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HONG KONG INTERNET NEWSLETTER- MAY 2017

Issue 30

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1. **Latest Hong Kong Law Developments:**

1.1 **Beneficial Ownership of HK Companies**: The Financial Services and the Treasury Bureau recently issued a paper for public consultation on its proposal to introduce a regime under the Companies Ordinance (Cap 622) which will require Hong Kong incorporated companies to keep a register of people having significant control over the company. The purpose of the is to allow law enforcement officers to combat money laundering and terrorist financing and to pierce the veil of ownership which is often obscured so that beneficial owners can distance themselves from the activities of the Company;

1.1.1 In 2018 as a member of the FATF, Hong Kong will undergo a mutual evaluation conducted by other member jurisdictions regarding its efforts to combat money laundering and terrorist financing and the HK Government sees a need to implement a regime on the transparency of beneficial ownership of companies. Currently the Companies Ordinance does not require in an annual return for the Company to identify the beneficial owner or owners of the Company;

1.1.2 The requirement to keep beneficial ownership information will apply to all companies incorporated in Hong Kong under the Companies Ordinance, including companies limited by shares, companies limited by guarantee, and unlimited companies. It will not apply to listed companies, as they are governed by the Securities and Futures Ordinance, which already requires every listed corporation to keep a register of those individuals or entities owning 5% or more interests in any class of voting shares (including any beneficial owner of such interests);

1.1.3 A "*Beneficial owner*" in relation to a company is to be defined as an individual who meets one or more of the following conditions:-

(a) directly or indirectly holding more than 25% of the shares;

(b) directly or indirectly holding more than 25% of the voting rights;

(c) directly or indirectly holding the right to appoint or remove a majority of directors;

(d) otherwise having the right to exercise, or actually exercising, significant influence or control; or

(e) having the right to exercise, or actually exercising, significant influence or control over the activities of a trust or a firm that is not a legal person, but whose trustees or members satisfy any of the first four conditions (in their capacity as such) in relation to the company, or would do so if they were individuals.

1.1.4 A company will be required to identify and keep a PSC Register, a person with significant control, being an individual who qualifies as a "*beneficial owner*" under one of the requirements in (a) to (e) above. A chain of ownership and control through another company will also have to be identified;

1.1.5 A company will be required to enter into the PSC Register details of an authorised person responsible for providing information and further assistance to law enforcement agencies. An option being considered is allowing companies to either authorise a natural person resident in Hong Kong, or a locally-based designated non-financial business and professional (such as accountants, solicitors, trust or company service provider) as the authorised person.

1.1.6 The PSC Register will be available for inspection (by any member of the company or person on the register without charge or by other members of the public on payment of a fee) at the company's registered office or any other place in Hong Kong as determined by the company;

1.1.7 A company and its responsible officers will be liable to a maximum penalty of a fine at level 4 (i.e. $25,000) and further daily fine of $700 for failing to keep a PSC Register and will be liable to a maximum penalty of a fine at level 4 (i.e. $25,000) for failing to make available company records for public inspection. Any person who knowingly or recklessly makes in the PSC register a statement which is misleading, false or deceptive in any material particular, may commit an offence under section 895 of the Companies Ordinance and be liable on conviction on indictment to a fine of $300,000 and to imprisonment for two years; or on summary conviction to a fine at level 6 (i.e. maximum of $100,000) and imprisonment for six months. A statutory obligation is to be placed on a notice addressee whom the company knows or has reasonable cause to believe to be a registrable individual or registrable legal entity knows the identity of someone who is a registrable individual or registrable legal entity in relation to the company or knows the identity of someone likely to have that knowledge, to comply with a notice to ascertain and confirm the relevant required particulars or relevant changes. Non-compliance is subject to a maximum penalty of a fine at level 4 (i.e. $25,000).

1.1.8 The FSTB is aiming to introduce a bill into the Legislative Council in the second quarter of 2017;

1.1.9 **Comment:** HK is not alone in having or considering a record of beneficial ownership for Companies. The UK and Singapore have such laws. It is a logical extension of common reporting standards (CRS). Australia and New

Zealand have no requirements for a register of beneficial owners but such is the hysteria over CRS and the pressure from FATF a register is a possibility in those countries. If the legislation is passed in its current form it will represent a major change for Hong Kong and in our view will have some impact on the attractiveness of Hong Kong as a business center, which has always allowed the use of nominees and protected the confidentiality of ownership of HK Companies. Any AML enquiry would require identification of a beneficial owner and that might be enough without the need for a new regime. Interestingly enough, the proposed legislation does not seem to apply to a limited partnership(or members of it) which may hold a business or assets in the same way as a company and of course it does not apply to individuals who may hold assets direct. Until the legislation is passed it is too early to comment on its scope or future ways to structure ownership.

1.2 Customer Due Diligence and Recordkeeping Obligations for Solicitors, Accountants, Real Estate Agents and Trust and Company Service Providers.

1.2.1 A proposed amendment to the Anti Money Laundering Ordinance (AMLO)would extend customer due diligence ("CDD") recordkeeping requirements to:

- **Solicitors and accountants,** when preparing for or carrying out transactions for clients concerning
    1. the buying or selling of real estate;
    2. managing of client money, securities or other assets;
    3. management of bank, savings or securities accounts;
    4. organization of contributions for the creation, operation or management of companies;

5. creation, operation or management of legal persons or arrangements; or
6. buying or selling of business entities;

- **Real estate agents,** when engaged in transactions concerning the buying and selling of real estate; and
- **Trust or Company Service Providers ("TCSPs"),** when preparing for or carrying out transactions for clients concerning
    1. the forming of companies or other legal persons;
    2. acting, or arranging for another person to act, as a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
    3. providing a registered office, business address, correspondence or administrative address or other related services for a company, a partnership or any other legal person or arrangement; or
    4. acting, or arranging for another person to act, as a trustee of an express trust or similar legal arrangement, or a nominee shareholder for a person other than a company whose securities are listed on a regulated market.

1.2.2 Under the above proposals the current rules governing financial institutions would be extended to such professionals who would be required to undertake customer due diligence measures when establishing business relationships with new customers, when carrying out transactions above HK$120,000 with customers with whom they do not already have a business relationship, where there are suspicions of money laundering and/or terrorist financing and when there are doubts about the veracity or adequacy of previously obtained customer identification data.

In the first two situations, these professionals would be allowed to apply simplified CDD measures but enhanced CDD requirements would be required when dealing with higher-risk situations, such as when a customer is a politically exposed person or is not physically present for identification purposes. Enhanced CDD requirements would include obtaining management approval for establishing or continuing the business relationship, and taking additional measures to mitigate the AML/CFT risk, such as enquiring with customers about their source of funds.

The proposed amendments would also codify additional recordkeeping rules, including requirements to maintain customer identification data collected, account files, business correspondence, and records of transactions with respect to each customer for a period of six years.

These proposed requirements would be implemented through the existing professional regulatory bodies for solicitors, accountants and estate agents.

1.2.3 TCSPs however would be required to apply for a license from the Registrar of Companies before they provide trust or company services as a business to the public; it will be a criminal offense to operate a TCSP business without a license.

1.2.4 The FATF has for some time recommended that financial institutions implement CDD measures to identify and verify customers and to date Hong Kong has implemented such recommendations through the AMLO. However, the FATF also recommends that such requirements be applied to "designated non-financial businesses and professions," or "DNFBPs," to prevent money-laundering and terrorist financing risks. DNFBPs include casinos, dealers in precious metals and stones, real estate agents, lawyers, notaries, accountants, and TSCPs.

1.2.5 **Comments:** If CDD measures contemplated are introduced it will mean very comprehensive changes in business practice by some business's accustomed to dealing with cash customers and we see considerable difficulties in enforcement and compliance. Combined with CSR, a beneficial ownership register for HK Companies it seems like " overkill " to us. Of most concern is the proposal to require " licencing" of TSCPs who may provide trust services. It is not clear who this would cover (private or offshore trust companies ?) and what criteria would be adopted to qualify. Onerous requirements will not be beneficial to the HK Trust industry. In addition, if all companies who provide company and secretarial services need to be licensed it will not assist HK as a business center and raise business expenses if licensing fees imposed by the HK Government are substantial.

2. **CRS in Hong Kong:** We referred to CRS in an earlier Newsletter. It refers to exchanges of information over bank and other accounts held by non- residents in Hong Kong. The Hong Kong Government has recently introduced draft legislation that adds 72 jurisdictions (in addition to UK and Japan already added plus Mainland China) to Hong Kong's list of reportable jurisdictions. The draft legislation proposes that Hong Kong financial institutions such as banks will be required to report to the Inland Revenue Department ('IRD') by May 2018 the information collected from 1 July 2017 to 31 December 2017 in respect of accounts held by tax residents of those 72 jurisdictions. This information will be kept by the IRD and exchanged with the IRD in the relevant jurisdiction after an AEOI agreement has been concluded with that jurisdiction.

2.1 **Comment:** Even for those clients who are fully tax compliant and who own or control companies or trusts based in Hong Kong with accounts at a Financial Entity or other entity covered by CRS legislation, the CRS obligations are unwelcome. Apart from being an invasion of privacy, reporting to the IRD in their home jurisdiction may well give opportunities for the IRD to open up a tax investigation despite the fact that all tax obligations have been complied with. A key issue is the completion of the self -certification form that all banks in Hong Kong will send in 2018 to those who are signatories on a bank account. With trusts (as will be noted later in this Newsletter) the self -certification form poses difficulties in that settlors, protectors and beneficiaries of Trust who are not resident in Hong Kong will all need to be reported to the HK IRD who in turn will report to the IRD where the settlor, protector or beneficiaries reside. Those effected would be wise to examine their obligations under CRS prior to 1/7/17 to see if any changes to the structure of companies, trusts or bank accounts are warranted or possible.

3. Trusts- are they still viable in light of obligations under CRS ?

3.1 CRS imposes complex disclosure requirements on Trustees of private trusts and the banks where trusts have bank accounts. The FATF in its wisdom chose to adopt some aspects of FATCA and there are a number of criteria in the CSS legislation in HK and other jurisdictions that may class a Trust as Financial Institution like a bank. If as a result of this criteria the trust is not classed as a Financial Institution then it will be classified as a Non-Financial Entity, and in turn further classified either as an Active Non-Financial Entity or Passive Non-Financial Entity. Most private client trusts, if they are not Financial Institutions will be Passive Non-Financial Entities. The result will be that their obligations under CRS will be confined to disclosing their identity and the identity of their 'Controlling Persons' (which is to be interpreted in accordance with the FAFT Recommendations relevant to AML/ KYC procedures) to Financial Institutions (eg banks or investment managers) with which they have accounts;

3.2 The usual process will be that a bank with whom the Trust has a bank account will send a self -certification form to the Trustee or the signatory on the account and the Trustee will, in strict legal terms, be under an obligation to conduct Due Diligence on its " Financial Accounts" which includes equity or debt interests. Under CRS legislation any Settlor or Protector exercising control over a Trust are deemed to have an equity interest whether or not they may do so under normal trust law;

3.3 In essence, the Trustee will need to complete the CRS form from the bank and name the Settlor, Protector and beneficiaries resident in a country outside where the bank is situated and also gives details of IRD numbers to that the HK IRD can report that information to the IRD in the country where the controlling persons are domiciled;

3.4 Other complex considerations arise under CRS in relation to Trusts and we do wish to comment in detail here. However, one important consideration is possible civil liability of banks or trustees to their clients and the potential for reputational damage in respect of incorrect reporting and this will be a serious consideration. Private clients and their advisers would be wise to undertake careful due diligence on their service providers to ensure that they have the capability to properly and accurately to implement the CRS. A Trustee would be unwise to complete and lodge a bank CRS self - certification form without direct instructions from the Settlor.

3.5 **Comment:** The increased disclosure requirement for private trusts may well cause potential settlors who wish to form trusts outside their home jurisdiction or settlors who have existing trusts to consider not forming them or winding them up before reporting obligations arise. Apart from the obvious issue that a

settlor, protector or beneficiary may not be totally tax compliant in their home jurisdiction other issues that are of concern are as follows:

(a) Settlors who form trusts domestically have total confidentiality but under CRS the names of beneficiaries and any distributions from a trust outside the home jurisdiction have to be revealed. Many settlors and beneficiaries see this a gross invasion of privacy;

(b) There seems little reason to deem a Protector to have a controlling interest in a Trust when in fact Protector powers are in the nature of a veto right only. Reporting of a Protector seems draconian;

(c) Loans made by a Settlor to the Trust are reportable and deemed an equity interest;

(d) Reporting obligations arise although no distributions have been made by a Trust and arise annually;

(e) Additional costs may arise for the Trust and the Settlor in forming or running a Trust under CRS;

(f) Trust jurisdictions such as New Zealand (named in the Panama Papers as the most popular Trust jurisdiction) have coupled new disclosure obligations in relation to foreign settlor trusts with Trustee obligations over CRS;

(g) It has become very difficult for a Trust to open a bank account as the banks have an irrational fear that the settlor may be involved in money laundering or tax evasion.

Comments: A review of the Trust and the Trust structure is recommended before CRS reporting obligations arise. We recommend consideration be given to the following:

(i) A reduction in the number of discretionary beneficiaries so that disclosures are limited;
(ii) Substituting by way of a Deed of Variation of Trust a very general and unnamed class of beneficiaries such as " the blood relations of the settlor or other family member;
(iii) Replacement of a Protector in a participating jurisdiction with one in the same jurisdiction as the Trust bank account or in a jurisdiction such as Thailand or Vietnam;
(iv) Cancellation of loans from the Settlor to the Trust;

(v) If legally feasible, Re- settlement of an existing Trust's assets on a new trust where the settlor and beneficiaries are in the same jurisdiction.

4. The New Zealand Financial Services Provider Company- too good to be true ?

4.1 Service providers in New Zealand for some time have promoted formation of a NZ incorporated company registered as a provider of financial services (FSP) as a suitable vehicle to offer international financial advice and such other services as currency dealing, securities advice and trading through licensed stock dealers, credit card services, passing on information on unit trusts etc;

4.2 The attraction is that New Zealand and its regulator the Financial Markets Authority (FMA) do not impose licensing requirements such as required for financial advisers under Hong Kong's Security Ordinance and simple registration on the NZ Companies office FSP Register plus appointment of a disputes resolution company is sufficient to set up an FSP. This has meant that a great many overseas companies have set up FSP's in NZ given that they can then advertise their services outside New Zealand and can claim to banks, customers etc that they are registered and regulated in a respectable and safe jurisdiction. Many companies wish to offer financial services or to be seen as registered and licensed and to many offshore companies the FSP regime in NZ has been very attractive. Costs to set up a FSP are cheap and a fraction of the cost necessary in Hong Kong or other jurisdictions. And if no financial advice or financial services are carried out in NZ compliance with local financial adviser's legislation and other regulations may be avoided;

4.3 There does need to be an office presence in NZ but local service providers are available to provide a local director, office address and services that may be required to comply with the FMA requirements.

4.4 The problem that has emerged with many FSP companies owned and run by offshore owners outside NZ is that some had no office in NZ at all or those that did marketed themselves as regulated in NZ but conducted all business offshore with no business in NZ. In response to concerns about "flag of convenience" companies registering in New Zealand, with implied regulatory oversight, the FMA was given new powers in 2014 to deregister a foreign FSP where registration was likely to create a misleading impression of the extent to which the FSP was subject to New Zealand financial regulation. In a recent case taken by the FMA against a foreign FSP, Vivier, the FMA directed last year that Vivier be de-registered because it became concerned that Vivier was not providing any financial services in or from New Zealand, and that its FSP registration might therefore mislead consumers, or damage the reputation of New Zealand's financial markets.

The Court of Appeal stated that what is far more material than incorporation or possession of a place of business in New Zealand, is whether the FSP **is providing financial services in or from New Zealand**, and whether it is generating any associated financial activity in New Zealand. If the FSP is not doing so, or cannot demonstrate any intention of doing so, then it will be difficult for it to maintain its registration as an FSP;

4.5 **Comment:** Clearly promotion of a NZ FSP without having a NZ office and providing some financial services from the NZ office will not be acceptable to the FMA and earlier promotions failed to make this clear. However, if a NZ office is set up with a service provider, some services are made available from NZ office and there are no misleading statements made about the FSP operations either in NZ or elsewhere a NZ FSP may be a suitable option in some circumstances and far cheaper than trying to comply with licensing requirements in some jurisdictions. We have advised clients from China on the establishment and documentation for FSP's in NZ and have dealt with service providers who may run an office for an FSP in NZ. Costs to form and set up an FSP may be as low as US$5000.00.

5. Hong Kong Employment Law- a brief summary of recent developments and points to note.

5.1 **Stock Option Plans: Employment.** Employees claiming that they are entitled to compensation for loss of rights under a Stock Options Plan where a Plan might be amended or discontinued or where their employment is terminated. There are HK laws which prohibit discrimination, and/or less favorable treatment of, employees on certain grounds including gender, disability and part-time status. Companies should be careful when determining the eligibility of employees to participate in a Plan;

5.2 **Offset of Severance Pay (SP) on redundancy and Long Service Pay (LSP) against MPH benefits:** In most countries employee pension funds are highly protected from reduction or interference but that has not been the position in Hong Kong. In certain circumstances on termination, an employee may be entitled to a statutory SP on redundancy, or LSP on dismissal with more than 5 years' service, in accordance with the Employment Ordinance (EO). Under the EO employers have had the right to offset the SP/LSP against the accrued MPF benefits that come from the employer's contributions to the employee's fund. The HK Government in response to pressure has proposed changes. The employee groups have got proposals that the right to offset will gradually be abolished. It will however only take full effect over time. On the other hand, SP and LSP will be reduced. The exact details are as follows:

(a) the abolition of the right to reduce SP and LSP will have no retrospective effect. This means the employers' MPF contributions before the implementation date of the proposal will be "grandfathered" and available to reduce SP and LSP;

(b) the formula for calculating SP and LSP will be amended so that the payments are reduced from the implementation date. Currently the employee is entitled to two-thirds of one month's wages for each year of service up to a capped amount; this will go down to one half a month's wages; and

(c) there will be a rebate scheme from the Government over a 10 year period as a transitional arrangement in order to help employers and share part of the expenses.

Comments: If the change does not have retrospective effect for all previous MPF contributions, there is an obvious concern that some employers will dismiss employees before the implementation date of the new amended legislation in order to ensure that the full offset is available to them. However, proposals may change after informed debate.

5.3 **Dismissal of Employee on the ground of Unlawful Discrimination:** Terminating the employment of a sick and/or pregnant employee is dangerous given the prohibitions on termination and the anti -discrimination ordinances. A recent case shows that the risks associated with unlawful termination can be reduced with careful planning. P was scheduled to return from maternity and annual leave on 9 August 2010, but she took sick leave between 12 and 20 August 2010. On 23 August 2010, on the day P returned to work after her sick leave, D terminated P's employment. P claimed that the issuance and implementation of the Leave Guidelines and the termination of her employment were unlawful discrimination because they were done on the grounds of her disability, sex and family status, in contravention of the Disability Discrimination Ordinance, Sex Discrimination

Ordinance and Family Status Discrimination Ordinance. The Court dismissed P's claim as the Leave Guidelines did not amount to unlawful discrimination. The Court held that the Leave Guidelines were aimed at malingering, not disability, and was applicable to all employees (not just P). It introduced a scheme in compliance with the provisions of the Employment Ordinance and the Court held it cannot reasonably be argued that an employer would commit an act of discrimination by following the law. The procedural requirements under the Leave Guidelines (i.e., how to report sick leave and the need to provide a sick leave certificate) were held to be reasonable and fair. Other claims of less favourable treatment were dismissed on the facts.

Comments: Obviously an Employer must have proper and legitimate reasons for terminating an employee under a discrimination ordinance in Hong Kong but it assists to have a clear record and paper trail to show what had been discussed and to counter any false assertions by an employee.

6. Enforcement of Judgement against a PRC company

6.1 Anyone having business dealings direct with a PRC company (that is a company registered in China, not a PRC company trading through a subsidiary in HK) faces huge risks if the PRC company defaults and it is necessary to enforce a court judgement obtained in court outside China. A judgement or arbitration award in a HK court is enforcable in the PRC under mutual arrangements made between HK and the PRC but our focus is on judgements in non -HK courts, say in the USA. China has refused to recognise foreign judgments unless there is a convention or treaty obligation or "reciprocity" practice. Needless to say, unless the PRC company has assets in a jurisdiction where the judgement can be enforced the judgement may be useless;

6.2 However, in December 2016, the Nanjing Intermediate People's Court recognised and enforced a judgment rendered by the High Court of Singapore based on the principle of reciprocity. A Swiss company had a dispute over a sales agreement with a Nanjing based textile company. The dispute was resolved by parties entering into a settlement agreement. The settlement agreement provided for all disputes to be submitted to the High Court of Singapore. The Nanjing based company failed to comply with the terms of settlement agreement. Subsequently the Swiss company commenced proceedings in the High Court of Singapore. A decision was reached by the High Court of Singapore in October 2015 against the Nanjing based company. The Swiss company applied to the Chinese Court to recognise and enforce the Singapore judgment even though there is no treaty or bilateral agreement which allows for the mutual recognition and enforcement of each other's judgments;

6.3 In a rare and ground breaking decision, the Court held that in the absence of a treaty on the recognition and enforcement of judgments, it could apply the principle of reciprocity in this matter on the basis that the Singapore Court had previously in 2014 enforced a judgment issued by the Jiangsu Suzhou Intermediate People's Court in *Giant Light Metal Technology (Kunshan) Co Ltd v Aksa Far East Pte Ltd.*[4].

Comments: Although the decision by the PRC court is to be welcomed, those clients outside HK dealing with a PRC company on major matters such as a distribution agreement, joint venture, IP licensing agreement would be well advised to exercise caution and consider the following issues:

(a) arbitration may still be the preferred choice in commercial contracts since it would be much easier enforcing an arbitral award under the New York Convention which China has ratified;

(b) Countries that do not have bilateral treaties or arrangements with China, are not members of an international convention which allows for the recognition and enforcement of foreign judgments, do not practice the principle of reciprocity and have not had the opportunity of enforcing a Chinese judgment may never have their judgments recognised and enforced in China;

(c) A company say in the USA entering into a substantial commercial contract with a PRC company would be wise to contract with a HK subsidiary of the PRC company and select HK law to apply to court actions and/or mediation or arbitration if access to the assets of the PRC company is required. However, USA law might be chosen if arbitration is agreed to resolve disputes and the New York convention applies;

(d) It is obvious that careful thought needs to be given the way a deal with a PRC company is structured and the choice of law and/or arbitration method adopted.

7. BANK ACCOUNTS- the difficulties of opening accounts in HK and some suggestions;

7.1 Many clients from Australia, UK, NZ and other countries have found it almost impossible to open a bank account in HK in recent times notwithstanding having legitimate business operations and passing all AML guidelines. Banks such as HSBC, stung by large fines in the USA and pressured by CRS issue and the FAFT, have withdrawn from the market and indeed also closed existing accounts and advised some customers to go elsewhere with no reasons given. Trying to open an account for a BVI or other offshore company is an almost impossible exercise unless a substantial existing customer;

7.2 Some clients, driven by fears of CRS disclosures , have tried to go to the other non- CRS countries, such as Vietnam, Thailand, Taiwan or Sri Lanka, but there are considerable legal barriers to say a HK company opening an account in those countries and it is expensive;

7.3 As mentioned above, a Trustee of a Trust may have considerable difficulties in opening a bank account. HSBC and Barclays in the UK refuse to do so even with the Trustee being resident there.

7.4 **Comments:** There is no excuse for banks not to open an account if the client meets AML guidelines but unfortunately the banks are paranoid about who they are dealing with and in most cases cannot be persuaded unless the business is very substantial and the customer has a HK ID card. Opening of a personal account in some instances might be easier than a corporate account and in the case of a Trust the Trustee may have to open a personal account and

use that for Trust business if the mandate does not refer to a trust. One other option might be to approach Kiwibank in NZ. They appear willing to open a bank account for any offshore company provided the company registers as a foreign company in the NZ Companies Register and if a NZ based director is appointed. No initial attendance in NZ by a signatory on the bank account appears to be required and no initial AML due diligence which they tell us will come later. Under NZ law registration as a foreign company is a simple and inexpensive process and the overseas company is not taxed in NZ if it has no business operations there. We are able to assist clients who wish to explore this option.

8. SHAREHOLDER AGREEMENTS- Do you Trust your Co- Directors and Shareholders ?- the importance of imposing fiduciary duties on Directors and Shareholders;

8.1 In past Newsletters we have stressed the need for a written shareholders agreement (SA) entered into between shareholders of a company and/or articles of association that cover essential matters such as management, voting rights at meetings, share sales and break ups, disputes, restraint of trade and who owns intellectual property rights;

8.2 A vital issue in an SA is whether, in addition to contractual rights, shareholder and directors owe each other fiduciary duties. Or if there is no SA, whether fiduciary duties apply;

8.3 Breach of fiduciary duties may offer greater compensation than simple contractual losses and a defaulter loses all profits he has made, must pay compensation for personal losses and must disgorge property taken. Exemplary damages may be awarded;

8.4 A typical fiduciary duty is that owed by a director to a company of which he is a director, but what is the scope of his duties to a joint venture partners if he takes actions not in the interests of the joint venture ?

8.5 To take an example, Director A is part of a joint venture with no written SA and is sole director of a subsidiary company of the JV holding company or for some reason decides to set up a new subsidiary company without the consent of the main board of the JV holding company. He says what he has done is in the interests of the JV but it is not and it is discovered later that Director A has causes losses and taken excessive salary from the subsidiary. Director A is also found to be carrying on business in competition with the JV parent company. If this sounds unlikely we know of cases where it has happened. Director A say he owes no fiduciary duties to the other directors, the shareholders or the JV and has no contractual obligations. In the absence of a written SA or duties owned to co- directors and shareholders sheeting home

liability against Director A would be difficult and was so in the example quoted;

8.6 In a HK case of Poon Ka Jason & Others V Cheng Wai Tai & Others the Court of Final Appeal found a Director who had set up a company to compete with a JV company (and with no written SA) was in breach of his fiduciary duties as a co- director to the JV company and the JV company may be able to recover damages. However in the absence of a written SA that imposes fiduciary duties between co- directors and shareholders losses suffered by the JV and personal losses may be limited.

8.7 **Comments:** The courts have been reluctant to impose fiduciary duties inter-se between directors and shareholders and we have always believed there needs to be a written JV that imposes such obligations. A typical clause to be included in a written SA would be as follows:

1. Fiduciary Duties between Directors and Shareholders:

1.1 The directors and shareholders acknowledge that they have an expectation that each of them will act in the interests of the joint venture and have trust and confidence in each other. Accordingly they shall owe a joint and several fiduciary duty of care to each other to:

(a) observe and perform the terms and conditions of this Agreement;
(b) act professionally and observe all normal, prudent and proper business practices appropriate to the running of the Business;
(c) comply with all laws and regulations;
(d) properly manage and control all subsidiaries of the Company in the interests of the parent company;
(e) be personally liable in proportion to their shareholdings for all losses of the Company and have personal liability for all losses of Co-Directors and Co-Shareholders caused by a breach of any fiduciary duty

2. Duties on Director after Dismissal:

2.1 If a Director is dismissed or resigns he shall not solicit or deal with any customers of the Company without written permission of the Board pending agreement on arrangements covering his dismissal or the coming into effect of any restraint of trade provisions in this Agreement.

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