CU Review Summer 2018

The Commercial Unit, Civil Division
The Department of Justice

What's inside

Editorial

We feature three articles in this edition. The first article discusses the current review of the Broadcasting Ordinance and Telecommunications Ordinance in view of the rapid development of the broadcasting and telecommunications sectors.

The second article discusses the latest reform in the regulation of auditors in order to bring Hong Kong in line with the international standard.

The third article talks about the new regime of Significant Controllers Register under the Companies Ordinance which aims to enhance transparency of beneficial ownership or control of companies.

We also feature three case reports in this edition. The first case is a case decided by the Court of Appeal more than 35 years ago but was only reported recently in the law report. It concerns the interpretation of s.76 of the Inland Revenue Ordinance which provides that where a taxpayer is in default of his tax liability, the Commissioner of Inland Revenue may give a notice to a third party who owes or is about to pay money to the taxpayer requiring the third party to pay such moneys not exceeding the amount of tax in default.

The second case is about the Court's power to make an order under s.214 of the Securities and Futures Ordinance to disqualify a director if the misconduct of the director involves a breach of standards of commercial probity, total or gross incompetence or extreme negligence in the management of a company.

The third case concerns the assessment of Wrotham Park damages – a notional price for buying out a restrictive covenant which the contract-breaker has breached.

YUNG Lap-yan

Review of Broadcasting Ordinance and Telecommunications Ordinance

Background

The regulatory regime for the broadcasting sector in Hong Kong is mainly housed in the Broadcasting Ordinance (Cap. 562) ("BO") with respect to television ("TV") broadcasting, and Part 3A of the Telecommunications Ordinance (Cap. 106) ("TO") with respect to sound broadcasting. The regulatory regime for the telecommunications sector is enshrined in the TO (except for Part 3A).

In view of the rapid development of the broadcasting and telecommunications sectors, the Government is reviewing the legislative and regulatory regimes governing the two sectors in Hong Kong ("Review") in two phases.

Phase One

Under phase one of the Review, the Government has scrutinised the existing statutory frameworks under the BO in respect of TV broadcasting and Part 3A of the TO in respect of sound broadcasting to see whether they meet technological advancements and market developments.

In considering the appropriate degree of control over different broadcast content carried by different media, the Government takes into account the following major criteria:

(a) Pervasiveness, Popularity and Influence - whether broadcast content is easily accessible by local households and its degree of pervasiveness on the viewing public;

(b) Impact on Minors - whether broadcast content can easily reach and influence children and young people;

(c) Personalised Content for Viewers/Listeners - whether individual viewers/listeners may choose to access broadcast content of their choices anytime anywhere; and

(d) Uniqueness/Presence of Alternatives - whether the broadcasting service is unique and whether there are alternatives to replace such service, and the number/accessibility of such alternatives.

The Government concludes that the existing framework is proportionate and reasonable and should remain intact, i.e. domestic free TV programme service ("free TV"), domestic pay TV programme service ("pay TV"), non-domestic TV programme service[1] ("non-domestic TV") and other licensable TV programme service[2] ("other licensable TV") should continue to be licensed under the BO, and sound broadcasting under Part 3A of the TO. To be commensurate with the accessibility and impact of and influence commanded by each type of the broadcasting services, free TV services should still be subject to the most stringent control, to be followed by pay TV and sound broadcasting. Minimal restrictions should apply to non-domestic and other licensable TV services due to their small scale of operation and the fact that they do not target the Hong Kong viewing public, or are only available for reception by a small number of local viewers. In line with international practices and in view of the enforcement difficulties involved, internet TV and radio programme services should remain not subject to the licensing controls of the BO and Part 3A of the TO.

When the bulk of the legislative control was enacted back in the 1960s well before the advent and popularisation of the internet, TV and radio were the only broadcasting services that could reach the public at large. With the rise of new media that enables access to multiple choices of infotainment specific to users' liking and taste at their own pace, traditional broadcasting service providers no longer command the same degree of influence that they used to have. Seen in this light, the existing stringent regulatory regime on traditional media is outdated and is not commensurate with the latest market developments. The imbalance in regulation hinders innovation and long-term sustainability of the incumbent licensees, and deters newcomers from joining the industry.

With the aim to maintain an adequate degree of control that public interest demands, while at the same time introduce amendments to encourage competition and innovation amongst companies operating traditional broadcasting services, the Government proposes to relax some restrictions imposed on traditional broadcasters as follows.

(A) Cross-media Ownership Restrictions

[1] E.g. satellite TV.
[2] E.g. hotel TV.

The Government proposes to narrow the scope of disqualified persons ("DP") who are restricted from holding/exercising control of free TV, pay TV and sound broadcasting licences/licensees, by removing certain categories from the definition of DPs in the BO and the TO.

For the BO, the Government proposes that a non-domestic TV licensee, an other licensable TV licensee, an advertising agency and a proprietor of local newspaper should no longer be restricted from holding/exercising control of free TV and pay TV licences/licensees.

For the TO, the Government proposes that an advertising agent, a person who in the course of business supplies material for broadcasting by a sound broadcasting licensee and a person who in the course of business transmits sound or TV material in Hong Kong or outside Hong Kong should no longer be restricted from holding/exercising control of sound broadcasting licences/licensees.

The Government also proposes to narrow the scope of "relative" under the definition of "associate" of DPs under the BO by confining its meaning to immediate family members, namely, spouse, parent, child, adopted child, stepchild and sibling.

(B) Foreign Control Restrictions

The Government proposes to adjust the threshold shareholdings in free TV licensees by non-Hong Kong residents that require the Communications Authority's prior approval from 2%, 6%, 10% and above to 5%, 10%, 15% and above.

(C) Requirement of Licensee Being a Non-subsidiary Company

The Government proposes to remove the requirement that free TV and sound broadcasting licensees must be non-subsidiary companies.

The Government has launched a public consultation on the above proposals and aims to introduce an amendment bill into the Legislative Council ("LegCo") in early 2019.

Phase Two

Phase two of the Review focuses on telecommunications regulatory matters under the TO. Improvement measures will be proposed seeking to ensure that the telecommunications control regime meets the latest developments in telecommunications technologies, with particular regard to the advent of the fifth generation mobile communications services and their applications in the era of Internet of Things (i.e. connecting any physical device to the internet). The Government expects to launch public consultation for this phase later in 2018 and aims to introduce an amendment bill into the LegCo in 2019.

Sandy Hung

Audit Regulatory Reform

Background

Throughout the years, the regulatory regime for auditors in Hong Kong is primarily administered by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), a self-regulatory body established pursuant to the Professional Accountants Ordinance (Cap. 50)("PAO"), which is responsible for the registration, inspection, enforcement, discipline, development and professional training of the audit profession in Hong Kong. Since 2007, the regulatory function to conduct investigations into possible auditing and reporting irregularities of auditors of listed entities has been transferred to the Financial Reporting Council ("FRC"), which is independent of the audit profession and established under the Financial Reporting Council Ordinance (Cap. 588) ("FRCO").

In recent years, it has become an international trend that the regulatory regimes for auditors of public interest entities ("PIEs") should be independent of the audit profession and subject to an independent oversight by bodies acting in the public interest. In order to be considered as being on par with the prevailing international standard and to enable Hong Kong to be represented on the International Forum of Independent Audit Regulators, the Government proposed to reform Hong Kong's auditor regulatory regime through amending the PAO and the FRCO. Public consultation was conducted and the response was generally supportive of the direction of the reform.

Objectives of the Bill

The policy objectives of the Financial Reporting Council Ordinance (Amendment) Bill 2018 ("Bill") are to further enhance the independence of the existing regulatory regime for auditors of listed

entities from the audit profession and ensure that the regime is benchmarked against the international standard and practice.

Major Proposals

The Bill provides that whilst the HKICPA will continue to perform certain statutory functions such as registration and setting standards on professional ethics, the FRC will act as the independent oversight body regulating the relevant auditors under the new regulatory regime. Major amendments to the auditor regulatory regime are set out as follows:

(1) Local and Overseas Auditors

Under the new regime, a practice unit that wishes to undertake specified engagements for listed entities ("PIE engagements") may apply to the HKICPA to be a registered PIE auditor. New roles such as engagement quality control reviewers and quality control system responsible persons are introduced. These persons will be responsible for different aspects of the PIE engagements carried out by the practice unit. There is however no material change to the existing eligibility criteria for a local auditor to be an auditor of a listed entity.

For an overseas corporation or overseas collective investment scheme ("CIS") listed in Hong Kong or seeking to be listed in Hong Kong and wishes to engage an overseas auditor to undertake PIE engagements, FSTB proposed that approval from the Hong Kong Exchanges and Clearing Limited or the Securities and Futures Commission, as the case may be, must be obtained. Once the approval is obtained, the overseas corporation or CIS concerned may apply to the FRC to recognize the overseas auditor as a recognized PIE auditor.

To protect the interests of investors, PIE auditors as well as their clients, it will be an offence for any person, other than a registered PIE auditor or a recognized PIE auditor, to undertake PIE engagements or to hold himself out as a PIE auditor.

(2) Inspection and Investigation

The HKICPA's power to conduct recurring inspections of local auditors in respect of their PIE engagements will be transferred to the FRC. Furthermore, the Bill provides for additional circumstances under which the FRC may initiate investigations in relation to auditors of listed entities.

(3) Disciplinary Mechanism

In the pre-amendment regime, the FRC did not have any disciplinary powers upon the conclusion of an investigation. Under the new regime, the FRC will be empowered to exercise disciplinary powers on PIE auditors and their responsible persons. Such disciplinary powers range from revocation of registration, private or public reprimand to pecuniary penalty of up to HK$10,000,000 or 3 times the amount of the profit gained or loss avoided as a result of the misconduct.

In order to serve its role as an independent oversight body and to avoid conflicts of interest, the FRC will put in place administrative arrangements such as seeking inputs from independent audit and legal experts and ensure that the executives who have participated in the investigation, inspection or disciplinary processes of a case would not take part in the disciplinary decision.

(4) Review and Appeal Mechanism

For any aggrieved person who is dissatisfied with the respective registration or recognition decisions of the HKICPA and the FRC or the disciplinary decisions of the FRC, the Bill provides an avenue for them to make an application to a new independent review tribunal. The tribunal will make determinations on any review against the aforementioned decisions. If the aggrieved person is dissatisfied with a determination of the tribunal, he may appeal to the Court of Appeal on a question of law, fact or mixed law and fact.

(5) Oversight

Although the FRC will not participate in the day-to-day operations of the HKICPA, in order to enable the FRC to ensure that the HKICPA performs its regulatory functions in the public interest, the Bill provides for a light-handed and independent oversight model by empowering the FRC to, for instance, request the HKICPA for reports on its regulatory activities and conduct assessment on the HKICPA's regulatory activities.

To enhance the independence of the FRC, existing statutory requirements on the nomination of members of the FRC by other regulatory bodies have been repealed. As opposed to the old regime where the majority of the members are required to be lay persons, the new regime requires the FRC to appoint persons who possess knowledge of and experience in PIE engagements to ensure that the FRC has sufficient expertise to perform its expanded functions.

Conclusion

The Government's reform entails very substantial changes to the regulation of the auditors. With the establishment of an internationally recognized independent auditor regulatory regime, it is hoped that the new regime will lead to better audit quality and investor protection in Hong Kong and bring Hong Kong in line with the international standard.

Beverly Yan and Fiona Lai

Significant Controllers Register under the Companies Ordinance

Introduction

To fulfil the international obligations of Hong Kong as a member jurisdiction of the Financial Action Task Force in combatting money laundering and terrorist financing, the Companies Ordinance (Cap. 622) ("CO") has been amended[3] to enhance transparency of beneficial ownership or control of companies. The new law is effective from 1 March 2018.

Scope of application

The new regime applies to "applicable companies"[4], which are companies incorporated in Hong Kong under the CO, except companies listed on the Hong Kong Stock Exchange.

New obligations on companies

Key obligations of an applicable company under the new law include:

(1) to keep a significant controllers register ("SCR") at the company's registered office or a prescribed place[5];

(2) to take reasonable steps to identify its significant controllers[6], including the giving of notices and obtaining their particulars;

(3) to enter the required particulars of its significant controllers in the SCR[7];

(4) to keep the information in the SCR up-to-date[8]; and

(5) to allow inspection of the SCR[9] by any person whose name is entered in the SCR as a significant controller and by law enforcement officers[10].

If an applicable company fails to comply with any of the above obligations, the company and each of its responsible persons commit an offence.

Significant controller

A significant controller means a registrable legal entity or a registrable person of an applicable company. A registrable legal entity is a legal entity which is a member of the applicable company and has significant control over the company. A registrable person is a natural person or a specified entity[11] having significant control over the company (subject to exceptions)[12].

Significant control

A person has significant control over an applicable company if one or more of the following conditions are met[13]:

(a) the person holds, directly or indirectly, more than 25% of the issued shares in the company; or if the company does not have a share capital, the person holds, directly or indirectly, a right to share in more than 25% of the capital or profits of the company;

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3 The Companies (Amendment) Ordinance 2018 (Ord. No. 3/2018) adds a new Division 2A to Part 12 and new Schedules 5A to 5C in the CO.
4 CO s.653A
5 CO ss.653H and 653M
6 CO Pt.12 Div.2A Subdiv.3
7 CO s.653I and Sch.5B
8 CO Pt.12 Div.2A Subdiv.4
9 CO ss.653W and 653X
10 CO s.653B, e.g. an officer of the Companies Registry, Customs and Excise Department, Hong Kong Monetary Authority, Hong Kong Police Force, Immigration Department, Insurance Authority, Independent Commission Against Corruption and Securities and Futures Commission.
11 e.g. a corporation sole, a government and an international organization
12 CO ss.653A, 653C, 653D
13 CO s.653E and Sch.5A Pt.1

(b) the person holds, directly or indirectly, more than 25% of the voting rights of the company;

(c) the person holds, directly or indirectly, the right to appoint or remove a majority of the board of directors of the company;

(d) the person has the right to exercise, or actually exercises, significant influence or control over the company;

(e) the person has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or a firm (that is not a legal person), whose trustees or members (in their capacity as such) meet any of the first four conditions in relation to the company.

The Companies Registry ("CR") has issued a *Guideline on the Keeping of Significant Controllers Registers by Companies* ("*Guideline*"), which provides, among other things, guidance on the above conditions with illustrative examples. In relation to the conditions in paragraphs (d) and (e) above, the *Guideline* states that: (a) where a person can ensure that a company generally adopts the activities which the person desires, this would indicate "significant control"; and (b) where a person can direct the activities of a company, this would indicate "control"[14].

Indirect holdings

A person holds a share or right indirectly in an applicable company if: (a) the person has a majority stake in a legal entity which holds the share or right in the company; or (b) the person has a "majority stake" in a legal entity which is in a chain of legal entities, provided that each of those legal entities (other than the last one in the chain) has a "majority stake" in the entity immediately below it in the chain and the last one in the chain holds the share or right in the company. Two examples of where a person has a "majority stake" in a legal entity are: (a) where the person holds a majority of the voting rights in the entity, and (b) where the person has the right to exercise, or actually exercises, dominant influence or control over the entity[15].

Ascertaining company's significant controllers

An applicable company is under an ongoing obligation to take reasonable steps[16] to ascertain the identity of each of its significant controllers. For example, if the company knows or has reasonable cause to believe that a person is a significant controller of the company, the company must give a notice within 7 days to the person to seek confirmation that the person is a significant controller[17]. If a notice addressee fails to comply with a requirement stated in the notice relating to the SCR given by the company within one month from the date of the notice, the notice addressee commits an offence[18]. If a person, in purported compliance with the notice, knowingly or recklessly makes a statement or provides any information that is misleading, false or deceptive in a material particular, the person commits an offence[19].

No significant controllers

Even if an applicable company does not have any significant controller, the company must still keep an SCR[20]. In such a situation, the company must note in its SCR that the company knows, or has reasonable cause to believe, that it has no significant controller[21].

Designated representative

An applicable company must designate a representative in Hong Kong to serve as a contact point for providing information about the company's SCR and related assistance to law enforcement officers[22].

Conclusion

The above only highlights some of the main requirements under the new regime. Further details can be found in the dedicated thematic section on SCR on CR's website[23], which contains the *Guideline* and other resources.

Ida Chan and Stefan Lo

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14 *Guideline*, paras. 10.5.2-10.5.3
15 CO Sch.5A ss.7 and 13
16 *Guideline*, para. 4.1.1, e.g. reviewing the company's register of members, articles of association, shareholders' agreements or other relevant agreements; considering interests in the company as held by individuals, legal entities and trusts or firms; and considering any evidence of joint arrangements or evidence of rights held through a variety of means that might ultimately be controlled by the same person.
17 CO s.653P
18 CO s.653ZA
19 CO s.653ZE
20 CO s.653H(2)
21 CO s.653I(2)(b) and Sch.5C s.2
22 CO s.653ZC
23 www.cr.gov.hk/en/scr

Hongkong and Shanghai Banking Corp v Attorney General
[2018] 1 HKC 305

The judgment of the above case was handed down by the Court of Appeal more than 35 years ago and the stake was only HK$96 in a joint account in the appellant bank ("HSBC"). Yet it was recently post-reported because it continues to be referred to and it concerns the interpretation of s.76 of the Inland Revenue Ordinance (Cap. 112) ("IRO"), which has remained substantially the same since the case was decided in 1982.

The relevant part of s.76 of the IRO is extracted below:

"(1) Where tax payable by a person is in default…and it appears to the Commissioner to be probable that any other person (hereinafter…referred to as ***the third party***)—

(a) owes or is about to pay money to such person (hereinafter…referred to as ***the taxpayer***); or

(b) holds money for or on account of the taxpayer…

the Commissioner may give the third party notice in writing…requiring him to pay such moneys not exceeding the amount of tax in default…The notice shall apply to all such moneys which are in the third party's hands or due from him or about to be paid by him at the date of receipt of such notice or which come into his hands or become due from him or about to be paid by him at any time within a period of 30 days thereafter.

(2) Any person who has made any payment in pursuance of this section shall be deemed to have acted under the authority of the person by whom the tax was payable or on whom it was charged and of all other persons concerned, and is hereby indemnified in respect of such payment against all proceedings civil or criminal notwithstanding the provisions of any written law, contract or agreement.

(3) Any person to whom notice has been given under subsection (1) who is unable to comply therewith shall… give notice in writing to the Commissioner acquainting him with the facts.

(4) Any person to whom a notice has been given under subsection (1) who could have complied therewith but failed to do so within 14 days after the expiration of the period referred to in subsection (1), shall be personally liable for the whole of the tax which he was required to pay, and such tax may be recovered from him by all means provided in [IRO]…"

Facts

HSBC received a notice under s.76(1) of the IRO ("Notice") on tax payable by a taxpayer ("X") who maintained a joint account at HSBC with a third party ("Y"). The mandate between HSBC, X and Y for the account provided that liability incurred by X and Y should be joint and several. Whilst the mandate was silent as to whether HSBC's liability to X and Y was also joint and several, by virtue of the repealed s.28 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23) ("LARCO") which changed the common law rule that a promise could not be made to two or more persons both jointly and severally[24], it was common ground that that section applied to this case, given that parties to the mandate had not contracted out its application.

HSBC took out a summons to seek the Court's declaration that the Notice was invalid and that it was not obliged to comply with the Notice since it had no specific authorisation from X to do so, and that the account concerned was jointly held by X and Y. The

[24] S.28 of the LARCO provided that, "(1) **An agreement** in writing…made with two or more jointly, to pay money…or to do any other act, to them or for their benefit…shall be construed as being also made with each of them. (2) This section applies only if and so far as a contrary intention is not expressed in the agreement, and has effect subject to the agreement and to the provisions therein contained…". It should however be noted that the above section was repealed in 1984. S.43(1) of the Conveyancing and Property Ordinance (Cap. 219) now provides that, "**Any agreement or covenant relating to land or other property**, express or implied, with 2 or more persons jointly to do any act for their benefit…unless the contrary intention is expressed…shall be construed as being made with each of them.". Whilst at first glance the agreements to which s.43(1) of Cap. 219 applies may seem to be different from those to which the now appealed s.28 of the LARCO used to apply, they appear not to differ from one another in substance - see commentary at Annotated Ordinances of Hong Kong, Cap. 219, Part IV [43.04], "This section is **not confined to covenants relating to land**, but covers agreements under hand or covenants or agreements which relate to other property whether express or implied.".

then High Court dismissed the summons and held, among others, that there was no ambiguity in the widely drawn s.76 of the IRO and the Notice was valid. The fact that HSBC owed money to X remained unchanged even when HSBC also owed the same money to Y. As to s.76 of the IRO, the Court made the following unequivocal ruling, "But no one was allowed to escape the net of the Inland Revenue, and if innocent bystanders suffer loss in the tax-gathering process, that is a consequence of the system of government under which we live. It takes priority over the joint and several liability of the bank to the joint account holders."

HSBC appealed and argued that it did not just owe money to X but also to Y and to X and Y jointly and severally, i.e. the condition under s.76(1)(a) of the IRO ("…it appears to the Commissioner to be probable that any other person owes… money to such person") was not squarely satisfied.

Canons of statutory construction irrelevant

Counsel for HSBC submitted that s.76 of the IRO must be strictly construed given its serious consequences on the recipient of a notice who failed to comply with its provisions and how it overrode both the common law property rights of X and the contractual rights of HSBC and Y. Such rights, he submitted, could be so infringed only if there were clear words requiring that this be so. He further submitted that words in s.76 of the IRO did not clearly indicate that it applied to a joint account, and that when interpreting that section, the overall intention of IRO (i.e. to obtain from persons monies which they owe as tax) must be borne in mind and that, given such intention, the legislature could not have intended that s.76 of the IRO be used to obtain money from third parties for payment of tax owed by another.

Counsel for the Attorney General ("AG") submitted that the relationship between a bank and an account holder was that of debtor and creditor. He further submitted that s.76 of the IRO had clear application because there existed a debtor (HSBC) who owed money to a creditor (each of X and Y). Given that s.76 of the IRO was manifestly clear without ambiguity and applied to this case, the canons of statutory construction did not come into play.

Decision

The Court of Appeal accepted the submission of the AG's Counsel. It held that the words of s.76 of the IRO were clear and indicated without ambiguity that where a person owed money to another, or held money on account of another, he must comply with a notice issued under that section. By the repealed s.28 of the LARCO the liability of HSBC was both joint and several - it did owe money to X and hold money on account of X, and thus it must comply with the Notice.

William Liu and Quinnci Wong

Re Freeman Fintech Corp [2018] 1 HKLRD 320

Facts

Roger Best ("D") was an experienced accountant and a non-executive director of Freeman FinTech Corp Ltd (the "Company"), which is listed on the Stock Exchange of Hong Kong ("HKSE").

Andrew Liu ("Liu") was a majority shareholder and a non-executive director of the Company. Liu proposed that the Company's subsidiary, Ambition Union Ltd ("Ambition"), should purchase 23.43% of the shares ("Sale Shares") of Liu's Holdings Ltd ("Liu's Holdings") as a long-term investment from Liu's parents (the "Sellers"). It was known to Liu that a deed executed in 1972 by the shareholders of Liu's Holdings (the "Deed") contains a complex set of pre-emption rights that place significant restrictions on the sale of shares in Liu's Holdings to third parties.

On 8 December 2010, the board of the Company (the "Board") approved the transaction.

On 10 December 2010, the Company published an announcement about the proposed acquisition (the "Announcement") that the transaction was on "normal commercial terms" and was "fair and reasonable and in the interests of the Company and its Shareholders as a whole".

On 20 December 2010, Deacons wrote to the Board on behalf of various shareholders of Liu's Holdings stating that the proposed transaction conflicted with the terms of the Deed (the "Letter"). The HKSE raised enquiries about the Letter and the Company sought legal advice from Lam & Co. Legal opinion from Lam & Co was that the Deed did not prevent the transaction being enforceable, but, subject to the terms of the Deed being successfully challenged, Ambition had no right to compel the transfer of the legal title in the Sale Shares to it.

On 30 December 2010, the Company published a circular containing information and recommendations in respect of the acquisition (the "Circular") for shareholders' approval at an extraordinary general meeting ("EGM") on 18 January 2011. On the day before the EGM, Deacons wrote a further letter (the "2nd Letter") to the Board on behalf of certain shareholders in Liu's Holdings reiterating that the proposed sale conflicted with the Deed. The Board maintained its recommendation and the EGM proceeded to approve the transaction without reference to the 2nd Letter. Subsequently, D resigned and the Sellers offered to repurchase the Sale Shares, resulting in a loss to the Company of approximately HK$77 million.

The Securities and Futures Commission ("SFC") issued a petition ("Petition") against D and other directors of the Company seeking disqualification orders against them under s.214(2)(d) of the Securities and Futures Ordinance (Cap. 571) ("SFO"). The case against D was that:

(i) D had improperly withheld material information in the 2nd Letter from the shareholders of the Company or the EGM;

(ii) D had improperly allowed or caused false or misleading statements or representations to be published in the Announcement and the Circular that the transaction was on "normal commercial terms" and was "fair and reasonable and in the interests of the Company and its Shareholders as a whole"; and

(iii) By withholding material information, D had acted otherwise than in good faith, in the best interests of the Company and/or with reasonable care, skill and diligence.

D applied to strike out the Petition against him, on the ground that it disclosed no reasonable cause of action and was frivolous.

Legal Principles

S.214 of the SFO

S.214 provides that if the Court is satisfied that if the business or affairs of a corporation have been conducted in a manner: (a) oppressive to its members; (b) involving defalcation, fraud, misfeasance or other misconduct towards it or its members; (c) resulting in its members not having been given all the information with respect to its business or affairs that they might reasonably expect; or (d) unfairly prejudicial to its members, the Court may make an order to disqualify the director.

S.214 is directed to identifying and sanctioning misconduct in the management of companies with a view primarily to protecting the investing public and institutions. It will be necessary for the Court to be satisfied that the director's involvement in the relevant matter involves a sufficiently serious failure to satisfy his duties in order to conclude that disqualification is justified and fair. A disqualification order could be made only if the misconduct of the director involved a breach of standards of commercial probity, total or gross incompetence or extreme negligence in the management of a company. Ordinary commercial misjudgment is in itself not sufficient to justify disqualification.

Strike out applications

The Court would only exercise its summary power to strike out any pleading if it is a plain and obvious case that the other party's claim is bound to fail. The claim must be obviously unsustainable and the burden of proof lies on the party seeking to strike out a pleading.

Decision

The Court ruled that whether D should be disqualified would depend on the Court being satisfied of the following matters:

(a) that the affairs of the Company have been conducted in a manner which comes within one of the four categories specified in s.214(1) of the SFO;

(b) that D has breached his duties in respect of that matter; and

(c) that D's breach was sufficiently serious to justify disqualification.

The Court held that it was clearly arguable that (a) may be satisfied.

Regarding (b), the Court considered that it was arguable that an independent non-executive director of D's experience should have raised concerns about proceeding with the transaction without obtaining thorough written legal advice. It was also arguable that the 2nd Letter should have alerted D that the restrictions on the transfer of the Sale Shares were not mere technicalities, but suggested a more serious problem might exist which went to the commercial

viability of the transaction. In this regard, it was arguable that D was in breach of duty.

The Court held that D failed to show that it was plain and obvious that a disqualification order could not be justified. Accordingly the summons to strike out the Petition was dismissed.

Angel Li

Million Add Development Ltd v Nok Wah Logistic (Hong Kong) Co Ltd [2018] HKLRD 636

Facts

P let a unit in an industrial development ("Premises") to D for a fixed term of six years from 1 December 2010 to 30 November 2016 for a monthly rent ("Tenancy Agreement"). A clause in the Tenancy Agreement prohibited D from subletting the Premises to any other person ("Clause"). In late October 2015, P discovered that D and a third party ("TP") had entered into a service agreement dated 6 May 2013 ("Service Agreement") under which D agreed to provide and make available the Premises for use by TP from 22 May 2013 to 21 October 2016 in consideration of the payment of monthly service fees by TP.

On 29 October 2015, P accepted D's repudiatory breach of the Clause and gave notice of immediate termination of the Tenancy Agreement. P obtained summary judgment against D. D then returned the keys to the Premises to P on 4 October 2016 which P accepted as a delivery of possession.

Decision

The hearing was for the assessment of damages. One of the issues to be determined was whether *Wrotham Park* damages should be awarded to P, and if so, the appropriate quantum.

Wrotham Park Damages

The focal instance of *Wrotham Park* damages is a notional price for "buying out" a restrictive covenant which the contract-breaker has already breached, often quantified by reference to the profits which the contract-breaker has made consequent to the breach[25].

P argued that it was entitled to *Wrotham Park* damages as the Clause was a restrictive covenant affecting land. P submitted that damages should be assessed as the difference between the contractual rent and the market rent.

The Court referred to *Pell Frischmann Engineering Ltd v Bow Valley Iran Ltd*[26] where the Privy Council provided some guidance on the award of *Wrotham Park* damages, some of which are set out as follows:

(1) *Wrotham Park* damages are readily awarded at common law for the invasion of rights to tangible moveable or immoveable property.

(2) The breach of a restrictive covenant is generally regarded as the invasion of a property right.

(3) *Wrotham Park* damages represent "such a sum of money as might reasonably have been demanded by the claimant from the defendant as a *quid pro quo* for permitting the continuation of the breach of covenant or other invasion of right".

(4) The nature of the hypothetical negotiation adopted in assessing *Wrotham Park* damages is one between a willing buyer and a willing seller in which the subject matter of negotiation is the release of the relevant contractual obligation. Both parties are to be assumed to act reasonably. The fact that one or both parties would in practice have refused to make a deal is to be ignored.

Insofar as the quantum of *Wrotham Park* damages is concerned, given that such damages are awarded not on the ordinary compensatory basis but on a restitutionary basis, a natural starting point is often the profit that the contract-breaker has anticipated to make as at the date of the hypothetical bargain. Although the exercise is "artificial" and damages are awarded "on a discretionary basis and to be arbitrary in amount"[27], it is inappropriate for the court to simply pick a figure based on its own subjective view in the absence of necessary evidence. The court is still required to be informed and guided by factual and/or expert evidence on the commercial and other parameters relevant to construing the hypothetical bargain between the parties in question.

The Court accepted that by the nature of D's breach, it was ordinarily difficult for P to assess any loss,

[25] Chitty on Contracts – Hong Kong Specific Contracts (5th edition), para. 10-056

[26] [2011] 1 WLR 2370

[27] *Choy Nga Wai Nancy v Gentle Smart Ltd* [2009] 4 HKLRD 75 at [37]

particularly where no direct damage (in the conventional sense) had been caused by the unlawful subletting. While P was entitled to *Wrotham Park* damages, P bore the legal and evidential burden to prove the appropriate quantum.

P contended that it would have demanded no less than the market rent of the Premises had D approached it to request a relaxation of the Clause, but such contention was rejected because there was no evidence to suggest that P and D, both acting willingly and reasonably, would have concluded a bargain on P's terms. In particular, there was no evidence to enable the Court to assess the parties' respective bargaining positions, and how easy or difficult it would have been for P to re-let the Premises as at the date of breach if it had to terminate the lease. All of these factors were highly relevant to assessing the sum P could have demanded. Taking into account the fact that the fee paid by TP to D under the Service Agreement included the use of the Premises ***together with all installed ancillary warehouse facilities and equipment***, the Court was not convinced that it was commercial for D to agree paying "no less than the market rent" to P for taking the trouble and the associated risk of sub-letting the Premises to TP and thus did not accept P's contention that the fee that the parties would have agreed in the hypothetical negotiation was the difference between the contractual rent and the market rent of the Premises as at the date of the breach.

As P had failed to discharge its burden of proof on the quantum of *Wrotham Park* damages in respect of the relevant period, a nominal amount of $100 was awarded to P.

Concluding Remarks

Although this case relates to a breach of tenancy, it is noteworthy that *Wrotham Park* damages may also be available for infringement of intellectual property rights or breach of an equitable duty of confidence in, for instance, employment cases where employers sought to claim such damages against former employees who had copied sensitive and valuable information of the employer[28]. *Wrotham Park* damages are not available for every breach of contract. Usually they are available only where (1) the contract-breaker has committed a deliberate breach for his own profit; and (2) the innocent party has a legitimate interest in preventing the profit-making activity of the contract-breaker and depriving him of the profits but would have difficulty showing any loss on his own part. However, where the misconduct has neither caused the innocent party to suffer any financial loss nor resulted in the contract-breaker making any financial gain, only nominal damages will be awarded[29].

While the award of *Wrotham Park* damages was allowed in a number of English cases, the cases in Hong Kong are relatively few and far between. Even in the UK, the law in this area is still developing. Thus, this case provides a good guidance on the factors that the court will take into account when awarding *Wrotham Park* damages and highlights the importance of adducing relevant factual and expert evidence to enable the court to assess the appropriate quantum of such damages.

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[28] Chitty on Contracts – Hong Kong Specific Contracts (5th edition), para. 10-056

[29] In *Marathon Asset Management LLP v Seddon* [2017] EWHC 300 (Comm), where no financial loss had been sustained by the company, the Court held that it was only entitled to £1 from each of its two former employees who had copied and retained certain confidential information prior to their departure from the business