# Bills Committee on Companies Bill

## Follow-up actions for the meeting held on 13 January 2012 in relation to Part 14 of the Companies Bill

## Purpose

This paper sets out the Administration's response to the issues raised by Members at the Bills Committee meeting on 13 January 2012 relating to Part 14 (Remedies for Protection of Companies' or Members' Interests) of the Companies Bill ("CB").

## Administration's response

Divisions 2 (Remedies for Unfair Prejudice to Members' Interests) and 3 (Remedies for Others' Conduct in relation to Companies etc.)

2. Members asked if the procedures for applications under Division 2 and Division 3 should be aligned as, in practice, the same sets of facts might be relied upon for both applications. Members also asked whether a clause similar to clause 716 should be introduced in Division 3 so as to empower the Chief Justice to make rules for actions under that Division.

3. We have consulted the Law Society of Hong Kong on the subject. The Law Society noted the possibility of some remedies which overlapped if applications were made under clauses 713 and 714 (unfair prejudice) and 717 and 718 (breaches of the CB or its predecessor Ordinance). It also noted the scope of protection under clauses 713 and 714 was much wider than that under clauses 717 and 718, both in terms of the nature of conduct complained of and the class of potential plaintiffs who could initiate a claim.

4. The Law Society advised that, in practice, situations which fell squarely within the unfair prejudice route would invariably involve a breach of fiduciary duties and thus a breach of the Companies Ordinance ("CO") etc. on the part of the wrongdoers, and that action would be taken under the unfair prejudice route as the court could provide the same type of remedies as under clause 718. However, if action was to be taken

against potential defendants, who might not have full control of the company in question, it would be difficult to use the unfair prejudice route and they would have to make an application pursuant to clause 717 and 718. The Law Society therefore preferred to retain the status quo as this provided potential claimants with more options when faced with a situation where their rights as a member of a company were being infringed.

5. Noting the Law Society's views, we propose no change to the two Divisions. As for whether rules have to be made under Division 3, we note that, unlike actions for unfair prejudice remedies, procedures for applications for injunctive relief are relatively straight forward as they are not usually associated with winding-up proceedings. The practice and procedures set out in the Rules of the High Court (Cap 4A), in particular Orders 28 and 29, are applicable to such actions. Therefore there is no need for separate rules to be made.

Clause 713 (When Court may order remedies)

6. In response to Members' enquiries, our research reveals no written decisions on actions taken by the Financial Secretary under section168A of the CO.

Clause 717(2) (Application of section 718)

7. Noting that there were no equivalent provisions in the United Kingdom ("UK"), Members asked why the relevant provisions in the CO were introduced in 2004, and whether there had been actual cases since their introduction.

8. Clauses 717 to 719 restate section 350B of the CO with modifications. Section 350B was added to the CO by the Companies (Amendment) Ordinance 2004 to enhance shareholder remedies. The proposal to introduce the new provision relating to injunctions was contained in the SCCLR's Consultation Paper on Proposals made in Phase I of the Corporate Governance Review published in July 2001, and received support from the comments received. The Administration considered that additional powers of the court would be useful to help address the practical difficulties in enforcing the duties of directors,

connected persons or controlling shareholders, therefore proposed that the court should have a general power, on application by an affected person or a relevant authority, to grant an injunction against any contravention of the CO or any breach of fiduciary duties.

9. There have been a number of cases concerning section 350B. A mandatory injunction has been granted under section 350B to compel a director of a company to proceed with the deregistration of the company's subsidiary on the ground that he was in breach of his duty as a director to carry out the board's resolution to proceed with the deregistration with due diligence[1]. There have also been applications for injunctions or interim injunctions under section 350B in relation to breaches of various sections of the CO, including sections 70(1A), 95, 98[2] and 120[3], and breaches of fiduciary or other duties by the directors[4]. The section serves useful purposes and should therefore be restated in the CB.

Clause 717(4) (Application of section 718)

10. Members queried why a breach of the company's articles should be included in clause 717(4)(c) as a ground for an application for remedies under clause 718. In this regard, clause 717(4)(c) is modelled on section 164(1) of the New Zealand Companies Act 1993, which expressly includes contravention of a company's constitution as a ground for an application for injunctive relief. In Singapore, although not expressly stated in section 409A of the Singapore Companies Act ("SCA"), it has been said that the section may provide a ready means whereby a minority member may more effectively ensure that the company is managed in accordance with the law and the articles of association, and that the power to enjoin breaches of SCA may perhaps be invoked to enforce compliance with the articles pursuant to section 39 of the SCA.[5] Taking into account the position in New Zealand and

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1 *Re Pal Active Ltd* (HCMP 2001/2008)

2 *王一帆與卓佳登捷時有限公司* (HCMP 1788/2008 (no.3)). The application for injunction was refused on the ground of lack of evidence of breach.

3 *有關多維媒體有限公司* HCMP (2650/2009)

4 *Leung Alfred Cheukwah v Unity Investments Holdings Limited* (HCMP 1885/2005). The application for an interlocutory injunction to restrain the defendant from holding an Extraordinary General Meeting ("EGM") and to postpone that EGM to a later date was refused as the court was not satisfied that there had been a breach of duties on the part of the directors.

5 *Woon's Corporations Law* para K[1553]

Singapore, we are of the view that it is desirable to expressly provide for a remedy in the CB preventing conduct that would contravene the company's constitution.

Clause 720 (Interpretation)

11. The Administration was asked to clarify whether statutory derivative actions ("SDA") were extended to proceedings of any court (instead of proceedings of the Court of First Instance only) as reflected in the definition of "proceedings". Members also queried why common law derivative actions ("CDA") had to be retained.

12. We consider that the proceedings that a member of a company or an associated company may bring or intervene in on behalf of the company (i.e. SDA) after leave is granted by the Court of First Instance should not be limited to proceedings in the Court of First Instance only. The intention is that SDA may be brought in any proceedings (except criminal proceedings) in any court of competent jurisdiction. The expression "court" is therefore used in the definition of "proceedings" in clause 720.

13. As to the reasons why CDA has to be retained, there are a large number of companies incorporated outside Hong Kong with Hong Kong residents as shareholders. The abolition of CDA might prevent Hong Kong shareholders of those foreign companies (which are not registered under the CO or the new CB) from seeking a derivative action in the Hong Kong courts by relying on the common law of Hong Kong. This would be the case if the *lex fori* (i.e. the laws of the jurisdiction in which a legal action is brought) applies in respect of the question of the availability of a derivative action. The decisions in *Waddington Ltd v Chan Chun Hoo* (2008) 11 HKCFAR 370 and *East Asia Satellite Television (Holdings) Ltd v New Cotai LLC* [2011] 3 HKLRD 734 suggest that the question is determined by the law of the place of incorporation and so, if the law of the place of incorporation allows for CDA, then derivative actions will be available regardless of whether CDA is available under Hong Kong law. However, it seems that there are lingering concerns that the law is not entirely settled on this point. The majority view in the public submissions in response to the First Phase Consultation of the Draft CB supported retention of CDA to provide a last resort for litigants. Taking into account the public views, we propose to retain CDA in the CB.

Division 5 (Members' Inspection of Company's Records)

14. In response to Members' suggestion, we will, for the avoidance of doubt, introduce a Committee Stage Amendment ("CSA") to add a provision similar to section 152FE of the CO to Division 5 of Part 14 (nothing in the provisions shall authorise the collection, retention or use of personal data in contravention of the Personal Data (Privacy) Ordinance (Cap 486).

Clause 728 (Interpretation)

15. In response to Members' query as to whether "record" includes electronic record, we will revise the definition of "record" in clause 728 to include electronic record by way of CSA.

Clause 729 (Court may order inspection of records)

16. Members sought information on the records which members of a company might inspect. In this regard, as the meaning of "records" within clause 729 is very general, it would include all documents owned or possessed by the company. Under clause 729(2) the inspection must be for a proper purpose and the application must be made in good faith. Clause 729(2) restates section 152FA(3) of the CO, which has been judicially interpreted. In the case of *Wong Kar Gee Mimi v Hung Kin Sang Raymond* [2011]5 HKLRD 241, the court had to decide whether the inspection sought under section 152FA of the CO was for a proper purpose. The court said that shareholder inspection rights were founded upon distinctly different justifications from those relating to director's rights of access to corporate information. Whilst a director's right to inspect the company's records depended directly on the director's fiduciary obligations in relation to the company, a shareholder's right of inspection originated from the shareholder's interest in the company vis-à-vis the rights that the shares in which he held embraced. Harris J said (in paras 30 to 32 of the judgment) that "in my view the court should incline to a liberal interpretation of "proper purpose" with a view to advancing the protection of shareholder rights and interest and the maintenance of appropriate standards of corporate governance… situations involving potential abuse within large companies, particularly publicly listed companies, are amongst the types of mischief that it is reasonable to assume that the legislature in enacting section 152FA had in

mind shareholders being able to address through greater access to information." He was however mindful that a balance needs to be struck and that adopting too wide of a construction of section 152FA could result in an encroachment of managerial decisions by members of the company. In that case, the records which had to be disclosed included, insofar as they related to the specified concerns or transaction, the followings –

- contracts or agreements;
- monthly management accounts;
- journal entries, vouchers, ledgers and supporting documents;
- bank statements and other evidence showing receipts and payments in respect of all the bank accounts opened in the name of the company;
- payroll records of a named person;
- employer returns submitted by or on behalf of the company to the Inland Revenue Department in respect of the person;
- minutes of meetings of the board of directors and all committees established by the board;
- minutes of general meetings;
- correspondence and communications between the company and its accountants; and
- reports prepared by the accountants for the company.

17. Other than clause 729, members of a company may inspect company's records pursuant to other provision in the CB. A list of the records is at **Annex**.

Clause 730 (Preservation of secrecy)

18. In response to Members' comments, we would consider introducing CSAs to clarify that both the applicant(s) and other persons who inspect the records would be bound by the clause.

**Financial Services and the Treasury Bureau**
**Companies Registry**
**13 March 2012**

**Annex**

## Company Records that Members of a Company may Inspect

| Relevant Clauses | Company Records |
|---|---|
| 304 | Register of debenture holders |
| 350, 351 | Register of charges |
| 442 | Register of loans, quasi-loans and other dealings in favour of directors |
| 462 | Directors' permitted indemnity provisions |
| 472 | Records of minutes of directors' meetings |
| 533 | Management contracts |
| 608 | Records of resolutions and meetings |
| 617, 620 | Register and index of members |
| 632 | Register of directors |
| 639 | Register of company secretaries |