The Financial Secretary has the power to prescribe model articles,[5] which apply to companies incorporated after the CO came into force. Pursuant to the above power, the Financial Secretary issued the Companies (Model Articles) Notice (Cap.622H, Sub.Leg.) (The Notice).

The schedules to the Notice set out in full the following three sets of model articles:

(1) public companies limited by shares (Sch.1 to the Notice);

(2) private companies limited by shares (Sch.2 to the Notice); and

(3) companies limited by guarantee (Sch.3 to the Notice).

The Notice took effect on 3 March 2014 in parallel with the CO.

It should be noted that no model articles have been prescribed for unlimited companies because very often these companies have very specific objectives that do not justify a standardised approach of adopting prescribed model articles. In any event, this type of company is relatively rare.

Compared with the First Schedule to the predecessor CO, the articles of the Model Articles have been reorganised by reference to the nature of matters involved: (1) directors (and their decision-making) and company secretaries; (2) decision-making by members; (3) shares and distributions (for public and private companies limited by shares); and (4) miscellaneous provisions.

Adoption of Model Articles

1.004 A company may adopt any or all of the provisions of the Model Articles as its articles of association.[6] Practitioners should bear in mind that when a company adopts the Model Articles, the version it adopts must be the version in force as at the date of the incorporation of that company. If the Model Articles are subsequently amended, these amendments will not automatically be incorporated into that company's articles of association.[7]

Deemed Adoption of Model Articles

1.005 If a company does not prescribe any articles of association then upon its incorporation, the relevant Model Articles in the CO are deemed to form part of the company's articles of association,[8] unless its articles of association have excluded or modified such Model Articles.[9]

Position of Table A of the Predecessor CO

1.006 Table A set out in the First Schedule to the predecessor CO is the predecessor of the Model Articles. It will continue to apply to those existing companies which have already adopted Table A under the predecessor CO (by default or otherwise) as their articles of association.[10] If an existing company has not adopted Table A of the

[5] *Ibid.*, s.78.
[6] *Ibid.*, s.79.
[7] *Ibid.*, s.78(2).
[8] *Ibid.*, s.80.
[9] *Ibid.*, s.80(3).
[10] *Ibid.*, Sch.11.

predecessor CO and instead has its own articles of association, then its existing articles of association save and except as may be modified and/or amended by the CO will continue to be effective.

It should be noted that when a company is free to adopt as its articles of association any or all of the provisions of the Model Articles prescribed in the Notice, there are certain information that must be included in the company's articles of association. Sections 81 to 85 of the CO state and list the specific information that must be included in the articles of association of a company. These are considered in more detail in the following paragraphs.

The Name Clause

1.007 Under the CO, a company must state its name in its articles of association.[11] A company's name may be in Chinese or English or in both languages. The last word of a company's name should be the word "Limited" or "有限公司" in Chinese.[12]

The following names are not allowed:[13]

(1) a name which is the same as that appearing in the index of company names maintained by the Registrar of Companies (the Registrar);

(2) a name which is the same as that of a body corporate established under an ordinance;

(3) a name which, if used, would, in the Registrar's opinion, constitute a criminal offence;

(4) a name which, in the Registrar's opinion, is offensive or otherwise contrary to the public interest; and

(5) a name which contains any word or expression specified by the Financial Secretary (under s.101 of the CO). For this purpose, the Financial Secretary has made the Companies (Words and Expressions in Company Names) Order (Cap.622A, Sub.Leg.).

The following names shall not be used *except* with the Registrar's prior approval:[14]

(1) a name which, in the Registrar's opinion, would likely give the impression that the company is connected with:

  (a) the Central People's Government;

  (b) the Government; or

  (c) any department or agency of the Central People's Government or the Government;

(2) a name which contains any word or expression specified by the Financial Secretary (CO s.101);

[11] *Ibid.*, s.81.
[12] *Ibid.*, s.102.
[13] *Ibid.*, s.100.
[14] *Ibid*

(3) a name which is the same or similar to a name appearing in the index of company names maintained by the Registrar (CO ss.108 and 771); or

(4) a name which, in the Registrar's opinion, is misleading as to its nature of activities or offensive (CO s.109).

A company's name must be in English and/or Chinese. A company name cannot consist of symbols such as "㈱" in Japanese or in any other languages. If a company would like to have such name for the purpose of carrying on business, it may consider registering such name as a trade name under the Business Registration Ordinance (Cap.310).

It should be noted that:

(1) trade names cannot be ended with the word "limited";

(2) a company could not have monopoly on the use of a trade name; and

(3) a company may consider registering a trade name with symbols or in other languages as a trade mark under Trade Marks Ordinance (Cap.559).

Except for those names which require prior approval from the Registrar (see above), it is not the practice, nor is it required, to "obtain prior approval" of the Registrar on the use of a particular company name, and the Registrar will not take a view on whether a proposed company name would be easily confused with the name of another company, before it issues a Certificate of Incorporation or Certificate on Change of Name, as the case may be. However, the Registrar, after the issuance of that certificate, has discretion to require a company to change its name within the period specified in the Registrar's direction,[15] if those names which:

(1) in the opinion of the Registrar should not be registered – too much similarity, causing confusion, not fulfilling the assurances, suggesting relationship with the Government, or the Financial Secretary does not approve; or

(2) are restrained for use under a court order.

The Registrar also has the power to direct a company to change its name under s.109 of the CO if such name:

(1) gives a misleading indication of the nature of the company's activities; *and*

(2) is likely to cause harm to the public; *or*

(3) should not be registered because

(a) the use of the name would constitute a criminal offence or

(b) is offensive or otherwise contrary to the public interest.

If a company fails to comply with such directions within the specified period, the Registrar may replace the company name with its company registration number (CO s.110). In *Power Dekor (Hong Kong) Ltd v Power Dekor Group Co Ltd*,[16] the defendant

[15] *Ibid.*, s.108.
[16] [2014] 1 HKLRD 845.

was ordered to change its company name. A direction was thus issued by the Registrar of Companies Registry to the defendant on change of name. Consequent upon the defendant's failure to comply with the said direction, the name of the defendant was changed to "Company Registration Number xxxxxx Limited" under s.110 of the CO.

Pursuant to the power prescribed under s.24 of the CO, the Registrar, on 6 January 2014, issued *Guideline on Registration of Company Names for Hong Kong Companies*. The Guideline took effect on 3 March 2014. It serves to explain the requirements for registration of a company name for Hong Kong companies. It should be noted that the Guideline does not have the effect of a subsidiary legislation.[17]

Incorporation of a company with a name does not automatically mean such name is protected under the Trade Marks Ordinance. Separate application for registration of a trade mark should be made with the Registrar of Trade Marks.

The Objects Clause and the Dilution of the Ultra Vires Doctrine

1.008 The objects clause in the constitution of a company sets out the purpose for which the company has been set up. It defines the capacity of a limited company when it deals with third parties. An action carried out by a company which is outside its objects clause is null and void; technically, this is called *ultra vires*. Action *ultra vires* cannot be enforced by the company or third parties; it also cannot be ratified by the company in a general meeting.[18]

An important reform of the *ultra vires* doctrine was introduced in Hong Kong by the Companies (Amendment) Ordinance 1997. One of the amendments to the predecessor CO was that pursuant to the then new s.5(1) and 5(1A), companies are no longer required to set out objects in their constitution.[19]

A limited company, except for those companies listed below, can elect to include (or exclude) an objects clause in its articles of association.[20] Those companies which are mandatorily required to include objects clauses in their articles of association upon incorporation are:

(1) those companies for which the Registrar has exercised its power to dispense with the word "Limited" (or "有限公司" in Chinese) in their names pursuant to s.103 of the CO; and

(2) any company which is subject to any other legislation that has prescribed the inclusion of objects clause.[21]

If a limited company does not include an objects clause in its articles of association, it will have the capacity, rights, powers and privileges of a natural person of full age.[22] On the other hand, if a limited company elects to include objects clauses in its articles of association, then,

(1) that company may do anything which it is permitted or is required to do by its articles of association or by any other legislation or rule of law;[23]

[17] See CO s.24(3).
[18] See *Ashbury Railway Carriage and Iron Co Ltd v Riche* (1875) (1874–75) LR 7 HL 653.
[19] See *Study Report on History of Company Incorporation in Hong Kong* (July 2013) Ch 2, Companies Registry.
[20] CO s.82(2).
[21] *Ibid.*, s.82(3).
[22] *Ibid.*, s.115(1). The full age is 18 (see s.2 of Age of Majority (Related Provisions) Ordinance (Cap.410)).
[23] *Ibid.*, s.115(2).

registered office clause in the articles of association. Notwithstanding the above, it is still customary to retain such a clause in the articles of association.

Participation of Profit by Non-Member

1.014 For a company limited by guarantee not having a share capital, it cannot have a clause in its articles of association to the effect that any non-member may have a right to participate in the divisible profits of the company. Such a clause shall be void.[35] There is no such provision for other types of companies.

Number of Members

1.015 In the past, the number of members was required to be set out in the articles of association of the following types of companies:[36]

(1) an unlimited company; and

(2) a company limited by guarantee.

The initial number of members could be increased in accordance with the articles of association. Within 15 days of the increase in the number of members, the company has to file with the Registrar a notice of such increase. Under the CO, a company limited by guarantee is now required only to state the number of members in the incorporation form (CO s.68).

Alteration to the Articles of Association

1.016 Section 87 of the CO provides for the alteration of the articles of association, save and except for those restrictions provided in that section. Upon the alteration of the articles of association, a company has to submit a notice of the alteration in a specified form[37] and a printed copy of its articles of association as altered and certified as correct by an officer of the company within 15 days of the date of the alteration.[38] However, please note the following.

Name Clause[39]

Company may by *special resolution* change its name.[40] That company shall, within 15 days of the passing of the special resolution to change its name, give notice in a specified form[41] of the change of its name to the Registrar. A special resolution is a resolution passed by not less than 75% of the votes cast at a general meeting.[42]

The Registrar may direct a company to change its name under ss.108 and 109 of the CO.

Upon the issue by the Registrar of a certificate of incorporation of the change of name, a company can use its new name.

[35] *Ibid.*, s.99(2).
[36] Predecessor CO s.10.
[37] Form NAA1.
[38] CO s.88(5).
[39] *Ibid.*, ss.107, 108 and 109.
[40] *Ibid.*, s.107(1).
[41] Form NNC2.
[42] CO s.564.

The Objects Clause

A company may, by special resolution, alter its objects clause.[43] The alteration could be abandonment of or restriction on any of that company's objects or adoption of any new object.[44]

A member of the company who does not agree to the alteration of the objects clause can apply to the Court for cancellation of the alteration.[45] The CO provides that the members of a private company, holding in aggregate not less than five percent (5%) in nominal value of such company's issued share capital, may apply to the Court for an order to cancel the alteration.[46] An application for cancellation of alteration to the objects clause shall be made within 28 days after the date of the relevant special resolution.[47] If upon hearing the objection, the Court approves the alteration of the objects clause, then that private company has to submit a printed copy of its articles of association as altered and certified as correct by an officer of the company together with an office copy of the order to the Registrar within 15 days of the date of the relevant court order. If no opposition to the proposed alteration of its objects clause is raised, and no opposition has been raised by the Court in respect of the alteration, the private company has to submit a printed copy of its articles of association as altered and certified as correct by an officer of the company to the Registrar within 15 days of the expiry of the aforesaid 28 days period.

Capital Clause

An alteration of the articles of association to increase the maximum number of shares could be approved by an ordinary resolution.[48] Save and except that, all the other permissible alterations to the articles of association have to be approved by special resolution.[49]

Special Alteration

1.017 Under the CO, if the alteration to the articles of association has the effect of requiring an existing member of a company to:

(1) take or subscribe for more shares than the existing number of shares held by him at the date on which the alteration is made; or

(2) contribute additional share capital; or

(3) pay money to such company;

then the alteration shall not bind an existing member save and except that those existing members who have already agreed to the alteration in writing. The agreement may have retrospective effect.[50]

[43] *Ibid.*, s.89(2).
[44] *Ibid.*, s.89(2)(a) and 89(2)(b).
[45] *Ibid.*, s.91.
[46] *Ibid.*, s.91(1)(a).
[47] *Ibid.*, s.91(5).
[48] *Ibid.*, s.88(3).
[49] *Ibid.*, s.88.
[50] *Ibid.*, s.92.

the company to the directors in default by way of fees or other remuneration for their services.[137]

Insufficient Directors to Act

5.028 Under s.569 of the CO, where a company does not have any director or sufficient directors capable of acting to form a quorum, then any director or any two or more members of the company representing at least 10% of the total voting rights of all members having a right to vote may call a general meeting,[138] insofar as the articles of the company do not make other provision in that behalf.[139] In this regard, a company's articles usually provide for the right of members to summon a meeting where there are insufficient directors to act. Such right on the part of members to convene a meeting arises only where there are insufficient directors to act. Otherwise, it remains incumbent on members to make a request to the company first. In *All Overseas Ltd v Best Codes Nominees Ltd*,[140] the articles provided that, where there are *no* directors able or willing to act, any two members may summon a meeting for the purpose of appointing directors.[141] The fourth defendant was irrevocably authorised under a share mortgage to act as proxies for the only two shareholders of the company. By a notice addressed to all members of the company, the fourth defendant as proxies purported to call an extraordinary general meeting. There was no evidence that any requisition was made to the board of the company for such meeting. The Court of Appeal said that the notice being addressed to members could not be regarded as a requisition. Without requisitioning for an extraordinary general meeting, the fourth defendant was not entitled as proxies for the only two shareholders to convene the same. It was thus held that the purported extraordinary general meeting and the resolutions passed thereat could not be valid.

Meetings Requested by Resigning Auditors

5.029 When an auditor of a company resigns by depositing a notice to that effect at the registered office of a company, such notice shall not be effective unless it contains either a statement that there are circumstances connected with his or her resignation which he or she considers should be brought to the notice of the members or creditors of the company, or otherwise a statement that there are no such circumstances.[142] In the former case, the auditors may, by another notice given to the company with the notice of resignation, require the directors to convene a general meeting for the purpose of receiving and considering such explanation of the said circumstances connected with the resignation.[143]

Again, there is no longer a "forthwith" requirement under s.421(1) of the CO, but the directors are given 21 days from the date on which the company receives another notice, to convene a meeting for a day not more than 28 days after the date

[137] CO s.568(6) and 568(7).
[138] CO s.569(1).
[139] CO s.569(2).
[140] (CACV 329/2005, 1 November 2006) [28]–[32] (Woo VP).
[141] Note that the company's articles prevail over the provisions in the former Table A in that case.
[142] CO s.424.
[143] CO s.421(1).

on which the notice convening the meeting is given. Directors who fail to take all reasonable steps to secure that a meeting is so convened would be liable to imprisonment and a fine.[144]

Under s.422 of the CO, the resigning auditor may give the company a statement by the person that sets out in reasonable length the circumstances surrounding the resignation and shall be entitled to be given every notice of, and every other item of communication, relating to the general meeting, that a member of the company is entitled to be given to attend the general meeting, and to be heard at the general meeting on any part of the business of the meeting that concerns the person as auditor or former auditor of the company. In the case where the resigning auditor is a firm or body corporate, such right to attend and to be heard may be exercised by an individual authorised by such auditor to act as its representative.[145]

Under s.422(5) of the CO, if the company receives the statement on a date that is more than two days before the last day on which notice may be given under s.571(1) of the CO to call the general meeting, every notice of the meeting given to the members is required to state that the statement has been made, and that a copy of the statement be sent to every member to whom a notice of the meeting is or has been given. Alternatively, if the company has not sent a copy of the statement to every member to whom a notice of the meeting is or has been given, the requirement to ensure that the statement is read out at the meeting. Failing compliance with s.422(5) of the CO, the person who resigns may request the company to comply with the requirement specified in relation to the statement.[146] It is however open to the company or any other aggrieved person to apply to the Court to dispense with the requirements to send out and read out the statement upon satisfying the Court that such rights are being abused to secure needless publicity for defamatory matter, in which case costs may also be awarded against the auditor (even if he is not a party to the application). The company must then, within 15 days beginning on the date on which the Court directs that copies of the statements are not to be sent, send a notice setting out the effect of the directions and to deliver a copy of the notice to the Registrar for registration.[147]

Meetings Convened by the Order of the Court

5.030 Pursuant to s.570 of the CO, if for any reason it is *impracticable* to call a meeting of a company in any manner in which meetings of that company may be called, or to conduct the meeting in manner prescribed by the articles or this CO, the Court may, either of its own motion or upon application of any director or any member entitled to vote at the meeting,[148] order a meeting of the company to be called, held and conducted in such manner as it thinks fit. The Court may further give such ancillary or consequential directions as it thinks expedient, including a direction

[144] CO s.421(3).
[145] CO s.422(5).
[146] CO s.422(2)(b).
[147] CO ss.426(6) and 427.
[148] A legal personal representative of a deceased member has *locus* to make the application under CO s.570(2)(b): *Tse Tsz Fung v Ever Point Asia Pacific Ltd* [2019] HKCFI 1216.

that one member of the company present in person or by proxy is to be regarded as constituting a quorum.[149]

Mode of Application

5.031 An application under s.570 of the CO should be brought by a member or director of a company, rather than the company itself.[150] Such requirement may also be satisfied if an applicant can demonstrate to the Court that it is probable that he will become a member of the company, for instance, an applicant for pending application for letters of administration of a deceased member.[151] It should be noted that s.570 relates to general meetings and in fact had nothing to do with meetings of board of directors.[152] Such application should be made by way of an originating summons in separate proceedings rather than by summons for interim relief in proceedings under CO s.772, etc.[153] The applicant may attach to the originating summons a schedule setting out the resolutions sought to be passed in the meeting to be convened. For the purpose of this s.570, the legal personal representative of a deceased member of a company is to be regarded as a member of the company having the same rights with respect to attending and voting at a meeting as the deceased member (if living) would have had.[154]

Approach of the Court

5.032 The relevant law has been summarised in various authorities.[155] Essentially, the Court applies a two-stage test towards applications under s.570 of the CO:[156] (1) firstly, an applicant must show that it is impracticable for a meeting to be called. This is important to confer jurisdiction on the Court to invoke s.570, and (2) secondly, if it is established that it is impracticable to call a meeting, the Court then has a discretion, after taking into all circumstances, whether to order a meeting or not. If, on an application under s.570, it is alleged by the respondent that they are the beneficial owner of the shares registered in the applicant's name, the Court may order that the issue of beneficial ownership be determined first before exercising its discretion under this s.570.[157]

[149] CO s.570(4).

[150] *Re Long Prime Ltd* (HCMP 877/2001, 29 May 2001).

[151] *Tsang Hoi Wah Ava, Deceased v Bancka Ltd* [2017] 6 HKC 87.

[152] *Ross v Telford* [1998] 1 BCLC 82, 87g.

[153] *Re Hong Kong Chung Shan Lung Chan Clan Association* (HCMP 1989/2004, [2008] HKEC 351) [11] (Kwan J). It does not mean that an order for holding a meeting could not be sought unders.168A proceedings if a case could be made out on the ground of unfair prejudice (as opposed to impracticability under s.114B). Hence, in *McGuinness v Bremner plc* [1988] BCLC 673, Lord Davidson granted the prayer of the petition under Companies Act 1985 s.459 (equivalent to the predecessor CO s.168A and the current CO s.724) to ordain five directors of a company to convene together with the first petitioner an extraordinary general meeting of the company to be held at a specified date and place, on the ground that the company's delay in holding the meeting was such that any reasonable bystander would conclude that it was prejudicial to the petitioners' interests.

[154] CO s.570(6).

[155] See *Re Success Plan Ltd* [2002] 3 HKLRD 560, 568; see also *Re Woven Rugs Ltd* [2002] 1 BCLC 324, 328g–329c; *Vectone Entertainment Holding Ltd v South Entertainment Ltd* [2004] EWHC 744 (Ch), 230i–231i; *Silver City International (Holdings) Ltd v Sino Luck Investment Ltd* (CACV 103/2004, [2004] HKEC 1138) 61A–63A.

[156] *Re Success Plan Ltd* [2002] 3 HKLRD 560, 568; see also *Silver City International (Holdings) Ltd v Sino Luck Investment Ltd* (CACV 103/2004, [2004] HKEC 1138).

[157] *Cheng Yuk Lin v Chan Choi Wah* (HCPI1189/1997, 10 August 1999). Of course, the Court will look at the evidence and form a view as to whether any serious issue has been raised regarding the shareholding, see *Re Realder and Marine Supply Co Ltd* [2002] 2 HKLRD 387, 393I–394A.

Impracticality in Calling Meeting

"Impracticable" is not synonymous with "impossible".[158] The Court should examine the circumstances of the particular case and determine whether, *as a practical matter*, the desired meeting of the company can be conducted.[159] 5.033

(1) **Not impracticable to hold a meeting**. It is not impracticable to hold a meeting simply because immediate meetings are required in the circumstances of a case and no immediate meetings could be held, as that would be a distortion of the language of s.570 of the CO which does not contain the word "immediate" before "meeting".[160] It is also not impracticable to hold a meeting if there are other steps that a shareholder could take under the Cap.622H (Sub.Leg.) Model Articles or this CO for a meeting to be convened, eg by requesting a meeting to be held under s.566 of this CO,[161] unless, having regard to the previous history of a case, it would have been pointless to requisition such a meeting.[162]

(2) **Impracticable to hold a meeting.** It would be impracticable to hold a meeting where the other director or shareholder of a company has died[163] or has been disqualified from acting as director[164] or cannot be contacted,[165] making it difficult (if not impossible) to hold any meeting of the company due to lack of quorum.[166] For instance, in *Re Long Prime Ltd*,[167] the plaintiff and the defendant were the only two directors and shareholders. The defendant was not accessible and, despite various attempts to contact him, never reported for duty for some time during which it had not been possible to hold any meetings of the company due to lack of quorum. The Court thus ordered that an extraordinary general meeting be convened in that case.

The refusal of another shareholder to form a quorum for a meeting is another example of a situation where it would be impracticable for a meeting of a company to be held. It could not be said that a shareholder by virtue of quorum provisions in the articles would have a right to prevent the other shareholder(s) from holding and conducting a meeting, since that power is not derived from the articles but from the accidental distribution of the shareholding in the company.[168] A quorum requirement does not "confer on the minority a right of veto not commensurate with their

[158] *Re Edinburgh Workmen's Houses Improvement Co Ltd* (1935) SC 56; *Hong Kong Korean Church Ltd v Lee Sun* (HCA 7989 and 8129/1993, 6 October 1993) (Rogers J).

[159] *Re El Sombrero Ltd* [1958] 3 WLR 349; see also *Jenashare Pty Ltd v Lemrib Pty Ltd* (1993) 11 ACSR 345, where Young J said (at 349) that: "Section 251 permits the court to order meetings in case of impracticability. Impracticability will cover a wide range of circumstances, from the case where all the corporators have been killed in a aircraft accident, down to situations where it is extremely inconvenient for a meeting to be called".

[160] *Hong Kong Estates Ltd v San Imperial Corp Ltd* [1980] HKLR 386.

[161] *Re HK-Asian Security Ltd* (HCMP 94/2004, [2005] 3 HKLRD G5) [12] (Kwan J).

[162] *Re Unlong Tung Yick Land Investment Co Ltd* (HCMP 589/1980, 13 October 1980) (Commissioner Hooper).

[163] *Re Tsun Tat Stationery Manufactory Ltd* (HCMP 631/2005, [2005] HKEC 623) (Kwan J); see also *Re Saint Tropez Fashion Makers Ltd* (HCMP 1807/2013, 2 September 2013) (Le Pichon DHCJ).

[164] *Re Topmart Ltd* (HCMP 736/2016, 29 April 2016) (Au-Yeung J).

[165] *Re Long Prime Ltd* (HCMP 877/2001, 29 May 2001); see also *Re Golden Bright Industrial Ltd* (HCMP 3963/2002, 18 December 2003) (Kwan J); *Re New Realm International Ltd* (HCMP 2074/2006, [2007] HKEC 204) (Kwan J).

[166] See also *Re Confucius Hall of Hong Kong Ltd* (HCMP 359/2005, 18 April 2005) (Poon DJ); *Smith v Butler* [2012] EWCA Civ 314; *Re Topmart Ltd* (HCMP 736/2016, 29 April 2016) (Au-Yeung J).

[167] (HCMP 877/2001, 29 May 2001).

[168] *Re El Sombrero Ltd* [1958] 3 WLR 349.

that it was agreed from the beginning that the plaintiff and himself would run the business together as partners. Harris J approached the issue by posing the question whether the first respondent would be entitled to an injunction to prevent his removal if the meeting could be held without the intervention of the Court[194] and held that the first respondent's contention did not amount to anything more than an initial understanding about how the business was to be managed. Harris J drew a distinction between the statutory right to remove the first defendant as director, and the potential unfair prejudice that may be constituted by such removal, which he considered as separate issues, and ordered the meeting to be held. Nevertheless, in *Re China NTG Investment Ltd*,[195] Deputy Judge L Chan distinguished *Re Mandarin Capital* on the ground that Harris J already made findings therein that the evidence did not demonstrate an agreement not to use the statutory right for removal of director and refused to authorise the proposal of a resolution at the meeting to change the composition of the board since he was not in a position to adjudge against the existence of a shareholder agreement at that stage.

Yet, Harris J's reasoning is not confined to the distinction so drawn, and is apparently of a wider application. Indeed, in *Re American Electronic Ltd*,[196] Harris J referred to his earlier decision in *Re Mandarin Capital Advisory Ltd* and remarked that matters concerning other proceedings in that case are not relevant to an application under s.560 of the CO in which the decision should be kept as simple as possible and focus firmly on whether or not the inability to satisfy a core requirement is preventing the provisions of a company's articles and the provisions of the CO being operated properly by the shareholders of the company.

Similarly, in *Re E-Harbour Services Ltd*[197] applied Harris J's *dicta* in *Re Mandarin Capital Advisory Ltd* and held that the mere assertion of a quasi-partnership or an oral agreement or understanding between the only two shareholders as to joint management of the company is normally not a sufficient ground for refusing to order a meeting under s.114B which will enable a majority shareholder to exercise his statutory right to remove a director, although it may be otherwise if the respondent minority shareholder can demonstrate to the satisfaction of the Court that he will be entitled to an injunction to restrain the applicant from convening a meeting and passing a resolution to remove him as a director. Ng J said:

> ... may be because in his view, it is highly questionable whether a statutory right of removal of director can be circumvented or abrogated by an unqualified agreement between shareholders not to remove a particular person as a director.

That said, the Court clearly has a discretion at the end of the day in considering which course will produce a solution that is most likely to protect the parties' interests and this will turn on the facts of each case.[198]

[194] The test posed by Harris J warrants further consideration in future. The courts in previous cases have not considered the issues of the possibility of unfair prejudice or the intervention of substantive rights from the perspective whether they are such as to warrant the grant of an injunction against the removal of directorship. Nevertheless, the general rule is that the Court will not lightly impose a director on a company in controversial circumstances in interlocutory proceedings, see *Pringle v Callard* [2007] EWCA Civ 1075; *Re Chime Corp* [2003] 2 HKLRD 905; *Muir v Lampl* [2005] 1 HKLRD 338; *MKGWH (aka MKKWH) v RKSH* [2011] 1 HKLRD 1048.

[195] [2012] 2 HKLRD 296.

[196] (HCMP 519/2012, 11 May 2012).

[197] [2014] 5 HKLRD 180, [32]–[33] (Ng J).

[198] *Re He-He International Holdings Development Ltd* (HCMP 2313/2009, [2010] HKEC 567) (Harris J); see also *Muir v Lampl* [2005] 1 HKLRD 338, [21], [25].

The gist of the above decisions appears to be that, where the class right or substantive right under a shareholder's agreement or other arrangement is at stake, the Court may exercise its discretion to preserve the *status quo* pending the resolution of the same.[199] Otherwise, the Court would be lending its aid to the commission of acts that could be unfairly prejudicial to the minority shareholders.

In this regard, it was said by Yuen J in *Re Success Plan Ltd*[200] that it would not be right for the Court to decide on the parties' substantive rights at an application of a limited nature such as one made under s.560 of the CO. In that case, one of the substantive rights concerned the interpretation of a supplemental deed to a shareholders' agreement. The plaintiff there contended that it should be entitled to appoint five directors after acquiring another shareholder's shares whereas the first and second defendants maintained that it could only appoint three. Notwithstanding such dispute, Yuen JA ordered a meeting to be held. She took the view that it was for the parties to resolve those dispute by directors' resolutions or an extraordinary general meeting and if, the directors acted in breach of fiduciary duties or the shareholders took actions that were oppressive, the prejudiced shareholders would then be entitled to present petitions for unfair prejudice or for a just and equitable winding-up of the company. It is true that the mere fact that the results of the proposed meeting would likely generate further litigation is not necessarily a bar to the grant of an order under that s.560 of the CO.[201]

(4) Undertakings and conditions. Notwithstanding any pending unfair prejudice petition proceedings, it cannot be right that a shareholder should be allowed to prevent the company having its accounts, annual returns, etc. dealt with by "quorum tactics". On the other hand, it would not be right for an applicant under s.560 of the CO to be given the opportunity of harming the other shareholder, eg by causing him to be dismissed as a director or by excluding him from participation in the affairs of the company pending the outcome of the petition proceedings. In such circumstances, it has been held in *Re Sticky Fingers Restaurant Ltd*[202] that the right course to take is to accede to an s.560 application but to qualify the order by appropriate undertakings. The order in that case provided that any additional directors appointed in the court-ordered meeting could not act until an undertaking was delivered to the defendant to the effect that, pending the outcome of the unfair prejudice petition, such additional director would not: (1) at any meeting vote in such fashion as to dismiss the defendant from his directorship or to exclude him from (or diminish) his rights and duties as director; (2) interfere with the defendant's day-to-day conduct of the company business as before and (3) vote to effect any alteration of articles or share capital.

In *Re Rich Long Ltd*,[203] the plaintiff majority shareholder (66%) and the first defendant minority shareholder (34%) were the only two directors of the company. A writ was issued against the company by a third party in the High Court. The plaintiff took steps to convene a directors' meeting and later a shareholders' meeting to authorise the board of directors to defend such action but the first defendant refused to attend taking

[199] Of course, the Court would assess the evidence and may refuse to give any weight to a bare allegation of shareholders' agreement (see eg *Re Woven Rugs Ltd* [2002] 1 BCLC 324).

[200] (at 620B).

[201] *Re Opera Photographic Ltd* [1989] 1 WLR 634; *Re Woven Rugs Ltd* [2002] 1 BCLC 324, 335b–335e; *Vectone Entertainment Holding Ltd v South Entertainment Ltd* [2004] 2 BCLC 224, 234c–234e.

[202] [1992] BCLC 84, 88i–90d; see also *Re Long Prime Ltd* (HCMP 877/2001, 29 May 2001).

[203] (HCMP 598/2003, 19 March 2003) (Kwan J).

the view that the company had no defence. Kwan J held that the first defendant could not satisfy the Court that the company's defence was so devoid of merits to render it a pointless exercise for the company to defend the action. That said, Kwan J also noted the plaintiff had brought a derivative action against the first defendant and there was a pending dispute whether the first defendant was wrongfully excluded from the management of the company. In the circumstances, Kwan J ordered a meeting be convened with a direction that the business to be conducted at the meeting was to be limited to matters relating to the proposed defence of the High Court action.

III. NOTICE OF MEETINGS

Introduction

5.035 One of the key formal requirements of a meeting is the need for sufficient advance notice to be given of the time, place and business to be transacted at the meeting. Not all shareholders would be interested to attend a meeting, especially where the business to be transacted or the resolutions to be proposed do not concern them. A valid and sufficient notice therefore serves two major functions: (1) firstly, it gives a fair warning of the nature and business of the meeting to enable the shareholder to determine in their own interest whether they ought to attend the meeting and (2) secondly, it confines the scope of business of a meeting so that those shareholders who decide to be absent in reliance of the notice will not be prejudiced by having other kinds of resolutions passed in their absence without prior notice to them.

Length of Notice

Computation of Notice Period

5.036 Under s.571 of the CO, except in the case of an annual general meeting where at least 21 days' notice is still required, it is only necessary to give at least 14 days' notice for any other general meeting in the case of a limited company (or at least seven days' notice in the case of an unlimited company), subject to any longer period of notice required by a company's articles.[204] Further, in the case of a resolution requiring special notice (eg for the removal of an auditor or director), the notice of such resolution to be given by the company to its members is reduced from 21 days under the previous version of the CO to 14 days under s.578(3) of the CO. In general, fractions of a day should be ignored in the computation of periods of time[205] and hence the length of notice shall be calculated on "clear day" basis, ie exclusive of the day of service (or the day of deemed service if despatched by post) and exclusive of the day on which the meeting is to be held.[206] Failure to comply with the notice requirement under the CO and/or the articles may render a meeting invalid.[207]

[204] CO s.571(2).

[205] *Pugh v Duke of Leeds* (1777) 2 Cowp 714, 720 (Lord Mansfield); *Re Railway Sleepers Supply Co* (1885) 29 Ch D 204, 205 (Chitty J); *Re Lympne Investments Ltd* [1972] 1 WLR 523.

[206] *Mercantile Investment and General Trust Co v International Co of Mexico* (1893) 1 Ch 484; *R v Turner* [1910] 1 KB 346; *Re Hector Whaling Ltd* [1936] 1 Ch 208, 210; *The Securities and Futures Commission v The Stock Exchange of Hong Kong Ltd* [1992] 1 HKLR 135.

[207] See *Woolf v East Nigel Gold Mining Co* (1905) 2 TLR 660. This is subject to the *Duomatic* principle and the irregularity principle as discussed in this chapter (VIII).

In *Pilot International Investment Ltd v Ingredients Plus Holdings (Pte) Ltd*,[208] in the context of a striking out application, the argument was made that as a party became a member only two days after service of a notice of an annual general meeting, therefore insufficient notice was given for that party. While the Court had "considerable reservations" as to the correctness of this approach, it was considered not wholly unarguable for the purposes of a strikeout.

Consent to Shorter Period of Notice

5.037 Where a meeting was called by a shorter notice than that specified under statute or the articles (whichever is longer), it may be deemed to have been duly called if it is so agreed by all members entitled to attend and vote in the case of an annual general meeting or, in the case of any other meeting, by a majority in number of the members having the right to attend and vote and together holding at least 95% in nominal value of the shares (or at least 95% of the total voting rights in the case of a company not having a share capital).[209]

In order for consent by members to cure the defect of a short notice, the rule:

> ... requires the persons who agree to a resolution being passed on short notice to appreciate that the resolution is being passed on short notice and to agree to its being so passed with that consideration in their minds.[210]

In *Re Pearce*,[211] less than 21 days' notice was given of an extraordinary general meeting for passing a special resolution for the reduction of capital. Sometime after the notice was given, the directors decided to submit an additional resolution to the meeting. The directors appreciated that they could not give proper period of notice for the latter resolution but had not by then realised that insufficient notice was given for the first resolution. The directors required the shareholders attending the meeting (who held more than 95% of shares) to sign a consent agreeing to shorter notice in respect of the latter resolution only. It was clear that the shareholders signing the consent did not have it in their minds that the initial notice was also defective in point of time. The consent thus obtained did not cure the defect of the first resolution (which validity was however upheld by the Court by applying the *Duomatic* principle).

Dispensing with Notice

5.038 Section 571(3) of the CO allows a shorter notice to be given upon the agreement of all or not less than 95% majority of shareholders, as the case may be. This section does not go so far as to dispense with the requirement for notice altogether. That said, if all relevant shareholders are in agreement, notice requirements may be waived in accordance with the *Duomatic* principle.[212]

[208] (HCMP 2454/2015, 10 March 2016).

[209] CO s.571(3).

[210] *Re Pearce* [1960] 3 All ER 222, 224D (Buckley J).

[211] *Ibid.*

[212] *Re Duomatic Ltd* [1969] 2 WLR 114; *Kinlan v Crimmin* [2006] EWHC 779 (Ch), [40]. See also the discussion on "*Duomatic* Principle" in this chapter (VIII).

For a variety of reasons then, members may be prejudiced by the conduct of the directors or the majority members. The law on members' remedies seeks to provide an avenue for members to protect their rights and interests in the company against such improper conduct. Yet while the various remedies discussed in this chapter are intended to alleviate some of the injustices that might occur under the doctrine of majority rule, there is always tension in the law in this area, as it needs to strike a balance between the interests of the majority members and that of the minority. Just as the majority might oppress the minority, so too can the minority oppress the majority if too much power is conferred on the minority under the law.

General Law Restrictions on Minority Remedies: *Foss v Harbottle*

Introduction

8.003 The rights of minority members to seek a remedy under the general law[5] are restricted by the rule in *Foss v Harbottle*.[6]

Proper Plaintiff Principle

8.004 Where directors have breached their duties owed to the company, or where any person has infringed any rights of the company,[7] then pursuant to the proper plaintiff principle in *Foss v Harbottle*, the right to seek a remedy against the wrongdoer resides in the company.[8] In that case, the court held that two individual shareholders did not have standing to bring an action against directors who had breached their duties owed to the company, as the proper plaintiff was the company itself. The proper plaintiff principle is generally regarded as the first limb of the rule in *Foss v Harbottle*.

Irregularity Principle

8.005 In relation to disputes between members, the doctrine of majority rule applies such that the decision of the majority in a general meeting is binding on the company. This doctrine of majority rule is reflected in what is regarded as the second limb of *Foss v Harbottle*, as explained in *Burland v Earle*,[9] namely the internal management or irregularity principle which provides that a member is not entitled to sue to complain of a mere informality or irregularity where the irregularity is one which can be cured

[5] Common law and equity.

[6] (1843) 2 Hare 461, 67 ER 189. On *Foss v Harbottle* generally, see KW Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*" (1957) 15 *Cambridge Law Journal* 194, (1958) 16 *Cambridge Law Journal* 93; SM Beck, "The Shareholders' Derivative Action" (1974) 52 *Canadian Bar Review* 159. On the historical origins of the rule, see BS Prunty, "The Shareholders' Derivative Suit: Note on Its Derivation" (1957) 32 *New York University Law Review* 980; AJ Boyle, "The Minority Shareholder in the Nineteenth Century: A Study in Anglo-American Legal History" (1965) 28 *Modern Law Review* 317. For a theoretical analysis, see RR Drury, "The Relative Nature of a Shareholder's Right to Enforce the Company Contract" 45 (1986) *Cambridge Law Journal* 219.

[7] As to corporate rights, see [8.011].

[8] *Re Chime Corp Ltd* [2004] 3 HKLRD 922, 934 (CFA); see also *Waddington Ltd v Chan Chun Hoo* (2008) 11 HKCFAR 370, 390; *Anglo-Eastern (1985) Ltd v Knutz* [1988] 1 HKLR 322, 326 (CA); *Tang Eng Guan v Southland Co Ltd* [1996] 2 HKLR 117, 105 (CA); *Richcombe Investment Ltd v Tin Fung* [2001] 2 HKC 115; *Samuel Tak Lee v Chou Wen Hsien* [1984] 1 WLR 1202 (PC); *Johnson v Gore Wood and Co (a firm)* [2001] 2 WLR 72.

[9] [1902] AC 83, 93–94 (PC); see also *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, 210; *King Pacific International Holdings Ltd v Chun Kam Chiu* [2002] 3 HKLRD 49, 55; *Re Hong Kong Sailing Federation* [2010] 1 HKLRD 801; *Re Dalny Estates Ltd* [2018] 1 HKLRD 409 (CA).

by a vote of the company in general meeting and where the intention of the majority members is clear.

Rationale for the Rule in Foss v Harbottle

8.006 The first limb of the rule in *Foss v Harbottle*, namely the proper plaintiff principle, follows logically from the doctrine of separate legal entity.[10] Additionally, both limbs have been justified from a policy perspective on various grounds:

(1) Firstly, the rule in *Foss v Harbottle* avoids a multiplicity of actions by a number of shareholders over the same issue[11] (though it has also been said that this problem could simply be avoided by the courts exercising its powers to consolidate proceedings).[12]

(2) Secondly, the company is in a better position to judge whether to institute proceedings than an individual shareholder.[13]

(3) Thirdly, where the dispute involves persons internal to the company (ie shareholders or directors), it might be appropriate for the company itself rather than the courts to decide, as a business or management matter, whether or not to take legal action.[14]

(4) Fourthly, the courts should not intervene where a majority of the shareholders do not support the commencement of legal proceedings. This is the majority rule doctrine, discussed in [8.001]. Related to this idea is the perceived need to avoid excessive litigation which might otherwise arise if there is a particularly litigious or cantankerous shareholder who wishes to complain of every minor irregularity even though the majority feels that litigation is unnecessary.[15]

One Rule or Two?

8.007 The interpretation of *Foss v Harbottle* above is that it contains two rules or two limbs — namely, (1) the proper plaintiff and (2) the irregularity principles. A different view is that the two rules are essentially one. This might be argued on the basis that the two aspects of the rule are simply manifestations of the one principle of majority rule.

The irregularity principle clearly reflects the doctrine of majority rule since the views of the majority prevent a minority from instituting action in relation to the irregularity. The proper plaintiff principle is also said to be a principle of majority rule, since where a wrong is done to the company, the majority of the members can decide whether or not to pursue the litigation.[16] Certainly, majority rule is one of the

[10] *Foss v Harbottle* (1843) 2 Hare 461, 490–491, 67 ER 189; see also *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, 224.

[11] *Gray v Lewis* (1872–1873) LR 8 Ch App 1035, 1051.

[12] AJ Boyle, *Minority Shareholders' Remedies* (Cambridge University Press, 2002) 7.

[13] RP Austin and IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf ed) para.11.240.

[14] *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9, 22–24; see also *Carlen v Drury* (1812) 1 Ves & B 154, 158.

[15] *MacDougall v Gardiner* (1875–1876) LR 1 Ch D 13, 25 (Mellish LJ).

[16] KW Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*" (1957) 15 *Cambridge Law Journal* 194, 198.

justifications given for the proper plaintiff principle. However, as discussed below,[17] if the articles confer on the board the power to authorise proceedings in the name of the company, the views of the majority members *prima facie* cannot prevail over the views of the board. Thus it would seem that the proper plaintiff principle operates independently of the doctrine of majority rule.

Another argument that there is only in essence one rule in *Foss v Harbottle* is on the grounds that the irregularity principle can be subsumed under the proper plaintiff principle. Two justifications might be given for this approach.

Firstly, it could be thought that where an irregularity has occurred (such as some procedural irregularity contravening the articles), a wrong has been occasioned to the company, so that the company is the proper plaintiff to commence proceedings. The company may decide, through a decision of a majority of the members, to ratify the wrong, with the effect that no complaint can subsequently be made over the irregularity.

However, the difficulty with this approach is that it overlooks the fact that the company's constitution operates as a statutory contract between the company and its members, as well as between members *inter se*,[18] and so contraventions of the constitution infringe on the rights of members. The wrong then is not simply to the company but also directly to the members as well.

Nonetheless, it could be argued that the courts draw a distinction between provisions in the articles which confer personal rights on members and those which do not[19] — and it is the latter which come within the proper plaintiff principle.[20]

The view that there is in essence only one rule in *Foss v Harbottle*, consisting of the proper plaintiff principle, is supported by the judgments in *McDougall v Gardiner*[21] and *Edwards v Halliwell*.[22] However, other cases have suggested that the irregularity principle is a principle separate to the proper plaintiff principle, including *Browne v La Trinidad*[23] and *Prudential Assurance Co Ltd v Newman Industries Ltd*,[24] and academic commentators generally discuss the two principles on the basis that they are separate.[25] There has now been explicit acceptance by the Court of First Instance in Hong Kong that the irregularity principle is separate to the proper plaintiff principle.[26]

[17] See [8.013].

[18] CO s.86.

[19] See [8.066].

[20] This approach could well be criticised as being artificial though in the sense that it is not really the company which is injured or wronged when there is some procedural irregularity that contravenes the articles: see, eg SM Beck, "The Shareholders' Derivative Action" (1974) 52 *Canadian Bar Review* 159, 187; C Baxter, "The Role of the Judge in Enforcing Shareholder Rights" (1983) 42 *Cambridge Law Journal* 96, 104.

[21] (1875–1876) LR 1 Ch D 13, 22–23 (James LJ), 24–25 (Mellish LJ) and 27 (Baggallay JA) (CA Eng).

[22] [1950] 2 All ER 1064, 1066 (Jenkins LJ) (with whom Sir Raymond Evershed MR agreed) (CA Eng).

[23] (1887) 37 Ch D 1, 10 (Cotton LJ), 17 (Lindley LJ) (Lopes LJ concurring) (CA Eng).

[24] [1982] Ch 204 [210] (CA Eng), see also *Link Agricultural Pty Ltd v Shanahan* [1999] 1 VR 466, 473 (CA, Victoria); *Papaioannoy v Greek Orthodox Community of Melbourne* (1978) 3 ACLR 801, 805.

[25] See RR Pennington, *Pennington's Company Law* (Butterworths LexisNexis, 8th ed 2001) 792–793; PL Davies, *Gower and Davies' Principles of Modern Company Law* (Sweet & Maxwell, 7th ed 2003) 449–450; V Joffe, *Minority Shareholders: Law, Practice and Procedure* (Butterworths, 2000) 2–3; SM Beck, "The Shareholders' Derivative Action" (1974) 52 *Canadian Bar Review* 159, 165, 189; SC Loh and WMF Wong, *Company Law: Powers and Accountability* (LexisNexis Butterworths, 2003) 1242–1247. *Cf* SW Mayson, D French and CL Ryan, *Mason, French and Ryan on Company Law* (Blackstone, 22nd ed 2005) para.18.3.1.

[26] *Re Hong Kong Sailing Federation* [2010] 1 HKLRD 801, [50].

Whether there is one rule or two can have implications in relation to the enforcement of individual rights of members in a personal action.[27]

General Law and Statutory Minority Remedies

Introduction

8.008 Although there are difficulties posed for minority members under the rule in *Foss v Harbottle*, there are various remedies under the general law and the CO which are intended to mitigate some of the harshness of the common law rule.

Firstly, in relation to breaches of directors' duties or other wrongs committed against the company, if the proper corporate organ for making the decision to institute action against the directors declines to do so, members who wish to commence litigation in the name of the company might be able to do so through a derivative action as an exception to the rule in *Foss v Harbottle* under the general law. Uncertainties and limitations in the scope of the general law exceptions have led to the legislature enacting a statutory derivative action (now contained in CO Pt.14 Division 4) as well, discussed further at [8.031]–[8.032].

The common law action however has not been abrogated (CO s.732(6)), and members can potentially choose between the statutory or common law derivative action. It should also be noted that in situations where the company's rights have been infringed, although members can only resort to the derivative action in order to remedy the company's loss, the same conduct giving rise to the company's cause of action might on the particular facts also give rise to other (personal) remedies for members.[28]

Secondly, in relation to conduct of the majority members which infringes on the personal rights of members, the members may have personal rights of action against the company or the persons engaged in the wrongdoing. Situations giving rise to a personal right of action of members under the general law are outside the scope of the proper plaintiff principle in *Foss v Harbottle* because it is not the company's right which is infringed but the member's personal right.[29] The proceedings brought by the member in these situations is a personal action of the member (as opposed to an action on behalf of the company). The precise cause of action will depend further on the source of the particular right that has been infringed. For rights conferred by the company's constitution, members might be able to seek to enforce the constitution pursuant to s.86 of the CO. Where personal rights are conferred by a separate contract between the parties (eg in a shareholders' agreement), then the right to sue is a contractual one derived from that agreement. The general law also recognises that members have personal rights in particular situations, and so members can enforce their rights pursuant to the general law principles (see [8.068]).

There are also statutory remedies, such as:

(1) Part 14 Division 2 of the CO (which reproduces the predecessor CO s.168A) allows members to seek certain personal remedies in relation to unfairly prejudicial conduct (see [8.073]);

[27] See [8.066]–[8.067].

[28] See [8.068] in relation to personal rights under the general law, and note also statutory remedies such as CO Pt.14 Division 2.

[29] *Edwards v Halliwell* [1950] 2 All ER 1064, 1067.

under s.168F (breaches of the CWUO or CO) may be made by the Companies Registrar, and applications for disqualification orders under the other provisions (CWUO ss.168E–168G) may be made by the Official Receiver, the Financial Secretary, a provisional liquidator or liquidator of the company, or any past or present member or creditor of the company. In the case of listed companies, the Securities and Futures Commission also has a right to seek disqualification orders under s.214 of the Securities and Futures Ordinance (Cap.571). Where the director's breach of duty involves the commission of a criminal offence (such as fraud or theft), then there may be investigations and prosecutions brought by the Commercial Crime Bureau of the Hong Kong police, the Independent Commission Against Corruption or the Department of Justice.

Proper Corporate Organ for Commencing Litigation

8.013 Where the company is the proper plaintiff to enforce the company's rights, the question arises as to who is entitled to take action in the name of the company. This will depend on the articles of association, and the courts have accepted that the conferral of general management powers on a corporate organ (usually the board) means that the particular organ also has powers to institute legal proceedings for the company.[43]

Irrespective of whether the articles vest management powers exclusively in the board, there is a suggestion that there is a special principle in relation to commencement of litigation whereby the general meeting has a concurrent power to institute legal proceedings.[44] Under this principle, even if the articles do not allow the general meeting to override a decision of the board to bring proceedings,[45] the general meeting still has power to pass an ordinary resolution to institute proceedings if the board has not done so. This view is supported by a number of early English cases,[46] including the English Court of Appeal decisions in *Harben v Phillips*[47] and *MacDougall v Gardiner*,[48] where it had been accepted that the general meeting could always authorise proceedings in the company's name. Neville J's decision in *Marshall's Valve Gear Co Ltd v Manning Wardle & Co Ltd*[49] might also be understood on the basis of such a rule allowing the general meeting to commence proceedings in the name of the company,[50]

[43] *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC 100; see also *Mitchell & Hobbs (UK) Ltd v Mill* [1996] 2 BCLC 102; *Broadview Commodities Pte Ltd v Broadview Finance Ltd* [1983] HKLR 384. As to whether the management powers of the board are subject to the directions of the general meeting under articles in the form of Table A art.82 of the predecessor CO (prior to the amendments in 2004); see also *Automatic Self-Cleansing Filter Syndicate Co v Cunninghame* [1906] 2 Ch 34; *Marshall's Valve Gear Co Ltd v Manning Wardle & Co Ltd* [1909] 1 Ch 627; *Salmon v Quinn and Axtens Ltd* [1909] 1 Ch 311; *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113; and *Tang Kam Yip v Yau Kung School* [1986] HKLR 448.

[44] See KW Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*" (1957) 15 *Cambridge Law Journal* 194, 201–202; RR Pennington, *Company Law* (Butterworths, 8th ed 2001) 793; PL Davies, *Gower and Davies' Principles of Modern Company Law* (Sweet & Maxwell, 8th ed 2008) para.17-3.

[45] *John Shaw and Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 (CA Eng).

[46] *Mozley v Alston* (1847) 1 Ph 789; *Exeter and Crediton Railway Company v Buller* (1847) 16 LJ Ch 449, 452; *Pender v Lushington* (1877) 6 Ch D 70, 79.

[47] (1883) 23 Ch D 14.

[48] (1875) LR 1 Ch D 13, [22].

[49] [1909] 1 Ch 267.

[50] Neville J had held that the general meeting could commence proceedings in the name of the company; however, the decision appears to be on the basis of the wider principle that the management powers of the board are subject to direction by the general meeting via ordinary resolution under articles similar to the former version of Table A art.82 of the predecessor CO (prior to those 2004 amendments to the predecessor CO). Whether that wider principle is correct is the subject of debate. However, even if the wider principle in *Marshall's Valve Gear* is wrong, it might be argued that the outcome in the case can be supported on the narrower basis of the particular rule allowing the general meeting to institute proceedings.

and in addition there are some *obiter* comments of the House of Lords in support of this position in *Alexander Ward & Co Ltd v Samyang Navigation Co Ltd*.[51] More recently though, Harman J in *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd*[52] rejected this principle. Australian cases have also held that where the articles confer general management powers exclusively on the board, there is no room for allowing the general meeting a concurrent power to commence proceedings.[53]

As a matter of principle, if the board does possess exclusive management powers pursuant to the articles, it is not entirely clear why an exception should be made in relation to the decision to institute legal proceedings compared with other matters of management.[54] One basis for a concurrent power of the general meeting to commence litigation might be the rule in *Foss v Harbottle* itself. It has been said that an important assumption behind *Foss v Harbottle*, derived from the majority rule doctrine, is that majority shareholders can decide to commence proceedings,[55] and that rejection of the view that the general meeting can bring an action in the company's name would lead the rule in *Foss v Harbottle* to: "… utter destruction by this sidewind".[56]

However, it is arguably incorrect to say that *Foss v Harbottle* would have no operation if that assumption was rejected. There is no inconsistency between the proper plaintiff principle and a principle allowing only the board to commence litigation in the name of the company. Moreover, the doctrine of majority rule would still have effect, since even if the majority cannot commence proceedings in the company's name, the majority could replace the recalcitrant directors from office with new directors who are willing to commence litigation.[57]

Whether or not the general meeting has a special power to commence litigation, the general meeting has residual powers of management where the board is unable to act, for example, due to deadlock in the board or where it is not possible for the board to form a quorum.[58] This principle has been adopted in relation to commencement of proceedings. In *Alexander Ward and Co Ltd v Samyang Navigation Co Ltd*,[59] two individuals had commenced proceedings purportedly for the company at a time when there were no appointed directors and where no general meetings had been held. The House of Lords held that although the proceedings were not properly commenced in the name of the company, it was possible for the liquidator of the company to subsequently ratify the decision to commence proceedings. The argument that the liquidator could not ratify due to the company not having the capacity to commence the proceedings in the

[51] [1975] 1 WLR 673, 679.

[52] [1989] BCLC 100, 104.

[53] *Kraus v JG Lloyd Pty Ltd* [1965] VR 232; *Massey v Wales* (2003) 57 NSWLR 718.

[54] See DL Larson, "Control of Corporate Litigation in the Light of the Doctrine of Constitutional Contract and *Bamford v Bamford*" (1970) 5 *University of British Columbia Law Review* 363, 367–368. Ford, Austin and Ramsay also reject the view that the general meeting has a concurrent power to institute legal proceedings: see RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf ed) para.7.140.

[55] See KW Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*" (1957) 15 *Cambridge Law Journal* 194, 201–202.

[56] KW Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*" (1957) 15 *Cambridge Law Journal* 194, 202.

[57] On the power of the general meeting to remove directors from office, see CO s.462.

[58] *Barron v Potter* [1914] 1 Ch 895.

[59] [1975] 1 WLR 673.

first place (when there were no directors and no general meeting held) was rejected, on the basis that the company *was* competent to commence proceedings either:

> … by appointing directors or … by authorising proceedings in general meeting which, in the absence of an effective board, has a residual authority to use the company's powers.[60]

This approach was applied in *Miracle Chance Ltd v Ho Yuk Wah David*[61] where the Hong Kong Court of Appeal held that, in circumstances where one of the two directors refused to attend board meetings such that there was insufficient quorum, the majority shareholder could authorise proceedings in the company's name through a general meeting resolution. By contrast, a narrower approach has been adopted in Australia, with the New South Wales Court of Appeal holding that although the general meeting has residual powers where the board is unable or unwilling to act, that power is not engaged where a deadlock can be resolved by the general meeting exercising power to appoint additional directors.[62] On this view then, the general meeting could not commence proceedings for the company if the members could appoint new directors to enable the board to act.

Under the Model Articles (as set out in the Companies (Model Articles) Notice (Cap.622H, Sub.Leg.)), the members in general meeting have a power to give directions to the board by passing a special resolution (Sch.2 art.4 (private companies) and Sch.1 art.3 (public companies) of this Cap.622H, Sub.Leg.). For companies which adopt these Model Articles, the general meeting would accordingly have a power to require the board to commence legal proceedings in the name of the company. These provisions in the Cap.622H Model Articles are derived from the version of Table A art.82 of the predecessor CO that was introduced in 2004.

III. DERIVATIVE ACTIONS

8.014 Where the proper organ for commencing legal proceedings in the name of the company has not done so, a member of the company can in some circumstances bring[63] an action on behalf of the company, that is, a derivative action. Derivative actions are possible under the common law by way of exceptions to the proper plaintiff principle in *Foss v Harbottle*. Members may also seek leave from the court to bring a statutory derivative action on behalf of the company pursuant to Pt.14 Division 4 of the CO. Despite the introduction of the statutory action, the right to bring a derivative action under the common law is preserved.[64]

[60] *Alexander Ward and Co Ltd v Samyang Navigation Co Ltd* [1975] 2 All ER 424, 428–429.

[61] [1999] 3 HKC 811. See also *Cheung Tse Ming v Cheung Yuk May* (HCA 9995/1995, [1996] HKLY 199) (Rogers J).

[62] *Massey v Wales* (2003) 57 NSWLR 718.

[63] The District Court has also accepted that under the common law a member could intervene in proceedings to defend an action on behalf of the company, though there does not appear to be any precedent on the point: *Myers Management Consulting v Topmix (International) Co Ltd* [2015] 4 HKC 422.

[64] CO s.732(6).

Prima facie, the question of whether a member of a company incorporated outside of Hong Kong can bring a derivative action in Hong Kong on behalf of the company depends on the law of the place of incorporation.[65] However, pursuant to the provisions in Pt.14 Division 4 of the CO, a statutory derivative action can be brought in Hong Kong on behalf of a non-Hong Kong company.[66]

IV. COMMON LAW DERIVATIVE ACTION

Grounds for a Derivative Action

8.015 The bringing of a derivative action by a member in relation to a wrong done to the company is allowed under the common law pursuant to the exceptions to the proper plaintiff principle in *Foss v Harbottle*. The judgment of Jenkins LJ in *Edwards v Halliwell*[67] is often cited as setting out the exceptions:

(1) *ultra vires* or illegal conduct;

(2) where the general meeting decides via an ordinary resolution in situations where a special majority is required;

(3) where members have a personal right of action; and

(4) fraud on the company.

In categories (1) and (2) above, members have a personal right of action to restrain the impugned conduct. Thus in that respect, the situations in those categories, along with other situations of personal rights in category (3), do not come within the proper plaintiff principle of *Foss v Harbottle*, and so are not actually exceptions to the principle. In those cases, members can bring a personal action in their own name rather than a derivative action to restrain the conduct.[68] However, where members wish to seek compensation or recovery of property for the company resulting from some *ultra vires* or illegal or unlawful act, then the proper action is via a derivative action on behalf of the company.[69] Such a situation, and the situations of fraud on the company[70] in category (4) are true exceptions to the proper plaintiff principle where a member could seek a remedy (for the company) only *via* a derivative action. There are also suggestions from Jenkins LJ's judgment that there is a further exception to the proper plaintiff principle where a derivative action would be allowed in any other case where that would be in the interests of the justice. There are uncertainties though as to whether this exception actually exists under the common law.[71]

[65] *East Asia Satellite Television (Holdings) Ltd v New Cotai LLC* [2011] 3 HKLRD 734; *Wong Ming Bun v Wang Ming Fan* [2014] 1 HKLRD 1108.

[66] CO s.722.

[67] [1950] 2 All ER 1064, 1067.

[68] See [8.059] as to the scope of members' personal rights.

[69] See [8.015]–[8.016].

[70] See [8.017].

[71] See [8.020].

and statutory body responsible for investor protection as the SEHK still maintains a certain amount of regulatory power and is responsible for investor protection as well. Finally, the government still wields a considerable amount of residual regulatory power and may intervene to provide investor protection.

The Securities and Futures Commission (SFC)

Introduction to the SFC

10.007 After its creation in 1989, the SFC was responsible for instituting a range of regulatory tools for investor protection. In 1991, the SFC led the enactment of the Securities (Disclosure of Interests) Ordinance (Cap.396) that compelled major shareholdings and transactions to be disclosed so that the public may be aware of important transactions and who may be in control of the company they were investing in. The SFC also led the enactment of the Securities (Insider Dealing) Ordinance (Cap.395) that introduced a novel concept of administrative penalties for insider dealers. Although it has been commented that neither of these measures were up to international standards,[26] they were beginning steps that would eventually result in the improvements made in the current SFO.

The SFC now consists of five operational divisions. The Corporate Finance Division is responsible for the dual filing functions in relation to listing matters, administering the Takeovers and Mergers Code and Share Repurchases Code, overseeing the SEHK's listing-related functions and responsibilities, and administering securities and company legislation relating to listed and unlisted companies. The Intermediaries and Investment Products Division is responsible for devising and administering licencing requirements for securities and futures, and leveraged foreign exchange trading intermediaries, supervising and monitoring intermediaries' conduct and financial resources, and regulating the public marketing of investment products. The Supervision of Markets Division is responsible for the supervision and monitoring of activities of the exchanges and clearing houses, encouraging development of the securities and futures markets and promoting self-regulation by market bodies. The Enforcement Division's responsibilities include conducting market surveillance to identify market misconduct for further investigation, undertaking inquiry into alleged breaches of relevant ordinances and codes, including insider dealing and market manipulation, and instituting disciplinary procedures for misconduct by licenced intermediaries. In response to the increasing availability of mainland Chinese securities and investment products on Hong Kong securities markets, the SFC has also dedicated an operation division to Policy, China and Investment Products Division.

Regulatory Ambit of the SFC

10.008 The SFC's principal objective is to maintain and promote fairness, efficiency, competitiveness, transparency and orderliness in the securities and future markets and to reduce systemic risks in the securities and futures industry in Hong Kong. The SFC is involved in all areas of regulation, ie, regulation of investment products, regulation of intermediaries and regulation of markets and shares its regulatory competence with other public or quasi-public bodies. The responsibility to regulate primary

[26] K Lynch, "Stock Market Crises and Insider Dealing in Hong Kong: The Need for Regulatory Reform" in R Wacks (ed), *New Legal Order in Hong Kong* (Hong Kong University Press, 1999) 237.

investment products such as offers of shares or debentures is shared between the SFC and the HKEx, as discussed in Section III of this chapter. The SFC's regulatory role with respect to the markets is not exclusive. The government is directly involved in certain regulatory aspects, especially with respect to market misconduct as will be discussed in Section IV of this chapter. As for the regulation of intermediaries, the SFC is responsible for recognising: (1) exchange companies,[27] (2) exchange controllers,[28] (3) clearing houses[29] and (4) investor compensation companies,[30] as well as approving intermediaries in respect of (5) specified regulated activities,[31] and (6) automated trading services.[32] The responsibility for recognition in respect of exchange companies, exchange controllers, clearing houses and investor compensation companies is different in nature from the authority to approve. These entities are currently monopolies in Hong Kong. For instance, the only exchange controller is the HKEx, that is the holding company of the securities and futures exchanges as well as the clearing house. Other than automated trading services, Hong Kong has not allowed other market-players to operate and all trading in financial instruments is concentrated and under the control of the HKEx. It is intended that the HKEx should have a self-regulatory role. Although the HKEx has been demutualised and has become a for-profit corporation, it is still expected to continue to maintain a certain extent of self-regulation.[33]

The SFO provides for the SFC to have residual powers where the HKEx is exercising primary powers in the interest of investor protection. The SFC could, with consultation with the Financial Secretary, withdraw recognition of the abovementioned entities, or resume any of the functions it transferred to any of these entities, with the blessing of the Chief Executive of Hong Kong.[34] The SFC is also expressly provided with the powers to prescribe listing rules and admission of exchange participants. Although these areas are at the moment within the self-regulatory purview of the SEHK, the residual powers of regulation would vest in the SFC for the purposes of investor protection. The rationale for any exercise of residual powers is not spelt out clearly in s.36 of the SFO, but this assumption of residual powers cannot be carried out unless with the approval of the Financial Secretary and upon consultation with the affected exchange company. Only in areas of revoking any authorisation granted to automated trading services under s.95 of the SFO, or intermediaries under s.116 of the SFO would the SFC have autonomous discretion.

Relationship with the HKEx

10.009 The HKEx owns and operates the only stock exchange and futures exchange in Hong Kong and three related clearing houses, which are: (1) Hong Kong Securities Clearing

[27] SFO s.19(2).

[28] Section 59(1), as subject to SFO s.62 that allows the Financial Secretary to exempt any person from having to be recognised by the SFC.

[29] SFO s.37(1).

[30] *Ibid.*, s.79(1).

[31] *Ibid.*, ss.116–122, including approvals of representatives, and of authorised financial institutions already under the supervision of the Monetary Authority of Hong Kong.

[32] SFO ss.95–97.

[33] This has been criticised in BM Ho, "Demutualisation of Organised Securities Exchanges in Hong Kong — The Great Leap Forward" (2002) 33 *Law and Policy of International Business* 283.

[34] SFO ss.25(6) and 28 in respect of an exchange company; SFO s.43 in respect of a clearing house; SFO ss.68(6) and 72 in respect of exchange controllers; SFO ss.80(6) and 85 in respect of an investor compensation company.

body[47] and a regulator[48] with public responsibilities, even though the SFC is the statutory regulator of the market. Under the SFO, the SEHK and the Futures Exchange, being recognised exchange companies, are charged with duties to maintain orderly and fair trading of the securities and derivatives markets, and to monitor the risks of trading as may be incurred by the participants in its markets.[49] To this end, they are allowed to prescribe rules for market conduct, regulation of market participants, listing criteria and conditions for withdrawal or suspension of listing, compensation arrangements and penalties for breach of its rules.[50] Nevertheless, these rules are not purely statutory and are by their nature contractual, private and consensual.[51] As required under the SFO, HKEx established a Risk Management Committee to formulate policies on risk management matters relating to the activities of HKEx, and to submit such policies to HKEx for its consideration.[52]

The HKSCC, SEOCH and HKCC, all wholly-owned subsidiaries of HKEx, are recognised clearing houses for the purposes of the SFO. The HKSCC and SEOCH provide services for the clearing and settlement of securities and stock option transactions respectively, including trades and transactions effected on, or subject to the rules of, the HKEx. The HKSCC provides services for the clearing and settlement of transactions on the Futures Exchange.[53] The three clearing houses are also charged with the duties of maintaining expeditious and fair clearing systems and may prescribe rules for the procedures of clearing, compensation arrangements and regulation of clearing participants.[54] The regulatory roles of the exchanges and clearing houses are buttressed by immunity provisions against civil liability for the functions discharged.[55] In this shared regulatory framework between the SFC and the self-regulating exchange and clearing entities, the SFO provides for information exchange in order for efficient and effective supervision of the financial market.[56]

Regulation by the SFC and Government

10.013 Besides the residual powers vested in the SFC earlier described, the SFC has the power to approve the exchange rules and the appointment of Chief Executives of

shareholding records, withdrawal and deposit of physical SCIP, and electronic voting and corporate action services. HKEx's commercial role is still subject to the regulation by SFC. For example, HKEx is required to obtain approval for any changes in its fees and charges from the SFC.

47 The HKEx is the sole operator of the securities and futures markets in Hong Kong. Given the importance of the securities market to the economy of Hong Kong, it is natural that the government wants to ensure that the public interest is observed. Section 63(2)(b) of the SFO states that HKEx shall ensure that the interests of the public prevails where it conflicts with its own interest. Half of the directors, including the Chairman, are appointed by the government in the public interest.

48 Almost all exchanges have a regulatory role of some sort. However, with demutualisation and the corporatisation of exchanges pursuing profit, many exchanges such as the London Stock Exchange have surrendered their regulatory roles.

49 SFO s.21.

50 *Ibid.*, s.23.

51 There have been some constitutional law and private law arguments in support of such view. See *Stock Exchange of Hong Kong v New World Development Co Ltd (2006)* (FACV 22/2005), available at http://legalref.judiciary.gov.hk and CK Low, "A Brave New World: The Stock Exchange of Hong Kong Holds Court" (2006) (8) *Journal of International Banking Law and Regulation* 464.

52 The Chairman of HKEx is the chairman of the Risk Management Committee.

53 See generally http://www.hkex.com.hk.

54 SFO ss.38 and 40.

55 *Ibid.*, ss.22, 39 and 81.

56 *Ibid.*, s.91.

the exchanges.[57] The SFC also has the power to examine and inspect the exchanges' records[58] and to monitor the control of HKEx in the exchanges companies and clearing houses.[59] It could be envisaged that any changes in corporate control of the exchanges and clearing houses may result in conflicts of interest between profit-making for the corporate exchanges and clearing houses and the regulatory roles they undertake. It seems that one way to mute any conflict of interest from arising is by regulatory control of the SFC over the internal corporate control of the exchanges and clearing houses. The SFC may also give directions to the HKEx to deal with conflicts of interest if they should arise,[60] and to serve restriction notices on the HKEx or any of the self-regulating subsidiaries, on any of the rules or actions undertaken by any one of them. The restriction notice may be envisaged for emergency situations in the interests of investor protection.[61] The SFC may, upon consultation with the Financial Secretary, issue suspension orders against any officer of the HKEx or its subsidiaries in the interests of investor protection.[62]

However, there is another layer of control over the regulatory roles of the exchanges and clearing houses, and that is the government itself. A person may not become a minority shareholder in the exchange controller, ie, the HKEx without approval of the SFC upon consultation with the Financial Secretary.[63] The HKEx is also compelled to set up a Risk Management Committee to formulate policies on risk management for all of its subsidiaries, and the Financial Secretary may appoint not less than three or more than five of the five to eight members of the Committee.[64] The Chairman of the HKEx has to be approved by the Chief Executive of Hong Kong,[65] and the Chief Executive or Chief Operating Officer of the HKEx has to be approved by the SFC upon consultation with the Financial Secretary.[66] If it is necessary for investor protection, the Financial Secretary may appoint up to eight Board members to the HKEx.[67] The Financial Services and Treasury Bureau, with the endorsement of the Legislative Council, is entitled to determine securities market policy. The Financial Secretary also has the power to initiate investigation under the CO. The Independent Commission Against Corruption (ICAC) has the power to audit or investigate the HKEx.[68] The Legislative Council, through its Panel on Financial Affairs, has the power to raise questions and invite the HKEx officials to its sessions to answer them.

Effects of Demutualisation and De-dualisation

10.014 Prior to the merger to form the HKEx, the Stock Exchange of Hong Kong and the Hong Kong Futures Exchange were mutual organisations, which were required to further the interests of their member brokers. This mutual arrangement was consistent with the

57 *Ibid.*, ss.24, 26 and 42. SFO s.29 also allows the SFC to give emergency directions to the exchanges.

58 *Ibid.*, ss.27, 42 and 84.

59 *Ibid.*, s.60.

60 *Ibid.*, s.75.

61 *Ibid.*, s.92.

62 *Ibid.*, s.93.

63 *Ibid.*, s.61. The consequences include criminal penalties and the statutory invalidation of votes cast in general meeting.

64 *Ibid.*, s.65.

65 *Ibid.*, s.69.

66 *Ibid.*, s.70.

67 *Ibid.*, s.77.

68 The SEHK is included in the list of the public bodies that are subject to the monitoring of the ICAC.

general practice around the world that most exchanges were mutuals. However, along with the globalisation, the mobility of capital and the need to maintain exchange competitiveness, many exchanges have demutualised to become for-profit corporations. HKEx was one of the earliest exchanges in Asia to demutualise. Although HKEx is no longer a membership organisation, it is still sensitive to the interests of its participants because its success is built upon the success of the participants.

The mutualised exchange is often regarded as a quasi-regulatory body that serves public interests. Thus, regulatory powers shared between the regulator and the exchange over investment products, participants and the market-place, a phenomenon called dualisation, is a common feature of many investment regulation regimes. With demutualisation and the corporatisation of the SEHK, de-dualisation of regulatory powers may help avoid operational confusion in the division of primary market regulatory duties between the exchange and the SFC. Further, the regulatory functions of many demutualised exchanges were more often than not transferred to the relevant regulatory authorities so that the exchanges would not be faced with potential conflict of interest issues.[69]

However, practical benefits of having more than one tier of regulation are also obvious. In particular, dualisation can avoid over-concentration of regulatory power but provide a front line as well as a backstop. The exchange is closer to the market than the government authority and is in a better position to provide a certain level of regulatory assurance. Compared to rigid laws and regulations, the exchange's policies and non-statutory rules can be interpreted in a more flexible manner and then can be amended and implemented in an easier but more efficient way. Due to various benefits, it is natural to see that the SEHK has been allowed to retain a regulatory role in the tripartite framework involving the SFC and the government.[70]

Regulatory Ambit of the HKEx

10.015 In the current regulatory regime, the HKEx is the "front-line" regulator and is solely responsible for the day-to-day administration of all listing-related matters and the supervision and regulation of listed companies through the making and enforcement of the Listing Rules.[71] The HKEx is delegated with substantial regulatory powers. In respect of listed companies, the process of approval for public offering and the process of approval for listing are both performed by the HKEx.[72] In such a regime, a disproportionate burden falls upon the HKEx's non-statutory Listing Rules. The HKEx, however, is not vested with any statutory investigatory powers and has to rely upon the terms of the listing agreements entered into by issuers.[73] Commitment to compliance is effected by means of the HKEx entering into listing agreements,

[69] The London Stock Exchange demutualised in 2000 and transferred all regulatory powers over listing to the UK Listing Authority, that is, the Financial Services Authority.

[70] In markets that follow the US model, the public offering is normally approved by the securities commission. In Taiwan, the statutory regulator, the Financial Supervisory Commission, has delegated to the exchange statutory authority over listed issuers under the Securities and Exchange Law.

[71] "Report of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure", available at www.info.gov.hk.

[72] The power of prospectus approval in respect of listing applicants was delegated by the SFC to the HKEx with effect from 1991 to remove duplication.

[73] See RG Kotewall and CK Kwong, "Report of the Panel of Inquiry on the Penny Stocks Incident" (2002), para.3.18, available at www.info.gov.hk.

which are commercial contracts, with the issuers. Private reprimand, public criticism, public censure, suspension of trading or cancellation of listing are the main sanctions available to the HKEx. In terms of investor protection, this level of enforcement power may be inadequate to deal with substantial mis-demeanour in the marketplace as reprimands and censures may not serve as sufficient deterrents if the financial gains from the wrongdoing outweighs the loss of reputation, and the suspension of trading and delisting will mainly be disadvantageous the minority shareholders' interests.[74] As a commercial entity, HKEx lacked "teeth" to enforce the Listing Rules rigorously. For example, HKEx does not have statutory powers of investigation and compelling companies to cooperate with its investigation. The introduction of dual filing in April 2003 to some extent addresses this concern and brings the SFC back into the approval process again, *inter alia*, in the context of the SFC's power to pursue false or misleading disclosure.[75] The underlying rationale of this dual filing system is to enable the SFC to impose criminal liability upon listing applications and listed companies that intentionally and/or recklessly provide false and/or misleading information. However, in terms of the listing approval, the HKEx plays a leading role and the SFC's role is in fact supplementary to the HKEx. For instance, the SFC has no statutory powers to enforce continuing disclosure requirements and disclosure with respect to connected transactions, which continue to reside in the Listing Rules.[76] Confusion can arise as to who is responsible for what under such an arrangement.[77] Compared to other major financial jurisdictions, Hong Kong's statutory regulator's power is generally weaker.

However, a new direction of change has been pointed out in SFC's August 2005 consultation paper, which seeks to enhance formal regulation. For example, a roadmap is proposed to enhance the listing regulation by embodying core disclosure provisions into the legislation.[78] There would be an "overall disclosure standard" in the SFO.[79] These proposals were significantly curtailed when the consultation concluded. The proposed changes[80] were eventually achieved through the passing of the current Companies Ordinance by the Legislative Council on 12 July 2012. The CO came into effect back on 3 March 2014. The prospectus regime, together with the winding-up and insolvency provisions, continue to be alive and were retitled as the CWUO. The SFC has indicated that it would lead the review of the prospectus regime and move the provisions relevant to the prospectus regime into the SFO. The approach announced by the SFC in February 2007 is three tiered. First, the SFO will embody broad general principles which are the statements of standards expected by the market. Second, the SFO will include a schedule incorporating future explanations of the principles and statutory requirements such as definitions, exemptions and factors taken into account

[74] "Report of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure", available at www.info.gov.hk.

[75] SFO s.384. However, the SFC has no powers in respect of non-disclosure.

[76] Details of disclosure requirements can be found in [10.017]–[10.88].

[77] See generally, HKEx's 2001/02 Primary Market Survey.

[78] The proposal is that the prospectus regime will be removed from the retitled CWUO to the SFO, which will then regulate the offers of shares and debentures separately to offers of other securities and investment products. See *SFC Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance* (29 August 2005). This is still being considered at the present time.

[79] See generally, R Mazzochi *et al*, "SFC Consultation Paper on the Hong Kong Prospectus Regime: A Change in Direction?" (2005) 11 *Hong Kong Lawyer* 31.

[80] *Consultation Conclusions on Possible Reforms to the Prospectus Regime in the Companies Ordinance* (September 2006).

2010, which governs "equity" REITs and which in some respects is based upon the requirements of the Code. REITs, which must be close-end unit trusts, are also authorised under s.104 of the SFO and must be listed under Chapter 20 of the Listing Rules.

Examples of investment funds that are authorised by the SFC and are then listed on the SEHK include: (1) iShares FTSE A50 China Index ETF (2) db x-trackers FTSE Vietnam ETF; (3) Hang Seng RMB Gold ETF; and (4) ChinaAMC CSI 300 Index ETF, which are all exchange-traded funds (ETFs).

The SFC has authorised two REITs to date, such as: (1) The Link REIT and (2) Champion REIT. Although authorisation by the SFC does not automatically ensure that a listing will be granted, the SEHK will normally grant a listing to collective investment schemes that have been authorised.

In respect of investment vehicles seeking listing under Chapter 21 of the Listing Rules, the Listing Division processes listing applications, including reviewing documents that are submitted to the SEHK in support of the applications. The Listing Division may reject a listing application made under that Chapter 21. However, for applications made under previous Chapter 20 of the Listing Rules, since the offer structure and offer documents have been vetted by the SFC, the SEHK's role is more limited and the function of granting listing approval of such investment vehicles will be discharged by the Listing Division.

The length of time required by the SEHK to process a Chapter 20 listing application is significantly shorter than that required for a Chapter 21 listing application because in the case of the former the SEHK seeks not to duplicate the review work that has already been completed by the SFC.

Information Disclosure in Relation to Public Offers

10.019 As part of the entry criteria, the issuer must comply with the contents requirements of disclosure rules when it applies to list on the Main Board. There are two main sources of the requirements relating to contents of listing documents. If the document is a prospectus as defined in the CWUO, it has to comply with the requirements of the SFO.[94] In addition, the listing document has to comply with the requirements of the Listing Rules whether or not the document constitutes a prospectus.

Prospectus Requirements under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32)

Contents Requirements for a Prospectus

10.020 The CWUO sets out the contents requirements for a prospectus of a Hong Kong-incorporated company. A prospectus issued by or on behalf of a company must be dated.[95] The CWUO provides that every prospectus issued by or on behalf of a company

[94] The term "prospectus" is defined in CO s.2. A prospectus must be in written form, and includes any prospectus, notice, circular, brochure, advertisement or other document. A prospectus must offer shares or debentures to the public or be calculated to invite offers for shares or debenture by the public. A prospectus can relate to new shares or debentures of the issuer or to shares or debentures already in issue. The consideration under the offer can be a cash or non-cash consideration.

[95] CWUO s.37. There is a rebuttable presumption that the date shown is the date of publication of the prospectus.

must set out certain information, including matters specified in both Pt.I and Pt.II of Sch.3 to the CWUO.[96] Every prospectus must contain in a prominent position, a recommendation that the recipient of the prospectus should seek independent professional advice if the recipient is in doubt about any part of the content of the document.[97] It is unlawful to issue an application form for a company's shares or debentures unless it is accompanied by a prospectus that complies with the requirement of the amended s.38 of the CWUO.

Excluded Offers under the Companies (Amendment) Ordinance 2004

10.021 There are 12 categories of excluded offers from the application of the prospectus requirement. These are:[98]

(1) Offers to "professional investors" as defined in the SFO, including those under the Securities and Futures (Professional Investor) Rules (Cap.571D, Sub.Leg.). Shares can be offered to regulated intermediaries, authorised financial institutions, recognised exchange companies, authorised insurers, authorised collective investment schemes, government institutions, high net worth individuals with portfolios of at least HK$8 million and any corporations or partnerships either with total assets of at least HK$40 million or a portfolio of at least HK$8 million;

(2) Offers to no more than 50 persons;

(3) Offers in respect of which the minimum subscription per investor is HK$500,000;

(4) Small offers, where the total consideration payable for the relevant shares or debentures is less than HK$500,000;

(5) Offers in connection with a good faith invitation to enter into an underwriting agreement;

(6) Offers in connection with a takeover or merger in compliance with the SFC's Codes on Takeovers and Mergers and Share Repurchases;

(7) Offers of shares of the same class free of charge to any or all holders of shares in the company concerned;

(8) Offers by a company or a group company of shares or debentures to current and former employees, directors, officers, consultants and their dependants;

(9) Offers by a charitable organisation or educational organisation;

(10) Offers by a club or an association to its members;

[96] *Ibid.*, s.38. Information shall be disclosed in both Chinese and English. The 3rd Schedule requirements do not apply to the issue of a prospectus relating to shares or debentures of the company to existing shareholders or debenture holders of that company, whether or not the applicant can renounce his rights in favour of a third party. A prospectus which relates to shares or debentures that are in all respects the same as shares or debentures issued previously and listed on the SEHK. A prospectus issued generally to the extent that the SFC has given a certificate of exemption pursuant to CWUO s.38A.

[97] An applicant for shares cannot waive compliance with these provisions.

[98] Companies (Amendment) Ordinance 2004 Sch.17.

(11) Offers in respect of an exchange of shares/debentures of the same company which does not result in an increase in the issued share capital of the company/the aggregate principal amount outstanding under the debentures; and

(12) Offers by authorised funds, ie where the relevant collective investment scheme has been authorised under the SFO and the relevant fund document has already been approved by the SFC. Unauthorised funds cannot be marketed to the public in Hong Kong even though they can be offered in Hong Kong under a limited number of exceptions including on a professionals only basis or by way of private placement.[99] In effect, this means that mutual fund companies which are authorised for retail distribution in Hong Kong will no longer have to register a prospectus with the Registrar of Companies.

The offer documentation for such categories are excluded expressly from the definition of "prospectus",[100] but the Companies (Amendment) Ordinance has not altered the fundamental principle that the prospectus provisions of the CWUO only apply to *public offers*. Nevertheless, this legislative movement indicates a shift of the focus of the Cap.32 prospect regime from "document-based" to "transaction-based" by providing that for the exemption from prospectus requirements of transactions which do not have a significant *public* element.[101] There is also scope for "private placement" outside the 12 specified categories of excluded offers. As s.48A of the CWUO, which contains the "domestic concern" provision, was not repealed by the Companies (Amendment) Ordinance 2004, if there is a special nexus between the offeror and the offeree, the offer could not be accepted by anyone other than those receiving the offer and there is resale restriction on the shares, the offer, outside the Seventeenth Schedule, may arguably be treated as "private" not subject to the prospectus requirements. The SFC has previously issued "comfort letters" in respect of offers to employees of the offeror companies as being a "domestic concern" not triggering the prospectus requirement. As the Companies (Amendment) Ordinance 2004 explicitly carved out offers to employees from the prospectus requirement, issues still remain as to what other "nexus" outside the Seventeenth Schedule of the SFC are recognised as a "domestic concern".

Exemption Power of the SFC

10.022 Under the CWUO, the SFC may, on application (by a Hong Kong local or overseas company), exempt an applicant from compliance with certain of the contents and

[99] Under professional investor rules made pursuant to the SFO, interests in unauthorised funds may be offered to certain high net worth individuals on an unlimited basis. High net worth individual professional investors for these purposes include individuals with net liquid assets of HK$8 million. Under the 17th Schedule to the CWOU which, in addition to the SFO, regulates public offers of shares in corporate funds, it is also possible to offer shares of unauthorised funds at the same categories of professional investors. In addition, the 17th Schedule provides for a minimum subscription exemption of HK$500,000 and a minimum number of offerees exemption (no more than 50).

[100] Most of the excluded offers are subject to the inclusion in the offer document of prescribed warning language set out in the 18th Schedule to the Companies (Amendment) Ordinance 2004. For instance, it shall be stated, among other things, that "the offer document has not been reviewed by any regulatory authority in Hong Kong".

[101] This shift is also recognised and recommended by the SFC in its 29 August 2005 consultation paper on possible reforms to the law relating to the public offering of shares and debentures. See generally, R Mazzochi *et al*, "SFC Consultation Paper on the Hong Kong Prospectus Regime: A Change in Direction?" (2005) 11 *Hong Kong Lawyer* 31.

other prospectus requirements where the SFC considers such compliance would be "irrelevant or unduly burdensome". The Companies (Amendment) Ordinance 2004 provides that such exemption may be issued if, having regard to the circumstances, the SFC considers that the exemption would not prejudice the interest of the investing public and compliance with any or all of those requirements would be "irrelevant or unduly burdensome" or is "otherwise unnecessary or inappropriate". This potentially applies to foreign entities that are listed elsewhere and have satisfied reasonably stringent requirements in these overseas regimes. As Hong Kong attracts at least half of its securities investment capital from abroad, many foreign enterprises are dually listed in Hong Kong, and the exempting of such "blue chip" enterprises from full compliance if they have already complied with a stringent set of offering regulations elsewhere would be attractive in making Hong Kong a dual-listing destination.

The SFC used to give little or no comments but has been more active than before. In early 2011, the SFC delivered a warning to investment banks that help companies sell shares after discovering material errors or omissions and obvious inaccuracies in a number of listing applications submitted by the sponsors. In a twice-yearly report released in January 2011, the SFC revealed that it had raised concerns about 82 out of 100 listing applications it received in the six months to September 2010 and noted that banks and brokers failed to do appropriate due diligence on companies. As a result, the SFC requested investment banks to provide detailed records of IPOs they arranged during the past two years so they can be audited for compliance with regulations. The SFC can take such sanctions as fines, the revoking of licences, or criminal action.[102]

Particulars to Be Disclosed in the Prospectus

10.023 The Third Schedule to the CWUO is divided into three parts. That Pt.I sets out matters which must be specified in a prospectus to which the Schedule applies. Sufficient information must be supplied so that, on the basis of that information, a reasonable person can form a valid and justifiable opinion of the shares or debentures of the issuing company and of the financial condition and profitability of the company at the time of the issue of the prospectus taking into account the nature of the shares or debentures being offered and the nature of the company, and the nature of the persons likely to consider acquiring them.[103] The CO introduced new requirements for registration of the allotment of debentures and filing of a return of allotment, to align with similar requirements for shares.[104]

The names, descriptions and addresses of the directors or proposed directors of the company must be stated. In the case of a natural person, the address stated should be his usual place of residence other than his business address.[105] Where the shares are offered to the public for subscription, the prospectus must include a statement of the minimum which, in the opinion of the directors, must be raised by the issue in order to provide for the purchase price of any property that has been purchased or is to be purchased using, in part or in full, the share issue proceeds preliminary expenses of the company and any commission payable to anyone in respect of subscribing for or

[102] R Cookson, "Hong Kong Regulator Warns Investment Banks on Listings", *Financial Times*, 28 January 2011, 24.

[103] CWUO para.3 Sch.3.

[104] CO Pt.7.

[105] CWUO para.6 Sch.3.