

### The Duties of Directors of Hong Kong companies

The corporate regime relating to directors in Hong Kong is contained in statute (the Hong Kong Companies Ordinance (“CO”)) and in common law case law. It is worthwhile noting that the Hong Kong Companies Registry (being the government entity with whom Hong Kong companies are to register, similar to the ASIC) has issued a guide on directors’ duties and the Hong Kong Institute of Directors has also issued the Guidelines for Directors, though these guidance notes do not have the force of law. Furthermore, the Hong Kong Financial Services and Treasury Bureau (“FSTB”) of the Hong Kong government is currently consulting the public on a re-write of the CO, and a new statutory regime for companies may be submitted to the Hong Kong Legislative Council in the year 2012.

#### General rules relating to the appointment of directors

Every Hong Kong incorporated private company should have at least one director (section 153A) and currently, such director may be an individual or may be a corporate. There are no requirements for such director to be a resident of Hong Kong. Pursuant to the draft Companies Bill published by the FSTB for public consultation, the law would be changed so that a Hong Kong company would be required to have at least one director who is a natural person. However, there are no plans to require such individual person to reside in Hong Kong.

#### Alternate Directors

There are no statutory provisions for alternative directors. Typically, the standard articles of a Hong Kong shelf company provide for the appointment of alternative directors. Section 153B of the CO provides that where the articles of a Hong Kong company authorize a director to appoint an alternate in his place, then unless the articles provide otherwise, the alternate director shall be deemed to be the agent of the director who appoints him and that director appointing the alternate will be vicariously liable for any tort committed by the alternate director while acting in the capacity of alternate director.

#### Powers of Director

The general power of managing the company is usually vested in the directors, and generally, the directors may exercise all powers of the company not specifically required by the CO or the articles to be exercised by the shareholders of the company. Under the CO, certain powers may only be exercised by the shareholders, including alteration of the company’s articles, financial assistance for the purchase of shares, unlisted companies buying back their own shares (whether out of distributable profits or capital), reduction of capital, granting directors’ rights to allot shares, variation of class rights, appointment and removal of auditors and voluntary winding up of the company. Other than these statutory exclusions, most other powers (unless otherwise provided by the articles of the company) may be exercised by the directors.

The articles usually provide that the directors may meet together to dispatch business, adjourn or otherwise regulate their meeting as they think fit. At common law, directors can only exercise their powers collectively by passing resolutions at a properly convened meeting of the board of directors and they have no power to act individually as agents for the company. However, a company's articles usually empower the board of directors to delegate its power to individual directors. Further, the articles of association usually provide that directors could exercise all the powers they are entitled to exercise by written resolution, and in the case of a sole director, such sole director is empowered to exercise all powers of the board of directors either in a meeting (in which case, such sole director is deemed to constitute a quorum) or by written resolution.

#### Proceedings at meetings of directors

There is no statutory provision setting out how often directors must hold meetings. However, each year, directors must approve a directors' report dealing with the profit or loss of the company for that financial year and attached to such directors' report shall be the balance sheet to be laid before the company in general meeting. As such, directors must have at least one meeting per year.

The articles of association usually provide that any director may summon a meeting of the directors, and that the company secretary must do so on the requisition of any director. The CO does not specify the notice period required for the calling of such meeting. The articles of association usually provide that the quorum necessary for the transaction of the business of the directors may be fixed by the directors themselves, but in the absence of any express decision by the directors, will be two (unless there is only one director). The directors may elect a chairman and decide the period for which he is to hold office. Standard articles of association usually provide that resolutions and questions are to be decided by a majority of votes.

There is no provision requiring directors' meeting to be physically held in any particular place. One point to note is that the place of directors' meeting is usually the place (for tax purposes) where the control and management of the company is exercised. The tax implication of this needs to be appreciated as a company (whether incorporated in Hong Kong or elsewhere) which is 'managed and controlled' in Hong Kong would, prima facie, be a Hong Kong tax resident and its Hong Kong sourced profits would be assessable to Hong Kong tax. On the other hand, if a company is incorporated in Hong Kong in order to take advantage of Hong Kong's growing network of double tax treaties, then such company needs to be a Hong Kong tax resident (i.e. managed and controlled from Hong Kong) in order to gain exemptions under such double tax treaties.

#### Material interests in contracts

Where a director is in any way directly or indirectly interested in a contract or proposed contract with the company, he must declare the nature of his interest (if it is material) at the earlier meeting of the directors at which it is practicable for him to do so. Section 162 CO provides that any director who fails to disclose his material interest is liable to a fine, though it is a defence if such director has no knowledge of the contract and he could not

reasonably have been expected to have such knowledge. The articles may contain additional provision as to whether such director is precluded from voting in respect of such contract.

It should be noted that pursuant to the FSTB is currently proposing that the CO be amended to include new provisions to ensure fair dealing by directors. These new provisions deal with particular situations in which a director is perceived to have a conflict of interest. It governs transactions involving directors or their connected entities which require members' approval (namely loan transactions, long-term service contracts, substantial property transactions and payments for loss of office), and covers disclosure by directors of material interests in transactions, arrangements or contracts. Legal advice should be sought if there are any such proposed transactions.

#### Documentation of minutes of meeting

Minutes of the proceedings of directors must be kept in a book kept for that purpose (section 119(1) CO). Failure to comply with this requirement would result in the default fine for the company and every office of the company in default.

#### Responsibilities of Directors

In Hong Kong, the general duties of directors are mainly found in case law, leaving aside certain specific obligations imposed by the Companies Ordinance, and by the memorandum and articles of association of a company. Director's duties can be classified into two broad categories: fiduciary duties, and duties of skill and care.

Director's duties are owed only to the company itself, but not to any individual shareholders (*Percival v Wright* [1902] 2 Ch 421). Generally, only owe a duty to the company itself but not to any individual shareholder of the company, regardless of whether he is a majority shareholder or minority shareholder in the company. However, if the directors have actively made themselves agents of any individual shareholder, in this exceptional circumstance, directors may owe a duty to that particular shareholder.

The fiduciary duties of directors, which are generally based on equitable principles, mainly include:

- duty to act in good faith in the interests of the
- company;
- duty to exercise powers for proper purpose; and
- duty to avoid conflicts of duty and interest.

Duties of skill and care differ from more set fiduciary duties as they require directors to exercise reasonable care and skill in the performance of their functions and the exercise of their powers. These duties are derived from the common law principles of negligence. These existing duties are typically portrayed as relatively lenient, especially when matched against the more onerous and rigorously enforced matrix of fiduciary duties

owed by company directors. A traditional laxity of application and a benevolent, sometimes almost indulgent judicial attitude has done nothing to contradict this image.

In *Re City Equitable Fire Insurance Co Ltd [1925] Ch 407*, Romer J formulated three propositions by which to measure a company director's skill and care; in doing so, he established the superstructure of the modern law in this sphere:

- A director needs not, in performance of his duties, exhibit a greater degree of skill than may reasonably be expected of a person of his knowledge and experience.
- A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings and at meetings of any committee of the board upon which he happens to be placed.
- He is not, however, bound to attend all such meetings, though he ought to attend whenever in the circumstances he is reasonably able to do so. In respect of all duties that may properly be left to some other official, having regard to the exigencies of the business and the articles of the company, a director, in the absence of grounds for suspicion, is justified in trusting that official to perform such duties honestly.

In the draft Companies Bill proposed by the FSTB, the common law directors' duty of care has been codified. Whilst Romer J's formulation of directors' duty of care is purely subjective (i.e. a director needs only exhibit a degree of skill reasonable expected of a person of his knowledge and experience), the proposed statutory duty to exercise reasonable care, skill and diligence is both subjective and objective. Under the proposals, the "reasonable care, skill and diligence" which must be exercised by directors is the care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and (b) the general knowledge, skill and experience that the director actually has.

## Risks and Liabilities of Directors

Where a director is in breach of his duties and the breach has not been disclosed to and ratified by the company, an action may be brought for one or more of the following remedies:

- *Rescission*: where the directors have failed to disclose their personal interest in a contract which they have entered into on behalf of the company, that contract may be avoided at the option of the company;
- *Damages*: all directors found to have acted negligently or in breach of their duties are jointly and severally liable in damages to the Company;
- *Account of profits*: the misapplication of the company's property renders the directors liable to account to the company in equity on the same basis as governs a misapplication of trust funds by trustees;
- *Fines*: where the company is in breach of the CO (for example, by failing to file annual returns, failing to file special resolutions of shareholders, failing to produce annual financial statements and audited accounts, failing to hold annual general meetings of shareholders, then the Company and each director/secretary could be subject to a default and daily fine); and
- *Personal liabilities in certain cases*: there are provisions in the Companies Ordinance which place onerous duties on the directors. For example, if, when a company is wound up, it appears that its business has been carried on with intent to defraud creditors or others the court may decide that the persons (usually the directors) who were knowingly parties to the fraud shall be personally responsible for debts and other liabilities of the company.

### *Risk management for directors of Hong Kong Companies*

To mitigate and manage the risk and potential liabilities of directors and officers of Hong Kong companies, we do recommend that Directors' and Officers' Liability insurance be purchased. The purchase and maintenance of D&O insurance is expressly authorized under the draft Companies Bill proposed by the FSTB, which provides that a 'company may purchase and maintain for the director insurance any liability incurred by the director in defending any proceedings taken against the director for any negligence, default, breach of duty or breach of trust...', though it should be noted that insurance cannot be purchased against liability arising from fraud of the director.

It is possible for the company to indemnify its directors against the costs incurred by them in defending any proceedings commenced by a third party, civil or criminal, in which judgment is given in their favour or in which they are acquitted. However, any provision contained in the company's articles or in any contract between a director and the company, which exempts any officer or director from, or indemnifies them against, any liability for negligence, default, breach of duty or breach of trust in relation to the company or a related company is void (s 165 CO).

## Execution of documents by HK Companies

### *Execution of contracts by HK companies*

If a contract is in writing, the contract will either be executed under hand by the company's authorised signatory or sealed by an attorney on behalf of the company or the contract can be sealed by the company by applying the company seal (in accordance with the formalities in the company's articles).

Generally, unless a contract is to be entered into in the form of a deed there is no necessity for a contract to be sealed by a company.

As a general rule, there is no legal requirement as to who should sign the contract on behalf of the Company (provided that the signatory is legally competent, e.g. not a minor or insane), nor is there any common law requirement that the person who signs, must sign before an attesting witness (except for statutory requirements). In certain cases, an attesting witness may be desirable for evidential reasons but practice on this varies.

Moreover, the extent to which a company uses its common seal, and the procedures to followed in so going, are (for the most part) matters for the company (acting through its board of directors) to determine. The best practice is for board resolutions to be passed approving a specified transaction, and then authorizing a specific director or two directors or an attorney to sign the documents, including affixing (in the case of deeds) the company seal.

A third party relying on the execution of a contract by an individual or other agent on behalf of a company will therefore be concerned to check whether:

- the signatory has been expressly authorised by the company, i.e. assuming that the entering into of the contract is within the capacity of the directors, that a board meeting has been properly held approving the entering into of the contract and authorising its signature by the signatory; or
- the signing of the contract is within the implied or usual authority of the signatory. For example, a managing director usually has the authority with regard to the management of the ordinary business of a company.

### *Execution of Deeds by Hong Kong Companies*

A deed is an instrument which describes itself as a deed (or otherwise makes it clear on its face that it is intended by the parties to take effect as a deed) and which is validly executed as a deed. Some examples of documents which must be executed as a deed:-

- Contracts which involve the creation, extinguishment or disposition of any legal estate in land.
- Powers of Attorney .
- Contracts not supported by consideration.

A deed which is to be executed by the company itself must be executed under the common seal of a Hong Kong company. The manner of execution must comply with the requirements laid down in the Articles of Association of the company – usually the standard articles of association will provide that the seal of the company shall be affixed by a director and... the company secretary or a second director or an attorney appointed by the directors for that purpose.

As such, there is two possibilities for the execution of deeds by a HK company:

- the company (acting through a director and another director and the company secretary) could sign in the name of the company and affix the company's seal;
- the company can appoint an attorney (whether an individual or a corporation) to execute a deed on its behalf. Such attorney should sign his own name and affix the company's seal.