BUSINESS & COMMERCE BUSINESS & COMMERCE SETTING UP AND RUNNING A SMALL OR MEDIUM-SIZED BUSINESS IN HONG KONG I. SETTING UP AND RUNNING A SMALL OR MEDIUM-SIZED BUSINESS IN HONG KONG B. LOCATION OF BUSINESS PREMISES, LICENCES, DOCUMENTS OF GUARANTEE AND HUMAN RESOURCES MATTERS B. LOCATION OF BUSINESS PREMISES, LICENCES, DOCUMENTS OF GUARANTEE AND HUMAN RESOURCES MATTERS In deciding whether to lease or buy office or retail premises for your business, you should consider the cash or credit that is available and the potential return on the investment. Note that for taxation purposes, any rent that is paid to lease a premises, or the capital costs that are incurred in purchasing, maintaining and repairing a premises can be deducted from the income of the business. If the business premises are leased, then attention should be paid to the following: Whether the rent is fixed or based on a percentage of sales (also called "turnover rent", which means that the rent will be calculated at a specified percentage of the sales turnover). Whether the tenant has the right to sublet if the business is to be downsized or closed down (thereby minimising the financial loss involved). Whether there is any option to renew the lease and how any rent increase is to be determined. Whether there are any restrictions on the use of the premises. Whether there is any right of access to shared facilities. The advice of a lawyer should be sought in relation to these matters. Please also refer to the Landlord and Tenant topic for basic information about tenancy law. You must also take out appropriate insurance against occupiers' liability. The Occupiers Liability Ordinance imposes a duty of care on you (as the owner or occupier of the premises) in relation to injuries to any visitors, including guests, workmen, and people who deliver goods to your premises. C. MAKING A BUSINESS CONTRACT C. MAKING A BUSINESS CONTRACT You will probably have to draw up and sign many contracts as part of your company's daily business transactions. Some of the most common business contracts include: sale and purchase agreements for premises; lease/tenancy agreements for premises; hire-purchase or lease agreements for equipment; employment contracts; insurance contracts; sales contracts with customers; procurement contracts with suppliers; financing contracts (including loan agreements, mortgages and guarantees). A contract can be made orally or in writing. In practice, many consumer contracts are made orally (see the Consumer Complaints topic), but some contracts are required by law to be made in writing. Examples of such contracts include cheques, insurance policies, the transfer of shares of registered companies, hire-purchase agreements, leases and agreements for the sale and purchase of real estate. For business transactions, it is always preferable that contracts are entered into in written form. If the contract involves a substantial amount of money, you should consult a lawyer before signing. D. INTERNATIONAL TRADE AND INTERNET TRANSACTIONS D. INTERNATIONAL TRADE AND INTERNET TRANSACTIONS If you have business dealings with foreign companies, you may need to consider the following issues. Customs duties are only levied on imported liquor, tobacco, hydrocarbonate oil and methyl alcohol at the rates that are set out in schedule 1 to the Dutiable Commodities Ordinance (Cap. 109 of the Laws of Hong Kong). You can also obtain more information from the website of the Customs and Excise Department. Import and export regulations cover packaging for shipment, means of transportation, freight cost and delivery time, insurance, import broker services, warehousing costs, packaging for local distribution, health and labelling requirements, method of distribution (by mail from home, agent or retailer), pricing, discounts and delivery costs. You may need a letter of credit, which is a bank's promise to pay the seller on behalf of the buyer against certain documents (e.g. bill of lading or other documents of title or ownership to the goods) to be received. This is a common method of payment in international trade. You need to know which country's law is applicable to your contract. In addition, you can rely on the United Nations Commission on International Trade Law Arbitration Rules (please refer to the website of the Hong Kong International Arbitration Centre) if no compromise can be reached between the contracting parties. Please note that the relevant legal points are very complex, and legal advice should therefore be sought. E. TAXATION, ACCOUNTING AND GOVERNMENT FUNDING E. TAXATION, ACCOUNTING AND GOVERNMENT FUNDING Taxation The main taxation items in Hong Kong include profits tax, salaries tax, property tax, stamp duty and customs duties (click the link for information about duties connected with the import of goods). Profits tax is charged

for each year of assessment on persons or companies that carry on a trade, profession or business in Hong Kong on assessable profits that have been generated in or derived from Hong Kong for that year. More information about taxation for sole proprietorships and partnerships can be found in the Taxation topic. If you are running a limited company, you should clarify with your auditor or accountant on any taxation matters. Under the Companies Ordinance (Cap.622) (“the CO”), every limited company must appoint an auditor for each financial year of the company (section 394 of the CO) to handle the taxation matters of the company (section 436). If you have business dealings in Hong Kong and Mainland China, you should note the special policies in relation to the avoidance of double taxation on income. The “Arrangement Between the Mainland of China and the HKSAR for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income” tries to allocate the right to tax between the two jurisdictions on a reasonable basis to avoid double taxation of income. More details about this Arrangement can be found on the website of Inland Revenue Department. Record-keeping system Regardless of whether you are running a small business or a big corporation, you are obliged to keep proper records of all documents that are related to the business, including without limitation the following: Transaction records: order forms, cash register records, delivery dockets, invoices, credit notes, cheque stubs and deposit slips. Accounting records: petty cash, accounts receivable, accounts payable. Employment records: copies of identity cards and resumes (these records must be strictly controlled for protection of personal data privacy). Stock records: stock location, levels, suppliers and delivery information, cost price, selling price and possible substitute products. Supplier records: reliability, quality, service, delivery times and price of potential and existing suppliers. Customer records: contact information, credit terms, arranged payment terms and special delivery instructions. If you have further questions on taxation or record-keeping matters, you should seek advice from a professional accountant or tax lawyer. Government funding According to Government statistics, there are about 340,000 small and medium enterprises (SMEs) in Hong Kong, which constitute over 98% of the business establishments and employ about 45% of the workforce in the private sector. In order to uphold the development of SMEs and to enhance their competitiveness, the Trade and Industry Department has set up a few fund schemes, including: The SME Export Marketing Fund (EMF): The EMF is a fund which focuses primarily on marketing/promotion activities. It strives to provide financial assistance to SMEs for participation in export promotion activities, hoping to encourage them to expand their markets outside Hong Kong. For details, please refer to this website: https://www.smefund.tid.gov.hk/english/emf/emf_update.html The Trade and Industrial Organisation Support Fund (TSF): The TSF provides financial support to non-profit-distributing organisations to implement projects which aim at enhancing the competitiveness of non-listed Hong Kong enterprises in general or in specific sectors. While the TSF does not provide direct subsidy to a SME, the beneficiaries will utilize the fund to conduct and prepare seminars, workshops, conferences, exhibitions, research studies, award schemes, codes of best practices, databases, service centres, support facilities and technology demonstrations, etc. which ultimately will benefit SMEs in Hong Kong. For details, please refer to this website: https://www.smefund.tid.gov.hk/english/tsf/tsf_objective.html The SME Loan Guarantee Scheme (SGS): The SGS is not exactly a fund scheme. Instead of providing fund/loan directly to a SME, the Government will act as a guarantor to provide loan guarantee to SMEs to help them secure loans from participating lending institutions for acquiring business installations and equipment or meeting working capital needs of general business uses. For details, please refer to this website: https://www.hkmc.com.hk/eng/our_business/sme_financing_guarantee_scheme.html F. BUSINESS DISPUTES AND LEGAL ACTION F. BUSINESS DISPUTES AND LEGAL ACTION Employment disputes If you are involved in a dispute about employment contracts, including wages payment and other conditions of employment, then you may go to the Labour Relations Division of the Labour Department to seek a preliminary consultation or voluntary conciliation service. If you wish to initiate legal action or defend a claim that has been made, then your case will be heard by the Labour Tribunal. Claims for work-related

injuries must be taken to the District Court. More information can be found in the Employment Disputes topic. Disputes in contract or tort Cases that involve monetary claims that do not exceed $75,000 will be heard by the Small Claims Tribunal. If the amount of the claim is over $75,000 but not more than $3,000,000, the case will be heard by the District Court. If the plaintiff is claiming for more than $3,000,000, such a case will be handled by the Court of First Instance of the High Court. Further details about the procedures for legal action concerning breach of contract, debt recovery or claims for compensation can be found in the topic of Bringing or Defending a Civil Case. You can also consider resolving the dispute through mediation or arbitration without going to court. More information about these options is available in the Alternative Dispute Resolution topic. Bankruptcy and winding-up Bankruptcy and winding-up are methods of closing down a business (or other person's business), and should only be considered as a last resort. Bankruptcy is an insolvency court action that is taken against a person (e.g. a sole proprietorship or partners in a partnership), whereas winding-up targets limited companies. For more details, please refer to the Bankruptcy Information, Individual Voluntary Arrangement and Winding-Up of Companies topic. G. THE COMPANIES ORDINANCE (CAP.622) G. THE COMPANIES ORDINANCE (CAP.622) Introduction: We have discussed about the characteristics and pros and cons of the 3 most common types of business organisations: the sole proprietorship, the partnership and the limited company. It appears that the limited company is the prime choice for most businessmen. It is therefore essential to take a look at the statute governing the limited company: the Companies Ordinance (Cap.622 of the Laws of Hong Kong) (the "CO"). The following are highlights of some parts of the CO. CASE ILLUSTRATION II. CASE ILLUSTRATION RELATED WEBSITES III. RELATED WEBSITES Companies Registry Inland Revenue Department Trade and Industry Department Hong Kong Trade Development Council Customs and Excise Department Labour Department Mandatory Provident Fund Schemes Authority Hong Kong Judiciary Legal Aid Department Hong Kong International Arbitration Centre Office of the Hong Kong Special Administrative Region in Beijing Hong Kong Economic and Trade Office in Guangdong Hong Kong e-Legislation Hong Kong Legal Information Institute A. SCENARIOS IN HONG KONG A. SCENARIOS IN HONG KONG Scenario 1 Company A advertised a conference table for sale for $50,000 in a local daily newspaper. They received one telephone call in response to the advertisement, and the manager of Company A arranged to meet the caller, the representative of Company B, at the showroom of Company A. Having inspected the conference table, the representative of Company B said that Company B would buy it but that they would need time to arrange the payment. Before leaving the showroom, the manager of Company A and the representative shook hands and exchanged business cards. Three days later, the representative of Company B telephoned the manager of Company A to say that he would deliver the cash to Company A the next day. The manager of Company A said nothing in response. Can the manager of Company A refuse to sell the conference table to Company B when the representative of Company B arrives at the showroom of Company A with the $50,000? Answer to Scenario 1 Scenario 2 The manager of Company A, a printing company, ordered a new colour printing machine from Company B to be delivered on 1 November. The machine was not delivered on time, but because there is a low demand for printing services between November and February, the manager of Company A did not contact Company B about the matter until 20 February of the next year, when he sent a fax to Company B enquiring about delivery of the machine. He was told by return fax that the machine would be delivered the following week. However, the machine was not delivered for another three months. Since the time when the manager of Company A enquired about the delivery of the machine, Company A has only been able to fulfil 50% of the printing jobs that it could have handled had they had the machine. Can Company A purchase the printing machine from another manufacturer and sue Company B for damages (compensation)? Would the basis for the calculation of the damages be different if Company A had also lost a profitable printing order because they were not able to meet the deadline for delivering the work without the new machine? Answer to Scenario 2 Scenario 3 Mr. A and his brother Mr. B were partners in a garment manufacturing company business for many years. On the advice of their accountant, they formed a limited company (A & B Ltd) and invited Mr. B's son to join them in the business. It was agreed

that Mr. A and Mr. B would each hold 40% of the shares and that B's son would hold the remaining 20%. Recently, Mr. A and Mr. B have been unable to agree on the design, quality of fabric or colour of their products, and consequently have neglected the business. They have failed to pay their suppliers and are unable to fulfil their contracted orders. Mr. B's son always agrees with his father. As a result, Mr. A now refuses to communicate with either of them. Are there any grounds on which A & B Ltd can be wound up by the court? Answer to Scenario 3 A. TYPES OF BUSINESS ORGANISATION - SOLE PROPRIETORSHIPS, PARTNERSHIPS AND LIMITED COMPANIES A. TYPES OF BUSINESS ORGANISATION - SOLE PROPRIETORSHIPS, PARTNERSHIPS AND LIMITED COMPANIES In general, there are three ways to start a small or medium-sized business in Hong Kong: starting a new business, buying an existing business or buying a franchise. If you choose to start a new business, you should conduct feasibility studies on demand (including customer profiles, buying habits, products and pricing), market share and competition, projected sales and estimated expenses (both fixed and variable). If you are thinking of buying an existing business, then you should note the following: You should be aware of the business assets (such as buildings, equipment, personnel and inventory, reputation and goodwill), sales revenue (established product and market), costs, debts and profits and losses of the company that you plan to purchase. Care must be taken with the negotiations and purchase agreement, which should include escape clauses that cover financing, the inspection of all records, obtaining the necessary licences and rights and any liability that is to be assumed. You should appoint a lawyer go through the purchase agreement. Buying a franchise is perhaps the fastest and easiest way to start trading, and carries the additional advantages that the product or service is usually well known and the market has been established. However, you should be aware of the following issues: Training, advice regarding location, advertising and promotion, and probably financing services are usually available from the franchiser. You must be careful of any hidden costs such as royalty arrangements (franchise fee) and supply agreements for equipment and materials, and should be aware of the potential for loss of control over management procedures. You should appoint a lawyer go through the franchise agreement. 1. WHAT ARE THE CHARACTERISTICS OF SOLE PROPRIETORSHIPS, PARTNERSHIPS AND LIMITED COMPANIES? WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF EACH TYPE OF BUSINESS? 1. WHAT ARE THE CHARACTERISTICS OF SOLE PROPRIETORSHIPS, PARTNERSHIPS AND LIMITED COMPANIES? WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF EACH TYPE OF BUSINESS? Sole proprietorships A sole proprietorship is a business that is run by a single individual who makes all the decisions, although the proprietor may engage employees. The sole proprietor is personally entitled to all of the profits and is responsible for any debts that the business incurs. Advantages of forming a sole proprietorship Sole proprietorship is the simplest and most flexible business structure. The sole proprietor has total control and full decision-making power over policies, profits and capital investment. It is easy to close down the business. Profits from the business will be taxed at the sole proprietor's marginal tax rate, which may be lower than the corporate (limited company) tax rate. Also, business losses can be offset against the other income of the proprietor (for more details on profits tax please go to another topic - Taxation). Disadvantages of forming a sole proprietorship Risks that are taken by the sole proprietor may result in personal bankruptcy. The death or prolonged illness of the sole proprietor will lead to the end of the business. Due to the limitations of a one-person business, the sole proprietor may not be able to raise additional capital from outside sources to expand the business. Partnerships A partnership is the relation which subsists between persons carrying on a business in common with a view of profit. The law relating to partnership is codified under the Partnership Ordinance (Cap. 38) and the Limited Partnerships Ordinance (Cap. 37) which stipulate that the rules of equity and common law applicable to partnerships shall continue in force except so far as they are inconsistent with the express provisions of such Ordinance. However the relation between members of any company or association which is (a) registered as a company under any Ordinance relating to the registration of joint-stock companies; or (b) formed or incorporated by or in pursuance of any other Ordinance, or any enactment or instrument, is not a partnership within the meaning of the Partnership Ordinance. In broad terms, there are two types of

partnership: general partnership and limited partnership. There is however a third type of partnership called limited liability partnership under the Legal Practitioners Ordinance (Cap.159), which is available only to law firms in Hong Kong. General partnership Each partner in a general partnership is personally liable for all the debts and obligations of the partnership. Each partner can bind the partnership and is responsible for the acts of other partners taken in the ordinary course of business. All partners are entitled to share in the profits of the partnership equally unless they agree otherwise. A general partnership is not a separate legal entity from its partners and cannot acquire rights, incur obligations or hold properties in its own right. Limited partnership A limited partnership must consist of at least one general partner and one limited partner. A general partner is a partner who is personally liable for all the debts and obligations of the limited partnership. A limited partner is a partner who at the time of entering into the limited partnership contributes a sum or sums as capital or property valued at a stated amount and is not liable for the debts and obligations of the limited partnership beyond the amount so contributed. Limited partners shall not, during the life of the partnership, draw out or receive back any part of their contribution and if they do, they become liable for the debts and obligations of the partnership up to the amount so drawn or received back. A limited partner has no power to bind the partnership and must not take part in the management of the partnership business. If a limited partner takes part in managing the partnership business, he or she shall be liable for all the debts and obligations of the partnership incurred while taking part in the management. A limited partnership must be registered as such with the Registrar of Companies in accordance with the Limited Partnerships Ordinance (Cap. 37). Until it has been so registered, the partnership will be deemed as a general partnership and every limited partner shall be deemed as a general partner. A limited partnership is required to notify the Registrar of Companies and where applicable to advertise in the Gazette if there are certain changes during the life of the partnership such as change of partnership name, principal place of address or the nature of the business or the partners (sections 8 and 9 of the Limited Partnerships Ordinance). Like a general partnership, a limited partnership is not a legal entity. Limited liability partnership Only law firms in Hong Kong may choose to operate in the form of a limited liability partnership (“LLP”). According to the Legal Practitioners Ordinance (Cap. 159), an innocent partner of an LLP will not be personally liable for the debts, obligations and liabilities of the LLP that arise from the provision of professional services by the LLP and as a result of the default of another partner, an employee, agent or representative of the LLP. This protection for LLP partners is however limited as follows: it does not protect a partner for his or her own default and/or the default of those employees, agents or representatives that he or she directly supervised at the time of default; it does not protect a partner who knew the default at the time of its occurrence and failed to exercise reasonable care to prevent its occurrence; and it does not protect a partner’s interest in the partnership property from claims against the LLP. The protection for LLP partners applies only if the law firm had complied with the following conditions at the time of the default: the law firm was an LLP; the law firm had maintained a top-up insurance policy as required under the Legal Practitioners Ordinance (Cap. 159); the client, at the time of the default, knew or ought reasonably to have known that the law firm was an LLP; and the law firm had informed the client of the identity of at least one partner who was responsible for the overall supervision for the relevant matter within 21 days the firm accepted instructions on the matter and had, throughout the time that the matter was handled by the firm, kept the client informed of the identity of at least one overall supervising partner for the matter. Subject to certain exceptions and conditions in the Legal Practitioners Ordinance (Cap. 159), if an LLP is unable to meet its debts, obligations and liabilities or the value of the remaining partnership property is less than the LLP’s debts, obligations and liabilities immediately after the LLP has made a distribution of its partnership property, the recipient(s) of that distribution may be liable to pay some or all (as the case may be) of the distribution back to the LLP. Every partner remains liable for the LLP ‘s ordinary business obligations such as office

rent and staff salaries. LLPs are not governed by the Limited Partnerships Ordinance but are subject to the Legal Practitioners Ordinance (Cap. 159) and its subsidiary legislation. Being a form of partnership, LLPs are also subject to the Partnership Ordinance and any other law that applies in relation to a general partnership, unless they are inconsistent with the Legal Practitioners Ordinance (Cap. 159). Transfer of interests The transfer of interests in a partnership to existing or new partners may be carried out in accordance with any partnership agreement or other agreement that is entered into by all of the partners. In practice, there is little market for the transfer of the interests of a partnership to public investors. Name of partnership The name of a partnership can be formed by combining the names (usually the surnames) of the partners. If there are many partners, then they may name the partnership "XX Company" or "XX & Co". An LLP must include the words “Limited Liability Partnership” or the abbreviation “LLP” or “L.L.P.” as part of its English name and the words “有限法律責任合夥” as part of its Chinese name. Subject to aforesaid, the English name of a partnership must not include the words "Limited" or "Company Limited" and the Chinese name of a partnership must not include the words “有限” or “有限公司”, as this is an offence that carries a fine. Note that a partnership can also use a business name or trade name (for example, XX Café) in addition to the partnership name. Partnership Agreements The Partnership Ordinance and the Limited Partnerships Ordinance contain default provisions on matters relating to profit and loss sharing, management of partnership business, changes to the composition of partners and duration and termination of partnership which shall apply to a partnership that does not have an agreement to the contrary. Such default provisions may not suit the manner in which partners would like to run the business and it is therefore important for the partners to enter into a Partnership Agreement to modify these provisions and agree on other relevant matters e.g. settlement of disputes. You are strongly recommended to appoint a lawyer to prepare the Partnership Agreement. Advantages of forming a partnership It is easier to raise finance as a partnership than as a sole proprietor. Partners pay tax on their share of the partnership profits at their respective marginal tax rates, and their share in the partnership losses can be offset against their other income (for more details on profits tax, please go to another topic – Taxation). Disadvantages of forming a partnership Partners (other than the limited partners and partners of an LLP) do not have the benefit of limited liability. Generally speaking, the participation of all the partners is needed for most legal transactions, which can result in disputes among the partners. The partnership will be dissolved when a partner (except a limited partner) dies or becomes bankrupt, unless the Partnership Agreement states otherwise (section 35 of the Partnership Ordinance and section 5(3) of the Limited Partnerships Ordinance). Limited Companies A limited company is a type of company formed and registered in accordance with the Companies Ordinance (Cap. 622) (“the CO”). The most common types of limited company used to run a business is the company limited by shares. Companies limited by shares A company is a company limited by shares if the liability of its members is limited by the company’s articles to any amount unpaid on the shares held by the members. The key characteristics of a company limited by shares can be described as follows: A company limited by shares has a separate legal status that allows it to enter into contracts, to sue or be sued, to own property and to borrow money in its own name. A company limited by shares is responsible for its own debts and obligations and the liability of each shareholder is generally limited to the amount which remains unpaid on that shareholder’s shares. Small and medium-sized businesses are usually run as private companies limited by shares, rather than public companies limited by shares. A private company limited by shares cannot offer shares to the public at large but may have up to 50 shareholders whose right to transfer their shares is limited (section 11 of the CO). A private company limited by shares (“private company”) must have at least one director (section 454 of the CO). Section 457 restricts corporate directorship by requiring a private company (other than one within the same group as a listed company) to have at least one director who is a natural person. It used to be the law that a company must have a memorandum of association which sets out what it can do as a legal entity. However, the CO, which follows the modern

trend of law of most jurisdictions, have abolished the memorandum of association. For older companies (i.e. companies formed under a former Companies Ordinance), the conditions in the memorandum are deemed to be contained in the articles of association, except for conditions relating to authorised share capital and par value, which are regarded to be deleted for all purposes (section 98 of the CO). Limited companies incorporated under the CO are required to have certain mandatory articles of association, e.g. the company name (section 81 of the CO), details of the liabilities or contributions of the members(sections 83 and 84 of the CO), etc. Company directors must declare any actual or potential conflicts of interest in relation to the company to the board of directors. In any event, company directors should try to avoid dealings which might have conflicts of interest in relation to their company. A limited company must keep specified record such as minutes of the proceedings of general meetings and meetings of directors, resolutions of members passed otherwise than at general meetings and resolutions passed by directors without a meeting, at its registered office or a prescribed place in accordance with the CO. Certain companies are allowed to prepare simplified financial and directors' reports. Companies which are qualified for simplified reporting are referred to in the CO as companies "falling within the reporting exemption". Sections 359 to 366A and Schedule 3 of the CO set out the qualifying conditions for companies to prepare simplified financial and directors' reports. A limited company must not be registered without "Limited" as the last word of its English name or "有限公司" as the last words of its Chinese name (section 102 of the CO). However, the Registrar of Companies, may, by licence, exercise power to dispense with the use of the word "Limited" or the words "有限公司" (section 103 of the CO) for non-profit making companies . It is prudent to prepare a Shareholders Agreement that covers the disposal or transmission of shares, the settling of managerial and policy disputes and the protection of interests of minority shareholders. You should appoint a lawyer to prepare this Agreement. Companies limited by guarantee A company limited by guarantee is a rather peculiar kind of company. It has many of the same characteristics as a private company limited by shares subject to the following key differences: A company formed under the CO as a company limited by guarantee does not have any share capital. A member of a company limited by guarantee is not liable to contribute to the company's capital while the company is a going concern. Instead, the member undertakes that if the company is wound up while he/she is a member of the company or within one year after he/she ceases to be such a member, he/she shall contribute an amount not exceeding a predetermined amount to the company's assets (i) for the payment of the company's debts and liabilities contracted before he/she ceases to be such a member, (ii) for the payment of the costs, charges and expenses of winding up the company, and (iii) for the adjustment, among the contributories, of their rights (section 810 of the CO). Due to its intrinsic nature, companies limited by guarantee are usually set up for charitable or non-profit making functions, rather than for carrying on normal business activities where the primary object is to make profits and distribute those profits to the members. Generally speaking, profits or other income generated by a company limited by guarantee will not be shared among its members but will instead be used to promote the objects of the company. A limited company may be permitted by licence to delete the word "Limited" or the words"有限公司"in its company name if it is proved to the satisfaction of the Registrar of Companies that (i) the objects of the company are restricted to promoting commerce, art, science, religion or charity or any other useful objects and to objects incidental or conducive to those objects, (ii) the company is required by its articles to apply profits or other income in promoting its objects and (iii) the company is prohibited by its articles from paying dividends to its members (sections 103(3) and 103(4) of the CO). It is not unusual that a company limited by guarantee may be granted such licence. A company limited by guarantee must have at least two directors (section 453 of the CO) and a body corporate must not be appointed a director of the company (section 456 of the CO). Advantages of forming a company limited by shares The most obvious advantage is that the liability of the shareholders for the company's debts is limited to the amount of their respective shareholding. The liability of the company as a whole is limited to its aggregate issued share capital and its

assets. An individual can be both sole shareholder and sole director, and hence has total control and full decision-making power over the company's policies and profits. It is easy to transfer the interests of the business by transferring shares to existing or new shareholders without interfering with the corporate structure by signing an instrument of transfer and a bought and sold note (based on the latest audited balance sheet and management accounts) on which the requisite stamp duty has been assessed and paid, provided that the approval of the company is obtained and the relevant rules that are set out in the company's Articles of Association are followed. The continuity of the business is not affected by the death, bankruptcy, retirement or mental disorder of any shareholder. Disadvantages of forming a company limited by shares A company limited by shares must pay profits tax at the corporate rate, which is higher than the rate for individuals paid by sole proprietors and partnerships (for more details on profits tax, please go to another topic – Taxation). Shareholders cannot withdraw their capital at will from the company (unless they sell their shares to others). The transfer of shares in a private company limited by shares may be restricted by the right of pre-emption (if any) in the Shareholders Agreement, which states that the existing shareholders must be given the first option to buy shares. The CO also gives the board of directors the right to veto potential new shareholders unless the directors do so in bad faith. Due to the nature of limited liability, many creditors of private companies limited by shares will ask for personal guarantees or bank guarantees from shareholders or directors of such companies, and those shareholders/directors will then have to bear the debt personally if the company is unable to pay it. It is obligatory to publicly disclose a company's certain information like its Articles of Association, registered office address, details of shareholders and directors at the Companies Registry. There are prolonged and costly procedures for dissolving the company after the business has ceased or if it fails (further details can be found in the Bankruptcy, Individual Voluntary Arrangement and Winding-up of Companies topic). Potential conflicts of interest may arise among the company, its shareholders and its directors. Minority shareholders may not have effective involvement in or control over decision-making or management. A company director may have to take personal liability for a contract that is drawn up in the company's name but subsequently proves not to be enforceable against the company (if a potential director signed a contract before the date of formal incorporation of the company, for example). Directors may also be personally liable for claims if they act negligently in the performance of their job duties. 2. HOW CAN I SET UP A SOLE PROPRIETORSHIP, PARTNERSHIP OR LIMITED COMPANY? DO I HAVE TO OBTAIN A BUSINESS REGISTRATION CERTIFICATE FROM THE INLAND REVENUE DEPARTMENT AND REGISTER WITH THE COMPANIES REGISTRY BEFORE COMMENCEMENT OF BUSINESS? 2. HOW CAN I SET UP A SOLE PROPRIETORSHIP, PARTNERSHIP OR LIMITED COMPANY? DO I HAVE TO OBTAIN A BUSINESS REGISTRATION CERTIFICATE FROM THE INLAND REVENUE DEPARTMENT AND REGISTER WITH THE COMPANIES REGISTRY BEFORE COMMENCEMENT OF BUSINESS? Business Registration The Business Registration Ordinance (Cap. 310 of the Laws of Hong Kong) requires every person who runs a business in Hong Kong, whether it is a sole proprietorship, partnership or limited company, to register the business at the Inland Revenue Department within one month from the date of commencement of business, and to display a valid Business Registration Certificate at the place of business. For more information about the application procedure, the relevant charges and a sample application form and certificate, please visit the website of the Inland Revenue Department. Registration of a limited partnership with the Companies Registry Besides registering with the Inland Revenue Department, a limited partnership must be registered with the Companies Registry. A Certificate of Registration of a Limited Partnership will be issued by the Companies Registry. Please visit the website of the Companies Registry for more information about the application for registration procedure. Notification to the Hong Kong Law Society in respect of limited liability partnership In addition to registering with the Inland Revenue Department, a law firm must notify the Hong Kong Law Society in a prescribed form at least seven days prior to commencement as a limited liability partnership ("LLP") and submit to the Law Society a commencement notification with more detailed particulars within 14 days of commencement. Please visit the website of

the Hong Kong Law Society for the notification procedure and more information on how to become an LLP. Incorporation of a limited company In addition to obtaining a business registration certificate, persons who intend to set up a limited company under the CO have to submit its incorporation form and articles of association. Any one or more persons may form a company by signing the articles of association of the company intended to be formed and delivering to the Registrar of Companies (the “Registrar”) for registration a copy of the articles in the same form as those signed by the founder members together with a completed incorporation form (section 67 of the CO). For more information about how to register or incorporate a limited company, please visit the website of the Companies Registry or call its hotline at 3142 2822. It is important to note that a limited company only comes into existence on the date on which its Certificate of Incorporation is issued by the Companies Registry. Rather than setting up a new company, you can purchase a ready-made company limited by shares (also called a "shelf company") from a company formation agent. After paying the prescribed service charge, the agent will arrange to transfer the shares of the selected company to you (and any other shareholders who may be involved) and handle the relevant documentation. You are recommended to consult a certified accountant or qualified solicitor before you buy a shelf company. 1. DO I HAVE TO OBTAIN A LICENCE(S) FROM THE GOVERNMENT FOR MY BUSINESS? 1. DO I HAVE TO OBTAIN A LICENCE(S) FROM THE GOVERNMENT FOR MY BUSINESS? The following list contains some examples of the types of business that require a licence. You may have to obtain other statutory licences in relation to your particular business area. An appropriate food licence must be obtained from the Licensing Office of the Food and Environmental Hygiene Department to run a general restaurant, light refreshment restaurant, seafood restaurant, bakery, cold store, factory canteen, food factory, fresh provisions shop, frozen confectionery factory, milk factory or "siu mei" and "lo mei" shop. A liquor licence or club liquor licence must be obtained from the Liquor Licensing Board to sell, advertise or expose for sale, supply or possess for sale and supply liquor. More information on food or liquor licensing is available from the website of the Food and Environmental Hygiene Department. A certificate of compliance and a licence must be obtained from the Office of the Licensing Authority of the Home Affairs Department to run a club with bed spaces, hotel, guesthouse or karaoke establishment. More information is available from the website of the Home Affairs Department. Registration with the relevant professional bodies is required for a company that provides professional services in areas such as law, accounting or insurance brokerage. All motor vehicles that are used by business organisations of any form must be registered with the Transport Department. More information is available from the website of the Transport Department. Factory registration with the Trade and Industry Department is necessary for factories that manufacture products that require a certificate of origin. More information is available from the website of the Trade and Industry Department. Approval must be obtained from the Immigration Department to employ foreign workers (please go to the Immigration topic for further information). A licence must be obtained from the Education Bureau to run an educational institute or tuition classes. More information is available from the website of the Education Bureau. A licence must be obtained from the Commissioner of Customs and Excise to manufacture optical discs. More information is available from the website of the Customs and Excise Department. Business registration - please refer to the relevant question and answer and the website of the Trade and Industry Department: https://www.success.tid.gov.hk/tid/eng/blics/index.jsp#. 2. ARE THERE ANY LEGAL STIPULATIONS ABOUT HUMAN RESOURCES MANAGEMENT THAT APPLY TO RUNNING A BUSINESS IN HONG KONG? 2. ARE THERE ANY LEGAL STIPULATIONS ABOUT HUMAN RESOURCES MANAGEMENT THAT APPLY TO RUNNING A BUSINESS IN HONG KONG? Some of the important legal matters concerning human resources management are laid out in the following answer. Labour law The common law (case law) and various statutes (such as the Employment Ordinance and the Minimum Wage Ordinance) give employees the following rights and obligations: Implied rights concerning rest days, holidays, maternity leave, paternity leave, wage protection, dismissal with notice or wages in lieu of notice, severance and long service payment. Implied rights are rights that are granted to employees even if they are not expressly

stated in their contract of employment (please refer to the Employment Disputes topic for further details). The obligation to take reasonable care when performing their job duties, to be honest to their company, to be obedient to relevant job commands and to maintain the confidentiality of the company's restricted information. Mandatory Provident Fund and Occupational Retirement Schemes All employers are required to join a mandatory provident fund or occupational retirement scheme for their employees under the Mandatory Provident Fund Schemes Ordinance and the Occupational Retirement Schemes Ordinance. Employers must make contributions to the funds in accordance with the relevant rules. More information is available from the website of the Mandatory Provident Fund Schemes Authority. Anti-discrimination policy Care should be taken when offering employment and formulating human resources policy to avoid violation of the provisions of the Sex Discrimination Ordinance, the Disability Discrimination Ordinance, the Family Status Discrimination Ordinance and the Race Discrimination Ordinance. More information is available in the Anti-discrimination topic. Vicarious liability Employers may be liable for the negligence of their employees. For example, if an employee negligently damages a customer's property, then the employer may be liable to pay compensation to that customer. Appropriate insurance should be taken out to cover these risks. Protective industrial and occupational safety law The Factories and Industrial Undertakings Ordinance gives the Commissioner for Labour the authority to make detailed industrial safety rules. It is a criminal offence for an employer to terminate, threaten to terminate or in any way discriminate against an employee who speaks out against the working, health and safety conditions in their factory. Non-industrial employers also have a general common law duty to provide a safe working environment for their employees. The Occupational Safety and Health Ordinance and the Occupational Safety and Health Regulation set out requirements to protect the safety and health of employees in workplaces (both industrial and non-industrial). Employers must also insure against their potential liability for their employees under the Employees' Compensation Ordinance (a no-fault accident compensation scheme that is financed by a compulsory levy imposed on all employers in Hong Kong, but that does not cover independent contractors or outworkers). More information is available in the Employment Disputes topic. Insurance Employers must take out business insurance policies that cover employees compensation, fire and all risks (or general liability), product liability, professional indemnity, motor vehicles (third-party risks) and group healthcare, etc. 3. WHAT ARE "PERSONAL GUARANTEES" AND "BANK GUARANTEES"? WHEN WILL I BE REQUIRED TO PROVIDE THESE DOCUMENTS TO OTHER PARTIES IN BUSINESS TRANSACTIONS? 3. WHAT ARE "PERSONAL GUARANTEES" AND "BANK GUARANTEES"? WHEN WILL I BE REQUIRED TO PROVIDE THESE DOCUMENTS TO OTHER PARTIES IN BUSINESS TRANSACTIONS? In a business transaction, if a party (e.g. the buyer) is either unwilling or unable to pay in advance, or if that party is a limited company and its creditworthiness is unknown, then the other party (e.g. the seller) may require some form of guarantee of payment. The person who gives the guarantee is called the "guarantor" (or sometimes called the "surety"). The following two examples illustrate the differences between a personal guarantee and a bank guarantee. Personal Guarantee Party A (a limited company) has entered into a contract with Party B. Due to Party A's limited liability, Party B requires Party A's shareholders or directors to sign a personal guarantee of payment. By signing this guarantee, the shareholders or directors (the guarantors) will be personally liable for the debt or compensation if the company fails to pay. Bank Guarantee Party A has entered into a contract with Party B. Party A does not pay in advance, and therefore Party B requires Party A to provide a bank guarantee to secure the payment. Party A obtains the guarantee from a bank and provides it to Party B. If Party A subsequently fails to pay, then the bank will be liable for the debt or compensation, and will have to pay Party B. You should note that if you have signed a personal guarantee as a guarantor, it will be difficult for you to avoid liability from that guarantee unless you can prove that you were misled or forced to sign the document, which is not easy to establish. In respect of bank guarantee, you may have to pay a fee in order to obtain a guarantee from a bank. Alternatively, the bank may ask you to sign a separate personal guarantee or to provide security to the bank, which means that if the bank pays any debt or compensation as a result of the bank

guarantee, the bank will then seek the same amount from you pursuant to the personal guarantee or through enforcing the security. Before you sign any document of guarantee, you must scrutinise all of the terms and conditions, and, if possible, try to consult a lawyer beforehand. 1. WHAT ARE THE BASIC REQUIREMENTS FOR MAKING A VALID CONTRACT? 1. WHAT ARE THE BASIC REQUIREMENTS FOR MAKING A VALID CONTRACT? A valid contract normally contains the following six basic elements. (i) Intention to create legal relations It is generally presumed that in a commercial transaction, the contracting parties must have the intention to create a legally binding contract. In other words, if you have signed a contract for business-related activities, then you will be able to sue the other party if that party does not fulfil the contractual provisions, and vice versa. This presumption can only be rejected if the parties expressly state that they do not intend to make a legally binding contract. Sometimes you may see the words "subject to contract" printed on a document. These words have the legal meaning that the document is not a contract, and that all of the contents will be bound by a subsequent contract (if the parties sign that contract). A party that is acting “subject to contract” can withdraw from the negotiation at any time before the contract is concluded. In case of dispute, the burden of proof that the intention was to create a binding contract rests on the person who wishes to rely on the contract. (ii) Offer An offer is an expression of readiness to do something which, if followed by the unconditional acceptance of another person (see item (iii)), results in a contract. For example, if a company tells you that it will sell you 100 boxes of red wine at the price of $100,000, that company is making you an offer. If no time limit is specified, an offer is valid for a reasonable length of time before the offeror (the person who makes the offer) can revoke or cancel it. To avoid potential disputes, however, the offeror should specify the deadline for the acceptance of an offer. It is also important to note that the offeror cannot take silence as a form of acceptance. This means the offeror cannot say "If I do not hear from you within 10 days, then I will assume that you have accepted my offer and will pay for the product". An offer must be distinguished from an "invitation to treat", which merely invites other people to make offers but is not in itself an offer. Examples of invitations to treat include: invitations to tender, displaying goods on the shelves of a shop, and the advertisement of goods or services in newspapers or on television (unless it is expressly stated that the advertisement is an offer). (iii) Acceptance There is no contract unless and until the offer is accepted by the person to whom the offer is addressed (sometimes called "the offeree"). Acceptance is normally made orally or in writing, but if the contract allows that the acceptance and performance of contractual duties are to be carried out simultaneously, then acceptance can also be made by conduct. For example, when a supplier receives your cheque, that supplier may immediately deliver the goods to you without saying or writing anything. It is recommended that both of the contracting parties clearly specify and agree to the method of acceptance. If the method of acceptance is not specified by the offeror, then the following rules may apply. Postal Rule – If it is reasonable to use the post for the offer and acceptance process, then the contract is formed at the time of posting the letter of acceptance, even if the letter is lost in the post. Receipt Rule – If the acceptance is made orally, then the contract is formed once the offeror received the acceptance. When an acceptance is sent by fax, it is deemed to be valid when the message is received, even if the offeror does not in fact read the fax immediately. This rule also applies to e-mail messages (see section 17 and section 19 of the Electronic Transactions Ordinance). Another important point to note is that a conditional (or partial) acceptance is only a "counter-offer" and does not constitute a valid contract. In other words, if the person to whom the offer is addressed only accepts some of the terms or proposes some new terms, then that person is not accepting the offer but is making a new offer to the other party. In the business world, there may be a series of counter-offers before a final acceptance comes out. (iv) Consideration (benefit given to the other party) In contract law, consideration means a detriment to the person who made the promise or a benefit conferred on the other party, both of which are measurable in economic terms. Money, goods and services are the most common examples of consideration. You should note that consideration need not be adequate, which means that if the seller

or service provider is contracted to sell a product or service at a price that is below the market price, then that seller or provider cannot subsequently go to court to claim the shortfall. A promise of a gift is not enforceable in law because of the lack of mutual exchange of consideration (the recipient does not have to pay anything in return). An exception to this rule is when a contract is executed in a specific form called a "deed", in which case the recipient may not be required to give consideration to the other party. (v) Capacity (the authority or ability to make contracts) Persons under the age of 18 (called "minors") and lunatics (mentally disordered or intoxicated persons) do not have the capacity to enter into contracts. Any contracts that are made by persons who are lacking in legal capacity are voidable: that is, the party who needs the protection can seek to avoid the contractual liability. An exception to this rule arises when the parties enter into a contract for "necessaries" (a legal term for "necessities", which means the goods or services that are suitable to the condition of life of a minor and to that minor's actual requirements at the time of the sale and delivery, such as clothes or food). A minor who fails to pay for "necessaries" can be sued by the seller. (vi) Certainty Contracting parties must ensure that their agreement is complete, i.e. not lacking in some essential terms and it is not uncertain, for example, vague or ambiguous. An agreement may be unenforceable if it is incomplete or uncertain. 2. OTHER THAN THE ESSENTIAL ELEMENTS AS MENTIONED ON QUESTION 1, WHAT ARE THE OTHER IMPORTANT MATTERS THAT THE PARTIES SHOULD NOTE WHEN MAKING A CONTRACT? 2. OTHER THAN THE ESSENTIAL ELEMENTS AS MENTIONED ON QUESTION 1, WHAT ARE THE OTHER IMPORTANT MATTERS THAT THE PARTIES SHOULD NOTE WHEN MAKING A CONTRACT? Privity of contract Under common law, a third party cannot sue or be sued regarding a contract, and only the parties to a contract can rely on the contract terms to take legal action. However, there are some exceptions to this principle, such as: If the contract is signed by an agent or representative on behalf of one of the parties, then that agent (who is a third party) may also bear the liability if he or she acted fraudulently or signed the contract without authorisation. It is common in insurance contracts to subrogate the insured person's rights to the insurance company. For example, if someone injures you and the insurance company subsequently pays your claim for the injury, then that insurance company (as a third party) can take over your legal rights to claim against the wrongdoer. The Contracts (Rights of Third Parties) Ordinance (Cap.623 of the Laws of Hong Kong) which came into force on 1 January 2016 has reformed the common law doctrine of privity of contract. It enables a third party to enforce a term of a contract where the contract expressly provides that the third party may do so or the term purports to confer a benefit on the third party. This Ordinance applies to all Hong Kong law-governed contracts entered into on or after 1 January 2016 save for certain types of contracts (such as contracts of employment) which are expressly excluded. If the contracting parties do not want to grant rights to third parties, they should include a clause into the contract to disable the operation of this Ordinance. Express or implied terms of a contract Generally speaking, the contracting parties are free to agree on the terms of a contract (unless such terms are illegal). However, some of the terms may not be expressly stated on the contract. These terms, known as "implied terms", are terms that have not been orally mentioned or written down by the parties, but that are still incorporated into the contract according to the law or previous dealings between the parties. Liquidated damages (compensation) Liquidated damages are a genuine pre-estimation of the loss or damage that would result if a certain event were to happen during the performance of the contract. A contract term that specifies liquidated damages binds the parties, whereas a "penalty clause" in the contract (i.e. when there is no genuine pre-estimation and the amount of compensation is arbitrary stated) is not binding. Legality Certain contracts are illegal under the law. Here are some examples: a contract to insure the life of a person in whom the insurance buyer has no insurable interest, contracts to commit a crime, contracts to corrupt public life (to bribe government officials), contracts to defraud the Inland Revenue Department, and contracts to oust the jurisdiction of the courts. Genuine consent of the parties There must be no threats of physical danger in the drawing up of a contract (i.e. a party cannot be forced by the other party to enter into a contract). Otherwise the contract may be

voidable, in which the party who needs the protection can seek to avoid the contractual liability. Discharge of contract With regard to the performance of contractual duties, the law requires the parties to perform all of their obligations under the relevant contract. However, a contract may be discharged by mutual agreement, performance of contractual duties, breach or frustration (the occurrence of certain unforeseen events that make a contract impossible to perform). (Note: This answer highlights only a few of the important issues. There may be other information that you need to know before signing a contract, in which case a lawyer is in a better position to help you.) Formalities of a contract As discussed above, a contract can be made orally or in writing. However, in reality, it is always difficult, if not impossible, to prove the content or even the existence of an oral contract. It is therefore always preferable to prepare and sign a business contract in writing. In terms of business contract, you may have come across the terms “agreement” and “deed”. So what are the differences between them? When to use an “agreement” and when to use a “deed”? By way of an “agreement”, the parties of a contract agree to do somethings which the other party desires. As discussed above under the section of “Consideration”, for a contract to be legally binding, each party has to provide and obtain benefit (i.e. the consideration) from the transaction. This sounds very typical in the business world. But what about some atypical cases where a party is prepared to give something to another party without getting any reward? Now this is where the “deed” comes into place. In the section on “Consideration”, we have briefly mentioned using a “deed” to construe a promise of a gift. Here are some more examples of deeds: Deed of Covenant: A covenant means a promise; and in many cases, a promise does not bear any consideration element. For example, a Deed of Covenant is usually used to evidence a donor’s promise to donate a certain sum of money regularly to a charity over a fixed period of time. Deed of Trust: By way of a trust, a trustee will be delegated with the responsibility to hold and control property for another person. The trustee may or may not receive any remuneration (i.e. consideration) for this. The document evidencing the trust should therefore be done by way of a “deed”. Deed of Guarantee: As discussed above in the section on “Personal Guarantee” and “Bank Guarantee”, it is not difficult to discern that a guarantor typically does not gain any benefit from entering into a guarantee. That is to say, there is no consideration for the guarantor to enter into the guarantee. It is therefore common for a guarantee to be executed in the form of a “deed”. Further, the deed is often described as a legal instrument in writing which transfers the title of an asset to a new owner. For example an “Agreement for Sale and Purchase” signifies the parties’ readiness to buy and sell; but it does not confirm the actual act of buying and selling. The parties subsequently have to enter into a “Deed of Assignment” to actually transfer the title of the subject asset to the buyer. You may also be interested in the following differences between an “agreement” and a “deed”: An “agreement” can be made either orally or in writing; a “deed” must be made in writing. An “agreement” in writing has to be signed by the parties; a “deed” must be signed, sealed and delivered. (Note: The act “signed” is obvious and probably does not require any explanation. The act “sealed” originally involves the use of sealing wax, but in modern days it only requires fixing a small red label onto the document. For delivered, the parties simply has to show an intention to be bound by the deed; in the case of companies, the law presumes that a document, if executed pursuant to certain procedures, is to be presumed to be delivered as a deed upon its execution (section 128 of the Companies Ordinance (Cap.622)). Contemporary law has also dispensed with some of the above formalities regarding the execution of a deed. The law now only imposes a “face value requirement”. In other words, if a document describes itself as a deed, it is a deed. For example, the words “executed as a deed” in the document would suffice to make it a deed. It may not be easy for a business person without legal training to decide whether to use an agreement or a deed to establish a contract. We strongly suggested that you should consult a lawyer before entering into any important contract, be it an agreement or a deed. 3. IF ONE PARTY BREACHES A CONTRACT TERM, WHAT CAN THE OTHER PARTY DO? WHAT ARE THE POSSIBLE LIABILITIES OF THE DEFAULTING PARTY? 3. IF ONE PARTY BREACHES A CONTRACT TERM, WHAT CAN THE OTHER PARTY DO? WHAT ARE THE POSSIBLE

LIABILITIES OF THE DEFAULTING PARTY? The first issue is whether the contract violation is a breach of condition or a breach of warranty. A condition is a central (major) term of the contract. If a party breaches a condition, the other party has the right to be discharged from the contract and to claim damages (compensation). A warranty is a minor term. Breach of a warranty by a party gives the other party the right to claim compensation, but not to be discharged from the contract. Whether a contractual term is a condition or a warranty should be determined using common sense, but it also depends on the seriousness of the infringement. The trade custom or previous dealings between the parties (if any) should also be considered. If such a dispute is brought before a court, then the judge will make the final decision. You should try to seek legal advice before taking legal action. Generally speaking, the innocent party can choose to take the following measures: treat the contract as discharged and sue for compensation (if a condition has been breached); continue to act on the contract but sue for compensation; or request the court to grant an order for specific performance, injunction, rectification or rescission (*note), provided that no third party's rights are affected. (*Note: "Specific performance" aims to compel the defaulting party to carry out its contractual obligations. "Injunction" means requiring the defaulting party to stop doing something. "Rescission" means cancelling the contract and restoring the parties to the position that they were in before the contract was made (e.g. refund of any money paid or return of any goods delivered)). The innocent party's duty to mitigate (minimise the loss) A party who suffers loss as a result of a breach of contract must take reasonable steps to avoid further loss and to prevent the effects of the breach from multiplying unnecessarily, otherwise that party may not be entitled to full compensation from the defaulting party. 4. TO AVOID CERTAIN LIABILITIES, SOME BUSINESS PEOPLE INSERT EXEMPTION OR EXCLUSION CLAUSES INTO THEIR CONTRACTS. ARE THESE CONTRACT TERMS VALID UNDER THE LAW? 4. TO AVOID CERTAIN LIABILITIES, SOME BUSINESS PEOPLE INSERT EXEMPTION OR EXCLUSION CLAUSES INTO THEIR CONTRACTS. ARE THESE CONTRACT TERMS VALID UNDER THE LAW? Exemption clauses are used to avoid liability when things go wrong. Such clauses are not always effective, and are regulated by the Control of Exemption Clauses Ordinance (Cap. 71 of the Laws of Hong Kong). Exemption clauses that exclude liability for death and personal injury are usually not effective. For those that exclude liability for financial loss or damage to property, their validity is subject to a "reasonableness" test. Schedule 2 of the Control of Exemption Clauses Ordinance sets out some guidelines on what may be considered "reasonable". Exemption clauses are also controlled by the rules of common law. For example, an exemption clause must be incorporated into the contract, and the person who is seeking to rely on the exemption clause must show that reasonable steps have been taken to bring the clause to the attention of the other party. 5. WHAT IF I AM MISREPRESENTED (MISLED) BY OTHERS IN ENTERING INTO A CONTRACT. WILL THE LAW HELP ME TO DISCHARGE THE CONTRACT OR CLAIM COMPENSATION? 5. WHAT IF I AM MISREPRESENTED (MISLED) BY OTHERS IN ENTERING INTO A CONTRACT. WILL THE LAW HELP ME TO DISCHARGE THE CONTRACT OR CLAIM COMPENSATION? A person who makes a false statement of fact that induces (or persuades) another person to enter into a contract is guilty of making a misrepresentation. The three pre-requisites for misrepresentation are: (i) someone has given a statement of fact, (ii) that statement is wrong, and (iii) that false statement induced the innocent party to enter into the contract. Note that a "statement of fact" is different from a "statement of opinion". For example, a car seller would only have given a statement of opinion if he told you that a van might be able to carry 1,000 kg of goods and asked you to try it before confirming your order. However, he would have made a statement of fact if he told you that the van had a 2,500 cc engine. The seller would be liable for misrepresentation if you confirmed your order as a result of his statement, but subsequently discovered that the actual capacity of the van's engine was only 1,500 cc. The Misrepresentation Ordinance (Cap. 284 of the Laws of Hong Kong) allows the innocent party to apply to court to rescind the contract (cancel the contract and restore the parties to where they were before the contract was made) and to claim compensation. 6. WHAT IF I NEED TO USE A MIDDLEMAN (SUCH AS AN AGENT) TO ACT ON MY BEHALF TO NEGOTIATE FOR BUSINESS OR ENTER INTO CONTRACTS WITH OTHERS. WHAT SHOULD I BE AWARE OF IN SUCH KINDS OF BUSINESS DEALINGS? 6.

WHAT IF I NEED TO USE A MIDDLEMAN (SUCH AS AN AGENT) TO ACT ON MY BEHALF TO NEGOTIATE FOR BUSINESS OR ENTER INTO CONTRACTS WITH OTHERS. WHAT SHOULD I BE AWARE OF IN SUCH KINDS OF BUSINESS DEALINGS? When a person or company sells products through sales agents, that person or company (as the principal) is liable for any contracts that are entered into by its agents, and may be sued on these contracts. The agent, who is not a party to the contracts, is generally not bound by the contracts between the principal and the other party. However, the agent may be personally liable if he acted without the necessary authority (did not act according to the principal's instruction). The duties of the agent towards the principal include acting in accordance with the principal's instructions with due care and skill, avoiding conflicts of interest, keeping confidential all aspects of the principal's business affairs (in particular avoiding the disclosure of confidential information to competitors), keeping proper accounts and disclosing any personal interest that might influence the principal in making the contract of agency. The duties of the principal towards the agent include paying the agreed remuneration (or the amount that the services are worth if not expressly stated in the agency contract), and indemnifying the agent for all liabilities and out-of pocket expenses that are reasonably incurred during the course of carrying out the agent's duties, unless such expenses are expressly excluded in the contract of agency. 1. WHAT SHOULD I BE AWARE OF BEFORE MAKING A CONTRACT WITH OTHERS THROUGH THE INTERNET?
1. WHAT SHOULD I BE AWARE OF BEFORE MAKING A CONTRACT WITH OTHERS THROUGH THE INTERNET?
According to section 17 of the Electronic Transactions Ordinance (Cap. 553 of the Laws of Hong Kong), contracts can be made by means of electronic records (such as e-mails) unless otherwise agreed by the contracting parties. In addition, electronic records that can be accessed for subsequent reference are allowed as evidence in court proceedings, except those that are set out in schedule 1 to the Electronic Transactions Ordinance such as wills, power of attorney, contracts for sale of land or real estate and mortgages. If the contract requires the signatures of the parties (but does not involve government organisations), then the parties can use any form of electronic signature that is reliable, appropriate and agreed by the recipient of the signature. For example, the parties may sign a hard copy, scan the document into a computer and then send it via e-mail. If the contract involves government or banking services, the parties must use "digital signatures", which are supported by a recognised certificate that is issued by the Postmaster General. For more information about digital signatures, please go to the website of the Hongkong Post. If a contract is made between two persons or companies in different countries over the Internet, then that contract will be enforced by the law of the place with the closest connection to the contract (* note). In terms of taxation, the tax law of the place where the profits are made will apply (unless otherwise stated). For example, if you ship your goods to Japan and sell them there, then you will be liable for Japanese tax. However, this is only the basic rule. You should consult an expert in that field before proceeding with such business. (* Note: In determining which place has the closest connection to the contract, the common law generally takes the following factors into consideration: the place of contracting, the place where the contractual duties are performed, the places of residence or businesses of the parties, and the nature and subject matter of the contract. However, the courts stress that these factors are not exhaustive, and that any other factors which are relevant to the contract may also be considered. You should therefore seek legal advice if there is a query or dispute.) Care must also be taken when submitting personal information through the Internet. The Personal Data (Privacy) Ordinance (Cap. 486) provides for specific controls over the use of the data by merchants and the rights of consumers to access their own data. You can obtain more information concerning this matter from the Personal Data Privacy topic. ANSWER TO SCENARIO 1 SCENARIO 1 Company A advertised a conference table for sale for $50,000 in a local daily newspaper. They received one telephone call in response to the advertisement, and the manager of Company A arranged to meet the caller, the representative of Company B, at the showroom of Company A. Having inspected the conference table, the representative of Company B said that Company B would buy it but that they would need time to arrange the payment. Before leaving the showroom, the manager of Company A and the representative shook hands and exchanged business cards.

Three days later, the representative of Company B telephoned the manager of Company A to say that he would deliver the cash to Company A the next day. The manager of Company A said nothing in response. Can the manager of Company A refuse to sell the conference table to Company B when the representative of Company B arrives at the showroom of Company A with the $50,000? Answer In contract law, an advertisement is only an invitation to treat (an invitation requesting the other party to make an offer, see the relevant question and answer) unless there is other evidence to the contrary. Therefore, the advertisement of Company A was not an offer, and no contract can be invoked at this stage. The gesture of Company B's representative that was made at the showroom probably did not constitute an offer to buy the table, as there was still some doubt as to when or whether payment could be arranged. The second telephone call from the representative of Company B constituted an offer, but the silence of the manager of Company A cannot be construed as an acceptance of that offer. As Company A has not made a valid acceptance, no contract has been created. The manager of Company A can thus refuse to sell the conference table to Company B. ANSWER TO SCENARIO 2 SCENARIO 2 The manager of Company A, a printing company, ordered a new colour printing machine from Company B to be delivered on 1 November. The machine was not delivered on time, but because there is a low demand for printing services between November and February, the manager of Company A did not contact Company B about the matter until 20 February of the next year, when he sent a fax to Company B enquiring about delivery of the machine. He was told by return fax that the machine would be delivered the following week. However, the machine was not delivered for another three months. Since the time when the manager of Company A enquired about the delivery of the machine, Company A has only been able to fulfil 50% of the printing jobs that it could have handled had they had the machine. Can Company A purchase the printing machine from another manufacturer and sue Company B for damages (compensation)? Would the basis for the calculation of the damages be different if Company A had also lost a profitable printing order because they were not able to meet the deadline for delivering the work without the new machine? Answer Time of delivery is vital to the performance of a sale of goods contract. Company A is entitled to damages if it can show that the late delivery caused actual business loss. If Company A has to pay a higher price for a new printing machine from another manufacturer to meet its printing deadlines, then it can also claim for the additional purchase price (provided that Company A has exercised reasonable effort to obtain the best offer in the market). However, Company A may not be entitled to claim for the loss of profits from the profitable order, as the order had not been converted into a formal contract and it is difficult for Company A to justify the loss. ANSWER TO SCENARIO 3 SCENARIO 3 Mr. A and his brother Mr. B were partners in a garment manufacturing company business for many years. On the advice of their accountant, they formed a limited company (A & B Ltd) and invited Mr. B's son to join them in the business. It was agreed that Mr. A and Mr. B would each hold 40% of the shares and that B's son would hold the remaining 20%. Recently, Mr. A and Mr. B have been unable to agree on the design, quality of fabric or colour of their products, and consequently have neglected the business. They have failed to pay their suppliers and are unable to fulfil their contracted orders. Mr. B's son always agrees with his father. As a result, Mr. A now refuses to communicate with either of them. Are there any grounds on which A & B Ltd can be wound up by the court? Answer A & B Ltd can be wound up by the court on any of the following grounds under section 177(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance: After the three owners have arranged to pay all of the outstanding amounts to their suppliers, they (as the members (shareholders) of A&B; Ltd) pass a special resolution agreeing to have the company wound up by the court. The business of A&B; Ltd has been suspended for a whole year. The debts that A&B; Ltd owe to its suppliers exceed $10,000 and a statutory demand has been served on A&B; Ltd and A&B; Ltd has, for 3 weeks after the service, failed to pay the sum due. The court is of the opinion that it would be just and equitable for A&B; Ltd to be wound up, as there is a breakdown of mutual trust and confidence among the three persons who are the shareholders and directors of A&B; Ltd that prevents the proper management of the company. For more information about the winding-up of a limited company, please go to the Bankruptcy, Individual Voluntary

Arrangement and Winding-up of Companies topic. 1. PART 1 PRELIMINARY 1. PART 1 PRELIMINARY Part 1 defines key terms used in the CO. For example, What is a “private company” and what is a “public company”? What is the difference between a “holding company”, an “associated company” and a “subsidiary”? What is an “ordinary resolution” and what is a “special resolution”? It is important to note that certain key terms defined in the CO may not carry the same meaning as used in daily language. For example, the term “responsible person”, in daily language, would simply mean someone who is responsible for doing something. But in the CO, it means a company’s officer or shadow director who authorizes or permits or participates in the contravention of the CO or failure to comply with a requirement or direction. A “responsible person” may therefore be subject to criminal sanction in such context. It is therefore essential to make sure you are acquainted with the use of certain terms used in the CO. 2. PART 2 REGISTRAR OF COMPANIES AND COMPANIES REGISTER 2. PART 2 REGISTRAR OF COMPANIES AND COMPANIES REGISTER This part deals with the general functions and powers of the Registrar of Companies (“the Registrar”). Under section 23, the Registrar may specify the form of any document required for the purposes of the Ordinance. The Registrar may issue guidelines— indicating the manner in which the Registrar proposes to perform any function or exercise any power; or providing guidance on the operation of any provision of the CO (section 24). According to section 45, the Registrar must make the Companies Register available at all reasonable times for public inspection. 3. PART 3 COMPANY FORMATION AND RELATED MATTERS 3. PART 3 COMPANY FORMATION AND RELATED MATTERS Company Formation Section 66 sets out the types of companies that may be formed under the CO : - private companies limited by shares; public companies limited by shares; private unlimited companies with a share capital; public unlimited companies with a share capital; and companies limited by guarantee without a share capital. Abolishing the Memorandum of Association As discussed above, it used to be the law that a company must have a memorandum of association which sets out what it can do as a legal entity. However, the CO, which follows the modern trend of law of most jurisdictions, have abolished the memorandum of association For companies formed under the old regime, the conditions in the memorandum are deemed to be contained in the articles of association, except for conditions relating to authorised share capital and par value, which are regarded to have been removed for all purposes (section 98). Companies which apply to be incorporated under the CO need to submit only their incorporation form and articles of association. Any person or persons may form a company by signing the articles of association of the company intended to be formed and delivering to the Registrar for registration a copy of the articles in the same form as those signed by the founder members, together with a completed incorporation form. The agreement by the founder members to form a company and take up membership of the company to be formed, previously contained in the memorandum of association, is now contained in the articles (section 67). Mandatory Articles of Association Companies incorporated under the CO are required to have certain mandatory articles of association: for instance, the company name (section 81), details of the company’s liabilities, or contributions of the founding members (sections 83 and 84). Companies incorporating under the CO are required to have as one of their mandatory articles a statement of their capital and initial shareholdings, which is also required to be contained in their incorporation forms. According to section 85(1), this requirement applies only to companies incorporated under the CO. It is not necessary for companies incorporated under the old regime to amend their articles to include this provision. Model Articles of Association According to section 79, a company may choose to adopt any or all of the provisions of the model articles of association prescribed for the type of company to which it belongs. These model articles are prescribed in Schedules 1 to 3 of the Companies (Model Articles) Notice (Cap. 622H). Three sets of model articles are prescribed by the Notice: one set for public companies limited by shares, one for private companies limited by shares, and one for companies limited by guarantee. The model articles prescribed for each type of company form part of the articles of a company if it does not register any other articles, and the model articles apply unless they are excluded or modified by the company’s registered articles (section 80).

Optional Articles Under section 82(2), companies may still choose to include objects in their articles. The articles of a company with a share capital may also state the maximum number of shares that the company may issue. “Limited”/ “有限公司” Limited Companies can only be registered with “Limited” as the last word of their English name or “有限公司” of their Chinese name (section 102). Common Seal The old regime required that every company have a common seal with the company name engraved in legible characters. Under the current law, a common seal is no longer mandatory. The keeping and use of a common seal is optional. A company may execute a document under its common seal (if it has one); and if the company executes a document under its common seal, it must comply with provisions related to the common seal as stated in its Articles of Association (section 127). 4. PART 4 SHARE CAPITAL 4. PART 4 SHARE CAPITAL Par Value, Share Premium, Authorized Capital…outdated concepts Section 135 provides that shares in a company have no nominal value. This applies to companies both under the new system and the old regime. As a result, concepts such as “par value”, “share premium” and “authorized capital”, which are applicable only in terms of the old regime of company law, are no longer used. Under section 98(4), conditions in the memorandum of association of a company incorporated under the old regime relating to authorized capital and par value are for all purposes regarded as obsolete. Share capital represents the total amount that the company actually receives from its shareholders as capital contribution; there is no need to maintain a separate share premium account. Alteration of Share Capital With the elimination of par value, a company can consolidate and subdivide shares more easily by simply reducing or increasing the number of shares without affecting its share capital. Bonus shares may still be issued in the absence of a share premium, as shares can be issued without transferring an amount to the share capital account. Under section 170, a company may— increase its share capital by allotting and issuing new shares in accordance with Part 4; increase its share capital without allotting and issuing new shares, if the funds or other assets for the increase are provided by the members of the company; capitalize its profits, with or without allotting and issuing new shares; allot and issue bonus shares with or without increasing its share capital; convert all or any of its shares into a larger or smaller number of shares; cancel shares— that, at the date the resolution for cancellation is passed, have not been taken or agreed to be taken by any person; or that have been forfeited. Transitions and Savings Section 149 provides that a company may apply its capital to writing off the preliminary expenses of the company, commissions paid, or any other expenses of any issue of shares. Sections 194 to 199 modify the merger and group reconstruction relief, so the two types of relief may operate in a no-par environment. Sections 35 to 41 of Schedule 11 contain transitional provisions relating to migration from shares having nominal value to shares having no nominal value. The contractual rights defined by reference to par or nominal value and related concepts will not be affected by the migration to no-par. 5. PART 5 TRANSACTIONS IN RELATION TO SHARE CAPITAL 5. PART 5 TRANSACTIONS IN RELATION TO SHARE CAPITAL Uniform Solvency Test Section 204 provides that a uniform solvency test be applicable to a reduction of capital, buy-backs, or financial assistance. The test is essentially a solvency statement in a specified form made by directors (section 206) who have formed the opinion that the company satisfies the solvency test in relation to the transaction concerned (section 205). In forming their opinion, the directors must inquire into the company’s state of affairs and prospects, and take into account the contingent and prospective liabilities of the company. The solvency statement must be made and signed by all directors for buy-backs or reductions of capital, and made and signed by a majority of directors for financial assistance. There is no requirement for an auditors’ report to be attached to the solvency statement. Reduction of Capital based on Solvency Test It is now possible to achieve reduction of capital by special resolution (without the necessity of court proceedings), subject to satisfaction of the solvency test and certain specified procedures, as follows: All the directors need to sign the solvency statement in support of the proposed reduction (section 216). The company needs to obtain members’ approval by a special resolution (sections 215 and 217). The company must publish notices with the relevant information in the Gazette and newspapers, and must register the solvency

statement with the Registrar (section 218). Any creditor or non-approving member of the company may, within five weeks after the special resolution is passed, apply to the court for cancellation of the resolution (sections 220, 221 and 222). During this five-week period, the company must make available the special resolution and solvency statement for members' and creditors' inspection (section 219). The company must deliver to the Registrar after the five-week period (but no later than seven weeks) a return in specified form if there is no court application (section 224), or within 15 days after the court makes the order confirming the special resolution or the proceedings are ended without determination by the court (section 225). The reduction of share capital takes effect when the return is registered by the Registrar. 6. PART 9 ACCOUNTS AND AUDIT 6. PART 9 ACCOUNTS AND AUDIT Reporting Exemption Certain companies are allowed to prepare simplified financial and directors' reports. Sections 359 to 366A and Schedule 3 set out the qualifying conditions for companies to prepare simplified financial and directors' reports- A "small private company" or a private company that is the holding company of a "group of small private companies" that satisfies any two of the following conditions automatically qualifies for simplified reporting - total (or aggregate total) annual revenue of not more than HK$100 million; total (or aggregate total) assets of not more than HK$100 million; no more than 100 employees. An "eligible private company" or an eligible private company that is the holding company of a "group of eligible private companies" that satisfies any two of the following conditions and has the approval of members holding at least 75% of the voting rights with no other members objecting qualifies for simplified reporting - total (or aggregate total) annual revenue of not more than HK$200 million; total (or aggregate total) assets of not more than HK$200 million; no more than 100 employees. A "small guarantee company" or a guarantee company that is the holding company of a "group of small guarantee companies" automatically qualifies for simplified reporting if its total annual revenue or aggregate total annual revenue (as the case may be) does not exceed HK$25 million. "Mixed group": If a group of companies consists of (i) small private company or eligible private company; and (ii) small guarantee company, and the holding company of this group of companies is a small private company or an eligible private company or a small guarantee company, then the group of companies also qualify for simplified reporting. For more details on the types of companies defined in the CO under this part, please refer to the following sections: Types of companies as stated in the CO Relevant sections "small private company" Section 359(1)(a)(i) Section 361 Schedule 3 section 1(1) and (2) "group of small private companies" Section 359(2)(a),(b) and (c)(i) Section 364 Schedule 3 section 1(7), (8) and (9) "eligible private company" Section 359(1)(c) Section 360(1) Section 362 Schedule 3 section 1(3) and (4) "group of eligible private companies" Section 359(2)(a),(b) and (c)(ii) Section 360(2) Section 365 Schedule 3 section 1(10), (11) and (12) "small guarantee company" Section 359(1)(a)(i) Section 363 Schedule 3 section 1(5) and (6) "group of small guarantee companies" Section 359(3) Section 366 Schedule 3 section 1(13) and (14) "mixed group" Section 366A Section 380(7) provides that these companies are not required to give a "true and fair view" of the financial position of the company as at the end of the financial year or the financial performance of the company for the financial year in their financial statements. Under section 388(3)(a), they are not required to include a business review in the directors' report to comply with Schedule 5. Under sections 3(3A), 4(3), 8(3) and 10(7) of the Companies (Directors' Report) Regulation (Cap. 622D), they are not required to disclose the following in the directors' report:- directors' interests in arrangements to enable directors to acquire benefits through the acquisition of shares or debentures; donations; directors' reasons for resignation or refusal to stand for re-election; or the material interests of directors in transactions, arrangements or contracts of significance entered into by a specified undertaking of the company. Under section 23 of the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G), there is also no requirement to disclose in the notes to financial statements the material interests of directors in transactions, arrangements or contracts of significance entered into by the company. 7. PART 10 DIRECTORS AND COMPANY SECRETARIES 7. PART 10 DIRECTORS AND COMPANY

SECRETARIES This part deals with the appointment, removal or resignation of directors or company secretaries. Number of Directors Section 454 requires that all Private Companies have at least one director. Section 453 requires that Public Companies and Companies with a limited Guarantee have at least two directors. Section 457 restricts corporate directorship by requiring a private company (other than one in the same group as a listed company) to have at least one director who is a natural person. Directors' Duty of Care, Skill and Diligence As stated in section 465(1), a director must exercise reasonable care, skill and diligence. In deciding whether a director has exercised reasonable care, skill and diligence, his or her conduct is compared to the standard that would be exercised by a reasonably diligent person having - the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (section 465(2)(a)); and the general knowledge, skill and experience that the director has (section 465(2)(b)). The test is a mixed objective and subjective test. Section 465(5) states that the duty applies to a shadow director. Section 466 preserves the existing civil consequences of breach (or threatened breach) of the duty. Ratification of the Conduct of Directors involving Negligence, etc. Section 473 states that any ratification by a company of conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be approved by a resolution of the members of the company disregarding the votes in favour of the resolution by the director, any entity connected with the director, or any person holding shares of the company in trust for the director or for the connected entity. Section 473(7) states that section 473 does not affect: any other Ordinance or rule of law imposing additional requirements for valid ratification; or any rule of law as to acts that are incapable of being ratified by the company. Indemnity to Directors Section 469 permits a company to indemnify a director against liability incurred by the director to a third party if the specified conditions are met. Certain liabilities and costs must not be covered by the indemnity, such as criminal fines, penalties imposed by regulatory bodies, defence costs of criminal proceedings where the director is found guilty, or defence costs of civil proceedings brought against the director by or on behalf of the company or an associated company in which a judgment is given against the director (section 469(2)). A company which provides any permitted indemnity to its directors or its associated company's directors must disclose the indemnity provision in the directors' report (section 470) and make it available for inspection by any member on request (sections 471 and 472). 8. PART 12 COMPANY ADMINISTRATION AND PROCEDURES 8. PART 12 COMPANY ADMINISTRATION AND PROCEDURE Written Resolutions in lieu of Meetings Section 548 provides for procedures for proposing, passing and recording written resolutions in lieu of passing resolutions in general meetings. Section 549 provides that directors or other members of a company may propose a resolution as a written resolution. Under section 551, the member of the company who proposes the resolution may request the company to circulate with the resolution a statement of not more than 1,000 words on the subject matter of the resolution. Once a written resolution is proposed, the company has a duty to circulate the resolution to every member for agreement if it has received a request to do so from members representing not less than 5% of the total voting rights or a lower percentage specified in the company's articles (section 552). According to section 553, the circulation may be effected by sending the copies in hard copy form or electronic form, or by making a copy available on a website. Under section 558, the period for agreeing to the proposed written resolution is 28 days from the time of circulation or such period as specified in the company's articles. Members may signify their agreement to a proposed written resolution and send it back to the company either in hard copy form or electronic form (section 556). Under section 559, if a resolution is passed as a written resolution, the company must send a notice of that fact to every member and the auditor of the company within 15 days. Dispensation with annual general meetings Companies can dispense with annual general meetings by the unanimous consent of members (sections 612, 613 and 614). Keeping of Significant Controllers Register With effect from 1 March 2018, all companies incorporated in Hong Kong, except listed companies, are required to obtain and maintain up-to-date information concerning significant controllers of the company by

way of keeping a significant controllers register, for inspection by law enforcement officers upon demand. A significant controller (“SC”) includes a “registrable person” (who is a natural person) or a “registrable legal entity” (which is a shareholder of the company) that has “significant control” over the company (sections 653C and 653D). A person or entity has “significant control” over a company if one or more of the following 5 conditions specified in Part 1 of Schedule 5A of the CO are met: the person or entity 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 or entity holds, directly or indirectly, a right to share in more than 25% of the capital or profits of the company; the person or entity holds, directly or indirectly, more than 25% of the voting rights of the company; the person or entity holds, directly or indirectly, the right to appoint or remove a majority of the board of directors of the company; the person or entity has the right to exercise, or actually exercises, significant influence or control over the company; and the person or entity 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, but whose trustees or members satisfy any of the first four conditions (in their capacity as such) in relation to the company. Section 653H provides that a company must keep a significant controllers register (“SCR”) which is either in the English or Chinese language. A SCR must contain the particulars mentioned in Section 653I and Schedules 5B and 5C. Such particulars shall be entered into the SCR within the prescribed time limit (Section 653I). The SCR should be kept at the company’s registered office or a prescribed place in Hong Kong (Section 653M). Section 653P provides that a company is required to take reasonable steps to identify its SC such as issuing notice to any person that the company knows or has reasonable cause to believe to be a SC or to know the identity of another person who is a SC (Section 653P) and must keep the information in the SCR up-to-date (Section 653T). A SCR should be open for inspection by law enforcement officers upon demand and taking of copies by a law enforcement officer (Section 653X). The company is required to designate at least one representative to provide information about the SCR and related assistance to law enforcement officers (Section 653ZC). 9. PART 19 INVESTIGATIONS AND ENQUIRIES 9. PART 19 INVESTIGATIONS AND ENQUIRIES This part deals with investigations and enquiries into a company’s affairs by Inspectors appointed under sections 840, 841 and 853, or the Financial Secretary. This part also provides a new power for the Registrar to obtain documents, records and information for the purpose of ascertaining whether there has been any conduct that would constitute specified offences relating to giving a false or misleading statement. An Inspector can require a person to preserve records or documents before presenting them to the Inspector (section 846(1)(b)), and can require a person to verify by statutory declaration any answer or explanation given to the Inspector (section 848(2)). Under section 863, criminal sanctions are introduced for non-compliance with a request made by an Inspector. Section 864 introduces an express provision to allow the court to order compliance with a request made by an Inspector, not just to punish for non-compliance. These powers are based on similar powers found in the Securities and Futures Ordinance, Cap.571 and the Financial Reporting Council Ordinance, Cap.588. Sections 880 to 882 contain confidentiality provisions relating to information obtained in both investigations of a company’s affairs by an Inspector under the provisions set out in Division 2 of Part 19, and enquiry into a company’s affairs by the Financial Secretary under the provisions set out in Division 3. Section 880 imposes a statutory obligation to preserve secrecy, and section 881 defines expressly how such information may be disclosed to other regulatory authorities. Section 882 creates an offence for breach of the secrecy provisions. Section 884 introduces provisions to provide protection (by granting immunity from liability for disclosure) to persons who volunteer information to facilitate an investigation of a company’s affairs or enquiry into a company’s affairs. Section 885 gives additional protection by expressly stating that the identity of an informer should be kept anonymous in civil, criminal or tribunal proceedings. Section 873 gives the Registrar the power to require records or documents to be produced, to make copies of the records or documents, and to require information or

explanations in respect of the records or documents, for the purpose of ascertaining whether there has been any conduct that would constitute an offence under section 750(6) or section 895(1) relating to the giving of false or misleading information in the documents delivered to the Registrar. Section 875 provides criminal sanctions for non-compliance with the Registrar's request. 3. INSTEAD OF SETTING UP A NEW BUSINESS, CAN I ACQUIRE AN ON-GOING BUSINESS? WHAT DO I HAVE TO BEAR IN MIND IF I INTEND TO DO THAT? 3. INSTEAD OF SETTING UP A NEW BUSINESS, CAN I ACQUIRE AN ON-GOING BUSINESS? WHAT DO I HAVE TO BEAR IN MIND IF I INTEND TO DO THAT? Starting a small business can be a challenging and exciting experience. However, rather than building a business from ground zero, you may consider purchasing an existing and on-going one. The advantages of acquiring an existing and on-going business are obvious. Just to name a few: the product or service is already on the market, the brand is probably well established, startup time can be significantly reduced, it is probably much easier to obtain financing, access to customer base is secured, etc. The purchaser just has to evaluate how much it is willing to pay for the business and find a seller who is willing to sell at a mutually agreed price. The most straight forward way to acquire an on-going business is to acquire all the shares in the company which runs that business. The company's entire rights, obligations and liabilities will be assumed by the purchaser. The purchaser of course has to conduct due diligence investigation on the subject company to make sure that it is buying what it really wants. The parties should then work on an agreement for sale and purchase of shares to stipulate items like price, completion date, warranties and representations by the seller, indemnity for tax liabilities, limitation of seller's liability, etc. Depending on the size and complexity of operation of the subject company, the entire sale and purchase process can be very complicated and could take months to complete. Since this is not an easy task to go through the entire sale and purchase procedure without professional assistance, the purchaser and seller will be taking considerable risks if they do not engage professionals like accountant and lawyer in the process. In cases where the purchaser only wants to acquire certain business(es) from a company instead of the entire company, the purchaser will be able to pick and choose which assets and liabilities it wishes to purchase. For example, a company may operate a chain of restaurants with different trade names; and a purchaser may be interested to acquire only one of the restaurants. In such circumstances, the parties will be dealing only with the sale and purchase of the business of that particular restaurant. This represents a transfer of business without any transfer of shares in the holding company. Apart from any agreements that the seller and the purchaser may make between themselves, the transaction will also be subject to the Transfer of Business (Protection of Creditors) Ordinance (Cap.49). This Ordinance provides that in a transfer of business, the purchaser will become liable for all the debts and obligations in relation to the carrying of the business unless the parties follow certain procedures set down by the Ordinance. The most significant procedure is that the parties have to publish a Notice of Transfer of Business in the Government Gazette not more than 4 months and not less than one month before the date the transfer takes effect. The Notice shall become complete upon the expiration of one month after its publication. The purchaser will cease to be liable for all obligations in relation to the business unless a creditor institutes proceedings against the seller in respect of any liability arising out of the business before the Notice becomes complete. If the business is run by a sole proprietor or a partnership, the concept of share-acquisition will be irrelevant. In case of sale and purchase of such a business, the scenario is similar to that discussed in the last paragraph for acquisition of business. The parties should also strictly follow the procedures set down by the Transfer of Business (Protection of Creditors) Ordinance (Cap.49).