The new Companies Ordinance in Hong Kong - Directors' duties

Restructuring Global Insight

25 MAR 2013
By: Jonathan Leitch

The Hong Kong Companies Ordinance (Cap. 32) was last updated in 1984. A new Companies Ordinance was passed by the Legislative Council in July 2012 and is expected to come into effect in 2014.

As we discussed in the last issue of Global Insight, the new legislation will at long last place more responsibility on the directors of companies.

This article concentrates on four of the key changes:

The burden on responsible persons

The new Ordinance retains many of the possible offences faced by directors for the failure to comply with certain administrative requirements, such as the filing of returns, but the burden of proof for establishing those offences will be lowered.

Under the old Ordinance, officers were only liable if they “knowingly or wilfully authorised or permitted the default”. It has often been difficult to prove a person has “knowingly or wilfully” done so. The new Ordinance states that the person “authorises or permits, or participates in, the contravention or failure”. While this does not cover negligence, it does cover those who turn a blind eye or act recklessly.

The new Ordinance also states that the person who can be liable is a “responsible officer”. This means that not just directors and the company secretary, but also shadow directors or a corporate officer of the company, are responsible and may be culpable – a considerably broader reach for this Ordinance.

Directors' duties

Many of the duties imposed on directors arise through common law rather than legislation. The new Ordinance codifies a director’s duty to exercise reasonable care, skill and diligence. There is a new two-pronged test: in performing duties, a director must bring to bear his or her own skills and experience (a subjective test), as well as those that any director in that position would be presumed to have (an objective test). While this represents a codification of the existing case law, it is now a statutory requirement. The duties apply to shadow directors in the same way they do to directors.

The new Ordinance does not codify the common law fiduciary duties, and these will remain subject to the existing

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as
The new Ordinance also codifies the circumstances in which a company is able to ratify the actions of a director which are negligent, in breach of duty or represent a breach of trust. In essence, such conduct may only be ratified by the passing of an ordinary resolution of disinterested members. If none of the members are disinterested, then approval must be with the unanimous resolution of all members. It remains prohibited to indemnify a director against criminal liabilities.

Financial reporting

The new Ordinance puts a requirement on all public and private companies (that do not qualify for simplified financial reporting) to produce an annual financial report. This does not just constitute the financial statements for the previous year – although it does include an obligation to give a “true and fair view” of these statements. There is also a requirement to prepare an analysis of the future prospects for the company using key performance indicators.

The appropriate performance indicators to be used will differ from one business to another and hence are not specified in the Ordinance. It appears that it will be a matter for the directors to determine (in conjunction, presumably, with their financial advisers) what indicators are used, by reference to which the development, performance or position of the company’s business can be measured effectively.

The annual report must also contain information on the risks and challenges that the company faces and any other issues which may impact on the performance of the company in the future. In circumstances where the disclosure of information about impending developments or matters still under negotiation would, in the directors’ opinion, be seriously prejudicial to the company’s interests, disclosure may be excused.

It has long been a matter of concern that the financial records of private companies are not available for inspection at the Companies Registry, and unfortunately the new Ordinance does not address this.

Only members are entitled to see the financial reports of private companies. It remains to be seen whether suppliers and others incurring a credit risk in their dealings with a company may come to insist upon seeing the directors’ report in order to commence or even continue a trading relationship with that particular company.

Directors’ interests

Under the old Ordinance, a director was only obliged to disclose to the company where he or she had an interest in a contract - the scope has now been widened. The new Ordinance puts an obligation on directors to disclose any “transaction or arrangement” which the director has entered or proposes to enter into, if it is of significance to the company’s business.

All of these changes seek to align directors’ duties in Hong Kong with a minimum standard applied in most of the developed world. They also provide clarity on issues which were previously only the subject of common law.

This article was first published in ‘Global Insight’, our e-newsletter which includes news, views and analysis from our Global Restructuring Group.

View the latest issue of Global Insight

AUTHORS

Jonathan Leitch
Partner
Hong Kong | T: +852 2103 0808
[email protected]