

The 2008 Declaration of Independence by Hong Kong Courts and Anomalies in the Hong Kong Company Law

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1.0 Abstract

This paper consists of two parts. The first part looks at a landmark decision by the Court of Final Appeal (CFA) in Hong Kong (HK) on 13th March 2008. The case re-affirmed the previous position that HK courts would no longer be bound by UK decisions. It also clarified certain misconceptions made by lower HK courts in the past. The second part looks at several unusual features in the HK company law. Despite a major effort by the HK Government in the same year to completely revamp the local company statute, there remain problem areas. The revised law is still user unfriendly and ambiguous at times.

2.0 Background

HK was a British colony between 1842 and 1997. On 1st July 1997, sovereignty over HK reverted back to the People's Republic of China (PRC). The new constitution applicable to HK is called the Basic Law. It was drafted by the PRC Central Government, the National People's Congress, and became effective after the handover. Despite the change of sovereignty, the Basic Law specifically provided that the common law system³ and the capitalist economy⁴ will continue in HK for 50 years. No one has ever suggested what will happen after that. It is submitted that with examples such as the USA and Canada, in

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³ Article 8, Basic Law

⁴ Article 10, Basic Law

which both common law and civil law jurisdictions can co-exist for more than two centuries, the common law in HK could continue indefinitely.

3.0 Judicial Precedents in HK

Only three courts in HK are capable of producing binding precedents. They are the CFA⁵, the Court of Appeal (HKCA)⁶ and the Court of First Instance (CFI)⁷. CFA was created after the handover. Before 1997, final appeals were heard in the Privy Council (PC) in London.

4.0 Changes Brought by *A Solicitor v the Law Society of Hong Kong*⁸ (FACV 24)

In FACV 24 a HK solicitor was brought before the Solicitors' Disciplinary Tribunal. He was charged by the HK Law Society for not conducting himself properly, in a manner likely to bring the profession into disrepute. The solicitor appealed against the Tribunal's decision, to the HKCA and eventually to the CFA. The key findings of the CFA in FACV 24 are set out below. The paragraph numbers in the footnotes refer to those in the CFA judgment.

In granting leave to appeal to the CFA, the HKCA formulated this specific question:⁹

“whether CFA is bound by its own decision(s) when that previous decision(s) was influenced or itself by a PC decision(s), which has since been either

⁵ For its jurisdiction see the HK Court of Final Appeal Ordinance, Cap. 484, Laws of HK at www.legislation.gov.hk.

⁶ For its jurisdiction see the High Court Ordinance, Cap. 4, Laws of HK at www.legislation.gov.hk.

⁷ For its jurisdiction see the High Court Ordinance, Cap. 4, Laws of HK at www.legislation.gov.hk.

⁸ FACV No. 24 of 2007, available at

http://legalref.judiciary.gov.hk/lrs/common/ju/ju_body.jsp?DIS=60404&currpage=T

⁹ Paragraph 3

overtaken and/or developed and/or departed from?”

It should be noted that this case was only concerned with the position of civil cases.¹⁰ It does not concern criminal cases.

4.1 CFA’s Analysis

CFA started by declaring that the rule of stare decisis in relation to HKCA must be considered in the context of the HK judicial system as a whole.¹¹ It then considered six types of judicial precedents:

- i. PC Decisions on HK Appeals before 1st July 1997
- ii. PC Decisions on non-HK Appeals before 1st July 1997
- iii. HL Decisions before 1st July 1997
- iv. Overseas Jurisprudence after 1st July 1997
- v. CFA Decisions in general
- vi. HKCA Decisions un general

Each type of precedent will be discussed below.

4.1.1 PC Decisions on HK Appeals before 1st July 1997

Before 1st July 1997, a PC appeal from HK bound all HK courts except the CFA. PC is considered part of the HK legal system for the purpose of handling HK appeals. This rule remains unchanged in light of FACV 24. The Basic Law reinforces this rule: the laws

¹⁰ Paragraph 27

¹¹ Paragraph 5

previously in force in HK shall be maintained except for any that contravene the Basic Law and subject to any amendment by the legislature.¹² In addition, the body of jurisprudence represented by PC decisions on appeal from HK continues to be binding in HK after the Basic Law came into effect on 1st July 1997.¹³

4.1.2 PC Decisions on non-HK Appeals before 1st July 1997

Before 1st July 1997, when handling appeals from non-HK courts, PC cannot be treated as part of the HK legal system.¹⁴ Therefore, these non-HK appeals are not binding on HK courts. CFA also made an important clarification. There were cases¹⁵ in which lower HK courts held that all PC decisions were binding on HK courts. No distinctions were made as to whether these decisions came from HK appeals or not. CFA declared these decisions as incorrect.¹⁶ These non-HK PC decisions are only persuasive precedents.

Even though these decisions are not binding, in practice they will still be followed by HK courts. CFA said that except where local circumstances were material, their persuasive authority was so great that the HK courts would invariably follow them.¹⁷ The reason was that, unless there were real grounds for distinction, it was unrealistic to expect PC to take a different view on a HK appeal from that taken in its earlier decision on a non-HK appeal, especially where that earlier decision was not an old one.¹⁸

¹² Article 8, Basic Law

¹³ Article 18, Basic Law

¹⁴ Paragraph 9

¹⁵ In paragraph 13, CFA cited *R V Lee Yuk Wah* [1985] HKLR 193 at 195H and 199A.

¹⁶ Paragraph 13

¹⁷ Paragraph 14

¹⁸ Paragraph 14

CFA did not specifically deal with the treatment of post 1997 non-HK PC decisions made before 1997. It is submitted that the position ought to remain the same. After the handover, HK courts no longer send appeals to PC. Both PC and HL decisions made at this time are persuasive precedents. This is the same treatment as decisions from any foreign common law jurisdictions. However, comparatively speaking PC and HL decisions are considered 'more persuasive' amongst other common law decisions.

4.1.3 HL Decisions before 1st July 1997

Obviously HL could not handle appeals from HK. Their decisions before 1997 were similar to that of non-HK PC decisions. HL and PC share a common membership.

Although such HL decisions are only persuasive, their authority was very great unless the decision was in a field where local circumstances made it appropriate for HK to develop along different lines.¹⁹ So in theory HL decisions do not bind HK courts, but in practice they will be followed by HK courts.

There is another instance where a HL decision binds HK courts in practice. Where an HL decision is concerned with the interpretation of recent English legislation which had been adopted in HK, PC stated that the HL decision has the same practical effect as if it was strictly binding (on HK courts).²⁰

4.1.4 Overseas Jurisprudence after 1st July 1997

¹⁹ Paragraph 15

²⁰ *de Lasala v deLasala* [1980] AC 546 at 558 C-F

The Basic Law expressly provides that HK courts may refer to precedents of other common law jurisdictions.²¹ Decisions from all such jurisdictions are persuasive. However, as the HK legal system originated from that in the UK, non-HK PC decisions and HL decisions would be treated with great respect.²² It is submitted that such decisions would be more persuasive to HK courts than those from other common law jurisdictions.

4.1.5 CFA Decisions in general

There is no dispute on the binding authority of CFA decisions on HK courts. CFA is entitled to depart from its previous decisions,²³ although such actions will be exercised most sparingly.²⁴

4.1.6 HKCA Decisions in general

The question in FACV 24, referred by HKCA on appeal to CFA, was specifically concerned with whether HKCA was bound by its previous decisions, in civil cases. CFA started by considering the original authority on this issue, *Young v Bristol Aeroplane*²⁵. It was held that HKCA was bound to follow its own previous decisions except in three circumstances:

- i. It has to decide which of two conflicting decisions of its own it will follow;

²¹ Article 84, Basic Law

²² Paragraph 17

²³ Paragraph 18

²⁴ Paragraph 20

²⁵ [1944] KB 718

ii. It is bound to refuse to follow a decision of its own which, though not expressly overruled, cannot, in its opinion, stand with a subsequent PC decision on appeal from HK, or a subsequent CFA decision;

iii. It is not bound to follow a decision of its own if satisfied that the decision was given per incuriam.

These rules were subsequently adopted by HK courts²⁶ and re-affirmed by HL.²⁷ After the handover, HKCA confirmed that the rule continued to apply to HK.²⁸

CFA now has to decide whether to continue to adopt this test, or formulate a new test.²⁹ It decided that only the third exception (the per incuriam exception) was a real exception.³⁰

The court then analysed the development of cases in HK and other common law jurisdictions, on the meaning of per incuriam.³¹ All along, CFA has to balance the tension between the need for certainty, predictability and consistency and the need for adaptability, flexibility and justice.³² The court concluded that a new exception should be introduced: HKCA is bound by its previous decisions unless it concludes, after an examination of legal developments, including subsequent comparative jurisprudence, that its earlier decision should now be regarded as plainly wrong.³³

²⁶ *Ng Yuen Shiu v Attorney General* [1981] HKLR 352

²⁷ *Davis v Johnson* [1979] AC 264

²⁸ *Cheung Lai Wah v The Director of Immigration* [1998] HKLRD 772 at 779 H-I, 782J-783C and 787B

²⁹ Paragraph 41

³⁰ Paragraph 31

³¹ Paragraphs 32 to 38

³² Paragraph 42

³³ Paragraph 52

4.2 Summary

At present, HK courts are bound by:

- a. HK decisions from CFA, HKCA and CFI, as well as
- b. PC decisions on appeal from HK before 1st July 1997.

Decisions from all other common law jurisdictions are persuasive. However, those from HL and PC (non-HK appeals) would be treated with great respect. In practice, they are usually followed by HK courts.

Previously, HKCA is bound to follow its own decisions. Now, HKCA can depart from this rule if a previous HKCA decision was ‘plainly wrong’.

Strictly speaking, FACV 24 did not contain anything new. The binding effects of PC and HL have been understood by the HK legal community for decades. Nevertheless this case was the first occasion after 1st July 1997 for CFA to re-affirm such a fundamental rule. It also clarified previous misconceptions on non-HK PC decisions. Therefore the case could be regarded as a reiteration of HK courts functioning in an independent legal system.

4.3 Other Significances of This Case

FACV 24 was significant in other aspects: First, it clarified that in disciplinary proceedings, the civil standard will be adopted.³⁴ The court emphasised that the same standard applies to different professions and vocations.³⁵ Second, it extended the final

³⁴ Paragraph 116

³⁵ Paragraph 60

appeal on disciplinary proceedings to CFA. Originally, appeal went only as far as HKCA.³⁶ It was held to be unconstitutional to deny the accused of the right to appeal to the highest court in HK. The Legal Practitioners Ordinance was amended as a result of this decision. Third, it reviewed the tough stance adopted by the Law Society of HK in combating solicitors' professional misconduct. In this case, a HK solicitor posed semi-nude on the covers of several gossip magazines. He was charged by the Law Society for not conducting himself properly, in a manner likely to bring the profession into disrepute. It is not an offence in HK for an ordinary citizen to repeat this solicitor's conduct, but the HK Law Society would not tolerate such action taken by a solicitor.

5.0 Anomalies in the HK Company Law

FACV 24 removed a major uncertainty on the issue of judicial precedents in HK. It benefits all areas in the law, including company law. The year 2008 is significant in the development of HK company law in another aspect. Since 2006, the HK Government commenced an ambitious project to completely revamp the HK Companies Ordinance. The Company Ordinance Re-write Group was formed. Nearly 100 company law experts from the Government, academia and practitioners were invited to join. There were four sub-groups. The lead author belonged to one. Up till the summer of 2008, more than ten meetings were held in each sub-group. The public was also invited to offer views.

This part is not a discussion on the work of the Re-write Group because the finalised version of the amended Companies Ordinance is far from ready. Instead, it will focus on several problem areas which have existed for a long time. Many positive changes were

³⁶ Section 13, Legal Practitioners Ordinance, Chapter 159, Laws of HK

introduced into the HK Companies Ordinance over the years. Yet, the amendments did not always adopt a practical approach. The statute contains ambiguous sections which are quite confusing to the laymen. The close connection between HK and Mainland PRC is another trouble area, because an ordinary businessman may not readily appreciate some fundamental differences between the company law in HK and Mainland China. It is submitted that the HK Companies Ordinance should clarify this issue from a HK point of view. This has not been done. Three problems have been identified.

- i. the legal representative,
- ii. the ultra vires rule, and
- iii. the duty of care of directors

5.1 The Legal Representative

It is a fundamental rule in companies incorporated in common law jurisdictions that there is not one single person who can represent his company, unless he is specifically authorised to do so. HK company law adopts the same rule. There is no section in the Companies Ordinance which talks about the legal representative. To those well versed in the law, this rule is well known. Yet, this accounts for only a small number of local directors. Various studies³⁷ show that HK company directors are not familiar with the law. This includes the lack of appreciation of the absence of the legal representative.

³⁷ See, for example, Majid A., Low C.K. and Arunjan K., "Company Directors' Perceptions of Their Responsibilities and Duties: A Hong Kong Survey" [1998] 1 *Hong Kong Law Journal* pp. 60-89; Lau and Young, "Corporate Governance in Hong Kong -The State of Affairs" *Compliance and Regulatory Journal* 2006/2007 Issue 1, pp. 49-59; Ho, Lau, Wong and Wu, *Handbook for SMEs*, HK Baptist University, 2005

There has been a growing economic relationship between Mainland PRC and HK. Today it is fair to say that most business persons in HK would have some PRC connection. The PRC operates a civil law system. Their limited companies have a legal representative³⁸ who can indeed represent his company by himself without authorisation from his company.³⁹ A HK layman may be confused into thinking that a HK company also has a legal representative, because its PRC counterpart has one. It is submitted that the HK Companies Ordinance should clarify this issue by specifically providing that no one can present a HK company unless a person is authorised to do so. This suggestion has so far not been adopted. The lead author is a member of the Training Committee of the HK Institute of Directors (HKIoD). Local company directors are required to take Continuous Professional Development courses offered by HKIoD to refresh their professional and technical knowledge. Whenever the lead author mentions the lack of legal representative in HK companies, this statement never fails to surprise even seasoned HK executives and professionals.

Perhaps HK entrepreneurs are influenced by Chinese traditional values where the head of the business (especially in small family businesses) is the representative of the company since the decision making structure is patriarchal. This cultural facet is an established part of Chinese business management structure, which is well researched in business literature but hardly noticed in the regulatory and legal literature.

³⁸ Article 13, PRC Company Law

³⁹ Article 38, PRC General Principles of Civil Law

5.2 The Ultra Vires Rule

On 10th February 1997, the HK Companies Ordinance abolished the ultra vires rule.⁴⁰

Many people have since been misled into believing that the abolition applies in every circumstance. This is not the case. The abolition is brought about in three sections of the Ordinance. First, object clauses in HK companies are now optional.⁴¹ Next, a company's activity outside its object clauses is still valid.⁴² Third, the exact wording on the section which abolishes the ultra vires rule reads, "*A person shall not be taken to have notice of any matter merely because of its being disclosed in the memorandum or articles kept by the Registrar or a return or resolution registered with him.*"⁴³ With respect, many people may not understand its meaning. The section says that the ultra vires rule is abolished with respect to three types of documents lodged at the HK Companies Registry: memorandum and articles, return or resolution. It does not cover every type of documents lodged there. There is a well known example not covered by this section.

Whenever a company creates a charge, a notice (Form M) must be lodged at the Registry within five weeks of creation in order to secure priority against other creditors.⁴⁴ Since this notice does not fall within the three types of documents covered by the section, ultra vires is not abolished with respect to it. In other words, once lodged at the Registry, the doctrine of constructive notice would apply and deem everyone to be aware of the lodgment. It is submitted that the language of the section is confusing to most people.

However, no effort has been made to amend its wording.

⁴⁰ By virtue of the Companies (Amendment) Ordinance 1997

⁴¹ Section 5A, Companies Ordinance

⁴² Section 5B, Companies Ordinance

⁴³ Section 5C, Companies Ordinance

⁴⁴ Section 80, Companies Ordinance

Again, the cultural factor may explain the difficulty in the doctrine of ultra vires for the local HK business community because it is an imported legal principle. This alien legal restriction often causes confusion for HK businessmen in their dealings.⁴⁵ From a traditional Confucian mindset the concept of ultra vires does not exist. The closest parable from a Chinese cultural perspective is: an act not sanctioned by the head of the company is morally wrong and would bring shame to the company. To the Chinese, ‘face’ or ‘*mianzi*’ is central in business dealings as trustworthiness and reputation are far more important than legal obligations

5.3 Duty of Care of Directors

The HK law on this area is still governed by the 80 year-old case of *Re City Equitable Fire Insurance*⁴⁶. For example, the 2001 HK case of *Law Wai Duen v Bolwin Construction Co Ltd*⁴⁷ still made use of the standard spelt out in the *Re City case*.

However, in the UK Companies Act 2006, the duty has been codified.⁴⁸ Despite the fact that the HK Companies Ordinance was adopted from the UK Companies Act of 1929 and 1948, no effort was made to follow suit. The location of director’s duties in case law is unsatisfactory for several reasons:

To the laymen, they are not used to looking up case law. In fact, most people do not know where to find it. If they cannot find the relevant law in the Companies Ordinance,

⁴⁵ See *European Asian Bank v Reicar Investment Ltd* [1988] 1 HKLR 45

⁴⁶ [1925] Ch 470

⁴⁷ [2001] 2 HKC 403

⁴⁸ Section 174

they might assume that such duties are not regulated by the law. Further, a subjective standard is difficult to measure accurately. It was high time something was done about this problem.

The duty of care is another Western legal principle imported into HK. More specifically, the test of standard of care is unheard of in Chinese legal and business cultures. Instead, traditional Confucian doctrines see duty as a moral obligation, where the standard varies according to the hierarchical status of persons. These are divided into three categories: between king and subject; father and son; and husband and wife. It is also high time to consider the extension of Chinese customary laws into areas like director's duties of family businesses managed and governed according to traditional Chinese family values. Besides, these traditional Chinese values are not unique to HK, much of which them can also be found in PRC's family owned and operated companies. Since cross border business dealings and economic integration between HK and PRC have been intensifying, the issue of Chinese cultural business practices and legal doctrines will become increasingly relevant to Chinese corporate governance and laws.

Conclusion

FACV 24 cleared up a major issue in the HK legal system. But in the realms of company law, HK still needs a functional statute to make the law operate smoothly both for the lawyers and the laymen. A statute must be drafted in such a way that even non-lawyers can understand its contents without resorting to legal advice just on its wording.

Otherwise the economy would not benefit from the full protection of the law because it is

incomprehensible. It is submitted that in future Re-Write Groups, laymen should also be invited to join and give opinions from the other side of the fence.

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