

Ms Becky Yu  
Clerk to Bills Committee  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central

Dear Ms Yu,

***Companies (Amendment) Bill 2002***

The Institute of Professional Development supports the Bill in general. Concerns and recommendations are limited to the following provisions regarding the right of shareholders to take direct legal action to enforce the company Memorandum and Articles:

- “(1) *Subject to the provisions of this Ordinance, the memorandum and articles shall, when registered, have effect as a contract under seal –*
- (a) *between the company and each member; and*  
(b) *between a member and each other member, and shall be deemed to contain covenants on the part of the company and of each member to observe all the provisions of the memorandum and articles.*
- (1A) *Without limiting the generality of subsection (1), the memorandum and articles shall, when registered, be enforceable by the company against each member and by a member against the company and against each other member.” (s23)*

Concerns

While we welcome the introduction of the provision in general, as it is legally and logically sound, and will bring a degree of clarity to a matter which has traditionally confounded the courts, we feel the provision, as drafted, will lead to unnecessary and perhaps disingenuous litigation, and may otherwise be used to hold companies in terrorem. There are very good reasons for the common law rule in *Foss v Harbottle* as regards breaches which amount to irregularities.

The following summary from the LEGCO Brief on Companies (Amendment) Bill 2002 (ref C2/155(2001)) is indicative of the overly broad view taken by the SCCLR and the Bill draftsmen:

*“It is important that the company’s affairs should be conducted constitutionally. Where this is not the case, every shareholder of the company should be able to enforce the terms of the memorandum and articles of association.” (para 3)*

Providing that ‘every shareholder of the company should be able to enforce the terms of the memorandum and articles’ is too broad, eg. it may be that enforcement by a minority shareholder is not in the interests of the company as a whole or even the other minority shareholders. It would therefore seem more sensible to give shareholders a qualified statutory right to enforce.

Recommendations

That the right of shareholders to take legal action to enforce company Memorandum and Articles of Association be qualified by adding elements regarding materiality and the application of the provision.

## 1. General

That the draft provision be amended to reflect:

- a) that a *material* breach may give rise to right of action
- b) that shareholders have a *prima facie* right to take action
- c) that the right to take action is subject to the discretion of the court, which may refuse to allow the enforcement action on the basis of one or more of the following considerations:
  - interests of the company as a whole
  - reasonability of behaviour of shareholder
  - availability of alternative courses of action

## 2. Considerations

Perhaps the best governance formula would be to make the right of action subject to the reasonability of the behavior of the shareholder in light of the alternative courses of action available.

Section 180(1A) of the Companies Ordinance, which concerns winding up orders, provides a good example of relevant provisions regarding alternative remedies. The section stipulates that where a petition is presented under s177(1f), *'the court shall not refuse to make a winding-up order -*

- *on the ground only that some other remedy is available to the petitioners, unless*
- *it is also of opinion that they are acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy'*

Although taking enforcement action for breaches to the company Memorandum and Articles is far less significant an event than seeking a winding up order, there is little doubt that the threat of action may be used to hold companies in *terrorem*. To paraphrase Yuen J, it cannot be just, or practical for a company to have the threat of legal action hanging over its head like the sword of Damocles (*see Tyler and Hei, 'HKLRD Review Series 2002: Company Law' at p77; Wong Tin Chee v Wong To Yick [2001] HKLRD 683*).

Any statutory provision giving the court the right to deny the right of action on the basis of an alternative course of action, must be carefully drafted so that it does not amount to a statutory injunction against the exercise of s23 rights, in cases where alternative remedies are available. Perhaps the court should be bound to exercise its discretion in light of all the relevant circumstances.

Thank you again for the opportunity to comment on the Bill. Should the Committee like to discuss any of the points in this submission, please do not hesitate to contact me directly.

Regards,



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Institute of Professional Development