

 **PCLL Conversion Notes**
Quick, easy and effective notes for PCLL Conversion Examinations!

Hong Kong Business Associations Notes & Model Exams

1st Edition
For use with
January 2025 Exams



PCLLConversion.com



TABLE OF CONTENTS

1.	<u>INTRODUCTION</u>	<u>5</u>
	A. How to use Conversion Notes.....	5
	B. Abbreviations and Legislation	5
2.	<u>SOLE PROPRIETORSHIP</u>	<u>6</u>
3.	<u>PARTNERSHIPS</u>	<u>6</u>
	A. Nature of partnerships.....	6
	i. Legal status.....	6
	ii. Formation.....	6
	B. Rights and duties of the Partners.....	7
	i. Among the Partners.....	7
	1) Rights and obligations.....	7
	2) Fiduciary duties of partners.....	7
	ii. Liabilities of partners to third parties.....	7
	1) Authority/liability of partners in contract.....	7
	2) Credit contracts and holding out.....	7
	3) Liability in tort.....	8
	C. Dissolution.....	8
4.	<u>COMPANIES</u>	<u>8</u>
	A. Formation	8
	i. Incorporation and Registration.....	8
	ii. Problems relating to incorporation.....	9
	iii. Types of companies.....	9
	1) Private vs public companies vs company limited by guarantee.....	10
	2) Company limited by shares vs limited by guarantee vs unlimited Companies.....	10
	3) Hong Kong vs Non-Hong Kong Companies.....	10
	B. Nature of a Company.....	11
	i. Separate corporate personality	11
	ii. Limited liability	11
	1) Liability of members limited by shares or limited by guarantee.....	11
	C. Piercing or lifting the corporate veil.....	11
	D. Corporate constitution and authority.....	12
	i. Memorandum and Articles of Association.....	12
	ii. Contractual effect of the Memorandum and Articles.....	12
	iii. Enforcement of the Articles of Association.....	13
	iv. Amendment to Articles of Association.....	13
	1) Restrictions under the Companies Ordinance.....	13
	2) Restrictions under the general law.....	13
	3) Enforceability of shareholders' agreements to alter the Articles.....	14
	v. Corporate liability.....	14



vi.	Corporate capacity.....	15
E.	Membership.....	16
i.	Subscribers to the Memorandum and Articles of Association.....	16
ii.	Registration of members.....	16
iii.	Membership in companies with share capital: issues and transfers of shares.....	16
iv.	Rights of members.....	16
v.	Order for inspection.....	17
	1) Standing.....	17
	2) Good Faith and Proper Purpose.....	17
	3) Making copies.....	17
	4) Ancillary orders.....	17
	5) Immunity from liability and secrecy.....	17
F.	Management and control.....	18
i.	The board of directors.....	18
	1) Director's meetings - Companies Ordinance.....	18
	2) Director's meetings – Common law.....	18
	3) Director's meetings – Model Articles.....	19
	4) Director's meetings – Table A.....	19
	5) Managing director.....	21
i.	Authority of directors to bind the Company.....	21
	1) Actual authority.....	22
	2) Ostensible authority.....	23
	3) Protected under Indoor management rule.....	24
	4) Statutory assumptions as to authority.....	25
ii.	The members' general meeting.....	26
	1) Resolution.....	26
	2) Special Resolution.....	26
	3) Scope of control of the board by the members in general meeting.....	26
	4) Disclosure obligations (Common Law).....	27
iii.	Residual control in general meetings (Doctrine of Unanimous consent).....	28
	1) Where the board is unable to act.....	28
	2) Ratification of directors' acts.....	28
iv.	Informal corporate acts.....	28
v.	Powers conferred by the Companies Ordinance.....	29
	1) Auditors.....	29
	2) Alteration of articles and objects clause.....	29
	3) Directors.....	29
vi.	Powers conferred by the Articles of Association.....	29
	1) Model Articles.....	29
	2) Table A.....	30

5. DIRECTOR'S DUTIES 30



A. Directors as fiduciaries – Standard of care.....	30
B. Acting bona fide in the interests of the Company.....	31
C. Exercising powers for proper purposes.....	31
i. What is the legal purpose for which the power may be used?.....	32
1) Improper purposes.....	32
2) Proper purposes.....	32
ii. Has the power been used for proper purpose as a matter of fact?.....	32
D. Conflicts of interest.....	33
i. Conflict rule.....	34
1) Was there a personal interest?.....	34
2) Was there adequate disclosure of a material personal interest?.....	34
3) Were statutory disclosure obligations satisfied?.....	34
ii. Profit rule.....	35
1) Was there “secret profits”?.....	35
2) Was there a ratification of the breach?.....	36
iii. Misappropriation rule.....	37
1) Businesses started by former directors.....	37
iv. Directors’ personally benefiting from opportunity turned down by the company.....	38
E. Acting with due care, skill and diligence.....	38
i. Duties in equity and Duties under the common law.....	38
F. Forgiveness and enforcement.....	40
i. Voidable and Void transactions.....	40
ii. Restrictions regarding relieving directors from liability.....	40
iii. Relief from Court.....	41
G. Requirements of the Companies Ordinance.....	42
6. <u>SHAREHOLDERS AND SHAREHOLDER RIGHTS AND REMEDIES: SHAREHOLDERS CONTROL OVER THE RUNNING OF THE COMPANY – MEMORANDUM AND ARTICLES.....</u>	42
A. Proper plaintiff and irregularity principles: Rule in Foss v Harbottle.....	42
B. Derivative actions on behalf of the Company.....	42
i. The common law derivative action: Fraud on the company exception to the proper plaintiff principle..	42
ii. The statutory derivative action.....	43
C. Members’ personal rights of action under the general law.....	44
i. Equitable restrictions on the powers of the majority in general meeting.....	44
D. Statutory remedy in relation to unfairly prejudicial conduct.....	44
E. Winding up on “just and equitable” grounds.....	46
F. Protection of class rights.....	47
i. Under the Company’s Articles and under the Companies Ordinance.....	47
G. Statutory injunctions.....	48
7. <u>CORPORATE INSOLVENCY AND LIQUIDATION.....</u>	49
A. Winding up.....	49
i. Compulsory winding up by the court and Members’ or creditors’ voluntary winding up.....	49



B. Insolvency and other grounds for winding up..... 50

 i. Winding up by the court..... 50

 ii. Voluntary winding up..... 50

C. Effect of a winding up order..... 51

D. Process of winding up..... 52

 i. Winding up by the court..... 52

 ii. Voluntary winding up..... 53

 1) Member’s Voluntary winding up..... 53

 2) Creditor’s Voluntary winding up..... 53

E. Functions and powers of the liquidator..... 53

F. Assets available for distribution..... 53

 i. Re-opening of antecedent transactions..... 53

 ii. Winding up by the court..... 54

 iii. Voluntary winding up..... 54

G. Distributions and priorities..... 54

 i. Winding up by the court..... 55

 ii. Voluntary winding up..... 56

H. Fraudulent/Unfair Preferences..... 56

I. Dissolution..... 57

 i. Winding up by the court..... 57

 ii. Voluntary winding up..... 57

1. INTRODUCTION

A. HOW TO USE CONVERSION NOTES

The Hong Kong Business Associations Notes are formatted into a step-by-step guide, which you can use as a checklist in your exams to ensure that every element of the exam question is answered. You may find the Table of Contents to be a quick and useful overview of the law to be applied. You should also answer the exam question using the ILAC method, which will ensure your answer is comprehensive.

Issue State the legal issue relevant to the problem

Law Identify the relevant case law and legislation

Analysis Analyse and apply the law to the legal issue. This is the most important part, so ensure your legal analysis is very thorough.

Conclusion Form a conclusion based on your analysis and application of the law, giving some practical advice to the hypothetical client.

It is very important to spend time perfecting your analysis section, as this is the part that examiners are most interested in. Do not worry if you reach the correct conclusion (there often isn’t one clear answer) – examiners will give more weight to your legal analysis, and sometimes may even reward answers that propose an innovative and unconventional answer!

B. ABBREVIATIONS AND LEGISLATION

The Hong Kong Business Associations Notes will refer frequently to the following using abbreviations.



CO or New CO	Companies Ordinance (Cap. 622)
Old CO	Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)
PO	Partnership Ordinance (Cap. 38)
BO	Bankruptcy Ordinance (Cap. 155)
BRO	Business Registration Ordinance (Cap. 310)
Articles	Articles of Association
Memorandum	Memorandum of Association
Model Articles	Companies (Model Articles) Notice (Cap.622H)

2. SOLE PROPRIETORSHIP

- A sole proprietorship (or a sole trader) is a business whereby an individual operates a business on his own account in his capacity as an individual, rather than by way of incorporating a company or forming a partnership with another individual.
- The sole proprietor will need to register as a business under the BRO and obtain a business registration certificate.
- A sole proprietor is personally liable and is not protected by limited liability (unlike with a company).

3. PARTNERSHIPS

A. NATURE OF PARTNERSHIPS

i. LEGAL STATUS

- A partnership is formed between two or more individuals as partners, who are joint owners.
- Each partner is personally liable for the partnership's obligations and liabilities (s 11 PO) and they are not protected by limited liability (unlike with a company). Such liability is joint and several (s 14 PO).
 - o Note that the Limited Partnerships Ordinance (Cap. 37) (**LPO**) allows for limited partnerships to be formed. Liability of a limited partner is limited to the amount of capital contributed to the firm at the time that limited partner joined the limited partnership (s 3(2) LPO). Restrictions on limited partnerships include:
 - Limited partners cannot manage the firm and cannot bind the other partners (s 5(1) LPO)
 - At least one partner must have unlimited liability (i.e. the general partner) (s 3(2) LPO)
- The partnership is not a separate legal person from its partners.

ii. FORMATION

- A partnership may be formed by contract – e.g. by each partner entering into a partnership agreement establishing the partnership. In considering whether a partnership exists, the court will consider, objectively, whether the parties intended to form a partnership (*Smith v Anderson* (1880) 15 Ch D 247; *Cox v Hickman* (1860) 8 HL Cas 268).
- Section 3(1) PO – “Partnership is the relation which subsists between persons carrying on a business in common with a view of profit” – these characteristics must exist in order for a partnership to arise.
 - o Partners must be carrying on a business together as partners – this is an essential requirement of s 3(1) of the PO and is supported by *Keith Spicer Ltd v Mansell* [1970] 1 All ER 462.
 - o The business must be carried on in common (i.e. one business rather than separate businesses)
- Factors in determining whether persons are in “partnership” (s 4 PO):
 - o joint or part ownership does not of itself create a partnership;
 - o sharing of gross returns does not of itself create a partnership;
 - o receipt by a person of a share of profits of a business is prima facie evidence that he is a partner unless there is an arrangement otherwise.
- *Chan Sau-kut v Gray and Iron Construction & Engineering Co.* [1986] 1 HKLR 84 – court held that the following clauses in the contract were sufficient to give rise to a partnership:
 - o Recital clause confirming parties wished to co-operate (i.e. business in common)
 - o All parties would observe the terms of the project contract (i.e. joint obligations)



- Establishment of a joint bank account (i.e. joint ownership)
- Provisions for meetings and joint management
- The partnership is required to register as a business under the BRO and obtain a business registration certificate.

B. RIGHTS AND DUTIES OF THE PARTNERS

i. AMONG THE PARTNERS

The rights and duties of the partners as against each other will depend upon the PO and construction of the partnership agreement.

1) Rights and obligations

Subject to any contrary agreement in the partnership agreement, s 26 PO sets out the rights and obligations of the partners:

- all the partners are entitled to share equally in profits and contribute equally to losses;
- partnership firm must indemnify every partner in respect of payments and personal liabilities incurred in the ordinary course of the partnership's business;
- a partner making, for the purposes of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of 8% per annum;
- no interest is payable to a partner on the partnership capital contributed by them;
- every partner may take part in the management of the partnership business;
- remuneration is not payable to a partner for acting in the partnership business;
- all partners must consent to the appointment of a new partner; and
- any disputes as to ordinary partnership matters may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners.

2) Fiduciary duties of partners

- Partners owe fiduciary duties to each other, including under the PO.
 - Every partner must account to the firm for any benefit derived by him, without the consent of the other partners, from any transaction concerning the partnership or from any use by him of the partnership property, name, or business connection (s 31 PO)
 - If a partner, without the consent of the other partners, carries on any business of the same nature as and competing with that of the firm, he must account for and pay over to the firm all profits made by him in that business (s 32 PO)
 - *Kao Lee & Yip v Koo Hoi Yan Donald* [2003] 2 HKC 113 – fiduciary duties include the duty to not place himself in a position where his or anyone else's interest would or may conflict with duties owed to the partnership, and the duty not to make a profit from his position.

ii. LIABILITIES OF PARTNERS TO THIRD PARTIES

1) Authority/liability of partners in contract

- Section 7 of the PO provides that every partner is an agent of the firm and his other partners for the purpose of the business of the partnership, and the acts of a partner in the normal course of business can bind the firm and the partners (i.e. if that partner has apparent or ostensible authority)
 - unless the partner actually does not have authority to so bind the partnership (i.e. lack of actual authority) and the contract counterparty is aware of that fact.
- A partner has apparent authority to act in the normal course of business of the firm even if that act is outside the actual authority given to him pursuant to the partnership agreement (*Mercantile Credit Co Ltd v Garrod* [1962] 3 All ER 1103).
- An agent who purports to contract on behalf of the principal without authority may be personally liable for damages to the contract counterparty, for breach of warranty of authority (*Collen v. Wright* (1857) 120 ER 241).

2) Credit contracts and holding out

- Everyone who, by words spoken or written or by conduct, represents himself, or who knowingly suffers himself to be represented, as a partner in a particular firm is liable as a partner to any one who has, on the faith of any such representation, given credit to the firm, whether the representation has or has not been made or communicated to the



person so giving credit by or with the knowledge of the apparent partner making the representation or suffering it to be made (Section 16 of the PO).

3) Liability in tort

- Section 12 of the PO provides that the firm is liable therefor to the same extent as the partner for any wrongful act or omission of any partner acting in the ordinary course of the business of the firm or with the authority of his co-partners, which has caused loss or injury to any person.

C. DISSOLUTION

Under s 34 of the PO, subject to any contrary agreement, a partnership is dissolved:

- (a) if entered into for a fixed term, by the expiration of that term; or
- (b) if entered into for a single adventure or undertaking, by the termination of that adventure or undertaking; or
- (c) if entered into for an undefined time, by any partner giving notice to the other or others of his intention to dissolve the partnership.

Other than as set out in s 34 PO, a partnership can be dissolved:

- by bankruptcy, death, or charge (s 35 PO);
- any event occurs which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership (s 36 PO);
- by application to the court by a partner (s 37 PO).

4. COMPANIES

Why are companies used for business purposes?

- Limited liability of shareholders
 - o Advantages
 - ◆ encourages passive investment
 - ◆ lower burden of monitoring
 - ◆ impersonalises shares for liquidity
 - ◆ encourages risk taking
 - o Disadvantages
 - ◆ moral hazard – limited liability companies externalise the risks onto third parties, such as creditors and tort claimants
- Perpetual succession – a company has no temporal limit on its existence, and is unaffected by underlying changes in membership / shareholders
- Financing purposes - Unincorporated forms of business organization are denied the corporate advantages of the power to create a floating charge over its assets or to make a public issue of its shares.
- However, note that the cost, formality and continuing reporting obligations are much more complicated for companies.

A. FORMATION

i. INCORPORATION AND REGISTRATION

- Companies are formed through the process of incorporation. The incorporation requirements are set out in the CO.
- Under the CO, an incorporated company is only required to have Articles of Association (sections 75 and 98 of the CO). There is no longer a need for a Memorandum of Association (this was previously required under the Old CO).
 - o Section 67 of the CO provides that a company may only be formed for a lawful purpose and that any one or more persons may form a company by—
 - (a) each founding shareholder/member signing the Articles of the company intended to be formed; and
 - (b) delivering to the Registrar for registration—
 - (i) an incorporation form in the specified form; and
 - (ii) a copy of the Articles.
 - o A certificate of incorporation will thereafter be issued.



- Sections 81 to 85 of the CO govern the information that must be included in the Articles such as company name. The Articles must contain the following provisions:
 - ◆ the company name (s 81 CO)
 - ◆ whether the liability of the members is limited or unlimited (s 83 and 84 CO)
 - ◆ details as to the initial share capital and maximum number of shares (s 85 CO)
- Section 79 of the CO provides that a company may adopt as its Articles any or all of the provisions of the model Articles prescribed for the type of company to which it belongs.
- Apart from the above, the Model Articles will apply to companies to the extent that the company's Articles do not displace the Model Articles (s 80 CO).
 - ◆ Section 80 of the CO provides that if the company's registered Articles do not prescribe any regulations for the company, on the incorporation of a limited company, the Model Articles that are prescribed for the type of company to which the company belongs and that are for the time being in force, so far as applicable, form part of the company's Articles in the same manner, and to the same extent, as if those Model Articles had been registered as the company's Articles.
 - ◆ If the company's registered Articles prescribe any regulations for the company, the Model Articles that are prescribed for the type of company to which the company belongs applies in so far as the Articles do not exclude or modify the Model Articles (section 80(3) of the CO).
- Apart from the process of incorporation as detailed by the CO, a company must also be registered under the BRO.
 - This is because it is compulsory that every person carrying on business in Hong Kong be registered pursuant to section 5 of the BRO. In this connection, companies incorporated pursuant to the Companies Ordinance is deemed to be a person carrying on business and must therefore be registered (sections 2(1A) and 5(2) of the BRO).

ii. PROBLEMS RELATING TO INCORPORATION

- Directors and Secretaries:
 - A private company must have at least one director (section 454(1) CO).
 - Every company shall have a secretary who (a) if an individual, ordinarily reside in Hong Kong; (b) if a body corporate, have its registered office or a place of business in Hong Kong (section 474 CO).
 - A director of a company may be a company secretary of the company. However, the director of a private company having only one director must not also be a company secretary of the company. Furthermore, no private company having only one director may have as company secretary of the company a body corporate the sole director of which is the sole director of the private company (section 475 CO).
- Eligible members:
 - Section 113 of the CO provides that a body corporate cannot be a member of a company of which the body corporate is a subsidiary; and any allotment or transfer of shares in a company to a body corporate that is a subsidiary of the company is void.
 - ◆ A body corporate is a subsidiary of another body corporate if that other body corporate is a holding company of it (section 15 of the CO). A body corporate is a holding company of another body corporate if (a) it controls the composition of that other body corporate's board of directors; (b) it controls more than half of the voting rights in that other body corporate; or (c) it holds more than half of that other body corporate's issued share capital (section 13(1) of the CO).
- Administrative matters:
 - A company must have a registered office in Hong Kong to which all communications and notices may be addressed (section 658 CO).
 - It used to be compulsory for a company to have a metallic common seal (section 93(1)(b) of the Old CO) but this is now optional (section 123 of the CO).
 - A company must keep in the English or Chinese language a register of members (section 627 CO), a register of directors (section 641 CO) and register of company secretaries (section 648 CO).

iii. TYPES OF COMPANIES

- Only the following companies may be formed under the CO:
 - a public company limited by shares;
 - a private company limited by shares;
 - a public unlimited company with a share capital;
 - a private unlimited company with a share capital;
 - a company limited by guarantee without a share capital.



- The New CO has abolished the following types of companies which used to be available under the Old CO:
 - o unlimited companies without share capital; and
 - o companies limited by guarantee with share capital (see section 4(4) of the Old CO).
 - ◆ However, such pre-existing companies formed under the Old CO can continue to operate under the New CO.

1) Private vs public companies vs company limited by guarantee

- Section 11 of the CO provides that a company is a private company if—
 - (a) its articles -
 - (i) restrict a member's right to transfer shares;
 - (ii) limit the number of members to 50; and
 - (iii) prohibit any invitation to the public to subscribe for any shares or debentures of the company; and
 - (b) it is not a company limited by guarantee.
- Section 12 of the CO provides that a company is a public company if—
 - (a) it is not a private company; and
 - (b) it is not a company limited by guarantee.
- A Company Limited by Guarantee is neither a public nor a private company under the CO.

2) Company limited by shares vs limited by guarantee vs unlimited Companies

- Section 8 of the CO provides that a company is a company limited by shares if the liability of its members is limited by the company's articles to any amount unpaid on the shares held by the members.
- Section 9 of the CO provides that a company is a company limited by guarantee if (a) it does not have a share capital; and (b) the liability of its members is limited by the company's articles to the amount that the members undertake, by those articles, to contribute to the assets of the company in the event of its being wound up.
- A company is an unlimited company if there is no limit on the liability of its members (Section 10 CO).

3) Hong Kong vs Non-Hong Kong Companies

- Generally, the CO applies to Hong Kong companies defined in section 2 as a company formed and registered under the CO (i.e. a company incorporated in Hong Kong).
- However, Parts 8, 14 and 16 of the CO also apply to Non-Hong Kong companies.
 - o Section 2 of the CO provides that a Non-Hong Kong company (非香港公司) means a company incorporated outside Hong Kong that—
 - (a) establishes a place of business in Hong Kong on or after the commencement date of Part 16; or
 - (b) has established a place of business in Hong Kong before that commencement date and continues to have a place of business in Hong Kong at that commencement date.
 - o Part 16 of the CO deals with Non-Hong Kong companies and the need for such companies to be registered (sections 776 and 777 of the CO).



We hope you have enjoyed this short preview of the Hong Kong Business Associations Notes & Model Exam Answers.

Don't forget to check out the Law Study Tips we have on our website at www.PCLLConversion.com!