

Updating Your Study Manual

Instructions for Inserting Version 1.3, 2003

The followings serve as the instructions for updating **Topic 2: Principles of relevant Hong Kong Law and the Companies Ordinance** of Study Manual 1 for the Licensing Examination for Securities and Futures Intermediaries. Please be reminded that only the updated sections are provided for downloading. You may replace the relevant sections with this updated version for the study manual you possess.

Instructions:

1. Download and print out the following pages.
 2. **Remove** pages 2-7 to 2-8 and **Insert** new pages 2-7 to 2-8.
 3. **Remove** pages 2-15 to 2-18 and **Insert** new pages 2-15 to 2-18.
 4. **Remove** pages 2-23 to 2-24 and **Insert** new pages 2-23 to 2-24.
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person has a duty to act for the benefit of the other on matters within the scope of their relationship. Examples of fiduciary relationships are those of stockbroker and client, agent and principal, solicitor and client, and trustee and beneficiary.

The Law of Tort

- 1.19 When parties who have no contractual relationship are in a situation where one party suffers loss or damage as a result of the act of the other, a wrong or tort may have occurred and under civil law a liability may have arisen. There are various branches of the law of tort of which *the tort of negligence* has the most direct application to our studies. The tort of negligence is a tort committed as a result of a failure to observe the standard of care expected under law in a particular case.
- 1.20 For example, financial advisers may be exposed to actions in tort if they are negligent in giving advice, reliance is placed on their advice and losses made. This is a complex area as there may be contractual as well as tortious relationships in such situations. Students will not be expected to have a detailed knowledge of the laws of contract and tort.

Employment Law

- 1.21 Under common law an employer must provide his employee with remuneration (there is no minimum wage in Hong Kong), indemnity for expenses, loss and liabilities incurred while performing his duties, and a safe working environment.
- 1.22 Also under common law, an employee must demonstrate skills and competence, faithful service, obedience and confidentiality.
- 1.23 If the two parties fail to show these basic elements in the relationship there can be a breach of the law as well as of the contractual relationship between them.
- 1.24 Employment law is important to the area of operations of the Mandatory Provident Fund Schemes Authority. In addition to the common law requirements, the Employment Ordinance and a number of other ordinances govern employment in Hong Kong.

The Hong Kong SAR system of law courts and tribunals

The Law Courts

- 1.25 The hierarchy of the law courts of Hong Kong SAR is as follows:
- The Court of Final Appeal is the highest Court in Hong Kong. It is headed by the Chief Justice.

- The Court of Appeal of the High Court hears appeals in all civil and criminal cases arising from the proceedings of the Court of First Instance, the District Court and the Lands Tribunal.
- The Court of First Instance of the High Court has unlimited jurisdiction in respect of criminal and civil cases. It also hears appeals from tribunals and criminal appeals from Magistrates' Courts. (The Court of Appeal and the Court of First Instance comprise the High Court).
- The District Courts consider more serious criminal cases (excluding very serious offences such as murder, manslaughter and rape) and civil cases involving disputes for amounts up to **HK\$ 1 million**.
- The Magistrates' Courts deal with the least serious criminal offences and impose smaller sentences than the District Courts (see Figure 1: Structure of the Courts).

1.26 The operations of the various Courts have direct relevance to the enforcement functions of the SFC as in performing enforcement actions the SFC may need to have recourse to the Courts.

Structure of the Courts

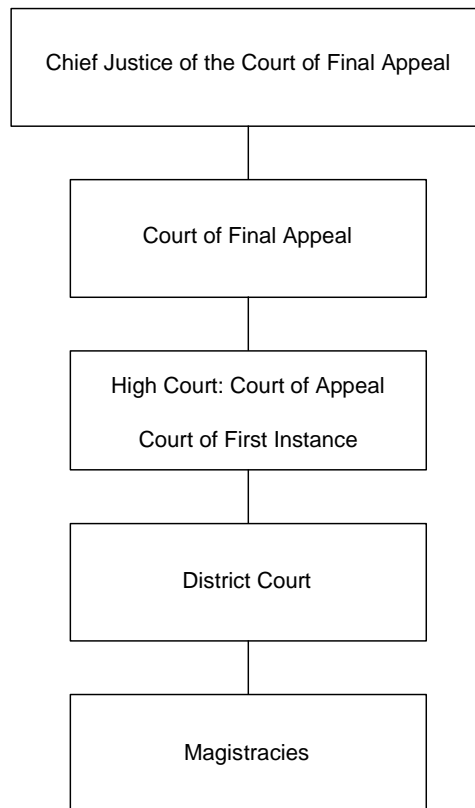


Figure 1: Structure of the Courts

Special resolution (s.116, CO)

2.26 A special resolution is one passed by at least 75% of members at a general meeting of which 21 days notice specifying the intention to pass the resolution has been given. Examples of matters which need special resolutions are:

- reduction of share capital;
- winding up of the company voluntarily or by court;
- alteration of objects, articles and conditions in memoranda that could have been included in the articles; and
- various buy-backs of shares affecting listed and unlisted companies.

A printed copy of a special resolution must be lodged with the Company Registrar within 15 days of its being passed.

Ordinary resolution

2.27 An ordinary resolution is not defined in the CO or in Table A. It generally refers to resolutions which may be passed by a simple majority of those present and voting at a meeting of members. Notice must be given.

Powers of shareholders

Powers exercisable by members in general meeting

2.28 These include:

- changes to articles and company name;
- matters relating to buybacks;
- issue of shares at a discount;
- alteration of capital including reduction;
- variation of class rights;
- [corporate](#) arrangements and reconstructions;
- appointment and removal of auditors;
- removal of directors;
- disposal of company assets;
- approval of payments for loss of office; and

- winding up petitions under court order and voluntary winding up.

Protection of members and minority shareholders

- 2.29 There are provisions in the CO and in Table A which enable a company to vary the rights of the holders of a class of shares. However if a variation is being processed, the holders of at least 10% of the nominal value of the shares of that class may petition the court to have the variation cancelled if it is against their interests. The decision of the court is final.
- 2.30 In addition to the above, an individual member may petition the court if the affairs of the company are being conducted in a manner prejudicial to the members generally (see paragraphs 2.32 and 2.33 for other situations where the interests of members are protected).

Protection of the interests of minority shareholders

(in relation to internal procedures)

- 2.31 The court will not generally interfere in internal management matters or where the company can deal with the matter by calling a meeting. This is the principle of majority power.
- 2.32 To ensure that the principle of majority power is not abused, certain safeguards are provided under the CO to protect the interests of minority shareholders:
- As seen in paragraph 2.26 above, a special resolution is required for certain matters.
 - Court sanction is required where the decision of the company will directly affect creditors.
 - Dissenting members may appeal to court to have certain resolutions cancelled.
 - Members with 5% of the paid-up capital which carries voting rights may requisition the directors to call a meeting; if the directors will not, the members may do so.
 - 100 members or 10% of the holders of the issued shares may ask the Financial Secretary to appoint an investigator into the company's affairs.
 - Under s.168A, CO, a member may apply to court for an order if he considers that the affairs of the company are being conducted in a manner prejudicial to the members generally or of some part of the members.
 - A member may petition for a winding up.

Judicial protection of the minority

- 2.33 In addition to the statutory safeguards above, the court may intervene to allow an individual member or members to bring an action:
- to enforce some personal rights (*a personal action*);
 - where a right has been infringed which affects all or a number of members in a similar way (*a class action*); or
 - where the alleged wrongdoers are in control of the company so that it is not possible for the action to be brought in the company's own name (*a derivative action*).

Directors and officers

Directors

- 2.34 The CO merely defines a director as including a person who occupies the position of director, by whatever name he is called. The CO itself refers very little to directors and there is more about them in Table A. The CO says that every company (not being a private company) must have at least two directors (s.153, CO) and every private company must have at least one director (s.153A, CO). The directors must be appointed by the members acting in general meeting.

Shadow directors

- 2.35 Shadow directors are persons in accordance with whose directions or instructions the directors or a majority of the directors of a company are accustomed to act. A person shall not be considered to be a shadow director of a company by reason only that the directors or a majority of the directors of the company act on advice given by him in a professional capacity.

Officer

- 2.36 An officer according to the CO includes a director, manager or secretary.

Qualifications, powers, duties, and liabilities of directors

Qualifications of directors

2.37 Persons require to meet the following requirements to be appointed directors:

- They must be at least 18 years of age.
- They must have any shareholdings (the qualification shares) that directors must hold according to the articles.
- They must not be undischarged bankrupts.
- They must not be disqualified by court order; the 4 principal grounds for such an order being:
 - conviction of an indictable offence for fraud or dishonesty or relating to forming or operating companies;
 - persistent default in relation to the CO or in acting as a liquidator or receiver;
 - fraud in relation to company matters or fraudulent trading; or
 - found to be unfit during directorship of an insolvent company.

Fraud and the other disqualifications apply to directors and shadow directors (e.g. see paragraph 1.7, topic 9 which describes disqualification orders made by the Market Misconduct Tribunal preventing persons committing market misconduct from being directors of companies).

Powers of directors

Directors may override shareholders

2.38 Matters relating to the control of the operations of companies are dealt with in Table A or the articles of the company whichever applies. The general powers to **manage the business of** a company are vested in the directors. Under Table A, they can exercise all the powers of the company except those otherwise required by the CO, the memorandum, the articles and any directions given by special resolution.

2.39 Directors in these circumstances are not bound by resolutions passed by members in a general meeting nor can the members override future management actions of the directors. It is only if the board of directors is:

- unwilling to act;
- seeking approval to act beyond the powers of the directors (the members can approve by ordinary resolution); or

- the basis of mutual trust, understanding and confidence on which the company was formed no longer exists.

Petitioners

2.56 The petitioners may be:

- the company,
- a creditor,
- a contributory (i.e. a present member, or a past holder of partly paid shares who has transferred his shares in the last year),
- the FS, if he thinks it desirable in the public interest,
- the Registrar of Company, if the company has breached provisions of the CO or is being carried on for an unlawful purpose,
- the Official Receiver, where there is already a voluntary winding up (s.179, CO), and
- the SFC, if it appears desirable in the public interest (SFO gives authority to SFC).

2.57 The court may appoint a liquidator who may be the Official Receiver. The powers of court in supervising a compulsory winding up and the powers of the liquidator are extensive and will not be considered here. Reference should be made to a textbook on insolvency practice if the reader wishes to know more.

Voluntary liquidation

2.58 A voluntary winding up may be started by members or creditors. There are less formalities than with a compulsory liquidation and this route is far more popular.

2.59 A voluntary winding up is started:

- when the period of the company's planned existence [as stated in its articles of association](#) comes to an end;
- by the passing of a special resolution for winding up;
- by the passing of a special resolution that it is advisable to wind up the company as it cannot continue due to its liabilities; or
- if the directors of a company or, in a case of a company having more than 2 directors, the majority of the directors deliver a winding-up statement under s.228A that the company should be wound up after passing a resolution to that effect at a board meeting (s.228, CO). In the case of a

private company having only one director, the sole director may make the winding-up statement.

Members' voluntary winding up (s.233, CO)

- 2.60 This may be done if the directors or in the case of a company having more than 2 directors, the majority of the directors issue a 'certificate of solvency' to the effect that they have:
- made a full enquiry into the affairs of the company; and
 - formed the opinion that the company will be able to pay its debts within 12 months from the commencement of the winding up as specified in the certificate of solvency.
- 2.61 In the case of a private company having only one director, the sole director may issue a certificate of solvency.
- 2.62 The certificate of solvency must be made within the 5 weeks preceding the resolution and be delivered to the Company Registrar for registration not later than when the copy of the winding up resolution is delivered and must include a statement of the company's assets and liabilities at the latest practicable date. If this is done it will be a members' voluntary winding up, if not it will be a creditors' voluntary winding up.

Creditors' voluntary winding up (ss.242 and 244, CO)

- 2.63 The company arranges a meeting of the creditors to be summoned for the day when the resolution to wind up is proposed or for the next day. Advertisements will have to be run in the gazette and newspapers. A statement of assets and liabilities, and a list of creditors and amounts due will be presented to the meeting at which a liquidator and a committee of inspection will be appointed. In the event of a conflict the liquidator selected by the creditors will be appointed.

Revision questions:

Question 9: By whom and in what circumstances may an inspector be appointed to enquire into the affairs of a company.

Question 10: What is the difference between a compulsory and a voluntary winding up?
