



Newsletter No. 182 (EN)

**Minority shareholders' rights
in Hong Kong**

July 2016

Although Lorenz & Partners always pays great attention on updating information provided in newsletters and brochures we cannot take responsibility for the completeness, correctness or quality of the information provided. None of the information contained in this newsletter is meant to replace a personal consultation with a qualified lawyer. Liability claims regarding damage caused by the use or disuse of any information provided, including any kind of information which is incomplete or incorrect, will therefore be rejected, if not generated deliberately or grossly negligent.

I. Introduction

The protection of minority shareholders of a company is ensured by certain safeguards provided by the Hong Kong Companies Ordinance (“CO”) and the Hong Kong Companies (Winding up and Miscellaneous Provisions) Ordinance (“CWuMPO”).

II. Special Resolution

Rather than a simple majority vote, a special resolution, i.e. a resolution that is passed by a majority of at least 75% of the shareholders who attend and vote (in person or by proxy) (section 564(1) CO), is required for important matters such as:

- alteration of the Articles of Association except an alteration of the Articles to the maximum number of shares that the company may issue (sections 88(2)(3) CO);
- alteration of objectives of the company (section 89(2) CO);
- alteration of conditions in the memorandum of the company which could have been contained in the articles (section 90(1)(3) CO);
- change of the company’s name (section 107(1) CO);
- re-registration of an unlimited company with limited liability (section 130(1)(a) CO);
- reduction of a company’s share capital (section 215(1) CO);
- an unlisted company buying back its shares (section 244(1)(2) CO);
- release from buy-back contracts (sections 243(1), 251(1) CO);
- pay out of a company’s capital in respect of the redemption or buy-back of shares (section 258(1) CO);
- winding up of the company after a court order (section 177(1)(a) CWuMPO);
- voluntary winding up of the company (section 228(1)(b) CWuMPO);
- to authorise the liquidator to accept shares as consideration for the sale of the company’s property in a voluntary liquidation (Section 237(1) CWuMPO).

For a valid **special resolution** of the shareholders, it is required that the notice and invitation to the meeting includes the text of the resolution and specifies the intention to propose the resolution as a special resolution. A general meeting of a company must be called giving a minimum 21 days’ notice in case of an annual general meeting (**AGM**) and at least 14 days for any other extraordinary general meeting (**EGM**) unless the company’s Articles of Association require a longer notice period.

Unless the Articles of Association of the company provide otherwise, the quorum required for a general meeting (AGM or EGM) is two members present in person or by proxy (Section 585 (3) CO).

Under Common Law, the physical presence of at least two members is required to form a quorum (*Re Sanitary Carbon Co. (1877) WN 233*). However, the Articles of Association of the company may provide that a general meeting may take place via video or telephone conference. The Articles should provide further details about the procedure of such non-physical meeting.

III. Sanction of the Court

An approval of the court is generally required by the Companies Ordinance where the decision of a company directly affects its creditors, such as a reduction of capital (sections 211 (b), 226 ff. CO) or the approval of a scheme of arrangement (section 673 (2) CO).

IV. Cancellation of Resolutions by the Court

In case of

- an alteration to the company's objectives (sections 89(5), 91 CO);
- an alteration to a private company's Articles of Association (sections 90(4)(10), 91 CO);
- a reduction of the company's share capital (section 220(1) CO); or
- a payment for a share redemption or buy-back of shares by the company out of the company's capital (section 263(1) CO),

the dissenting members have the right to apply to the court to have a resolution cancelled, and the court might do so and set aside or amend the resolution as it thinks fit (sections 91(6)(a), 222(1), 265(1) CO).

V. Request and Power to call General Meetings

If members of the company representing at least 5% of the total voting rights request to call a general meeting, the directors have to call a general meeting within 21 days (sections 566(2), 567(1) CO) after having received the request. A meeting called upon the request of members must be held at a date not more than 28 days after the date of the notice convening the meeting has been given (section 567(2) CO). If the directors do not call the meeting in accordance with

section 567 CO, the members who requested the meeting or any members representing more than 50% of the total voting rights may call a general meeting (section 568(1) CO) by themselves.

In the event that the company does not have any directors or if the directors are not capable to form a quorum, any 2 or more shareholders of the company representing at least 10% of the total voting rights of all the members who are entitled to vote at general meetings may call a general meeting themselves (section 569 CO).

VI. Inspection of Records or Documents

On application to the court by members that represent at least 2.5% of the voting rights of all the members who are entitled to vote at the company's general meetings (section 740(6)(a) CO) or at least 5 members of the company (section 740(6)(b) CO), the court may make an order to authorise a person to inspect any record or document of the company if it is satisfied that the application is made in good faith and the inspection is for a proper purpose (section 740(1)(2) CO).

The authorised person is not allowed to disclose the information obtained to a person who is not the applicant without the company's prior written consent (section 741(2) CO), unless stated otherwise by section 741(3) CO (e.g. for the use in criminal proceedings, or any other requirement under the law).

VII. Investigation of the Company's Affairs

On application of members holding at least 10% of the issued shares, the Financial Secretary of Hong Kong or its representative may appoint a person to investigate a company's affairs if the Financial Secretary is satisfied that it is in the public interest to do so (sections 840(1)(2)(4) CO). According to section 840(3) CO, the application must be

supported by evidence that shows that the applicant has good reason for requesting the investigation.

VIII. Right to be bought out

In the event of a successful takeover offer, the minority shareholders who did not accept the offer have the right to be bought out by the purchaser. The reasoning is that the purchaser has acquired or has unconditionally contracted to acquire the majority, but not all of the shares, and the minority shareholders did not accept the offer.

If the takeover offer does not relate to shares of different classes, the right to be bought out requires that, at any time before the end of the offer period, the offeror represents at least 90% of the company's shares (section 700(1) CO).

If the offer relates to shares of different classes, the minority shareholders are entitled if, at any time before the end of the offer period, the shares in the company controlled by the offeror represent at least 90% of the shares of the respective class (section 700(2) CO).

According to section 700(3) CO, the minority shareholders can exercise their rights given to them by section 700(1)(2) CO only within 3 months after the end of the offer period or the date of the notice given to them under section 701 CO, informing him about their right to be bought out, whichever date is later.

A similar provision is made by section 718 CO for the case of a successful buy back. In case the repurchasing company has bought back, or agreed to buy back its shares, the holder of any shares to which the offer relates who has not accepted the offer before the end of that period may require that the company buys back his shares as well.

Like in the event of a successful takeover offer, the rights given to the shareholders by section 718(2)(3) CO can be exercised only within 3 months.

IX. Unfair Prejudice Remedy

On a petition of a member of a company, the court may order remedies if it considers that the affairs of the company are being or have been conducted in a manner that is unfairly prejudicial to the interest of the members in general or of one or more members (section 724(1)(a) CO) or an actual or proposed act or omission of the company is or would be prejudicial (section 724(1)(b) CO). The court may make any order that it thinks fit (section 725(1)(a) CO). For example, the orders mentioned in section 725(2)(a) CO are:

- order restraining the continuance of the conduct;
- appointing a receiver or manager for the company's property or business; or
- an order that obliges the company or any other person to pay any damages plus interest to a member of the company whose interests have been unfairly prejudiced (section 725(2)(b) CO).

The court may even alter the Articles of Association by an order as clarified by section 726 CO. However, the CO does not define what would constitute unfairly prejudicial conduct.

X. Statutory Injunction

In case that a responsible person of the company

- has engaged or is intending to engage in conduct that constituted, constitutes or would constitute a contravention of the Companies Ordinance (section

728(1)(a)(i) CO), or would be a breach of his fiduciary duties (section 728(1)(a)(iii)(4) CO); or

- has refused or is refusing to perform an act that the person is required by the Companies Ordinance to do (section 728(1)(b) CO),

the court may, on application of any member whose interests have been affected by the conduct or by the refusal or failure, grant an injunction (section 729(1)(a) CO), order the person to pay for damages (section 729(1)(b) CO) or declare any contract to be void or voidable (section 729(1)(c) CO).

XI. Derivative Actions

Derivative actions entitle a member to bring proceedings on behalf of the company if the company is engaged in misconduct. Misconduct is defined as fraud, negligence, breach of duty, or default in compliance with any Ordinance or rule of law.

In *Foss versus Harbottel* (decided in 1843), a shareholder sought a declaration from the court to the effect that the directors should account for losses suffered by the company due to misapplication of property and improper mortgages being granted and a receiver should be appointed. The court held that the shareholders could not bring such proceedings as they should be brought by the company. Thus, since then, it is the general proposition that it is for the company as the interested party to bring actions against directors or shareholders in the event that such persons are allegedly at fault against the company. However, where a wrong is suffered by the company and the wrong is to the benefit of these persons who control the company, there is an imminent need for minority shareholders to be able to bring legal proceedings.

1. Common Law Derivative Action

Under Common Law, an action known as derivative action (since the right to take action derives from the company’s rights) can be taken by minority shareholders in case that the directors or the majority shareholders abused their powers and the company suffered a loss due to this abuse.

However, a Common Law derivative action is only possible if the minority shareholders, as the plaintiff, show that the wrongdoers acted fraudulently. Negligence or gross negligence is not sufficient so that the fraud requirement is quite a high threshold.

2. Statutory Derivative Action

Unlike the Common Law derivative action, the statutory derivative action in Section 731 CO does not carry the fraud requirement. Instead, the plaintiff does only need to show to the court:

- That it appears in the interests of the company to start legal action against the wrongdoers;
- That there is a serious case to be tried (which means that the issue in question is important for the company); and
- The plaintiff has served a 14 days’ notice on the company.

3. Rule against Reflective Loss

Once the court finds that the company suffered loss due to a wrongdoing of its directors and/or majority shareholders, the company can claim for compensation from the wrongdoers. In most cases it is not possible that the minority shareholder who did bring the action on behalf of the company can claim compensation, because it is the company who suffered the genuine loss. This is generally known as the “Rule against Reflective Loss”. This rule has been upheld and confirmed by several Hong Kong court decisions since the reform of the Companies Ordinance in 2014.

Assuming that the value of the shares of the minority shareholder decreases due to an act of the directors/ majority shareholder, the minority shareholder would not be able to claim compensation for the diminution of the value of his shares, because the genuine loss is suffered by the company by diminishing the total value of its assets.

4. Multiple Derivative Actions

In 2010, it was decided that multiple derivative actions are possible. A minority shareholder in a holding company may be allowed to bring proceedings on behalf of a wholly owned subsidiary which has the cause of action, in circumstances where the alleged wrongdoer is in control at every level of the corporate chain. The Hong Kong Court of Final Appeal confirmed this since the reasons for allowing members to bring a simple derivative action also justify a multiple derivative action, as the wrongdoers who control both parent company and subsidiary can preclude the subsidiary from taking action against the wrongdoers.

XII. Winding up

The company may, on a petition of any member, be wound up by the court. The grounds can be as follows:

- the company has resolved by special resolution that the company should be wound up by the court (section 177(1)(a) CWuMPO);
- the company failed to commence or suspended its business for more than 12 months (section 177(1)(b) CWuMPO);
- the company is unable to pay its debts (section 177(1)(d) CWuMPO);
- an event on which the memorandum or the Articles of Association provide that the company is to be dissolved occurred (section 177(1)(e) CWuMPO); or
- the court is of the opinion that it is just and equitable that the company should be wound up (section 177(1)(f) CWuMPO).

Examples for circumstances in which the court would make a just and equitable order are a deadlock in management or an improper or unfair exclusion of a person from the management (this often happens in quasi-partnership companies). An order according to section 177 (1) (f) CO may also be made if a company was formed to carry out fraud or to carry on an illegal business.

*We hope that the information provided in this brochure was helpful for you.
If you have any further questions, please do not hesitate to contact us.*

LORENZ & PARTNERS (Hong Kong) Ltd.

Suite 2906, 29th Floor, Wing On Centre
111 Connaught Road, Central, Hong Kong S.A.R.

Tel.: +852 2528 1433

E-Mail: hongkong@lorenz-partners.com

Annex

1. Overview

This Annex identifies certain key statutory rights of shareholders of a Hong Kong company limited by shares (with a single class of shares and with no special rights attached to the shares under its Articles of Association) under the CO and also under the Securities and Futures Ordinance (Cap. 571) according to the percentage of their shareholding.

2. One Share

Owning one share in a company gives the shareholder the right to:

- (a) request and receive copies of the company's up-to-date Articles of Association (section 97 CO);
- (b) request and receive copies of the company's last annual accounts, directors' report and auditors' report ("reporting documents") (section 430(1) CO);
- (c) be mentioned in the company's register of members and, subject to the Articles of Association, receive a share certificate (articles 64 and 80 of Schedule 1);
- (d) inspect the register of members and the index of names of members without charge (in case of a company which has more than 50 members) and request a copy of the register and the index on payment of a prescribed fee (section 631 CO);
- (e) inspect minutes of general meetings without charge (section 620(1) CO);
- (f) exercise the right to require a third party that has acquired 90% of the number of shares in the company pursuant to a takeover offer to acquire his shares on the same terms (section 700 CO);
- (g) make a petition to the court for a remedial order that the affairs of the company have been conducted in a manner unfairly prejudicial to the interests of members in general or some part of them (section 724 CO);
- (h) apply to the court for leave to bring a statutory derivative action on behalf of the company against directors for a breach of duty (section 733 CO);
- (i) receive a dividend, if declared;
- (j) exercise the full rights of membership of the company as conferred by the CO and the company's Articles of Association (section 86 CO);
- (k) prevent the holding of the annual general meeting called by a short notice (section 571(3) CO).

For each successive level of shareholding considered below, the rights attached to each of the lesser shareholding levels apply.

3. 2.5% holding

The ownership of shares representing 2.5% (in aggregate) of a company's total voting rights gives the right to require the company to:

- (a) give notice to the shareholder of a resolution to be passed at the next annual general meeting (section 615 CO);
- (b) circulate a statement of up to 1,000 words concerning the resolutions to be passed at a general meeting (section 580(1) CO); and
- (c) apply to the court to inspect any records of the company (section 740 CO).

4 5% holding

The ownership of shares representing 5% (in aggregate) of a company's total voting rights gives the right to:

- (a) apply to the court for cancelling the alternation of the objects of the company as passed by special resolution of which notice has not been duly given to all members of the company (section 91(1) CO);
- (b) require the company to convene a general meeting (section 566(2) CO); and
- (c) demand a poll at a general meeting (section 591(2)(b) CO).

5. More than 5% holding

The ownership of shares representing more than 5% (in aggregate) of a company's total voting rights gives the right to prevent the holding of any general meeting (other than an annual general meeting) called by a short notice (section 571(3)(b) CO).

6. 10% holding

The ownership of shares representing 10% (in aggregate) of a company's total voting rights gives the right to:

- (a) apply to the court to cancel any variation of class rights pursuant to section 182(1) CO;
- (b) make an application to the Financial Secretary for the appointment of inspectors to investigate the company's affairs (section 840(2) CO); and

- (c) investigate the membership of the company with a view to determining ownership or control of the company (section 356 of the Securities and Futures Ordinance).

7. More than 25% holding

The owners of shares representing more than 25% (in aggregate) of a company's total voting rights can block a special resolution.

8. More than 50% holding

The owners of shares representing more than 50% (in aggregate) of a company's total voting rights are able to pass ordinary resolutions and can also block remaining shareholders from passing such resolutions.

9. 75% holding

The owners of shares representing 75% (in aggregate) of a company's total voting rights are entitled to pass a special resolution (section 564(1) CO).

10. 90% holding

Where by way of takeover offer the offeror has obtained 90% of the shares to which the offer relates, the CO entitles:

- (a) the offeror to acquire compulsorily any minority shareholder's shares at the offer price (section 693(1) CO); or
- (B) any minority shareholder who has not accepted the offer to require the offeror to buy his shares at the offer price (section 700(1) CO).

11. Over 95% holding

A majority in number of the shareholders having the right to attend and vote at a general meeting, being majority together representing at least 95% of the total voting rights, can consent to a general meeting (other than an annual general meeting) being called by short notice (section 571(3)(b) CO).