Part 10
Directors and Company Secretaries

INTRODUCTION

Part 10 (Directors and Company Secretaries) of the new Companies Ordinance (Cap. 622) ("new CO") contains provisions relating to directors and company secretaries.

POLICY OBJECTIVES AND MAJOR CHANGES

2. Part 10 contains initiatives that aim at enhancing corporate governance, improving regulation and modernising the law. The initiatives that aim at enhancing corporate governance include –

(a) restricting corporate directorship in private companies (paragraphs 6 to 8);

(b) clarifying the standard of directors' duty of care, skill and diligence (paragraphs 9 to 13); and

(c) requiring ratification of conduct of directors by disinterested members' approval (paragraphs 14 to 16).

3. The initiatives that aim at improving regulation and modernising the law include –

(a) enabling the Registrar of Companies ("the Registrar") to give directions to a company relating to the appointment of directors and company secretaries (paragraphs 17 to 19); and

(b) clarifying the rules on indemnification of directors against liabilities to third parties (paragraphs 20 to 22).

4. Apart from the above major changes, this Part also restates a miscellany of provisions in the Companies Ordinance (Cap. 32) ("Cap. 32") concerning directors and company secretaries, including directors' vicarious liability for the acts of their alternates (**section 478**), the avoidance of acts done by a person in a dual capacity as director and company secretary (**section 479**), prohibition of undischarged bankrupt from acting as director (**section 480**) and the keeping of minutes of proceedings at directors' meetings (**sections 481 and 482**).

5. The details of the major changes in Part 10 are set out in paragraphs 6 to 22 below.

Restricting corporate directorship in private companies (Section 457)

Position under Cap. 32

6. Cap. 32 prohibits all public companies and private companies which are members of a group of companies of which a listed company is a member from appointing a body corporate as their director. There is no restriction for other private companies.

Position under the new CO

7. **Section 456** of the new CO maintains the restriction in corporate directorship in public companies, companies limited by guarantee and private companies which are members of a group of companies of which a listed company is a member. As for other private companies, they are required by the new CO to have at least one director who is a natural person to enhance transparency and accountability.

Key provisions in the new CO

8. **Section 457** restricts corporate directorship by requiring a private company (other than one within the same group as a listed company) to have at least one director who is a natural person.

Clarifying the standard of directors' duty of care, skill and diligence (Sections 465 and 466)

Position under Cap. 32

9. There is no provision on directors' duty of care, skill and diligence in Cap. 32 and the common law position in Hong Kong is not entirely clear. The standard in old case law which focuses on the knowledge and experience which a particular director possesses (which is generally called the subjective test), is considered to be too lenient nowadays. There is a judicial trend in other comparable jurisdictions towards the use of a mixed objective and subjective test in the determination of the standard of care, skill and diligence expected of directors. The adoption of a mixed objective and subjective test in overseas jurisdictions has occurred through both the decisions of the courts on the common law and through confirmation of that test under statute. In light of overseas developments in the common law, it is likely that Hong Kong courts would also adopt the mixed objective and subjective test. However, there remains some uncertainty because of the absence of a clear case authority in Hong Kong.

Position under the new CO

10. With a view to providing clear guidance to directors, the standard for company directors' duty of care, skill and diligence is clarified in the new CO to incorporate a mixed objective and subjective test.

Key provisions in the new CO

11. **Section 465(2)** sets out a mixed objective and subjective test for the standard in carrying out a director's duty to exercise reasonable care, skill and diligence under **section 465(1)**. The test requires the acts of a director to be judged both objectively and subjectively. In deciding whether a director of a company has breached the duty of care, skill and diligence owed by him to the company, his conduct is compared to the standard that would be exercised by a reasonably diligent person having –

(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 (objective test in **section 465(2)(a)**); and

(b) the general knowledge, skill and experience that the director has (subjective test in **section 465(2)(b)**).

12. **Section 465(4)** further provides that the duty has effect in place of the corresponding common law rules and equitable principles. **Section 465(5)** provides that the duty applies to a shadow director. It is considered appropriate to subject shadow directors to the same duty as a duly appointed director, because anyone

who interferes in the affairs of a company to the extent that makes him fall within the definition of a shadow director must take on the same responsibilities and duties as those of a director.

13. **Section 466** preserves the existing civil consequences of breach (or threatened breach) of the duty. The remedies for breach of the duty will be exactly the same as those that are currently available following a breach of the common law rules and equitable principles that the said duty replaces.

Requiring ratification of conduct of directors by disinterested members' approval (Section 473)

Position under Cap. 32

14. There is no specific provision in Cap. 32 on ratification by members' approval of acts or omissions of directors and the ratification of acts or omissions of directors is subject to common law rules, which generally require members' approval in a general meeting to release the directors from their fiduciary duties. Ratification would have the effect of barring the company from bringing actions against the director for damages it suffered as a result of the ratified act or omission, albeit it might not prevent dissenting minorities from pursuing unfair prejudice claims or statutory derivative claims. Under the Cap. 32 regime, conflict of interest may arise in situations where the majority shareholders are directors or are connected with the directors.

Position under the new CO

15. The new CO requires the conduct of directors to be ratified by disinterested members' approval to prevent conflicts of interest and possible abuse of power by interested majority shareholders in ratifying the unauthorised conduct of directors.

Key provisions in the new CO

16. **Section 473** provides that any ratification by a company of conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be approved by resolution of the members of the company disregarding the votes in favour of the resolution by the director, any entity connected with the director and any person holding shares of the company in trust for the director or for the connected entity. **Section 473(7)(b)** preserves existing common law rules which restrict ratification.

Enabling the Registrar to give directions to a company relating to the appointment of directors and company secretaries (Sections 458 and 476)

Position under Cap. 32

17. Cap. 32 requires a private company to have at least one director and a public company at least two directors. In the event of contravention, the company and every officer in default are liable to a fine. In addition, every company should appoint a company secretary though there is no offence provision for failure to appoint one.

Position under the new CO

18. For better enforcement of the statutory requirements to have directors and company secretaries, the new CO empowers the Registrar to issue directions to a company to appoint directors and company secretaries.

Key provisions in the new CO

19. **Sections 458 and 476** give the Registrar the power to issue a direction to a company where it appears to the Registrar that any of the requirements in **section 453(2), 454(1) or 457(2)** regarding the appointment of director

or in **section 474(1) or (4) or 475(2) or (3)** regarding the appointment of company secretary is contravened. Non-compliance with the direction is an offence. The company and every responsible person of the company will be liable to a fine.

Clarifying the rules on indemnification of directors against liabilities to third parties (Sections 467 and 469 to 472)

Position under Cap. 32

20. The law regulating a director's right to be indemnified against liabilities to third parties is currently found in case law, which is fairly difficult for lay directors to understand. In particular, the scope of the right of directors to be indemnified against liabilities to third parties is not clear. The uncertainty over the right to be indemnified against liabilities to third parties may deter competent persons from accepting directorships.

Position under the new CO

21. To remove such uncertainty, the rules on indemnification of directors against liabilities to third parties are clarified.

Key provisions in the new CO

22. **Section 469** permits a company to indemnify a director against liability incurred by the director to a third party if the specified conditions are met. Certain liabilities and costs must not be covered by the indemnity, such as criminal fines, penalties imposed by regulatory bodies, the defence costs of criminal proceedings where the director is found guilty and the defence costs of civil proceedings brought against the director by or on behalf of the company or an associated company in which judgment is given against the director. To enhance transparency, a company which provides any permitted indemnity to its or its associated company's directors must disclose the indemnity provision in the directors' report (**section 470**) and make it available for inspection by any member on request (**sections 471 and 472**).

TRANSITIONAL AND SAVING ARRANGEMENTS

23. Transitional and saving arrangements are set out in **sections 88 to 94 of Schedule 11** to the new CO. The transitional provisions in respect of the major changes are as follows –

- **Section 89, Schedule 11** –

  For existing private companies with no natural person director, there will be a grace period of 6 months after the commencement of the new CO for the companies to comply with the new requirement to have at least one director who is a natural person in **section 457(2)** of the new CO. There is an exemption for existing dormant companies, but they are required to comply with the requirement when they cease to be dormant.

- **Section 90, Schedule 11** –

  Section 157 of Cap. 32 continues to apply in relation to the validity of acts of a person acting as a director done before the commencement of **section 461** of the new CO.

- **Section 92, Schedule 11** –

  So far as it relates to directors, section 165 of Cap. 32 continues to apply in relation to any relevant exemption or indemnification provision existing immediately before the commencement of **sections 468, 469 and 470** of the new CO.