

Editorial

Lawyers in the CU also needed a different set of skills in advising on a number of new matters! This has contributed to the delay in releasing the CU's Autumn 2009 edition.

The new matters include production and film development finance, enhancement of investor protection including the legal repercussions from the sale of mini-bonds and similar derivatives whose value is derived from transactions affecting reference entities such as corporate debtors; Islamic finance initiatives and licensing restrictions on radio broadcasters. "Old friends" including Competition law and the Rewrite of the Companies Ordinance have continued to keep us occupied, and the Courts in Hong Kong and other common law jurisdictions have been busy issuing judgments important in their relevance to our work.

We feature these and other matters in this and later editions of the CU Review with an update on developments in Competition law, new Islamic finance initiatives and the scope of "consultation".

Four case reports are also included. Two of them consider when safeguards appropriate to criminal offences **are** and are **not** applied to **civil** cases of commercial relevance (*Koon* and *Chau Chin Hung*). The third answers the question why the chairman and chief executive for more than 17 years of a substantial company such as Sun Hung Kai Properties (SHKP) had no redress against dismissal by its board of directors (*Kwok Ping Sheung, Walter v SHKP*), and the fourth considers the meaning of the arresting words in the *Beximco Case*: "Subject to the principles of Glorious Sharia'a', this agreement shall be governed by and construed in accordance with the laws of England".

This is the last time I am privileged to edit and contribute to the CU Review. It is hoped that the CU Review can continue to state principles of commercial law in practical and down-to-earth terms – not the law from 30,000 feet!

CHARLES BARR

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Notes:

Islamic Finance

In his Policy Address in October 2007, the Chief Executive remarked that Islamic finance had considerable potential and announced the idea of developing an Islamic bond market in Hong Kong. This was followed by the launch of the first Islamic Fund in Hong Kong in November 2007, which was an umbrella fund that tracked the performance of the Dow Jones Islamic Market China/Hong Kong Titans Index. Subsequently, the Airport Authority announced its decision (not implemented we believe) to issue Hong Kong's first Islamic bond on which the Commercial Unit advised. Interest in Islamic Finance flared pre-recession but remains a potential source of finance, investment and fees for financial, legal and other professional intermediaries.

What is Islamic Finance?

Islamic Finance refers to financial activities and products that are structured in compliance with Islamic law or Shariah principles. Shariah is a body of religious principles which governs every aspect of a Muslim's life, public and private, including economics and banking. The basic sources of Shariah are Quran (scripture), the Sunnah of Muhammad (practices and traditions of the Prophet Muhammad) and Hadith (sayings of the Prophet Muhammad). There are different schools of thought within Islamic jurisprudence with no universally accepted set of applicable Shariah codes. This diversity of thinking carries potential uncertainty and lack of international uniformity.

The main principles of Islamic Finance are marked by a number of prohibitions including:

- Taking or receiving interest (*riba*) E.g. financial services that involve charging or receipt of interest.

- Uncertainty about the subject-matter and terms of contract (*gharar*) E.g. Forward foreign exchange contracts.
- Gambling and speculation activities (*maisir*) E.g. Gaming business.
- Investing in unlawful / forbidden (*haram*) businesses E.g. Selling pork, alcohol or pornography.

Shariah Compliant Financing

There are a number of Shariah compliant financing techniques.

Below are some of the more common ones:

- Musharaka (or Musharakah) (i.e. Joint-venture)
- Mudaraba (or Murdarabah) (i.e. Profit sharing)
- Murabaha (or Murabahah) (i.e. Cost-plus financing)
- Ijarah (i.e. Leasing)
- Istisna'a (i.e. Custom or commissioned manufacturing)
- Sukuk (i.e. Islamic bonds)

School of Thought	Region
Shafi	Far East such as Malaysia
Hanbali	Middle East such as Saudi Arabia
Hanafi	South East Asia such as Pakistan
Maliki	African continents

This article will focus on two popular sukuk structures that have been used in the Islamic debt capital markets recently.

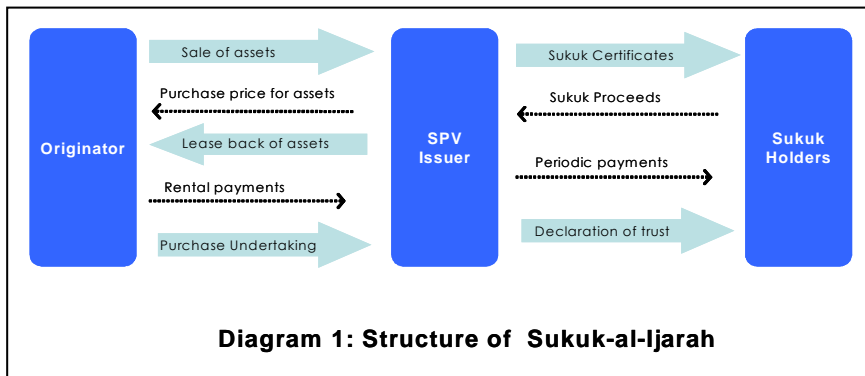
Sukuk

Sukuk are often called Islamic bonds. However, unlike conventional bonds, the underlying income stream for sukuk must not be based on interest. Sukuk are not debt instruments but are medium to long-term certificates expressed as trust instruments (but with restricted rights given to the beneficiaries/sukuk investors under the trust), backed by Shariah compliant assets whose performance is designed to replicate the economics of the conventional bond.

Sukuk-al-Ijara

In this structure, the originator sells

certain assets to a special purpose vehicle (SPV). The SPV finances this purchase by the money raised through the issue of the sukuk certificates. The SPV will then lease the assets back to the originator for a period corresponding to the tenor of the sukuk certificates. The periodic lease payments from the originator to the SPV will match the periodic payments to the sukuk holders. Upon maturity of the sukuk or in the event of default, the originator will purchase back the assets pursuant to a purchase undertaking at a pre-determined price. The payment will be used for repayment to the sukuk holders as the sukuk are redeemed. Sukuk-al-ijara is inherently inflexible because the size of the sukuk issue is restricted by the value of the underlying asset which is sold by the originator to the SPV.



Sukuk-al-Musharaka

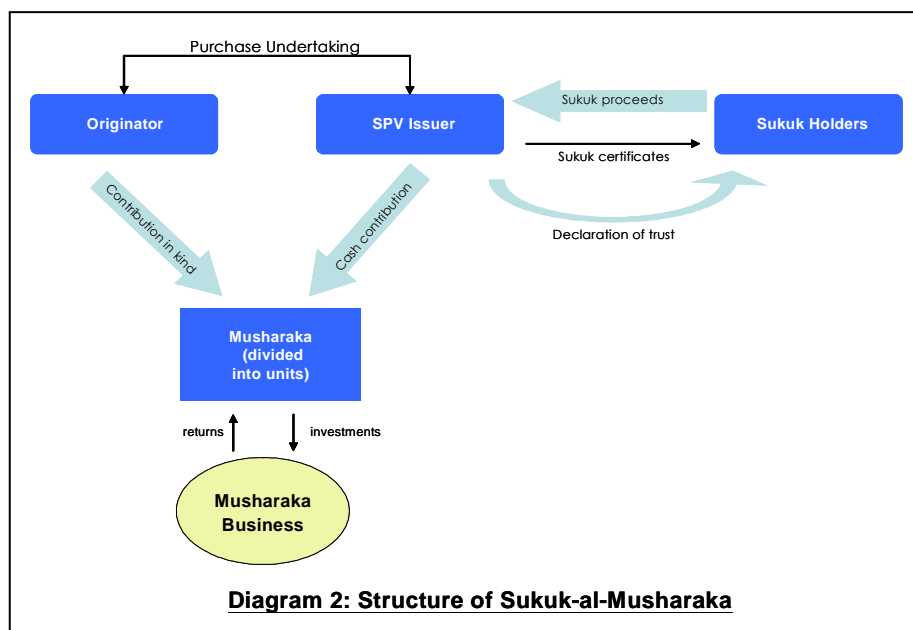
In this structure, the originator and the SPV enter into a joint venture (musharaka). The originator contributes assets to the musharaka and the SPV contributes cash raised from the issue of the sukuk certificates. It should be noted that the musharaka represents only an agreement between the partners and is not a legal entity in its own right under English or Hong Kong law. The partners appoint a managing agent to act on behalf of the musharaka and this managing agent is often the originator. The assets are then employed by the managing agent to generate a cash return to service the coupon payments. Upon maturity of the sukuk or in the event of default, the originator will purchase all the mursharaka units held by the SPV and may retain any cash generated in excess of the coupon payments.

This structure is more flexible as the amount that is to be raised does not have to correspond with the value of the underlying assets that is transferred into the musharaka.

Legal, Tax and Regulatory issues

Possible Uncertainty

To ensure compliance with Shariah principles, the proposed structure of Islamic finance products has to be scrutinized and certified by a Shariah board which is a religious board consisting of a number of distinguished Islamic scholars. Most Islamic banks or conventional banks with Islamic windows have their respective Shariah boards which discuss policy and specific transactions. A single issue may give rise to different views held by different boards. The uncertainty is however mitigated to the extent that



different schools of thought are practised predominantly in different regions.

Over the past year, a leading religious scholar from AAOIFI¹ has expressed concerns over the manner in which a number of sukuk issuances had been structured using musharaka and murabaha principles. The concerns lie in the guaranteed return which goes against the spirit of Islamic finance where interest is prohibited and investors should share risk and profit in the structure. While AAOIFI's views carry weight, they are not binding on all the banks. The industry is continuing to grapple with different religious interpretations.

Governing Law

Shariah is the key pillar of Islamic finance. However, the proper law governing a contract has to be the law of a country, not a non-national body of religious principles such as Shariah law. In *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals ltd and others*² the English Court of Appeal decided that where the parties agree that English law governs their financing agreements, the words "Subject to the principles of Glorious Sharia'a", did not incorporate Shariah principles into the agreements. This case is the subject of a case law report in this CU Review.

Default

Conventional bonds often provide for interest on late payment of the amount due. If the Issuer (debtor) defaults, the bondholder (creditor) could simply accelerate the debt so that the full amount would become immediately due and payable. In the context of sukuk, no interest can be charged and there is no debt to accelerate. To replicate

the economics of the conventional bond, there may be some form of discount formula stipulating an agreed discount rate to be applied for each day that payment is made prior to a backstop date, with the backstop date being the latest date on which funds might be expected to be paid³. In the event of the Issuer's default, the Issuer will exercise the purchase undertaking and the Issuer would then have a debt claim against the originator which is due and payable.

Regulatory Framework

Some jurisdictions have an Islamic banking regulatory framework that

exists in parallel with their conventional framework, e.g. Malaysia. Others like the UK and Singapore have accommodated Islamic banking within the conventional banking regulatory framework. As the Muslim population accounts for only about 1% of Hong Kong's total population and the existing regulatory framework does not appear to pose any legal impediment to the development of Islamic bond market in Hong Kong, it is believed that no major changes to the regulatory framework are required. The rules may be fine-tuned as the market develops.

Tax issues

The nature and structure of Islamic financial products normally involves transfer of assets which tend to attract more tax (e.g. stamp duty) than their conventional counterparts. Tax neutrality has been achieved in a number of jurisdictions including Malaysia, Singapore, Indonesia and UK. Some countries have also provided additional tax incentives to attract Islamic financing activities. For instance, Malaysia gives 100% tax exemption for 10 years for Islamic Banks, Takaful (Insurance) and Fund Managers involved in

“Islamic finance has been experiencing spectacular growth in the past decade”

foreign currency transactions or managing foreign investors fund. The Hong Kong Government is currently conducting a review of Hong Kong tax law. The aim is to achieve and maintain tax neutrality as between financial products structured in compliance with Shariah principles and their conventional counterparts such as bonds, convertible bonds and discounted bonds.

Challenges Ahead

Islamic finance has been experiencing spectacular growth⁴ in the past decade. While the exponential development may have slowed⁵ due to the recession and financing difficulties as well as AAOIFI's criticism of certain sukuk structures⁶ for non-compliance with Shariah principles, it is expected that Islamic finance and sukuk markets will continue to grow as bankers re-engineer structures to meet the approval of clerics and customers.

Although Hong Kong has little experience or tradition in Islamic financial markets, it has an advantage of being a gateway to investments from and into Mainland China.

¹ AAOIFI stands for the Accounting and Auditing Organisation for Islamic financial Institutions which is a Bahrain-based standard-setting organisation for Islamic finance.

² [2004] 4 All ER 1072

³ If a party receives a payment that was solely attributable to the issuer's delay in payment, that party is required to hand over the net amount after deduction of the costs and expenses it has incurred as a result of the issuer's delay to such charitable institution as it may select.

⁴ Globally, Islamic assets have been growing at over 20 per cent a year and reached US\$900 billion in 2007, and were expected to reach US\$2 trillion by 2010, as estimated by Ernst & Young. The global Islamic bond market reached a record market value of US\$51.5 billion in 2007, according to the Islamic Finance Information Service. See Business Times, 8 May 2008.

⁵ The first quarter of 2008 saw 80% drop in the value of sukuk issued according to data from regional business information provider zawya.com.

⁶ The criticism was focused on sukuk musharaka and sukuk mudaraba which began to dominate the market towards the end of 2006. And see generally Islamic Finance Special Reports Financial Times 6 May 2009 and SCMP 23 June 2009.

Mayanna To

Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Limited and Others [2004] 4 All ER 1072

The claimant bank was incorporated under the laws of Bahrain. Bahrain encouraged Islamic banking practice as national policy, and the bank held itself out as applying Islamic banking principles. The bank entered into a number of financing agreements with the first and second defendants, in respect of some of which, the third to fifth defendants provided guarantees. The governing law clause in the financing agreements provided that, “*Subject to the principles of the Glorious Sharia'a, this agreement shall be governed by and construed in accordance with the laws of England*”. Various defaults and terminating events (defined under the terms of the financing agreements) occurred and the bank issued proceedings in the

English courts. On an application made by the bank, the defendants argued that on a true construction of the governing law clause, the financing agreements were enforceable only in so far as they were valid and enforceable **both**:

- (i) in accordance with the principles of Sharia'a, and
- (ii) in accordance with English law;

and that the agreements were invalid and unenforceable under the principles of Sharia'a. The judge at first instance decided that he was not concerned with the principles of Sharia'a at all. There could not be two separate systems of law governing the contract; moreover, the Rome

Convention on the Law Applicable to Contractual Obligations 1980 (as set out in Sch 1 to the Contracts (Applicable Law) Act 1990), art 1(1) [a], only made provision for the choice of the law of a country, and did not provide for the choice or application of a non-national system of law such as Sharia'a; the words “*Subject to the principles of the Glorious Sharia'a*” were no more than a reference to the fact that the bank purported to conduct its affairs according to the principles of Sharia'a. The defendants appealed to the Court of Appeal arguing that the financing agreements were governed by English law, but that they were enforceable only in so far as they were consistent with the principles of Sharia'a i.e. that Sharia'a principles were incorporated as paramount contractual provisions.

“The doctrine of incorporation only operates where the parties have by the terms of their contract sufficiently identified specific “black letter”provisions of a foreign law.....”

The Court of Appeal decided that the financing agreements were governed by English law alone. The intention of the parties at the outset had been for the agreements to be legally binding, and the court should lean against a construction which would or might defeat that commercial purpose. The reference to the principles of Sharia'a was simply intended to reflect the Islamic banking principles according to which the bank held itself out as doing business, rather than incorporating a system of law intended to “trump” the application of English law as the law to be applied in ascertaining the liability of the parties under the terms of the agreement.

Having chosen English law as the governing law, the doctrine of incorporation did not apply to render Sharia'a principles as terms of the financing agreements. The doctrine of incorporation only operates where the parties have by the terms of their contract sufficiently identified specific “black letter” (i.e. clear and specific) provisions of a foreign law or an international code or set of rules apt to be incorporated as terms of the relevant contract such as a particular article or articles of the French Civil Code or the Hague Rules. By that method, English law is applied as the governing law to a contract into which the foreign

rules have been incorporated contractually. The general reference to principles of Sharia'a in this case afforded no reference to, or identification of, those aspects of Sharia'a law which were intended to be incorporated into the contract.

Charles Barr

Scope of Consultation

We regularly advise on consultation provisions in statutes and commercial agreements. Sometimes Government or a senior public officer must consult a counterparty; sometimes the counterparty must consult Government or a senior public officer such as the Financial Secretary (FS). What does “consult” involve? Is it a pretext, a perfunctory ritual for doing nothing or being dismissive of the consulted party’s response?

Regulators in Hong Kong often have a statutory duty or discretion to “consult” before exercising a statutory power.

Where there is statutory duty to consult persons affected, this must genuinely be done¹ and reasonably opportunity for comment must be given².

The essence of consultation is the communication of a genuine invitation to give advice. Thus, the mere sending of a letter which is not received is not sufficient for the purpose of consultation : Agricultural, Horticultural and Forestry Industry Training Board v Aylesbury Mushrooms³.

To satisfy “consultation”, sufficient information and time must be given by the consulting to the consulted party. In this context, sufficient does not mean ample, but at least enough to enable the relevant purpose to be fulfilled. The scale, complexity and importance of the subject matter are factors in assessing how much time is required for the consultation. Allowances will be made where decisions are

required to be taken urgently, and the court will assess the time allowed by reference to the facts as they appeared to the consulting party at the time. However, no degree of urgency can absolve the consulting party from the obligation to consult : R v Secretary for Social Services, ex parte Association of Metropolitan Authorities⁴.

Further, the consulting party should properly consider and take into account the results of the consultation when the ultimate decision is made : Lam Yuet Mei v Permanent Secretary for Education and Manpower⁵.

Statutory Examples

There are numerous examples of an obligation to consult in our legislation. To name a few:

- ◆ Before appointing certain members of the MPF Industry Schemes Committee, the FS is required to consult the Mandatory Provident Fund Schemes Authority – section 6U of the Mandatory Provident Fund Schemes Ordinance, Cap. 485.
- ◆ The Monetary Authority must consult the FS before proposing to revoke the authorisation of a bank to carry on banking business in Hong Kong – section 22 of the Banking Ordinance, Cap. 155.
- ◆ When the Securities and Futures Commission proposes to make rules regarding the listing of securities, it is required to

Practical Tips for consultation

- The consulting authority, person or bureau or department (collectively B/D) must not predetermine or be seen to predetermine the issues the subject of the consultation; it must be seen to keep an open mind.
- The consultation paper should be careful to state that the views and recommendations of the consulting B/D are “initial” or “provisional” or “proposed”. Expressions such as “subject to the responses” (from those consulted) and “reviewing the position” will assist in deflecting arguments that the consultation is a perfunctory ritual.
- A statement along the lines: “No decision has been made by the B/D. Nothing in this should be read as indicating that the B/D has finalised any opinion or decision on these issues.” is helpful.
- The B/D should qualify statements and answers to the media by “if”, and stress that no decision has yet been made.
- Sufficient reasons for the proposal and a reasonable time to respond should be given to the public /industry/person being consulted.

consult the FS and the Hong Kong Stock Exchange Company Limited – section 36 of the Securities and Futures Ordinance, Cap. 571 (SFO).

- ◆ The Chief Executive must consult the chief executive of the Securities and Futures Commission before issuing a direction to the Commission under section 11 of the SFO.
- ◆ Before the Broadcasting Authority approves any code of practice for licensees, it must consult such bodies representative of the licensees to which the code will apply - section 3 of the Broadcasting Ordinance, Cap. 562.
- ◆ The Secretary for Development must consult the public before finalising any urban renewal strategy – section 20 of the Urban Renewal Authority Ordinance, Cap. 563.

A recent challenge

What constitutes a proper consultation was considered by the Court of First Instance and the Court of Appeal in PCCW-HKT Telephone Limited v. Telecommunications Authority⁶. PCCW-HKT Telephone Limited (PCCW) filed a judicial review against the Telecommunications Authority (TA), which arose out of the TA's statutory power in section 6C of the Telecommunications Ordinance, Cap. 106 to consult those affected on whether to withdraw existing regulatory guidance governing the payment of interconnection charges by mobile network operators to fixed network operators. On the basis of statements made by TA at a press conference, PCCW accused the TA of apparent bias in advance of the outcome of the consultation process, TA appeared to have predetermined that the existing régime regulating fixed mobile interconnection charges was obsolete and should be

dismantled. PCCW requested TA to discontinue the consultation and to reconstitute it. TA rejected the allegation of apparent bias and PCCW filed the judicial review application. PCCW lost both the application at first instance and the appeal to the Court of Appeal.

What is a proper consultation?

The key words to a proper consultation with the industry or the public are “procedural fairness”. The consultation must be a genuine stage in the decision-making process and not a perfunctory ritual. TA has to **keep an open mind** on the subject under consultation and **must not display bias**. There is “apparent bias” if a hypothetical fair-minded observer would conclude that there was a reasonable possibility of bias in the way in which the TA came to a decision.

“The key words to a proper consultation with the industry or the public are “procedural fairness””

Who is a fair-minded observer?

A fair-minded observer is taken to be a reasonable person, who adopts a balanced approach and is neither complacent nor unduly sensitive or suspicious. In arriving at any conclusion of bias or the absence of it, the observer is assumed to be fully informed of all facts capable of being known to the general public in relation to the relevant decision-making process.

Was the TA entitled to form provisional views on the matter to be consulted?

The Court of First Instance noted that TA's responsibilities included ensuring that the laws were compatible with the latest technological developments. Thus, it would be surprising if TA did not form provisional views on issues to be ventilated in a consultation. Indeed, it was observed by the Court of First Instance that a predisposition to a certain course of action would seem a normal and inevitable incident of the TA's job. This should not by itself lead a fair-minded observer to suspect apparent bias.

The Court of Appeal agreed with the above.

“[TA] as a regulator should candidly articulate his thinking and provisional views: it is not only unobjectionable, it is good administrative practice. If the Authority holds strong views regarding a proposal, I see nothing wrong in his making that fact transparent; indeed, the forcefulness of his views may well serve to elicit responses from persons holding different views who might otherwise not be inclined to contribute to the debate.”

Predisposition vs Predetermination

In considering whether TA has predetermined the issues, the Court of First Instance drew a distinction between a legitimate **predisposition** towards a particular outcome and an illegitimate **predetermination** of the outcome. The former was consistent with a **preparedness to consider and weigh relevant factors** in reaching the final decision; the latter involved a **mind that is closed to the consideration** and weighing of relevant factors.

Evidence of an open mind

PCCW's allegations of predetermination were based on words and statements made by TA during the press conference. Consequently, the Court examined in detail the various statements and stressed that they had to be **seen in context**. For

instance, the Court of Appeal disagreed that the expression “*we are dismantling regulation*”, which was not prefaced by the word “*proposed*”, indicated that the TA had predetermined the issue. Instead, the Court took into account various other statements made by TA during the press conference and those contained in the Consultation Paper and concluded that what was put forward by TA was merely a proposal.

Relevance of past conduct

The Court further said that TA should prima facie be trusted. The TA could safely be assumed to know his obligation to carry out a transparent and even-handed consultation and to be ready and willing to fulfil such obligation. In this connection, the fair-minded observer would be aware of the historical fact that on at least four recent occasions,

TA had issued a paper setting out his view on a matter, only to reach a different conclusion at the end of a consultation. It is also because of such past conduct that the Court decided that significant weight could be attached to TA's declaration of open-mindedness.

¹ *Grunwick Processing Laboratories Limited v ACAS* [1978] AC 277; *Agricultural etc. Training Board v Aylesbury Mushrooms Ltd* [1972] 1 WLR 190

² *Re Union of Benefices of Whippingham and East Cowes, St. James'* [1954] AC245; *Port Louis Cpn v AG of Mauritius* [1965] AC 111

³ [1972] 1 W.L.R. 190

⁴ [1986] 1 All ER 164

⁵ [2004] 3 HKLRD 524

⁶ [2007] 2 HKLRD 536; [2007] HKCU 1595

Beverly Yan

Chau Chin Hung v Market Misconduct Tribunal **[2008] HKCU 1463**

This is a Court of First Instance (CFI) case decided after the decision of the Court of Final Appeal (CFA) in *Koon Wing Yee v Insider Dealing Tribunal*¹ (see earlier in this CU Review). *Chau Chin Hung* concerns the market misconduct proceedings of the Market Misconduct Tribunal (MMT) under Part XIII of the current Securities and Futures Ordinance, Cap. 571 (SFO).

The most fundamental challenge made by counsel on behalf of the four specified persons in the case went to the true nature of the proceedings before the MMT – that is, whether the proceedings

were civil or criminal in nature.

The CFI followed the CFA's decision in *Koon* and held that for the purpose of determining whether the proceedings involved the determination of a “**criminal charge**” within the meaning of Art. 11(2) of the Hong Kong Bill of Rights (BOR), the following three criteria must be considered:

- (i) **classification of the proceedings under the domestic law of Hong Kong;**
- (ii) **nature of the offence;** and
- (iii) **nature and severity of the potential sanction.**

The CFI took the view that factor (iii) was the most important factor. It then considered each of the following sanctions in Part XIII of SFO given to the MMT under section 257(1) of SFO:

- (i) **“disqualification” orders,** namely orders that disqualify an identified person from being concerned in the management of listed or other specified companies (section 257(1)(a));
- (ii) **“cold shoulder” orders,** namely orders that deny an identified person access to the financial markets (section 257(1)(b));

(iii) **“cease and desist” orders**, namely orders that an identified person shall not again perpetrate any conduct which constitutes such market misconduct as is specified in the orders (section 257(1)(c));

(iv) **“disgorgement” orders**, namely orders to disgorge any profits made by an identified person (section 257(1)(d));

(v) **“cost” orders**, namely orders that an identified person shall pay the costs incurred by the Government

and others in relation to the proceedings (section 257(1)(e) – (fa);

(vi) **“disciplinary” orders**, namely orders that any body which may take disciplinary action against an identified person as one of its members be recommended to take disciplinary action against him (section 257(1)(g)).

the application of the three criteria test, the MMT proceedings were civil in nature and did not involve the determination of a “criminal charge” within the meaning of Art. 11(2) of the BOR.

Yung Lap-yan

The CFI was of the view that none of the above statutory sanctions given to the MMT under section 257(1) of SFO individually or in combination was criminal in nature. The CFI concluded that, on

Kwok Ping Sheung Walter v Sun Hung Kai Properties Limited & Others **[2008] 3 HKC 465**

Walter Kwok, the chairman and chief executive since November 1990 of Sun Hung Kai Properties Limited (SHKP) agreed with the board of SHKP to take a three-month leave of absence and resume his duties as chairman and chief executive after that leave if his mental health, supported by the opinion of doctors, was satisfactory. Subsequently and allegedly in breach of this agreement, the board of SHKP convened and removed Walter Kwok from his positions as chairman and chief executive.

The Court of First Instance and the Court of Appeal unanimously decided that the whole matter was a matter of internal management by the board of directors. The Articles of Association of the company made it clear that the choice of chairman and the choice of the executive directors were matters for the board. Those matters were first and foremost for the board itself. The court could not dictate to a board who should be its chairman or its executive directors. The alleged agreement did not provide that the company

should not use its constitutional powers to remove Walter Kwok as chairman or executive director. It could not be said that there was an implied term that if Walter Kwok were shown to be medically fit, the directors would allow him to resume duties as chairman and chief executive, whether or not the board felt it was in the best interests of the company that he should be removed on grounds other than medical unfitness. The directors had a continuing duty to exercise their discretion and decide what was in the best interest of the company from time to time. It was impossible to attribute to the board an intention to enter into a binding agreement with Walter Kwok that would have the effect of fettering their discretion or their statutory powers in section 157B of the Companies Ordinance, Cap. 32 (a company can by ordinary resolution remove a director before the expiration of his period of office). If the agreement were to this effect, it would be unenforceable against the company as this would be seeking to circumvent the statutory

requirement for any alteration of the Articles of Association to be by special resolution – a 75% majority. An agreement by a company to fetter its statutory power in section 157B was unenforceable.

The case also illustrates the principle of majority rule established in 1843 in *Foss v Harbottle*¹. The choice of executive directors was a matter for the board of the company and the court could not dictate to a board who should be its chairman or its executive directors. Complaints about internal management should be brought by the company not by a shareholder or director. Where the complaint concerns a matter of internal management which is valid if done with the approval of the majority of the shareholders or is capable of being confirmed by the majority, the court will generally not interfere.

¹ (1843) 2 Hare 461

Charles Barr

Proposed Major Provisions for the New Competition Law in the 2008 Government Consultation Paper

In our Spring 2007 CU Review, we wrote that the Government had issued a public consultation document “Promoting Competition – Maintaining Our Economic Drive” in November 2006 to gauge the community’s views on the way forward for competition policy. The results of the exercise showed clear support for the introduction of a cross-sector competition law.

In order to give the public a clearer idea of the likely shape of a competition law, the Government published a consultation paper “Detailed Proposals for a Competition Law” (Consultation Paper) in May 2008 which set out the proposed major provisions for the future Competition Ordinance. Responses to the Consultation Paper continued to indicate broad public support for the introduction of a cross-sector competition law.

We set out below some of the proposed major provisions for the future Competition Ordinance contained in the Consultation Paper. Changes are expected to be made to

the provisions during the legislative process.

Proposed Major Provisions contained in the Consultation Paper

(1) Appointment of a Competition Commission

- An independent Competition Commission to be set up to enforce the new competition law.
- The Commission to have the power, among other things, to investigate infringements of the conduct rules (Conduct Rules) under the Competition Ordinance.
- The Commission to be able to commence an investigation either on its own initiative or in response to a complaint. It should be able to exercise its formal investigative power when it has reasonable cause to believe that an infringement of

the Conduct Rules has taken place.

(2) Appointment of a Competition Tribunal

- A Competition Tribunal to be established to hear, among other things, applications for review of the decisions of the Commission and private actions under the Competition Ordinance.
- Tribunal members would comprise judicial members and non-judicial members with expert knowledge in economics, commerce or competition law.
- Appeals against decisions of the Tribunal to be heard by the Court of Appeal.
- The Tribunal to be constituted as a “special court” exercising the judicial power of the Hong Kong SAR for the purposes of Arts. 80 and 81 of the Basic Law.

“An independent Competition Commission to be set up to enforce the new competition law.”

(3) Prohibitions against anti-competitive conduct

- Two Conduct Rules to apply to prohibit anti-competitive conduct:
 - (i) a general prohibition on agreements and concerted practices that have the purpose or effect of substantially lessening competition; and
 - (ii) a general prohibition on an undertaking that has a substantial degree of

market power from abusing that power with the purpose or effect of substantially lessening competition.

- Infringement of the Conduct Rules should be subject to civil, not criminal, penalties. Penalties, including e.g. fines up to 10% of the turnover during the period when the infringement occurred, and disqualification from holding a directorship or a management role in any company for up to five

years, to be imposed by the Tribunal.

(4) Right to institute private action

- Any person who has suffered loss or damage from an infringement of the Conduct Rules to have the right to bring a private action against the infringer.
- Such private action may take the form of a “follow-on” action or a “stand-alone” action.

- A “follow-on” action is one that is brought by a private party seeking a remedy in respect of conduct that has been found by the competition authority to have infringed the Conduct Rules.
- A “stand-alone” action is one brought by a private party seeking a ruling as to whether an infringement of the Conduct Rules has taken place, and if so, an appropriate remedy.

(5) **Concurrent jurisdiction with the Broadcasting Authority (BA) and the Telecommunications Authority (TA)**

- At present, the BA and TA have jurisdiction over competition matters in the broadcasting and telecommunications sectors respectively.
- The Competition Ordinance to provide for concurrent jurisdiction over competition matters between the Commission in respect of non-broadcasting and non-telecommunications sectors and the BA and TA in respect of the broadcasting and telecommunications sectors respectively.

(6) **Exemptions and exclusions**

- An agreement may be exempted from the prohibition on anti-competitive agreements if it yields economic benefit that outweighs the potential anti-competitive harm. A party to an anti-competitive agreement to apply to the Commission for an exemption if it has grounds to believe that such an exemption should be granted.
- The Commission may issue a block exemption in respect of a

category of agreement that is likely to yield economic benefit that outweighs any anti-competitive harm.

- The Conduct Rules should not apply to any undertaking entrusted with the operation of services of general economic interest, such as essential public services of an economic nature.
- Chief Executive in Council may exclude activities from the prohibition on anti-competitive conduct if he considers that there are sound reasons of public policy for so doing.
- The Conduct Rules should not apply to the Government or statutory bodies.

There has been criticism of the width of the proposed exemption and exclusion powers, particularly in their proposed general disapplication to the Government.

Introduction of the Competition Bill

The Commerce and Economic Development Bureau is finalising draft drafting instructions for the Competition Bill on which the CU has commented. According to the current timetable, the Government aims to introduce the Bill into the Legislative Council in the 2009-2010 legislative session.

One of the recent judicial decisions that requires consideration is the decision of the Court of Final Appeal (the “CFA”) in *Koon Wing Yee v Insider Dealing Tribunal*¹. In this case, the CFA held that for the purpose of determining whether there is a “**criminal charge**” within the meaning of Article 11(2)(g) of the Hong Kong Bill of Rights (BOR), three criteria must be taken into account, namely

Correction of Article in SCMP

In the article entitled “Courts to hear competition cases” published in the South China Morning Post on 1 August 2009, the author commented that the proposed revision to the Competition Bill, pursuant to which the Competition Commission would serve as an investigator and prosecutor only while the Competition Tribunal would be established as a new special court to rule on infringements and to hear private cases, was sparked by the CFA’s decision in *Koon Wing Yee v Insider Dealing Tribunal*. With due respect, the reference to the *Koon* case was incorrect. The correct reference should be the decision of the Court of First Instance in *Luk Ka Cheung v Market Misconduct Tribunal* (HCAL 49/2008) in which the Court held that the judicial power of Hong Kong must be reserved exclusively for the courts of Hong Kong.

- (i) the classification of the proceedings under the domestic law of Hong Kong;
- (ii) the nature of the offence; and
- (iii) the nature and severity of the potential sanctions.

The CFA was of the view that factor (i) was no more than a starting point, and that factors (ii) and (iii) carried substantially

greater weight than factor (i). The CFA held that if the relevant proceedings involved the determination of a “criminal charge”, then criminal safeguards and the criminal standard of proof would apply to the proceedings. The *Koon* decision is considered inapplicable in the case of regulated or licensed classes (such as broadcasting and telecommunication licensees) at least in the absence of imprisonment or a very heavy fine

for serious misconduct. In this connection, it should be noted that in the UK and Australia, the standard of proof to be applied in competition law proceedings is the civil standard.

¹ [2008] HKCU 430

**Yung Lap-yan &
Amy So**

Koon Wing Yee v Insider Dealing Tribunal [2008] HKCU 430

This is a Court of Final Appeal (CFA) case concerning an inquiry by the Insider Dealing Tribunal (IDT) conducted under the now repealed Securities (Insider Dealing) Ordinance, Cap. 395 (SIDO). The legal principles established by this case still have great relevance.

Facts

Koon was the chairman of two listed companies in Hong Kong. In early 2000, the share prices of the two listed companies rose significantly before and after the announcement of a take-over bid. The Securities and Futures Commission (SFC) launched an investigation under section 33 of the now repealed Securities and Futures Commission Ordinance, Cap. 24 (SFCO) into possible insider dealing in the shares of the two listed companies. During the investigation, Koon was compelled by the SFC under section 33 of SFCO to answer incriminating questions – the answers of which might tend to incriminate him in the investigation.

Following the SFC investigation, the IDT conducted an inquiry into whether there had been insider

dealing in the shares of the two listed companies. The IDT was empowered by section 17 of SIDO to require any person to attend and give evidence, and to require such person to answer all questions put by the IDT. Koon appeared before the IDT and gave evidence under section 17 of SIDO. The IDT also admitted into evidence the incriminating answers given by Koon to the SFC under section 33 of SFCO.

Under section 23(1) of SIDO, the IDT had the power to make three orders:

- (i) “disqualification” orders, namely orders that disqualify an identified person from being concerned in the management of listed or other specified companies (section 23(1)(a));
- (ii) “disgorgement” orders, namely orders to disgorge any profits made by an identified person (section 23(1)(b)); and
- (iii) orders to impose on an identified person a penalty of an amount not

exceeding three times the amount of any profit gained or loss avoided as a result of insider dealing (section 23(1)(c)).

The principal questions before the CFA in the case were whether Arts. 10 and 11 of the Hong Kong Bill of Rights (BOR) applied to the IDT proceedings and, if so, whether the use by the IDT of incriminating answers compulsorily given by Koon to the SFC and the standard of proof applied by the IDT complied with these provisions.

Art. 10 of the BOR provides:

“In the determination of any **criminal charge** against him ..., everyone shall be entitled to a fair and public hearing by a competent, independent and impartial tribunal established by law.”

Art. 11(2) of the BOR provides:

“In the determination of any **criminal charge** against him, everyone shall be entitled ... (g) not to be compelled to testify

against himself or to confess guilt.”

Decision

The CFA held that for the purpose of determining whether there is a “**criminal charge**” within the meaning of Art. 11(2) of the BOR, the following 3 criteria should be taken into account:

- (i) **classification of the proceedings under the domestic law of Hong Kong;**
- (ii) **nature of the offence;** and
- (iii) **nature and severity of the potential sanction.**

The CFA was of the view that factor (i) was no more than a starting point, and that factors (ii) and (iii) carried substantially greater weight than factor (i).

In this case, having regard to the fact that the nature of “insider dealing” was very serious misconduct and that the IDT had the power to impose a very severe penalty under section 23(1)(c) of SIDO, which was punitive and deterrent in nature, not regulatory, compensatory or protective, the CFA held that, on the application of the three criteria test, the IDT proceedings involved the

determination of a “**criminal charge**” within the meaning of Art. 11(2) of the BOR.

Accordingly, the CFA held that Art. 11(2) of the BOR applied to the IDT proceedings and that section 17 of SIDO was an infringement of the privilege against self-incrimination and a violation of Art. 11(2)(g) of the BOR.

The CFA also held that as the IDT proceedings involved the determination of a “**criminal charge**”, the standard of proof should be the criminal standard of “beyond reasonable doubt”, not

“Art. 10 of the BOR provides: In the determination of any criminal charge against him ..., everyone shall be entitled to a fair and public hearing by a competent, independent and impartial tribunal established by law.”

the civil standard of “balance of probability”.

The CFA was of the view that section 23(1)(c) of SIDO conferring the power on the IDT to impose severe penalties (three times profit made or loss avoided) violated Art. 11(2)(g) of the BOR. Had it not been for the existence of this power under section 23(1)(c), the IDT proceedings would not have acquired a substantially

criminal character and there would not have been a violation of Art. 11(2)(g) of the BOR. In the circumstances of the case, the CFA held that it was appropriate and just for it to strike down section 23(1)(c).

With the striking down of section 23(1)(c), the reason for characterizing the IDT proceedings as criminal was eliminated, and it then followed that the true

character of the IDT proceedings in the light of the relief granted was civil, and that the IDT was correct in admitting into evidence the incriminating answers compulsorily given by Koon and in applying the civil (not criminal) standard of proof.

Yung Lap-yan

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