CU Review Summer 2007

The Commercial Unit, Civil Division
The Department of Justice

What's inside

Notes:

Editorial

We have appreciated the positive responses to our Spring 2007 Review.

In this Summer Review our articles cover the Capital Investment Entrant Scheme which facilitates entry to Hong Kong for residence by persons who make a capital investment in land and/or certain financial investments in Hong Kong, the first of a number of articles on the Companies Ordinance Rewrite – what film makers might enticingly describe as a prequel or "the early days", and the Unsolicited Electronic Messages Ordinance.

Our two case studies cover the tricky issue of mandatory versus discretionary requirements in tender documentation – the China Harbour Case, and whether the statutory right to inspect the register of members of a company infringes the Basic Law or Hong Kong Bill of Rights Ordinance. In our next CU Review we will consider the first of two important Court of Final Appeal decisions on contract formation.

The Commercial Unit ("CU") consists of three teams – CU I, CU II and CU III specialising in (1) broadcasting, telecommunications, electronic communications and media related work such as regulation, licensing and film finance as well as competition law and project related work e.g. the Hong Kong Disneyland Resort (CU I); (2) traditional company/corporate work such as securities including the Securities and Futures Ordinance, mergers, initial public offerings, placements, bond and debt issues and project finance, as well as regulatory aspects of insurance companies, Mandatory Provident Funds and bank legislation (CU II); and (3) the rewrite of the Companies Ordinance including representing the Secretary for Justice on the Standing Committee of Company Law Reform (CU III). Major projects are handled by teams of CU lawyers who may be drawn from CU I, II and III. In our next Review we will share a little of the background of Counsel in the CU.

We are very grateful to Professor Richard Cullen whose cartoon entertainingly exposes some misunderstanding (surely) of Corporate Social Responsibility nowadays. To cartoonists and satirists in our ranks whose work is published in the Review we can offer lunch – we may confidently say this is not a benefit or inducement, and a grateful acknowledgment. We invite readers to venture their candid opinions of commercial law, or commercial lawyers, in this medium.

CHARLES BARR

The Companies Ordinance Rewrite – Part I

CU involvement

The CU has a new team – Commercial Unit III (CU III) namely the Companies Ordinance Rewrite team (CORT). Financial Services and the Treasury Bureau (FSTB) has the carriage of the Rewrite exercise and has established the Companies Bill Team (CBT), and CORT is assisting in the preparatory work in a number of ways which will be discussed in later issues of the CU Review.

Company Law reform in Hong Kong

The first Companies Ordinance (CO) was enacted in 1865 and was based on the English Companies Act 1862. Subsequent COs followed shortly after their English equivalents. After the Second World War (1939-45) and the Japanese occupation Hong Kong had more important matters to attend to than companies legislation. The major English consolidation in 1948 was not followed by new legislation in Hong Kong and the current CO is still the 1932 CO.

It is hard to imagine now, but until the early 1960s Hong Kong was still quite a commercial backwater and most businesses operated as sole proprietors or partnerships. The influx of mainland entrepreneurs in 1949 and the Korean and Vietnam Wars eventually changed that.

A number of bank and securities and investments scandals in the early 1960s persuaded the HK Government to appoint a Companies Law Revision Committee (CLRC) to review the companies legislation, but first to deal with securities legislation. The CLRC produced its first report on The Protection of Investors in 1971 (and that led to the Securities Ordinance and the Protection of Investors Ordinance in 1974). The CLRC then turned to the companies legislation and produced its second and final report on Company Law in 1973. That report led to a white bill in 1981 and subsequently to the Companies (Amendment) Ordinance 1984, a major piece of reforming legislation.

One recommendation of the CLRC, which was enacted in the 1984 Ordinance, was the establishment of a standing committee on company law reform. Since 1984 the Standing Committee on Company Law Reform (SCCLR) has made a great contribution to company law reform. But it is only a part-time body. It is made up of ex officio members representing relevant government departments and ordinary members from professional bodies, commercial interests and academia. It meets 11 times a year, usually on a Saturday morning, though occasionally sub-committees are formed on particular topics, such as company charges. However it is influential and its recommendations are generally accepted by government and enacted in due course.

In his Budget speech for 1994

Insurance Arrangement in relation to the Hong Kong Port Area

Overview

With the Shenzhen Bay Port Hong Kong Port Area ("HKPA") Ordinance (Cap. 591) coming into full operation on 1 July 2007, the laws of Hong Kong apply to the HKPA as an area lying within Hong Kong (section 5). If a future document contains a reference to Hong Kong to describe the territorial limit of a right or obligation (other than a pre-existing right or obligation acquired, accrued or incurred on or before 1 July 2007), then, unless the contrary intention appears, the territorial limit of the right or obligation is to be construed as including the HKPA (section 12(1)).

Implications of the HKPA Ordinance on insurance policies

An insurance policy issued on or after 1 July 2007 which contains a reference to Hong Kong to describe the territorial limit of a right or obligation will be construed as including the HKPA, unless the contrary intention appears. However, a similar reference in insurance policies issued before 1 July 2007 will not automatically be construed to include the HKPA.

The two classes of mandatory insurance which have been identified to be affected by the operation of the HKPA Ordinance are insurance policies taken out for the purposes of section 4 of

the then Financial Secretary stated that the CO had reached a stage when a thorough review of the CO, rather than piece meal amendment, was required. Shortly after that consultants were appointed to undertake the review. The Consultancy Report on the Review of the CO was published in March 1997. That report is usually referred to as the Pascutto Report, named after the principal consultant. The general tenor of the Report was to recommend the adoption of the North American Business Corporations Acts model. A public consultation exercise on the Report did not find much favour with its recommendations and in February 2000 the SCCLR published its own report on the Pascutto Report, rejecting the majority of the latter's recommendations and making 62 recommendations for reform and a re-writing and restructuring of the CO. The SCCLR urged the Administration to give priority to further study or consultation in respect of those of its recommendations which could not be taken forward quickly through amendment bills to the CO and to the more structural changes to the CO it had proposed. The SCCLR had already agreed to embark on a study of Corporate Governance based on a paper prepared by FSTB. Consultation Papers on Phases I and II of the Corporate Governance Review were published in July 2001 and June 2003 respectively. And in January 2004 the SCCLR issued its Final Recommendations arising from proposals in Phase II of the Corporate Governance Review. At its April 2004 meeting the SCCLR received a paper from the Companies Registry entitled "Overall Review of the Companies Ordinance (Progress Report No. 4)" and agreed the key points on the process and procedure for the proposal to rewrite the CO.

On 5 July 2004 the Financial Affairs Panel of LegCo (FA) discussed a paper from the Administration on the proposed rewrite exercise. The FA was concerned about the cost and the length of the exercise. The Administration came back in July 2005 with a more detailed structure and proposals and a time frame. Subsequently in January 2006 the LegCo Finance Committee approved the funding for the CBT. The cost of the entire rewrite exercise will be funded by the Companies Registry Trading Fund. By late 2006 the CBT had been established, an external consultant had been appointed for research on complex areas of the CO, work had started on the rewrite and a dedicated DPGC and SGC had been appointed to support CU III.

(To be continued in a later CU Review)

TED TYLER

the Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap. 272) and section 40 of the Employees' Compensation Ordinance (Cap. 282). Policyholders who have taken out these policies before 1 July 2007 ("Existing insurance policies") are required to obtain additional insurance protection to cover their liability in relation to the HKPA unless and until they have renewed their existing policies or taken out new policies.

The market agreement

The Hong Kong Federation of Insurers and the Government have discussed options to deal with the transitional problem brought about by the HKPA Ordinance. With the effort of all relevant parties, all 60 insurers carrying on motor and employees' compensation insurance business have entered into a **market agreement** prepared by the CU of the Department of Justice with the Government (as represented by the Insurance Authority) in early June 2007 to extend the territorial limit of the liability of the insurers under the Existing Insurance Policies to include the HKPA, notwithstanding any exclusion clauses to the contrary contained in these policies, at no extra cost to the policyholders.

Details of the **market agreement** and the names of the participating insurers can be found in the websites of the Office of the Commissioner of Insurance and the Hong Kong Federation of Insurers.

RITA WONG

Meaning of the word "*may*" as used in tender conditions

The meaning of the word "*may*" as used in the Conditions of Tender of a public works contract was considered by the Court of First Instance in *China Harbour Engineering Company (Group) v. The Secretary for Justice* [2006] HKEC 432.

The relevant Condition of Tender ("**CT**") provided as follows:

"The tenderer shall price [certain works] such that [a prescribed formula] is complied with.

Failure to price the tender in accordance with the above condition **may** invalidate the tender." (emphasis added)

The Court did **not** accept China Harbour's argument that in the context of the CT "*may*" meant "*must*".

The Court decided that:

(1) If "*may*" meant "*must*", the final sentence of the CT (i.e. "Failure to price the tender in accordance with the above condition may invalidate the tender.") would serve no purpose and should have been omitted. It had been included for a reason. The obvious message to tenderers was - "do your members, including rank and file, might leave those members open to various forms of hostility and refused the application. Subsequently, fearing prosecution under section 98(3) and/or the issuing of an originating summons by the applicant for an order for immediate inspection pursuant to section 98(4), the DP sought a declaration that, to the extent that it applies to political parties which have incorporated under the CO, section 98 was inconsistent with the fundamental right of freedom of association under article 27 of the Basic Law (BL) and article 18 of the Hong Kong Bill of Rights (HKBOR) and with the right to privacy under article 30 of the BL and article 14 of the HKBOR.

The right to inspect the register of members of a company pursuant to Companies Ordinance (CO) section 98 is not absolute – *Democratic Party v Secretary for Justice*, CFI, HCAL 84/2006, 21 May 2007

CO section 95 requires every company incorporated under CO to keep a register of its members, including their names and addresses. CO section 98 provides that the register of members shall be open to inspection by any member **and any other person**.

By section 98(3), if inspection is refused the company and every officer who is in default is liable on summary conviction to a level 3 fine (i.e. in the range $3,001 to $10,000) and a daily default fine of $300. And section 98(4) provides that, if the company refuses inspection, the court may compel an immediate inspection.

In 1994 the Democratic Party (DP) incorporated as a company limited by shares under the CO, each member holding a share. The consequence of that was, prima facie, that any person who wanted to learn the identity and addresses of the members of the DP need do no more than exercise their right of inspection of the register of members under the CO.

In 2006 a third party (not a member, nor a prospective lender or supplier to the DP) applied to inspect the register. The DP took the view that revealing the identity of all its

It is worth noting that section 98(4) and its English equivalent only appeared for the first time in England in the Companies Act 1929 and in Hong Kong in the Companies Ordinance 1932. Prior to 1929 the general view of practitioners and the major Company Law text books, such as *Buckley* and *Palmer*, was that the right to inspect was the price of incorporation and absolute and the fact that the person seeking inspection was actuated by motives hostile to the company was no defence to his legal right to inspection. Section 98(4) was intended to provide a convenient remedy for a person seeking inspection who had been refused; not to give the court a discretion to refuse to compel compliance with a demand for inspection which was so divorced from the purposes contemplated by the legislation as to amount to an abuse. That interpretation, which survived until quite recently, came from an era before the

sums according to [the prescribed formula], if you do not you run the risk of being disqualified however good the rest of your bid is."

(2) As the word "*may*" gave the procuring entity a discretion not to invalidate tenders which had not complied with the CT, the prescribed formula in the CT did not constitute an "*essential requirement*" for the purposes of Article XIII of the WTO GPA. To be "*essential*", a requirement must be mandatory.

This judgment was upheld by the Court of Appeal (see the report on the judgment of the Court of Appeal in [2007] HKEC 124).

PRACTICAL TIP

When drafting or instructing it is often sensible to minimise "mandatory" or "essential" requirements (those which if not complied with disqualify a bidder) and maximise the "may" requirements. In this way the risk of non-conforming bids is minimised and negotiation possibilities are maximised.

TONY TANG

modern development of human rights and of interest groups who wanted to search the register to send mail to members, to protest or worse. In 2002 the Court of Appeal in England in *Pelling v Families Need Fathers Ltd* [2002] 2 All ER 440, following *O'Brien v Sporting Shooters Association of Australia (Victoria)* [1992] 2 VR 255, held that the equivalent of CO section 98(4) showed that the legal right to inspect was not an unqualified one. Hartmann J in the DP case followed these authorities, saying that in whatever manner section 98 may have been construed in the past, since the coming into effect of the Basic Law, the section should be given a purposive/remedial construction and a court had power under section 98(4) to refuse to compel compliance with a demand for inspection which amounted to an abuse. He was further satisfied that such a demand not only went to civil liability under section 98(4), but also to criminal liability under section 98(3). This, of course, leaves open as to what is "abuse" in this context.

As to the human rights aspects of the case, Hartmann J held that neither the right of freedom of association nor the right to privacy was absolute. The restrictions in section 98 sought to achieve a legitimate purpose. In the commercial and financial sphere, such as Company Law, an individual must expect that rules intended to secure fairness for all and transparency would impinge on his individual rights. Members of and creditors, donors and persons dealing with an incorporated political party were entitled to learn who stood behind it. (So, question whether beyond such persons a demand for inspection might be abusive.) Accordingly, the proportionality test was satisfied. A factor in determining that was that the DP could have chosen a number of viable alternatives, e.g. shareholding by nominees, to protect the anonymity of the rank and file members. The judge was not prepared to make the declaration sought. The question now is whether the DP will be prosecuted under section 98(3).

PRACTICAL TIP

The decision has ramifications beyond the inspection of the register of members to the inspection of other registers, a matter which will have to be considered by the Companies Ordinance Rewrite exercise and the registrars of public registers required to be kept under the CO and other legislation.

TED TYLER

Highlights of the Unsolicited Electronic Messages Ordinance-Part I

The Unsolicited Electronic Messages Ordinance, Cap. 593, (UEMO) regulates the sending of unsolicited electronic messages **with a Hong Kong link**. UEMO applies to electronic messages which offer, advertise, or promote goods, services, facilities, land, business or investment opportunities, or their suppliers or providers, **in the course of or in the furtherance of any business**.

"In the course of or in the furtherance of any business"

"Business" includes a trade and profession. These words " in the course of or in the furtherance of any business" in the definition of "commercial electronic message" have received extensive consideration in a number of jurisdictions including for tax purposes in the United Kingdom's VAT legislation. They are words which may cause difficulties to Government bureaux, charitable organizations, Hospital Authority, welfare clubs, religious organizations, and mutual societies such as co-operative societies where any profit is shared between members. Government Trading Funds need to pay particular attention to whether they are caught by this provision. Readers should note that UEMO binds the Government although neither the Government nor any public officer in the officer's capacity as such is liable to be prosecuted for an offence against UEMO.

"Hong Kong Link"

Despite initial reports to the contrary in the media, this is widely defined in UEMO. A commercial electronic message has a Hong Kong link if:

(a) the message originates in Hong Kong;

(b) the individual or organization who sent the message or authorized the sending of the message is (i) an individual who is physically present in Hong Kong when the message is sent; (ii) an organization (other than a Hong Kong company) that is carrying on business or activities in Hong Kong when the message is sent; or (iii) a Hong Kong company (i.e. companies within the meaning assigned by section 2(1) of the Companies Ordinance (Cap 32) or a body corporate that is incorporated or otherwise established by or under any other Ordinance);

(c) the telecommunications device that is used to access the message is located in Hong Kong;

(d) the registered user of the electronic address to which the message is sent is (i) an individual who is physically present in Hong Kong when the message is accessed; or (ii) an organization that is carrying on business or activities in Hong Kong when the message is accessed; or

(e) the message is sent to an electronic address that is allocated or assigned by the Telecommunications Authority.

Examples and exceptions

Instances caught by UEMO Include without limitation:

- a pre-recorded voice message sent to a Hong Kong telephone number, offering telephone service packages or medical services;

- text messages sent through Short Messaging Services or multimedia messages sent through Multimedia Messaging Services, advertising banking services

- a fax advertisement sent to a company in Hong Kong, advertising personal computers or landed properties ; and

- an email message sent to an email address accessed by the registered user whilst physically in Hong Kong, promoting printer toner cartridges or investment proposals.

However, Schedule 1 of UEMO sets

*UEMO regulates the sending of unsolicited commercial electronic messages with a "**Hong Kong Link**"*

out a list of electronic messages which are exempted from UEMO. They include person-to-person telemarketing calls, messages sent in response to the recipient's specific requests such as fax-on-demand, messages such as invoices or receipts to confirm a commercial transaction that the recipient has previously agreed to enter into with the sender, sound broadcasting services and television programme services.

Phased Launch

UEMO is being launched in phases. The first phase took effect on 1 June 2007. It covers the rules against address-harvesting and the rules against fraud and illicit activities related to transmission of commercial electronic messages. Subsequent phases will commence on a date or dates to be appointed by the Secretary for Commerce and Economic Development and will cover many provisions including **rules governing the sending of commercial electronic messages** including the unsubscribe facility in Part II of UEMO.

Rules governing the sending of commercial electronic message

Two approaches (i.e. opt-in approach and opt-out approach) are adopted in different jurisdictions around the world to deal with the issue of whether a sender of a commercial electronic message must obtain consent from a recipient before or after the commercial electronic message is received.

Opt-in Approach

Under the opt-in regime, a sender is forbidden to send a commercial electronic message to a recipient without his or her prior consent. An express consent from a recipient to receive a commercial electronic message must be obtained by a sender before the commercial electronic message is sent to the recipient. This approach is adopted by jurisdictions which take an aggressive approach to curb spamming activities, e.g. Australia and the European Union.

Opt-out Approach

Under the opt-out regime, a sender is allowed to send a commercial electronic message to a recipient until the recipient indicates that he or she does not wish to receive commercial electronic messages from the sender. The opt-out approach is more commercially friendly. UEMO and the United States' CAN-SPAM Acts of 2003 adopt the opt-out approach to regulate sending of commercial electronic messages. You may wish to visit (http://www.ofta.gov.hk/en/uem/main.html) for more information on the implementation of UEMO.

In Part II, we will address details on the operation of UEMO including enforcement and appeal, some case law on the meaning of "in the course of or in the furtherance of any business", the position of internet service providers, the reaction of the industry and consumers to UEMO and a glossary of some of its principal terms.

*UEMO adopts "**the opt-out approach**" to regulate the sending of commercial electronic messages*

PRACTICAL TIP

Some bureaux and departments may be eager to promote on their websites the services they offer. To that end, the bureaux and departments may invite users of their websites to submit email addresses of the latter's friends and contacts for the purpose of contacting them.

UEMO binds the Government. The Government as well as the user ("the user") who submits his friends or contact's email address may be regarded as a sender if the bureau or department sends commercial electronic message to such email address, regardless of whether the bureau or department purports to send it "on behalf of" the user. The user runs the risk of having "caused" the commercial electronic message to be sent.

Compliance therefore requires an "unsubscribe facility" to be incorporated, a check made against the Do-not-call Register and Part II of UEMO requirements to be satisfied.

RAYMOND FONG

Introduction to the Capital Investment Entrant Scheme (the "Scheme")

Objective & Scope of Application Policy

The objective of the Scheme is to facilitate the entry for residence by persons who make capital investment in Hong Kong. The Scheme's rules are expressed in simple English and are intended to be given a fair, large and liberal interpretation to ensure the attainment of the objects of the Scheme. Examples are given in the Scheme's rules by way of illustration. Nevertheless the Scheme is more elaborate and flexible than some overseas jurisdictions such as Singapore and Australia. The Scheme is applicable to foreign nationals (except nationals of Afghanistan, Albania, Cuba and the Democratic People's Republic of Korea), Macao SAR residents, Chinese nationals who have obtained permanent resident status in a foreign country, stateless persons who have obtained permanent resident status in a foreign country with proven re-entry facilities and Taiwan residents.

Eligibility Criteria

To qualify for admission under the Scheme, the entrant must:

(a) be aged 18 or above when applying for entry under the Scheme;

(b) have net assets (i.e. after deducting the amount of any encumbrances secured on that asset) of not less than HK$6.5 million to which he is absolutely beneficially entitled throughout the two years preceding his application;

(c) have invested within certain time limits specified in the Rules for the Capital Investment Entrant Scheme not less than HK$6.5 million net in permissible investment asset classes (see below);

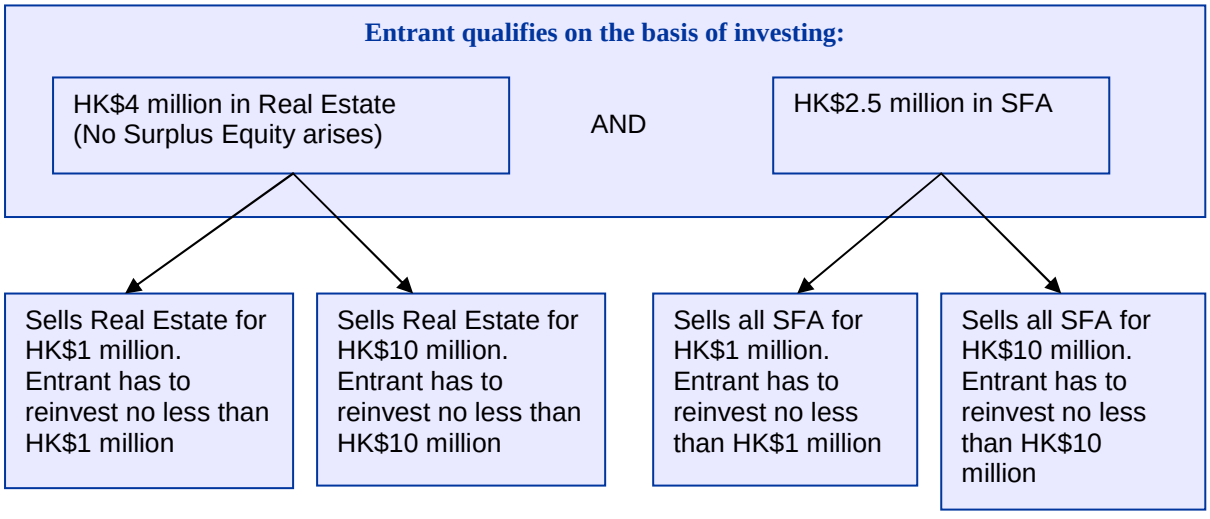
(d) be able to demonstrate that he is capable of supporting and accommodating himself and his dependants, if any, on his own without relying on any return on the permissible investment assets, employment or public assistance in Hong Kong; and

(e) have no adverse immigration record and meet normal immigration and security requirements.

Investment

The entrant should invest not less than HK$6.5 million in **either or both** of the two permissible investment asset classes (i) "Real Estate" covering commercial, industrial or residential properties in Hong Kong and (ii) "Specified Financial Assets" ("**SFA**") covering financial assets such as equities, debt securities and eligible collective investment schemes. Portfolio maintenance and ring-fencing requirements are imposed to ensure that the entrant does not reduce his investment commitment while he is permitted to stay in Hong Kong under the Scheme. This is illustrated in the Example.

Example



Changes in the Value of Investment

The entrant is not required to top up the value of his investment in either asset class should the value of his total investment under the Scheme fall below the requisite minimum level of HK$6.5 million.

With exceptions for (i) the amount required to redeem his outstanding mortgage on Real Estate (if any), "Surplus Equity" (which only arises where the entrant acquires Real Estate with a market value of more than HK$6.5 million net) and rental income in respect of Real Estate and (ii) cash dividend income and interest income in respect of SFA, the entrant is NOT allowed to withdraw any appreciation from his portfolio of permissible investment assets under the Scheme even if the subsequent market value of those assets rises above the requisite minimum level of HK$6.5 million. This is illustrated in the Example.

Ring-fencing

The entrant is permitted to switch his permissible investment assets from one class to another (e.g. from Real Estate to SFA or vice versa and any number of times) if the ring-fencing principle is adhered to, i.e. the entire proceeds from the disposal at market value of the assets are reinvested in the Scheme.

Statistics

As at 30 June 2007 the total investment in Scheme cases amounted to HK$9.241 billion with HK$2.639 billion attributed to Real Estate and HK$6.602 billion attributed to SFA.

JOSEPHINE HO