolution.[214] In any case it seems that ratification can be made by the unanimous assent of the members.[215] Ratification need not be express but can be implied.[216] Once ratified, the third party can also enforce the transaction against the company without the need to rely on the principles of apparent authority or the indoor management rule.

2. Liabilities for Civil and Criminal Wrongs

2.1 Tort and other civil liabilities

2.1.1 *Corporate liability*

12.101 **Company liable in tort.** A company can be liable in tort as well as for other civil wrongs, whether under the common law or statute. Imposition of liability on the company reduces the profits of the company available for distribution to shareholders.

[210] See para.12.093 above and see also P Smart, "Conveyancing and Companies: The Single Director and the Company Seal (Part 1)" (2001) 9 *Hong Kong Lawyer* 46.
[211] *Morris v Kanssen* [1946] AC 459, 474-475 per Lord Simmonds.
[212] *Hughes v NM Superannuation Pty Ltd* [1993] 29 NSWLR 653.
[213] *Re Portuguese Consolidated Mines Ltd* (1890) 45 Ch D 16, 26–27; *Yifung Developments Ltd v Liu Chi Keung Ricky* [2017] 5 HKLRD 16 (CA).
[214] *Irvine v Union Bank of Australia* (1877) 2 App Cas 366.
[215] See Chapter 6.
[216] *Re Mawcon Ltd* [1969] 1 WLR 78.

Accordingly, the shareholders are ultimately required to bear the burden of the company's liability. This can be justified on the basis of collective responsibility of the shareholders, who are the residual bearers of risk in the company and are the persons for whose benefit the company's activities are undertaken.[217]

Vicarious liability

12.102 **Company can be principal for acts committed by its employees or agents.** Liability in tort or for other civil wrongs can be imposed on a company through the principles of vicarious liability. Despite some doubts in earlier times,[218] it is now well established that a company can be a principal which is liable for the acts of its employees or agents committed within the scope of their employment or authority, pursuant to ordinary principles of vicarious liability.[219]

Primary liability

12.103 **Can also be liable directly, e.g. for safety of persons.** A company can also be liable directly rather than vicariously. For example, where a company is under a duty of care to ensure the safety of persons, the absence of reasonable care taken can be sufficient for the company to be regarded as being in breach of the duty without the need to establish negligence on the part of any particular individual within the company.[220] Such a situation means there is primary or direct liability on the part of the company rather than vicarious liability.

12.104 **Individuals' conduct or mental state attributed to company.** There can also be primary liability on the part of a company where certain individuals' conduct or states of mind are treated as the company's own through the principles of attribution, discussed below.

Attribution of conduct and mental states to company

12.105 **Rules of attribution.** The leading decision on attribution is the Privy Council's decision (as delivered by Lord Hoffmann) in *Meridian Global Funds Management Asia Ltd v Securities Commission*.[221] Pursuant to the principles set out in Lord

[217] See John Keeler, "Thinking Through the Unthinkable: Collective Responsibilities in Personal Injury Law" (2001) 30 *Common Law World Review* 349; Stefan H C Lo, *In Search of Corporate Accountability: Liabilities of Corporate Participants* (Cambridge Scholars, 2015) ch.3.

[218] It was thought, for example, that the doctrine of *ultra vires* restricted the circumstances when a company would be liable for the conduct of its officers or agents: see *Abrath v North Eastern Railway Co* (1866) 11 App Cas 247, 251–252.

[219] See, e.g., *Citizens' Life Assurance Co Ltd v Brown* [1904] AC 423; *New Zealand Guardian Trust Co Ltd v Brooks* [1995] 1 WLR 96. On vicarious liability of principals for agents' torts generally, see Peter Watts and F M B Reynolds, *Bowstead and Reynolds on Agency* (20th edn, Sweet and Maxwell 2014) [8–177].

[220] See *Commonwealth v Introvigne* (1982) 41 ALR 577; *Cathay Pacific Airways Ltd v Wong Sau Lai* (2006) 9 HKCFAR 371. The position is different in relation to criminal liability: see *Attorney-General's Reference (No. 2 of 1999)* [2000] QB 796.

[221] [1995] 2 AC 500. For the facts of the case, see para.12.122 below. The rules of attribution are also discussed at length by Lord Walker in the Court of Final Appeal decision in *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218. For an earlier Hong Kong case which applied the principles from *Meridian*, see *Goldlion Properties Ltd v Regent National Enterprises Ltd* (2009) 12 HKCFAR 512. See also Ernest Lim, "Attribution in Company Law" (2014) 77 *Modern Law Review* 794.

Hoffmann's judgment, there are three categories of rules of attribution to determine whether certain acts or mental states are to be regarded as the company's:

1. Primary rules of attribution. These are set out in the corporate constitution (such as where articles specify that decisions of the board or of the members in general meeting on particular matters are decisions of the company) or implied by principles of company law (such as the doctrine of unanimous consent of members).
2. General rules of attribution. These are rules which are equally applicable to natural persons, namely principles of agency law.
3. Special rules of attribution. Where the above principles of attribution are not appropriate for determining how a particular law applies to companies, it is necessary for the court to fashion a special rule of attribution to determine whether the act or mental state of a particular individual should be attributed to the company for the purposes of that particular law.[222] This is a matter of interpretation of the substantive rule of law in question. If the rule is intended to apply to companies, then one asks the questions: how was it intended to apply, and whose act (or knowledge or state of mind) was for this purpose intended to count as the act etc. of the company? Where the law is contained in a statute, the issue is determined as a matter of statutory interpretation, taking into account the language of the statutory provision and its content and policy.

12.106 ***Meridian Global* case.** In the *Meridian Global* case,[223] the company (Meridian) failed to give notice of its substantial securities holdings in a listed company in breach of securities legislation. An investment manager of Meridian had knowledge of the company's substantial holdings. In holding the company to be liable, the Privy Council applied a special rule of attribution to attribute the knowledge of the investment manager to the company. The policy of the statutory provision in question was to compel, in fast-moving markets, immediate disclosure of substantial securities holders so as to ensure market transparency as to the identity of controllers of listed companies. Accordingly, for the purpose of the statute, it would be appropriate to treat the knowledge of the employees of the company who have authority to acquire securities for the company. The policy of the statute would be defeated if only knowledge of the board or senior managers would be attributed to the company.

12.107 ***Lennard's Carrying Co* case.** In *Lennard's Carrying Co v Asiatic Petroleum Co*,[224] the relevant statutory provision provided that an owner of a ship would not be liable for "any loss or damage happening without his actual fault or privity" where any goods taken on the ship are lost or damaged by reason of fire. Accordingly, liability was based on primary liability of the ship-owning company and vicarious liability would not be covered. A cargo of benzine on board the appellant company's ship was

[222] The special rules of attribution are not confined to statutory rules but can also be applied to legal rules under the common law: *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218, [78]; *Bilta (UK) Ltd v Nazir (No.2)* [2015] 2 WLR 1168, [197] *per* Lords Toulson and Hodge (UKSC).

[223] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500.

[224] [1915] AC 705; applied in *Wong Hing Faat v Hong Kong and Yaumati Ferry Co Ltd* [1992] 1 HKC 497.

lost by a fire caused by the unseaworthiness of the ship in respect of the defective condition of her boilers. The managing director of another company which managed the ship on behalf of the appellant company was at fault. That managing director was also a director of the appellant company. Viscount Haldane LC considered that for the appellant company to itself be at fault, there must be a person who can be regarded as a "directing mind and will of the company", such as the board itself or a person who has authority comparable with that of the board given to him under the articles. The House of Lords attributed the managing director's fault as the appellant company's personal fault and the company was held liable, on the basis that the company failed as a matter of evidence to discharge its burden of showing that the managing director was only a servant or agent.[225] Lord Hoffmann in the *Meridian* case interpreted Viscount Haldane's approach as one involving the application of a special rule of attribution based on an interpretation of what the statutory provision required.[226]

12.108 **"Directing mind and will" can distract from purpose of rules of attribution.** Although the concept of the "directing mind and will" of a company is still sometimes cited by judges and commentators when dealing with the question of attribution, particularly in criminal cases,[227] Lord Hoffmann had observed in the *Meridian* case that such anthropomorphism distracts from the purpose of rules of attribution.[228] It is well to heed Lord Hoffmann's observations. Focus should be on construction or interpretation of the substantive rule to see how it should be applied to achieve the purpose of the rule, rather than dwelling on the "metaphysics" of a company.[229] Conceiving of the company as having human characteristics and equating directors or others as the company itself can give rise to confusion in legal reasoning, as happened in the much-criticised decision in the case of *Stone & Rolls Ltd (in liq) v Moore Stephens*.[230]

12.109 **Individual director's or board's knowledge.** Where the board's knowledge is to be attributed to the company under the primary rules of attribution, the knowledge of a single director would not be regarded as the company's knowledge where the other directors do not possess that knowledge.[231] As the decision of a majority of directors is a decision of the board, then it seems that the collective knowledge or intentions of the majority should be sufficient for attribution of that state of mind to the board.

[225] The memorandum and articles were not put in evidence and the managing director also did not give evidence.
[226] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 509.
[227] See para.12.124 below.
[228] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 509–510.
[229] See [1995] 2 AC 500, 511; see also *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218, [67], [71], [106] *per* Lord Walker. *cf. Bilta (UK) Ltd v Nazir (No.2)* [2015] 2 WLR 1168, [70], where Lord Sumption expressed the view that the "directing mind and will" concept remains valuable in describing a person who can be identified with the company for the purpose of imposing direct, as opposed to vicarious, liability on the company. However, it is submitted that the rules of attribution can adequately deal with imposition of direct liability (*e.g.* under the primary rules of attribution) without any need for invoking the concept of the "directing mind and will".
[230] [2009] 1 AC 1391. See note 239 below; and see further Eilis Ferran, "Corporate Attribution and the Directing Mind and Will" (2011) 127 *Law Quarterly Review* 239.
[231] *Powles v Page* (1846) 3 CB 16, 136 ER 7; *Red Sea Tankers Ltd v Papachristidis* [1997] 2 Lloyd's Rep 547.

Where attribution is on the basis of a special rule of attribution, it is possible to treat an individual director's knowledge as the company's for the particular purposes at hand.[232]

12.110 **Concept of aggregation can be applied.** It also seems to be possible to apply the concept of aggregation in the civil context, such that acts or knowledge of different persons can be combined together and attributed to the company.[233] Thus, where the elements of a tort cannot be established against any individual in a company but can be established against the company by attributing the acts of separate individuals to the company, then the company will be liable.[234] However, aggregation is not possible for the purposes of establishing a fraudulent or dishonest intent on the part of a company.[235]

12.111 **Wrongdoing or knowledge of director or agent not necessarily attributed to company for all purposes: *Bilta* case.** There are circumstances where a person's conduct or state of mind would not be attributed to the company by reason of the person's fraud perpetrated on the company or his or her breach of duty owed to the company. In *Bilta (UK) Ltd v Nazir (No.2)*,[236] the directors of a company procured the company to engage in transactions to defraud the Revenue in relation to VAT (valued added tax). The fraudulent scheme involved the company becoming insolvent, with a VAT liability that it could not discharge by reason of the insolvency. The liquidators brought proceedings on behalf of the company against the directors and others to recover compensation for breach of the directors' fiduciary duties. Two defendants sought to have the proceedings dismissed on the basis of the illegality defence. Under this defence, the courts would not allow a claimant to succeed in a cause of action that is founded on an illegal act. It was argued that the company was itself a party to the fraud and hence cannot rely on its own illegality in the action against the defendants. The UK Supreme Court rejected that argument, and held that where a company has been the victim of wrongdoing by its directors or agents, the wrongdoing or the knowledge of the director or agent concerned would not be attributed to the company as a defence to a claim brought against the director or agent by the company for the loss suffered by the company as a result of the wrongdoing, even though the wrongdoing or knowledge may be attributed to the company in other types of proceedings and even though the wrongdoers were the only directors and shareholders of the company.[237] Where the company is making a claim against the director or agent for their breaches of duties owed to the company, their wrongdoing or knowledge cannot be attributed to the company to defeat the company's claim against them because the duty of

[232] In the pre-*Meridian* case law, this was held to be appropriate where the individual director is regarded as the directing mind and will in the circumstances of the case: *El Ajou v Dollar Land Holdings Plc* [1994] 1 BCLC 464.
[233] *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 5 ACSR 424.
[234] *W B Anderson and Sons Ltd v Rhodes (Liverpool) Ltd* [1967] 2 All ER 850.
[235] *Macquarie Bank Ltd v Sixty-fourth Throne Pty Ltd* [1998] 3 VR 133.
[236] [2016] AC 1.
[237] [2016] AC 1, [7] *per* Lord Neuberger, [42]–[45] *per* Lord Mance, [87]–[92] *per* Lord Sumption, [181], [204]–[207] *per* Lords Toulson and Hodge.

which they are in breach exists for the protection of the company against the director or agent.[238] As stated by Lord Mance, "it is certainly unjust and absurd to suggest that the answer to a claim for breach of a director's (or any employee's) duty could lie in attributing to the company the very misconduct by which the director or employee has damaged it".[239]

12.112 **Whether person's fraud or wrongdoing is to be attributed to company depends on nature of the proceedings being brought.** On the other hand, where a third party is pursuing a claim against the company arising from the misconduct, the rules of attribution can potentially be applied to attribute to the company the conduct and state of mind of the director or agent.[240] For example, the rules of agency may require the company to be vicariously liable to the third party for any act within the course of the agent's employment.[241] Where the company is making a claim against a third party, whether or not there is to be attribution of the act or state of mind of the director or agent again depends on the nature of the claim. For example, if the company is claiming under an insurance policy, the knowledge of the director or agent could be attributed to the company in accordance with the normal rules of agency if there had been a failure to disclose a material fact. But if the claim of the company, for example for dishonest assistance or knowing receipt, arose from the involvement of a third party as an accessory to a breach of fiduciary duty by a director, there is no good policy reason to attribute to the company the act or state of mind of the director who was in breach of duty.[242]

12.113 **Application of rules of attribution depends on context.** The principles set out at para.12.111 above have previously been referred to as the "fraud exception" (or the

[238] [2016] AC 1, [44] *per* Lord Mance, [89]–[90] *per* Lord Sumption, [206] *per* Lords Toulson and Hodge.

[239] [2016] AC 1, [38] *per* Lord Mance, and see also [89] *per* Lord Sumption; *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218, [106] *per* Lord Walker; *UBS AG (London Branch) v Kommunale Wasserwerke Leipzig Gmbh* [2017] 2 Lloyd's Rep 621 (Eng CA). The suggestion that the company's claim could be defeated by a defence of illegality gained some traction following the decision of the House of Lords in *Stone & Rolls Ltd (in liq) v Moore Stephens* [2009] 1 AC 1391, where the auditors successfully raised the illegality defence in a claim by the liquidator on behalf of the company against the auditors for their negligence in failing to detect the fraud committed by the sole director/shareholder of the company. In *Safeway Stores Ltd v Twigger* [2011] Bus LR 1629, the English Court of Appeal applied *Stone & Rolls* and denied a company's claims against its directors on the basis of the illegality defence. Although not expressly overruled by the Supreme Court in the *Bilta* case, Lords Toulson and Hodge in the latter case were critical of the reasoning in *Safeway Stores*: see *Bilta (UK) Ltd v Nazir (No.2)* [2016] AC 1, [156]–[162]. The case of *Stone & Rolls* itself has been much criticized (see, e.g. Peter Watts, "Audit Contracts and Turpitude" (2010) 126 *Law Quarterly Review* 14; Peter Watts, "Corrupt Company Controllers, their Companies and their Companies' Creditors: Dealings with Please of Ex Turpi Causa" [2014] *Journal of Business Law* 161; Sarah Worthington, "Corporate Attribution and Agency: Back to Basics" (2017) 133 *Law Quarterly Review* 118); and since there was no majority *ratio* in the case, the decision has now been expressly confined to the facts of its case and does not stand for any wider authority: see *Bilta (UK) Ltd v Nazir (No.2)* [2016] AC 1, [24], [30] *per* Lord Mance, [154] *per* Lords Toulson and Hodge; *cf* [81] *per* Lord Sumption.

[240] [2016] AC 1, [88] *per* Lord Sumption, [205] *per* Lords Toulson and Hodge; *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218, [106] *per* Lord .

[241] [2016] AC 1, [88] *per* Lord Sumption.

[242] [2016] AC 1, [207] *per* Lords Toulson and Hodge.

Hampshire Land principle).[243] However, the phrase "fraud exception" is a misnomer because the above principles for non-attribution are not confined to fraud perpetrated on the company but also apply to other breaches of duties.[244] Moreover, the principles should not be seen as an "exception" that is applied to negate a preliminary view that the conduct or state of mind is attributed to the company.[245] Whether to attribute conduct or states of mind to a company depends on the context and the purpose in and for which attribution is invoked or disclaimed.[246] It is a fallacy to say that a principal is *prima facie* deemed to know at all times and for all purposes that which his agents know. Before attribution occurs, there must be some purpose for deeming the principal to know what the agent knows.[247] The question in each case is whether attribution is required to promote the policy of the substantive rule, or (to put it negatively) whether, if attribution is denied, that policy will be frustrated.[248]

12.114 ***Moulin Global* case.** The case of *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue*[249] involved a company whose accounts were falsified (with profits overstated) by certain directors of the company over a period of 5 years. The company's tax returns were prepared on the basis of those false accounts. Subsequently, the company entered into liquidation, and the liquidator applied for a refund of the overpaid taxes. One of the grounds for a refund was on the basis of Inland Revenue Ordinance (Cap.112), s.70A, which allows refunds for overpayment by reason of an error or omission in the tax return. Deliberate misstatements in the return are not "errors" within s.70A, and hence whether s.70A could be applied in the present case depended on whether the directors' knowledge of the fraud should be attributed to the company. By a 4:1 majority, the Court of Final Appeal held that the fraudulent knowledge of the directors must be attributed to the company in the present

[243] See *Re Hampshire Land Co* [1896] 2 Ch 743; *Stone & Rolls Ltd (in liq) v Moore Stephens* [2009] 1 AC 1391, [43], *per* Lord Phillips, [137]–[168] *per* Lord Walker; *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218. In the latter case, Lord Walker also seemed to confine the principles on the "fraud exception" to the barring of unmeritorious defences in claims by corporate employers against dishonest directors or employees or their accomplices: [134]. However, arguably this approach is unduly restrictive (see Ernest Lim, "Attribution and the Fraud Exception" [2015] *Lloyd's Maritime and Commercial Law Quarterly* 14) and might not be consistent with the approach approved of by a majority of the UK Supreme Court in the later decision of *Bilta*. As noted by Lords Toulson and Hodge in *Bilta*, the so-called fraud exception "is simply an instance of a wider principle that whether an act or a state of mind is to be attributed to a company depends on the context in which the question arises": *Bilta (UK) Ltd v Nazir (No.2)* [2016] AC 1, [181]; and see text to notes 225 to 228 below. Although the Court of Final Appeal (CFA) decision in *Moulin Global* is the present binding authority in Hong Kong, there is no material difference between Hong Kong and English common law on the attribution rules, and it is submitted that the insights gained from *Bilta* should also be taken aboard by the CFA in Hong Kong in future.

[244] *Bilta (UK) Ltd v Nazir (No.2)* [2016] AC 1, [9], [71], [181].

[245] This was the approach adopted by the majority in *Bilta (UK) Ltd v Nazir (No.2)* [2016] AC 1: see [9] *per* Lord Neuberger, [37] *per* Lord Mance, [191] *per* Lords Toulson and Hodge. *cf* [92] *per* Lord Sumption.

[246] [2016] AC 1, [9] *per* Lord Neuberguer, [41] *per* Lord Mance, [181] *per* Lords Toulson and Hodge.

[247] Peter Watts and F M B Reynolds, *Bowstead and Reynolds on Agency* (20th edn, Sweet and Maxwell 2014) [8-123], cited with approval in *Bilta (UK) Ltd v Nazir (No.2)* [2016] AC 1, [44] *per* Lord Mance, and [191] *per* Lords Toulson and Hodge.

[248] *McNicholas Construction Co Ltd v Customs and Excise Comrs* [2000] STC 553, [44] *per* Dyson J, cited with approval in *Bilta (UK) Ltd v Nazir (No.2)* [2015] 2 WLR 1168, [195] *per* Lords Toulson and Hodge.

[249] (2014) 17 HKCFAR 218.

circumstances, and hence the overstatement of the profits is not an error within s.70A. In giving the majority judgment, Lord Walker did not consider it to be appropriate to deny attribution on the basis of the directors' fraud , as this, in his Lordship's view, would frustrate the statutory purposes of Cap.112.[250] Lord Walker took the view that an essential part of the statutory scheme is that the Commissioner should be able to make assessments on the basis of the taxpayer's returns.[251] Yet as pointed out by Tang PJ in the dissenting judgment, s.70A was enacted precisely to ensure that a refund could be obtained for errors despite the tax assessment being otherwise final and conclusive under Cap.112, s.70.[252] If a company could be entitled to refunds on the basis of errors due to negligence of its directors, it is difficult to see why the company should not be allowed refunds for errors caused by the directors' fraud.[253] Tang PJ held that the directors' fraud should not be attributed to the company since the object and purpose of Cap.112, s.70A was that the taxpayer should pay what is properly chargeable and no more and that, subject to the 6-year limitation period for applications under s.70A, the Commissioner has no good policy reason to wish to keep tax paid in excess of what was properly chargeable.[254]

2.1.2 *Liabilities of individuals*

12.115 **Where company liable, individuals involved might be liable.** Where a company is liable in tort or for some other wrong, individuals involved in the conduct could also be liable. In the case of statutory liabilities, the statutory provision might expressly set out the circumstances when a director or other person would be liable.[255] Otherwise, it is a matter of determining whether the elements giving rise to the plaintiff's cause of action in respect of the wrong can be established against the individual concerned. Where the company's liability is vicarious, arising from the wrongful conduct of an agent, the fact that the company is liable to a plaintiff as principal does not prevent the agent from being liable. This follows from ordinary agency law principles.[256] The same applies in respect of wrongful conduct of directors.[257] However, directors are not personally liable merely because of the company's liability—the question is whether the elements of the tort or other wrong can be established against the director (in which case there is primary liability on the part of the director) or whether the director's involvement in the wrongdoing comes within the general principles of secondary liability.[258] Similarly,

[250] (2014) 17 HKCFAR 218, [134]. The Court of Appeal (CA) had decided on a different basis, namely that the "fraud exception" could not be applied as that "exception" only applies under agency law principles and cannot be invoked where the primary rules of attribution impute conduct or knowledge directly to a company: see [2012] 2 HKLRD 911. Although the Court of Final Appeal (CFA) dismissed the appeal, the CFA held that the CA was wrong in so confining the "fraud exception": (2014) 17 HKCFAR 218, [106], [113].

[251] (2014) 17 HKCFAR 218, [134].

[252] (2014) 17 HKCFAR 218, [25].

[253] (2014) 17 HKCFAR 218, [29].

[254] (2014) 17 HKCFAR 218, [31]. There is force in Tang PJ's views. For a critique of the majority judgment, see also Ernest Lim, "Attribution and the Fraud Exception" [2015] *Lloyd's Maritime and Commercial Law Quarterly* 14.

[255] E.g., see retitled Cap.32 s.40 (misstatements in prospectuses).

[256] *Bennett v Bayes* (1860) 5 H & N 391; *Swift v Jewsbury and Goddard* (1874) LR 9 QB 301.

[257] *Standard Chartered Bank v Pakistan Intl (No 2)* [2003] 1 AC 959; *Yakult Honsha v Yakudo* [2004] 1 HKC 630; *Tai Shing Diary Ltd v Maersk Pty Ltd* [2007] 2 HKC 23; and see generally Stefan H C Lo, "Liability of Directors as Joint Tortfeasors" [2009] *Journal of Business Law* 109.

[258] In the case of tort, the ordinary principles of joint tortfeasors are applicable: see generally *Credit Lyonnais Bank Nederland NV v Export Credit Guarantee Department* [1998] 1 Lloyd's Rep 19 (Eng CA); [2000] 1 AC 486 (HL).

members are not personally liable simply because the company is liable, but they could be liable if they have themselves committed the wrongful conduct, such as where a member breaches a duty of care that the member itself owed to the plaintiff.[259]

12.116 **Dis-attribution fallacy.** The fact that a director or agent's tortious or other wrongful acts can be attributed to the company for certain purposes (such as in imposing liability on the company) does not mean that there must be a "dis-attribution" of that conduct from the director or agent. It is a fallacy ("dis-attribution fallacy") to say that attribution of the conduct to the company must of necessity lead to dis-attribution for the director or agent so as to relieve him or her from personal liability.[260] Accordingly, even if a person's tortious acts or other wrongdoing is attributed to the company for particular purposes, the person can still be regarded as having engaged in the wrongdoing and therefore be personally liable for the wrongdoing.

2.2 Criminal liabilities

2.2.1 *Corporate liability*

12.117 Corporate criminal liability. In earlier times, it was thought that corporations could not be criminally liable. The early reticence in accepting that a corporation could be guilty of a crime was even greater than in respect of torts, for criminal liability depends on a guilty mind and it was thought that corporations could not be moral agents, having neither a soul nor a conscience.[261] Moreover, not having a body, a corporation could not be committed to prison.[262] However, the modern position is that companies and other corporations can be guilty of criminal offences, with the courts applying rules to attribute conduct of individuals to the company.[263] There are still some offences which a company cannot commit, such as offences which by their nature cannot be committed through another person, as in perjury.[264] Also a company will not be indictable for an offence where the only punishment that a court could impose is corporal (e.g. murder[265]).[266] However, where a fine is an alternative penalty that can be imposed for an offence,[267] then a company could be considered to be capable of committing that offence. Thus, it has been held that a company can be guilty of manslaughter[268] (where a fine can be imposed as an alternative to imprisonment[269]).

[259] See, e.g., *Chandler v Cape Plc* [2012] 1 WLR 3111; and see further Stefan H C Lo, "A Parent Company's Tort Liability to Employees of a Subsidiary" (2014) 1 *Journal of International and Comparative Law* 117.

[260] See further Stefan H C Lo, "Dis-attribution Fallacy and Directors' Tort Liabilities" (2016) 30 *Australian Journal of Corporate Law* 215.

[261] See, e.g., *Case of Sutton's Hospital* (1612) 10 Coke Reports 23a, 77 ER 960.

[262] Blackstone, *Commentaries on the Law of England* (vol 1, 1769) 464–465.

[263] For an overview of the change in judicial opinion, see *R v ICR Haulage Ltd* [1944] KB 551. See also Criminal Procedure Ordinance (Cap.221) s.49(3) which overcomes the procedural obstacle arising from requirements for the accused to be physically present at trial on indictment.

[264] *R v ICR Haulage Ltd* [1944] KB 551, 554; *Smorgon v FCT* (1976) 13 ALR 481, 487–488.

[265] The penalty for murder is life imprisonment: Offences Against the Person Ordinance (Cap.212), s.2.

[266] *R v ICR Haulage Ltd* [1944] KB 551, 554.

[267] See generally Criminal Procedure Ordinance (Cap.221), s.113A.

[268] *R v P&O European Ferries (Dover) Ltd* (1991) 93 Cr App R 72. This case resulted from the 1987 ferry disaster where the Herald of Free Enterprise ferry capsized off the Belgian port of Zeebrugge, killing 193 passengers and crew.

[269] Offences Against the Person Ordinance (Cap.212), s.7.

of instructions from the board. Those persons are distinguished from the company's employees or agents who are subordinates of senior management. The House of Lords held that in the present case the shop manager could not be identified as the company. The board never delegated any part of its functions. The board had set up a chain of command through regional and district supervisors, but they remained in control. The shop managers had to obey the directions and orders of their superiors.

12.124 **Reformulation of identification theory under the *Meridian* framework.** As illustrated by cases such as *R v St Regis Paper Company Ltd*, discussed above at para.12.122, the identification theory and the "directing mind and will" concept have still been used by the courts following the *Meridian* case in the context of criminal cases.[283] However, as explained by Lord Hoffmann in *Meridian*, the concept should simply be seen as an application of a special rule of attribution to determine whose acts or state of mind should be treated as the company's for the purpose of the substantive law in question.[284] As the imagery used in the concept of persons being the "directing mind and will" can distract from the purposes of attribution,[285] it is preferable to avoid references to the "directing mind and will". Thus, for criminal offences where it is necessary to establish *mens rea* on the part of the company under the common law principles of attribution, the question of whether the wrongdoing individual's conduct and mental state are to be attributed to the company for the purpose of determining primary criminal liability of the company should simply be determined on the basis of whether the individual is a director or a senior officer carrying out the functions of management with full discretion to act independently of instructions from the board.[286] This approach adopts the substance of the rules on the "directing mind and will" concept but avoids the use of that terminology and the confusion in legal reasoning that sometimes results from the notion that directors or others are to be regarded as the company itself.

12.125 **Appears not possible to aggregate acts or knowledge of individuals.** In attributing conduct or mental states to the company, it appears that it is not possible to aggregate acts or knowledge of different individuals within a company to impose criminal liability on the company where the elements of the offence cannot all be established with respect to any single individual who is to be regarded as the company itself.[287] For example, where an offence requires knowledge of facts A, B and C, and one individual in the company knows of A (but not B or C), and another knows of B and C (but not A), it is not possible to combine their knowledge to treat

[283] See also *Attorney-General's Reference (No.2 of 1999)* [2000] QB 796 in the context of manslaughter.

[284] See Lord Hoffmann's explanation of the *Tesco* decision in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 507–508.

[285] See para.12.108 above, and see further Eilis Ferran, "Corporate Attribution and the Directing Mind and Will" (2011) 127 *Law Quarterly Review* 239; Sarah Worthington, "Corporate Attribution and Agency: Back to Basics" (2017) 133 *Law Quarterly Review* 118, 125; Stefan H C Lo, "Context and Purpose in Corporate Attribution: Can the 'Directing Mind' Be Laid to Rest?" (2017) 4 *Journal of International and Comparative Law* 349.

[286] This is subject to any statutory modification on the requirements relating to the elements of an offence for a company.

[287] See *Attorney-General's Reference (No.2 of 1999)* [2000] QB 796, 813; and see generally E Colvin, "Corporate Personality and Criminal Liability" (1995) 6 *Criminal Law Forum* 1.

the company as knowing A, B and C. Also, where the *actus reus*, but not the *mens rea*, can be established against one person in the company, it is insufficient that another person in the company (who did not carry out the *actus reus*) might have the requisite *mens rea*. However, where, for example, the board has the requisite *mens rea* and instructs an employee to carry out the acts forming the *actus reus*, general principles of criminal law could still lead to the company being criminally liable. The *mens rea* of the board would be attributed to the company, and it seems that the company could be liable as principal offender acting through an innocent agent[288] or alternatively there may be accessorial liability.[289] A company can be guilty of conspiracy[290] and so this offence could also be relevant depending on the circumstances.

Vicarious liability

12.126 **When vicarious liability has been imposed.** Vicarious liability is less commonly used in criminal law compared with civil law, but courts may often be prepared to treat regulatory offences as giving rise to vicarious liability. Vicarious liability has traditionally been imposed on corporations for statutory offences of strict or absolute liability.[291] In addition, courts have been prepared to apply vicarious liability to corporations in relation to statutory offences where there are due diligence or other similar defences available.[292] However, it is not necessarily the case that a strict liability regulatory offence entails vicarious liability, nor is it the case that an offence requiring *mens rea* for the primary offender cannot lead to vicarious liability of the offender's principal without the need for *mens rea* on the part of the principal.[293] Whether a statutory offence imposes vicarious liability is a matter of statutory interpretation.[294]

Organisational fault

12.127 **Ineffectiveness of common law approach to criminal liability in case of large corporations.** The principles of corporate liability under the common law based on the identification theory (whether as traditionally applied or as reformulated under the *Meridian* framework of attribution[295]) have been much criticised as being ineffective

[288] *Deutsche Genossenschaftsbank v Burnhope* [1995] 1 WLR 1580. On the principles relating to acting through innocent agents generally, see *R v Tyler* (1838) 8 C & P 616.

[289] See generally *Attorney-General's Reference (No.1 of 1975) [1975] QB 773; R v Szeto Kwok-hei* [1991] 2 HKLR 178.

[290] *R v ICR Haulage Ltd* [1944] KB 551; *R v Blamires Transport Services Ltd* [1964] 1 QB 278 (conspiracy with officers); *Williams v Hursey* (1959) 103 CLR 30, 128 (conspiracy with members).

[291] See, e.g., *R v Cheung Siu-yu* [1991] 2 HKLR 142.

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

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

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

[295] See para.12.124 above.

16.100 **Requirements for experts' consents and registration of prospectus for foreign companies; liabilities for misstatements under Cap.32.** Similar to the position for Hong Kong companies, there are requirements for experts' consents (s.342B) and registration of the prospectus (s.342C). There is also civil liability (s.342E) and criminal liability (s.342F) in respect of misstatements in prospectuses,[169] and there are also provisions on SFC exemptions (s.342A), amendment of prospectuses (s.342CA) and programme prospectuses (s.342CB).

16.101 **Section 41 anti avoidance provision also applies to foreign companies under s.343.** The anti-avoidance provision in respect of sales of shares or debentures under s.41 also takes effect for foreign companies: Cap.32, s.343(1).

3. Advertising Restrictions

3.1 Introduction

16.102 **Necessary to regulate advertising to prevent release of inaccurate information.** The regulation of disclosure in prospectuses would not be effective from preventing the company from releasing inaccurate information to entice investors if there were not also restrictions on the scope of advertising that a company can engage in with respect to a public offer.

16.103 **Ways in which advertising regulated.** Advertising is restricted on the following bases:

- Cap.32, s.38B—advertisements concerning prospectuses;
- the requirements under Cap.32, ss.38 and 38D by reason of the definition of "prospectus"; and
- Securities and Futures Ordinance (Cap.571), s.103.

3.2 Advertisements concerning prospectuses: Cap.32, s.38B

16.104 **Prohibition on publishing or advertising part or all of prospectus.** Cap.32, s.38B(1) prohibits any person from publishing extracts from or abridged versions of a prospectus or any advertisement in relation to a prospectus or a proposed prospectus.

16.105 **Exceptions to prohibition.** The prohibition is subject to exceptions as set out in Cap.32, s.38B(2):

- Advertisements within Sch.19 of Cap.32.[170] Schedule 19 sets out the information that can be contained in such an advertisement. Only bare information on certain specified matters is permitted, such as information on the name of the company, the shares or debentures offered and the dates on which and places at which the prospectus will be available. Such advertisements are in the nature of offer awareness statements or "tombstone advertising" which are intended to alert the public to the existence of the public offer.
- Advertisements authorised by the SFC (under Securities and Futures Ordinance (Cap.571), s.105).[171]
- Publication of an extract from or abridged version of a prospectus in accordance with requirements specified by the SFC.[172]
- Publication of the English version only of a prospectus in an English language newspaper or the Chinese version only in a Chinese language newspaper.[173]

[169] The provisions in the Securities and Futures Ordinance on remedies or liabilities for false or misleading statements (SFO, ss.107, 108, 213, 277, and 298) can also apply to foreign companies: see, e.g, *Securities and Futures Commission v Qunxing Paper Holdings Co Ltd (No.2)* [2018] HKCFI 271, [2018] 1 HKLRD 1060.

[170] Cap.32, s.38B(2)(e).

3.3 Advertisements constituting an offer or invitation: Cap.32 definition of "prospectus"

16.106 **Definition of prospectus under Cap. 32.** "Prospectus" is defined in Cap.32, s.2 to mean any prospectus, notice, circular, brochure, advertisement or other document offering shares or debentures of the company for subscription or purchase (or calculated to invite offers by the public to subscribe for or purchase such shares or debentures). Documents in respect of offers exempt under Sch.17 are excluded from the definition, and so are advertisements exempted from the advertising restrictions under s.38B(2).

16.107 **Written advertisements forming part of prospectus may contravene ss.38 or 38D of Cap.32.** The wide definition of prospectus means that written advertisements coming within the definition would contravene Cap.32, ss.38 or 38D if the advertisement does not contain the information required by s.38 or is not registered as a prospectus under s.38D.

16.108 **Advertisements or documents issued by third parties could be caught under wide "prospectus" definition.** The restrictions apply not only to the company that is issuing the shares or debentures but can also cover advertisements or documents issued by third parties. For example, pre-IPO or pre-deal research reports by connected analysts could potentially be caught by the restrictions. Pre-IPO research reports are produced by analysts to provide information to potential investors. The reports often contain more background on the industry sector and macro environment (such as analysis of competitors) than contained in the company's prospectus, and provides the analyst's expert assessment of

[171] Cap.32, s.38B(2)(c), 38B(2)(f).

[172] Cap.32, s.38B(2)(a), 38B(2)(d), 38B(2A). For offers of shares or debentures to be listed, the Stock Exchange has been given the function of specifying requirements under s.38B(2A)(b): see Securities and Futures (Transfer of Functions—Stock Exchange Company) Order (Cap.571AE), s.3.

[173] Cap.32, s.38B(2)(b).

the company's strengths and weaknesses.[174] Where the reports are produced by analysts employed by the sponsor or an underwriter to the offering, then there is a risk that the reports could be regarded as being calculated to invite offers for the shares or debentures within the definition of "prospectus".[175]

3.4 Restrictions under Securities and Futures Ordinance (Cap.571), s.103

16.109 **SFO s.103 prohibits advertisement, invitation or document inviting offers from public without authorisation.** Securities and Futures Ordinance (Cap.571) (SFO), s.103(1) prohibits the issue of an advertisement, invitation or document inviting, *inter alia*, offers from the public to acquire or subscribe for shares or other securities unless there is authorisation by the SFC under that later s.105. A number of exceptions to this basic prohibition are set out in s.103. For example, there is no contravention of s.103 if the document is a prospectus complying with Cap.32 or is an advertisement permitted under that Cap.32, s.38B(2).[176]

16.110 **Pre-IPO reports could be caught by s.103.** Pre-IPO reports[177] could *prima facie* be caught by SFO, s.103, but there is no contravention if the report is issued by licensed intermediaries (such as licensed securities advisers) within the exemption for advertisements by licensed intermediaries in s.103(2).

16.111 **Roadshow, oral or visual presentations may also be caught by s.103.** Roadshow presentations or information provided orally or through visual presentations would not come within the Cap.32 provisions but may be caught by SFO, s.103, which covers oral as well as written advertisements or invitations.[178] Again, presentations given by licensed intermediaries would be exempt, as would be presentations given to professional investors.[179]

4. Listing on the Stock Exchange

4.1 Introduction

16.112 **Shares can only be traded on stock exchange if securities listed.** Companies can only have their shares or securities traded on the stock exchange in Hong Kong if the shares are listed on the Stock Exchange of Hong Kong. Applications for listing are made pursuant to the Listing Rules of the Stock Exchange. Securities can be listed either on the Main Board or the Growth Enterprises Market (GEM). The GEM

[174] SFC, *Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance* (August 2005), [29.1].

[175] SFC, *Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance* (August 2005), [29.2]. Pre-deal reports given to, for example, professional investors would not be caught due to the exemptions in Sch.17. For the SFC's proposals on regulation of pre-deal research generally, see SFC, *Consultation Paper on the Regulatory Framework for Pre-Deal Research* (September 2010), and *Consultation Conclusions* (June 2011).

[176] Securities and Futures Ordinance, s.103(3)(a).

[177] See para.16.108 above.

[178] See the definitions of "advertisement" and "invitation" in Securities and Futures Ordinance, s.102.

[179] Securities and Futures Ordinance (Cap.571), s.103(3)(k).

was established to facilitate public fund-raising by new enterprises which have good business ideas and growth potential but which do not fulfil all the requirements for listing on the Main Board. The listing requirements for the GEM are accordingly relatively less stringent, compared with the requirements for the Main Board.

16.113 **Local and foreign companies can have securities listed.** Both local companies and foreign companies[180] can have their securities listed on the Hong Kong Stock Exchange. Most companies listed on the Stock Exchange are incorporated outside Hong Kong.[181] This is partly due to historical reasons, with many local companies re-domiciling overseas before the handover in 1997. Hong Kong has also become the primary venue for mainland enterprises for raising funds outside their domestic markets.

16.114 **Equity and debt securities can listed.** Both equity and debt securities can be listed on the stock exchange. The discussion below focuses on the listing requirements for equity securities (which includes shares), where listing is sought on the Main Board.[182]

4.2 The stock exchange

16.115 **History of Stock Exchange of Hong Kong.** The Stock Exchange of Hong Kong Ltd and the Hong Kong Futures Exchange Ltd[183] demutualised in 2000 and merged together, along with the Hong Kong Securities Clearing Company Ltd,[184] under the single holding company, Hong Kong Exchanges and Clearing Ltd (HKEx). Before 2000, the Stock Exchange was operated essentially as a private industry association of brokers. Concerns whether the exchange was being operated in the public interest and the need to modernise both the regulatory structure and securities laws in Hong Kong led to reforms which included the demutualisation. Both HKEx and the Stock Exchange of Hong Kong Ltd have statutory responsibilities under the SFO as a "recognised exchange controller" and "recognised exchange company" respectively under that Ordinance.

4.3 Listing rules of the stock exchange

4.3.1 *Function and purpose of the listing rules*

16.116 **Companies seeking to have securities listed must comply with Listing Rules to ensure proper regulation and efficient operation of market.** Companies (issuers) which seek to have their securities listed on the Stock Exchange must comply with the Listing Rules of the Stock Exchange. The Listing Rules (LR) are made under s.23 of the SFO, which authorises the recognised exchange company to make rules, *inter*

[180] For additional obligations that may be imposed on foreign issuers, see Chapters 19 and 19A of the Listing Rules.

[181] 1246 out of 1448 listed companies were incorporated outside Hong Kong as at June 2011: FSTB, "Bills Committee on Companies Bill Follow-up Actions to be Taken by the Administration for the Meeting held on 28 June 2011" (CB(1)2756/10-11(01), 7 July 2011) 1.

[182] References to the Listing Rules hereafter are references to the Listing Rules for listing on the Main Board of the Stock Exchange. There are separate listing rules for the GEM. The Listing Rules can be accessed from the website of HKEx: http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/listrules.htm.

[183] Responsible for the futures exchange.

[184] Responsible for the central clearing and settlement system (CCASS), which provides for the electronic system for the holding and transfer of securities traded on the exchange.

alia, for the proper regulation and efficient operation of the market which it operates. In particular, a recognised exchange company operating a stock market may make rules for matters including applications for listing of securities and the requirements to be met before securities may be listed. The Listing Rules contain both requirements imposed before admission to listing as well as continuing obligations with which an issuer must comply once listing has been granted.

16.117 **Purpose of Listing Rules: for investors to have and maintain confidence in market.** The Listing Rules aim to ensure that investors have and can maintain confidence in the market and in particular that:

- applicants are suitable for listing;
- the issue and marketing of securities is conducted in a fair and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer;
- investors and the public are kept fully informed by listed issuers of all factors which might affect their interests;
- all holders of listed securities are treated fairly and equally;
- directors of a listed issuer act in the interest of its shareholders as a whole; and
- all new issues of equity securities by a listed issuer are first offered to existing shareholders unless they have agreed otherwise.[185]

16.118 **Listing Rules provide some merit regulation for protection of investors.** The conditions for listing imposed by the Listing Rules provide a degree of merit regulation for the protection of investors in Hong Kong.

4.3.2 *Status of the listing rules*

16.119 **Listed issuer bound to rules as matter of contract.** Under LR 13.01, an issuer whose securities have been admitted to listing is required to comply with the Listing Rules. Issuers undertake to comply with the rules pursuant to the issuer's application for listing. The effect of these provisions is that a listed issuer is bound to the rules as a matter of contract.[186]

4.3.3 *Enforcement of the listing rules*

16.120 **Sanctions for failing to comply with Listing Rules.** The Stock Exchange has power to suspend dealings in any securities or cancel the listing of any securities, including where an issuer fails, in a manner which the Exchange considers material, to comply with the listing rules.[187] The Listing Committee of the Exchange can also exercise disciplinary powers under LR 2A.09 in relation to breaches of the rules. The sanctions that can be imposed under this rule include:

- issue a private reprimand;

[185] LR 2.03.
[186] See *New World Development Co Ltd v Stock Exchange of Hong Kong Ltd* [2004] 2 HKLRD 1027, [10].
[187] LR 6.01.

- issue a public statement which involves criticism;
- issue a public censure; and
- require breaches to be rectified.

16.121 **Proposals to give statutory backing to some provisions of Listing Rules.** Many have argued that the sanctions under the Listing Rules are insufficient and "lack teeth".[188] To address such concerns, the government has proposed to give statutory backing to the more important provisions of the Listing Rules by incorporating the provisions in the Securities and Futures Ordinance.[189] Civil or possibly criminal sanctions can then be imposed pursuant to the Securities and Futures Ordinance. The earlier proposals of the government were to provide statutory backing to a range of disclosure obligations, including disclosure of price-sensitive information, disclosure or publication of annual and periodic reports, and disclosure and shareholder approval requirements for notifiable transactions and connected transactions.[190] However, there has been considerable resistance in the market and to date, the government has only implemented the reforms in respect of price-sensitive information.[191]

4.4 Methods of listing

16.122 **Ways in which equity securities can be listed.** Chapter 7 of the Listing Rules sets out the different ways in which equity securities can be listed on the stock exchange. These are:

- Offers for subscription: i.e. offers to the public by or on behalf of an issuer of its own securities for subscription.[192]
- Offers for sale: i.e. offers to the public by or on behalf of the holders or allottees of securities already in issue or agreed to be subscribed.[193]
- Placings: i.e. the obtaining of subscriptions for or the sale of securities by an issuer or intermediary primarily from or to persons selected or approved by the issuer or intermediary.[194]
- Introductions: i.e. applications for listing of securities already in issue where no marketing arrangements are required because the securities for which listing is sought are already of such an amount and so widely held that their adequate marketability when listed can be assumed (e.g. where the securities have already been listed on another stock exchange).[195]

[188] See, e.g., Betty Ho, *Public Companies and their Equity Securities: Principles of Regulation under Hong Kong Law* (Kluwer 1998) 743–747, 799–812.
[189] See FSTB, *Consultation Paper on Proposals to Enhance the Regulation of Listing* (2004) and *Consultation Conclusions* (2004); FSTB, *Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements* (2005).
[190] See SFC, *Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules* (2005) and *Consultation Conclusions* (2007).
[191] See para.16.129 below.
[192] LR 7.02.
[193] LR 7.06.
[194] LR 7.09.
[195] LR 7.13.

- Rights issues: i.e. offers by way of rights to existing holders of securities which enable those holders to subscribe for securities in proportion to their existing holdings.[196]
- Open offers: i.e. offers to existing holders of securities to subscribe for securities, whether or not in proportion to their existing holdings, which are not allotted to them on renounceable documents.[197]
- Capitalisation issues: i.e. allotments of further securities to existing shareholders, credited as fully paid up out of the issuer's reserves or profits, in proportion to their existing holdings, or otherwise not involving any monetary payments (e.g. the issue of scrip dividends via a capitalisation of profits).[198]
- Consideration issues: i.e. issues of securities as consideration in a transaction or in connection with a takeover or merger or the division of an issuer.[199]
- Exchanges: i.e. the listing of securities by an exchange or a substitution of securities for or a conversion of securities into other classes of securities.[200]
- Other methods: securities may also be brought to listing by the exercise of options or warrants or similar right; or any other method as approved of by the Exchange.[201]

4.5 Qualifications for listing

16.123 **Conditions to be met to seek listing of securities under Chapter 8 of Listing Rules.** Chapter 8 of the Listing Rules sets out the basic conditions which have to be met in order for the company to be qualified to seek the listing of the particular securities.

16.124 **Examples of conditions to be met under Chapter 8 of Listing Rules.** Examples of the requirements include the following:

1. The issuer must be incorporated[202] and must be a public company.[203]
2. The issuer must satisfy the profit test or either of the two market capitalisation tests.[204] Under the profit test, the issuer must have attained profits of at least

[196] LR 7.18.
[197] LR 7.23.
[198] LR 7.28.
[199] LR 7.30.
[200] LR 7.32
[201] LR 7.34.
[202] LR 8.02.
[203] LR 8.03.
[204] LR 8.05. Biotech companies which are unable to satisfy these tests may still be listed if they satisfy the requirements in LR Ch.18A (introduced with effect from 30 April 2018). In 2017, the Stock Exchange had considered whether to introduce a new board to facilitate listing of companies from emerging and innovative sectors. Subsequently, it was decided that instead of a new board, a new Ch.18A would be introduced to allow the listing of biotech companies that do not meet the financial eligibility tests. The requirements in Ch.18A are intended to ensure adequate investor protection from the risks associated with such companies: see HKEx, *Concept Paper: New Board* (June 2017), and *Consultation Conclusions* (December 2017); HKEx, *Consultation Paper: A Listing Regime for Companies from Emerging and Innovative Sectors* (February 2018), and *Consultation Conclusions* (April 2018).

$20 million in the most recent year and an aggregate of at least $30 million for the preceding two years. The first market capitalisation test[205] requires the issuer to have a market capitalisation[206] of at least $2,000 million, revenue of at least $500 million for the most recent audited financial year and positive cash flow from operating activities of at least $100 million in aggregate for the preceding three financial years. The alternative market capitalisation test[207] requires the issuer to have a market capitalisation of at least $4,000 million and revenue of at least $500 million for the most recent audited financial year. For each of these tests, there are also requirements for the issuer to have a trading record of at least three financial years, and there must also have been management continuity for at least the three preceding financial years and ownership continuity for at least the most recent audited financial year.

3. There must be an adequate market in the securities.[208] This means that there must be sufficient public interest in the business of the issuer and in the securities for which listing is sought.
4. There must be an open market in the securities.[209] This normally requires at least 25 percent of the issued share capital to be held by the public.[210] There must also be an adequate spread of holders of the securities to be listed—the number will depend on the size and nature of the issue, but in all cases there must be at least 300 shareholders.
5. The expected market capitalisation at the time of listing of the securities of a new applicant which are held by the public must be at least $50 million, while expected total market capitalisation at the time of listing must be at least $200 million.[211]
6. The share capital of a new applicant must not include shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares when fully paid.[212] This is subject to certain exceptions, including new exceptions taking effect from 30 April 2018 which allow certain companies to be listed with a WVR (weighted voting right) structure. "Weighted voting right" refers to "the voting power attached to a share of a particular class that is greater or superior to the voting power attached to an ordinary share, or other governance right or arrangement disproportionate to the beneficiary's economic interest in the equity securities of the issuer".[213]

[205] Market capitalisation/revenue/cash flow test.
[206] Market capitalisation means the market value of the entire size of an issuer, including all classes of securities of the issuer irrespective of whether the securities are listed or unlisted: LR 1.01. Market capitalisation is an estimation of the value of the business by multiplying the number of shares by the current price of a share.
[207] Market capitalisation/revenue test.
[208] LR 8.07.
[209] LR 8.08.
[210] As to meaning of the public, see LR 8.24.
[211] LR 8.09.
[212] LR 8.11.
[213] LR 8A.02.

The relaxation of the Listing Rules to allow companies with WVR structures is intended to facilitate listing of high growth and innovative companies in Hong Kong. Such companies seek to have a WVR structure as they rely heavily upon the technical expertise, market knowledge and foresight of their founders. The existence of a WVR structure ensures that the founders can maintain control of their company despite their smaller shareholdings which may result after seeking outside investors.[214] Companies seeking to list with a WVR structure must satisfy the requirements in Listing Rules Ch.8A.

7. The securities for which listing is sought must be freely transferable.[215]
8. There are a number of requirements imposed in respect of management. A new applicant must have at least two executive directors ordinarily resident in Hong Kong.[216] The Stock Exchange must be satisfied that the directors have the character, experience, integrity and competence commensurate with their position as director of a listed company.[217] There must also be at least three non-executive directors[218] who represent at least one-third of the board.[219]
9. The issuer must have a company secretary who is an individual and who is capable of discharging the functions of company secretary by virtue of his academic or professional qualifications[220] or relevant experience.[221]

4.6 Application procedures and listing documents

16.125 **New applicant must have sponsor for initial listing application.** A new applicant must have a sponsor to assist it with its initial application for listing.[222] A sponsor must be a corporation or authorised financial institution which is licensed[223] or registered[224] for Type 6 regulated activities (namely advising on corporate finance) and permitted under its licence or certificate of registration to undertake work as a sponsor.[225]

16.126 **Application procedure.** Details on the application procedure and requirements are set out in LR Ch 9. A listing application form must be completed by the sponsor and

[214] HKEx, *Consultation Paper: A Listing Regime for Companies from Emerging and Innovative Sectors* (February 2018) para.97. See also the *Consultation Conclusions* (April 2018). On the background to the new regime allowing WVR structures, see also HKEx, *Concept Paper: New Board* (June 2017), and *Consultation Conclusions* (December 2017). See further Shen Junzheng, "The Anatomy of Dual Class Share Structures: A Comparative Perspective" (2016) 46 *Hong Kong Law Journal* 477; Flora Huang, "Dual Class Shares Around the Top Global Financial Centres [2017] *Journal of Business Law* 137.

[215] LR 8.13.

[216] LR 8.12.

[217] LR 8.15 and 3.09, and see further LR Ch 3.

[218] LR 3.10.

[219] LR 3.10A.

[220] The following academic or professional qualifications are acceptable: member of the Hong Kong Institute of Chartered Secretaries, a solicitor or barrister (as defined in the Legal Practitioners Ordinance), or a certified public accountant (as defined in the Professional Accountants Ordinance): LR 3.28 Note 1.

[221] LRs 8.17, 3.28.

[222] LR 3A.02.

[223] Under Securities and Futures Ordinance (Cap.571), s.116.

[224] Under Securities and Futures Ordinance (Cap.571), s.120.

[225] LR 1.01. For other provisions in respect of requirements and role of the sponsor, see LR Ch 3A.

which is to be lodged by the sponsor on behalf of the issuer.[226] Applications for listing are made to the Listing Division of the Stock Exchange pursuant to LR 2A.05. The applications are then considered by the Listing Committee.

16.127 **Listing document may also be prospectus and must comply with all prospectus requirements.** The listing application form must be accompanied with a number of specified documents, including a draft of the listing document that is substantially complete.[227] The requirements for the listing document are set out in LR Ch 11 and Appendix 1. Where the issuer is required to comply with Cap.32, the listing document will be the prospectus which must comply with the prospectus requirements under Cap.32.[228] The final proof of the listing document must be lodged with the Stock Exchange at least four clear business days before the date of the hearing of the application for listing.[229] No listing document may be issued until the Stock Exchange has confirmed to the issuer that it has no further comments thereon.[230] On the date of the issue of the listing document, a formal notice must be published notifying the public of the proposed listing.[231]

16.128 **Restrictions on preferential treatment of employees or directors of issuer under Listing Rules.** Chapter 10 of the Listing Rules imposes certain restrictions regarding preferential treatment of employees or directors of the issuer in the allocation of shares pursuant to the public offering. For example, no preferential treatment is to be given to directors,[232] and no more than 10 percent of the securities can be offered to employees on a preferential basis.[233]

4.7 Continuing disclosure obligations

4.7.1 *Introduction*

16.129 **Listed companies required to disclose price-sensitive information to market.** As part of the disclosure philosophy, listed companies in Hong Kong are required to disclose material price-sensitive information to the market in order to ensure that the market is fully informed. Timely disclosure of price-sensitive information (information which would affect the price of the securities of a company) ensures that there is a fair and open market, thereby promoting confidence of investors that there is a level-playing field. Before 1 January 2013, the listing rules contained the main obligations in relation to continuing disclosure. With effect from 1 January 2013, the general disclosure obligation in relation to price-sensitive information (referred to as "inside information" in the legislation) is contained in the SFO. The general disclosure obligation previously contained in LR 13.09 of the Listing Rules was repealed with effect from the same date. The moving of the disclosure obligation from the Listing Rules to the SFO was done as

[226] LRs 9.02 and 9.03.

[227] LRs 9.03 and 9.11. The draft listing document submitted with the application is referred to as to the "Application Proof".

[228] See also LR Ch 11A in relation to the Stock Exchange's role in vetting and authorisation of the prospectus.

[229] LRs 11.02 and 9.11(18).

[230] LR 12.01.

[231] LR 12.02.

[232] LR 10.03.

[233] LR 10.01.

the first step in the government's proposal to give statutory backing to a number of the more important continuing obligations under the Listing Rules.[234]

4.7.2 *Mandatory disclosure of inside information*

General

16.130 **Only civil sanctions and remedies for non-disclosure of price-sensitive information ("inside information").** Price-sensitive information (referred to as "inside information" in the SFO) is regulated under Pt XIVA of the SFO.[235] The original proposals for regulating price-sensitive information provided for both civil and criminal consequences for contravention of the disclosure obligation.[236] However, the present provisions provide only for civil sanctions and remedies for breach due to market concerns on the severity of the law in light of perceived uncertainties as to what would amount to price-sensitive information.[237]

Disclosure obligation

16.131 **Disclosure obligation under SFO s.307B.** Under SFO, s.307B(1), a listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public.[238]

Inside information

16.132 **Definition of "inside information".** "Inside information" is defined in SFO, s.307A(1) and is in substance the same as the concept used for the purposes of the provisions on insider dealing in the SFO.[239] "Inside information" means specific information that:

- is about:
  - — the corporation;
  - — a shareholder or officer of the corporation; or
  - — the listed securities[240] of the corporation or their derivatives;[241] and

[234] See para.16.121 above.

[235] Introduced by the Securities and Futures (Amendment) Ordinance (9 of 2012). For background, see FSTB, *Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations* (2010) and *Consultation Conclusions* (2011). See also the SFC's *Guidelines on Disclosure of Inside Information* (June 2012).

[236] See FSTB, *Consultation Paper on Proposals to Enhance the Regulation of Listing* (2004) and *Consultation Conclusions* (2004); FSTB, *Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements* (2005); SFC, *Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules* (2005) and *Consultation Conclusions* (2007).

[237] Enoch Yiu, "Tribunal Proposed to Handle Non-Disclosure by Listed Firms", *South China Morning Post* (24 August 2009); Enoch Yiu, "Government Waters Down Stock Market Reform", *South China Morning Post* (30 March 2010).

[238] The manner of disclosure is set out in Securities and Futures Ordinance, s.307C.

[239] The insider dealing provisions in SFO Pt XIII previously used the term "relevant information", but this has now been replaced with the term "inside information".

[240] "Listed securities" is defined in SFO, s.307A(1).

[241] "Derivatives" is defined in FO, s.307A(1).

- is not generally known to the persons who are accustomed or would be likely to deal in[242] the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities.

16.133 **"Specific information" information capable of being identified, defined and unequivocally expressed.** The concept of "specific information" was considered in *Securities and Futures Commission v Chan Pak Hoe Pablo*[243] in the context of the insider dealing offence. The court accepted that specific information is information which possesses sufficient particularity to be capable of being identified, defined and unequivocally expressed. The requirement for the information to be "specific" does not mean that the information must be "precise", in that the lack of precision of information does not prevent it from being specific. A mere rumour is not specific information. However, information about a proposed transaction can be specific information where the proposal is beyond the stage of being a vague exchange of ideas. Where negotiations or contacts have occurred, there must be a substantial commercial reality to the negotiations which goes beyond a merely exploratory testing of the waters and which is at a more concrete stage where the parties have an intent to negotiate with a realistic view to achieving an identifiable goal before information about the proposed transaction would be regarded as specific information. However, there is no need to establish that there be any foresight that the transaction will "probably" or "likely" come to fruition before information concerning the contemplated transaction becomes sufficiently specific. The fact that further negotiations are required and that the transaction would ultimately have to be approved by the board or by the shareholders does not mean that the information about the proposed transaction cannot be specific information.

16.134 ***Du Jun* case test of materiality: information must be kind that would not only interest investor but lead to investment decision that would affect price.** On the test of materiality in para.(b) of the definition, the Court of Appeal in *HKSAR v Du Jun*[244] has commented that the question is the likely impact of the information on the ordinary reasonable investor—whether the information is important information likely to be of interest to such an investor, not being of passing interest only, but interest of a kind that would be likely to lead to an investment decision such as would effect a material change in the price of the security. Information can be material within the statutory definition whether the impact on the price is positive or negative.

16.135 **United States test of materiality: substantial likelihood reasonable investor would consider information important to investment decision.** In a different context, it has been held in the United States that information is material if there is a substantial

[242] The Australian provisions on disclosure of price-sensitive information (Corporations Act 2001 (Cth of Aust) ss.674–678) refer to "persons who commonly invest" in the securities. In that context, it has been held that the expression is a class description, such that the inquiry is to determine what information would or would not be likely to influence a hypothetical class of persons who commonly invest in securities. The *class* description avoids the need to distinguish between large or small, frequent or infrequent, sophisticated or unsophisticated *individual* investors: see also *Grant-Taylor v Babcock & Brown Ltd* (2016) 330 ALR 642, [115]–[116].

[243] [2011] 5 HKC 484.

[244] (unrep., CACC 334/2009, [2012] HKEC 1280), [107].