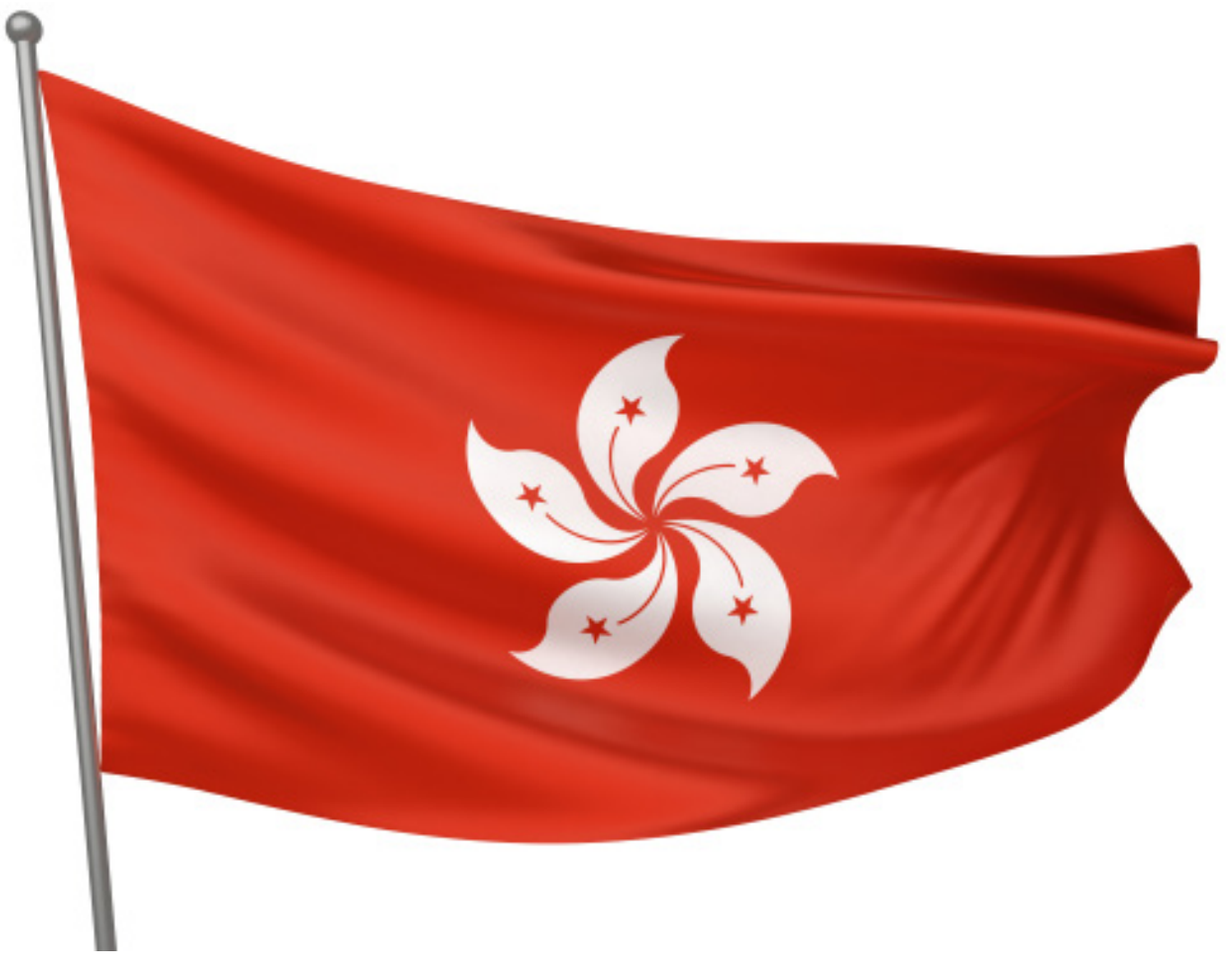
Hong Kong SAR



Chapter 1: Introduction

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An international financial centre, Hong Kong is no longer only or primarily a gateway for foreign capital inflow into mainland China. Of course, in 2019 Hong Kong continued to facilitate international investment in the mainland, much like it did in the early years after the transfer of sovereignty to the PRC in 1997. Indeed, at the end of 2018 Hong Kong's outward direct investment to mainland China accounted for more than 40 per cent of the city's total direct investment outflow, making it the most important investment destination for Hong Kong. At the same time, the mainland was Hong Kong's second-largest source of investment, with a share of 26.8 per cent of Hong Kong's inward direct investment.

However, the Hong Kong Special Administrative Region (HKSAR) has in recent years increasingly become an international centre for business, commerce and services in its own right, while reaffirming its position as a global hub for finance, trade and dispute resolution. Over the past decade Hong Kong has consistently achieved top rankings in the World Bank's annual *Doing Business* report. As recently as October 2019 the city moved up from fourth place to rank third among 190 economies in the *Doing Business 2020* report. Hong Kong was, in early 2020, the world's freest economy and – with services sectors making up more than 90 per cent of GDP – also the world's most services-orientated economy.

Hong Kong's success as an international business centre is, in part, due to the 'one country, two systems' principle enshrined in the Basic Law, which is the constitutional document for Hong Kong that guarantees the 'high degree of autonomy' of the HKSAR and recognises the concept of 'Hong Kong people administering Hong Kong'. This principle of 'one country, two systems', in turn, lays the foundation for much of the legal and economic systems on which Hong Kong's commercial fortunes rests. In this spirit, the Basic Law contains, among others, the following major provisions:

- 'The HKSAR has a high degree of autonomy, and enjoys executive, legislative and independent judicial power, including that of final adjudication.'
- 'The socialist system and policies shall not be practised in the HKSAR, and the previous capitalist system and way of life shall remain unchanged for 50 years.'
- 'The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene the Basic Law and subject to any amendment by the legislature of the HKSAR.'
- 'The HKSAR shall protect the right of private ownership of property in accordance with law.'
- 'The HKSAR remains a free port, a separate customs territory and an international financial centre… There shall be free flow of capital.'
- 'The HKSAR shall pursue the policy of free trade and safeguard the free movement of goods, intangible assets and capital.'

- ‘The HKSAR may on its own… maintain and develop relations and conclude and implement agreements with foreign states and regions and relevant international organizations in the appropriate fields, including the economic, trade, financial and monetary… fields.’

These provisions provide a constitutional footing to the preservation of Hong Kong’s common law system under the supervision of an independent judiciary, while also conferring to the SAR the power to negotiate and conclude trade and investment agreements independently of the mainland. Thanks to the ‘one country, two systems’ formula, Hong Kong has maintained its close investment and trade ties with mainland China, and at the same time has been able to nurture a business-friendly legal and regulatory environment that has led major global corporations and financial institutions to set up regional headquarters and offices in the city.

Against this backdrop, the following 13 chapters will provide an overview of various aspects of Hong Kong’s legal system, each of which is relevant in one way or another to the conduct of business in Hong Kong. In short, the following topics will be addressed:

- Chapter 2 summarises different components of Hong Kong’s business environment. In addition to highlighting initiatives that illustrate the close ties between the SAR and the mainland, the chapter provides an introduction to Hong Kong’s legal and financial infrastructure and tax regime.

- Chapter 3 outlines common forms of business and corporate structures in Hong Kong. Limited companies, unincorporated businesses and different types of business collaboration are discussed under separate headings.

- Chapter 4 concerns the M&A regime in Hong Kong, with a focus on share transfers involving private companies. Relevant legal issues are explained, followed by an overview of the due diligence exercise and the core documentation involved in the sale of a company or business.

- Chapter 5 addresses foreign investment in Hong Kong and considers two specific sectors which, by way of exception to the city’s free market economy policy, are subject to certain restrictions on investment.

- Focusing on corporate insolvency, Chapter 6 summarises winding-up procedures under Hong Kong law, as well as available statutory methods for effecting a corporate rescue. It concludes by examining Hong Kong’s cross-border insolvency regime.

- Chapter 7 discusses legal aspects of employment, industrial relations, and work health and safety in Hong Kong, including, among other things, the law relating to employment rights and contracts, as well as the termination of employment.

- Chapter 8 introduces Hong Kong’s taxation regime. To this end, the chapter first outlines different types of tax, before briefly addressing tax disputes and anti-avoidance under Hong Kong tax law.

- Intellectual property is the subject of Chapter 9, which provides a general overview of the scope of protection of the main categories of intellectual property rights in Hong Kong.

- Chapter 10 provides a general outline of the law relating to Hong Kong's financial landscape, covering the legal and regulatory framework for bank lending and the taking of security, as well as legal aspects of the city's debt and equity capital markets.
- Chapter 11 contains a summary of privacy laws and data protection in Hong Kong. A description of the regulatory framework and the data protection principles is accompanied by discussions relating to third-party processing, direct marketing and cross-border transfers of data. The chapter concludes by mentioning a recent proposal for statutory changes.
- Chapter 12, on competition law in Hong Kong, provides a general overview of the competition law regime, followed by an explanation of the First and Second Conduct Rules and the merger rule.
- To conclude the walkthrough of Hong Kong's legal environment for business, Chapter 13 deals with dispute resolution, with separate sections to address litigation before the Hong Kong courts, Hong Kong seated arbitration and mediation.

Chapter 2: Business environment

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This chapter explains the business environment in Hong Kong. Hong Kong has a market-orientated and free economy. Due to its unique history, combined with its status as a SAR of the PRC, Hong Kong has established itself as a respected international financial centre that also serves as a key gateway to the rapidly developing mainland China market. With well-established legal and financial infrastructures in place and a favourable tax regime, Hong Kong is considered a prime location for businesses to thrive.

2.1 Hong Kong's free economy

2.1.1 Overview

Hong Kong has long been recognised as one of the freest and most competitive economies in the world. Hong Kong's economy was consistently rated the freest in the world from 1995 to 2019 on the Index of Economic Freedom published by the Heritage Foundation.[1]

1 See www.heritage.org/index/country/hongkong?version=562 accessed 13 May 2020.

Hong Kong is ranked the second-most competitive economy out of 63 economies according to the *World Competitive Yearbook 2019,* published by the International Institute for Management Development.[2]

2.1.2 Free flow of capital, free port and free trade

The freedom and openness of Hong Kong's economy is supported by the adoption of positive non-interventionist economic policies as enshrined under the Basic Law of Hong Kong. In particular, Hong Kong has no foreign exchange control policies. A policy of free trade is adopted with safeguards over the free movement of goods, intangible assets and capital. Hong Kong also maintains its status as a free port. There are no trade barriers or tariffs on the import and export of goods. Hong Kong's free economy provides room and flexibility for businesses to prosper.

2.2 Gateway to mainland China

Businesses in Hong Kong are also able to access trade and investment opportunities in mainland China, taking advantage of Hong Kong's geographical location and favourable policy treatment by the central government.

2.2.1 CEPA

Hong Kong businesses enjoy preferential treatment on the trading of goods, provision of services and investment in the PRC under the mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA).

Under CEPA, all goods of Hong Kong origin enjoy a zero tariff upon being imported into mainland China.

With effect from 1 June 2020, the entry of Hong Kong service providers and professionals into the mainland China market was further liberalised pursuant to an amendment to CEPA. This amendment provides an opportunity for Hong Kong service providers to further expand their business presence in mainland China.

Hong Kong investors that fulfil the requirements under CEPA also enjoy preferential treatment regarding investment in non-service sectors, as well as further investment protection.

2.2.2 Connectivity of financial and capital markets

The Hong Kong and mainland China capital markets enjoy a high degree of connectivity, with large volumes of trades. This connectivity is enshrined in various policy initiatives, principally the Shanghai-Hong Kong Stock Connect, the Shenzhen-Hong Kong Stock Connect and the Bond Connect. These initiatives allow international investors to tap into the mainland China stock and bond markets by trading and clearing through the Stock Exchange of Hong Kong Limited (HKEX).

2 See www.imd.org/wcc/world-competitiveness-center-rankings/world-competitiveness-ranking-2019 accessed 13 May 2020.

In addition, Hong Kong is a significant offshore RMB hub. Most of the world's RMB payment transactions are processed through Hong Kong.[3] Hong Kong had the highest daily turnover of RMB foreign exchange and interest rate derivatives among offshore markets as of April 2019.[4]

2.2.3 National initiatives

With the implementation of the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area, the central government is committed to providing support to strengthen Hong Kong's status as an international financial, transportation and trade centre, global offshore RMB hub, and international asset management and risk management centre. Hong Kong also plays a significant role in the Belt and Road Initiative. Hong Kong's participation in the national initiatives will provide more opportunities for cross-border business cooperation.

2.3 International outlook

Hong Kong is a highly internationalised trade and financial hub that allows businesses to capture opportunities worldwide.

Hong Kong has established trade and economic relationships with developed economies around the world. Hong Kong has entered into free trade agreements with, among others, the ASEAN, Member States of the European Free Trade Association, Australia and New Zealand. It has also entered into investment promotion and protection agreements, and comprehensive double taxation agreements with multiple jurisdictions around the world.

Hong Kong is also a popular destination for foreign investment, ranking third and fourth in terms of FDI inflow and outflow, respectively, according to the UN Conference on Trade and Development (UNCTAD) *World Investment Report 2019*.[5]

Hong Kong is also a well-recognised international financial centre, ranking third in the world according to the Global Financial Centres Index.[6] It also has active participation in multiple regional and international financial organisations, including the WTO, Asia-Pacific Economic Cooperation, Pacific Economic Cooperation Council, Asian Infrastructure Investment Bank and Asian Development Bank.

2.4 Well-established legal and financial infrastructures

2.4.1 Legal system

Hong Kong maintains a separate legal system from mainland China. Hong Kong adopts the common law system and has an independent judiciary with the power of final adjudication. Since the handover

3 According to Brand Hong Kong's International Financial Centre Fact Sheet, as of 2019 about 75 per cent of the global offshore RMB payments are processed via Hong Kong: see www.brandhk.gov.hk/uploads/brandhk/files/factsheets/Hong_Kong_Themes/International%20financial%20centre_E_April%202020.pdf accessed 29 May 2020.

4 According to the Triennial Central Bank Survey of Foreign Exchange and Over-the-Counter Derivatives Markets in 2019, conducted by the Bank for International Settlements.

5 See https://unctad.org/en/PublicationsLibrary/wir2019_en.pdf accessed 13 May 2020.

6 See the Global Financial Centres Index 26 published in September 2019 www.longfinance.net/programmes/financial-centre-futures/global-financial-centres-index/gfci-26-explore-data/gfci-26-rank accessed 13 May 2020.

in 1997, Hong Kong has developed its own jurisprudence under the framework of the Basic Law in accordance with common law principles and with the benefit of international insights brought by the eminent judges from other common law jurisdictions appointed to Hong Kong's highest court. The mature and well-developed legal system in Hong Kong, which contains strong safeguards for private property rights and enjoys the support of a deep pool of local and foreign legal talent, serves as the backbone for Hong Kong's success as an international financial centre.

Hong Kong has developed its reputation as an international dispute resolution centre, with respected mediation and arbitration services. With the Arbitration Ordinance (Cap 609) providing a legal framework and institutions such as the Hong Kong International Arbitration Centre (HKIAC) in place, businesses have the alternative to resolve commercial disputes in a speedy and confidential manner via arbitration in Hong Kong. For an overview of Hong Kong's dispute resolution framework, see Chapter 13 (Dispute resolution).

2.4.2 Financial infrastructure

Hong Kong has a vibrant financial market. HKEX is one of the largest and most respected stock exchanges in the world. HKEX has been a popular destination for fundraising by businesses. The Hong Kong IPO market ranked first globally in terms of IPO funds raised in 2019. With new changes to the Listing Rules to allow for the listing of 'new economy' companies with a weighted voting rights structure and pre-revenue biotechnology companies, as well as secondary listing, the Hong Kong stock market is expected to become an even more diverse channel for fundraising.

The Linked Exchange Rate System pegs the Hong Kong dollar to the US dollar and provides stability to Hong Kong's monetary and financial market.

The financial sector prospers in Hong Kong with the support of a talented local workforce, with over 6.8 per cent of the population employed in the sector directly, contributing 19.7 per cent of Hong Kong's GDP as of 2018.[7]

2.5 Favourable tax regime

Hong Kong has adopted a territorial-based profits tax regime. Profits with a source in Hong Kong are taxable. With effect from the year of assessment 2018/19, a two-tiered profits tax rate was introduced. Profits tax rates for corporations and unincorporated businesses are 8.25 per cent and 7.5 per cent, respectively, on assessable profits up to HK$2m, and 16.5 per cent and 15 per cent, respectively, on any part of assessable profits exceeding HK$2m.

There is no CGT or WHT on dividends in Hong Kong.

7 See www.brandhk.gov.hk/uploads/brandhk/files/factsheets/Hong_Kong_Themes/International%20financial%20centre_E_April%202020.pdf accessed 29 May 2020.

Chapter 3: Business and corporate structures

David Norman, Allen & Overy, Hong Kong SAR

Dominic Chiang, Allen & Overy, Hong Kong SAR

This chapter highlights the common forms of business and corporate structures in Hong Kong.[8]

The most common form of business structure in Hong Kong is the limited company. Other forms of structure, such as limited partnerships, are also available, but are less commonly used. Non-entity-based structures, such as unincorporated businesses and other forms of business collaboration without separate legal personality, are also possible.

3.1 Limited company

The characteristics of and requirements regarding a limited company are set out under the Companies Ordinance (Cap 622) (CO 622).

3.1.1 Incorporating a limited company

A common way for businesses to establish a local presence in Hong Kong is by incorporating a Hong Kong limited company. Hong Kong limited companies have the following features and requirements:

- Hong Kong companies can structure their capital in a highly flexible manner. There is no requirement as to the size of the issued capital or the nominal value of the shares. Share capital may be denominated in a currency other than Hong Kong dollars.
- The constitutional document of a Hong Kong company is its articles of association, which prescribes the internal regulation of the company. The articles of association can be tailored, but must include certain mandatory articles that set out the company's name, the liability of its members, initial share capital and shareholders in accordance with CO 622. For a private company, the articles of association must also restrict the transfer of shares in the company, limit the number of its shareholders to 50 and prohibit invitations to the public to subscribe for shares or debentures in it. The articles of association must be filed with the Companies Registry and will be a matter of public record.
- A Hong Kong company must have at least one shareholder. Shareholders of Hong Kong companies may be individuals or corporations. There is no requirement for the shareholder to be a Hong Kong identity card holder or be resident in Hong Kong. Hong Kong companies must keep an up-to-date register of members and significant controllers (ie, people with significant influence or control over the company, including indirect stakeholders). These registers are not a matter of public record.

8 For the avoidance of doubt, it is noted that the forms and structures discussed in this chapter are not exhaustive.

- A Hong Kong company must have at least one director. A body corporate may be appointed as a director, but at least one director must be a natural person. There is no nationality or residency restriction on directors. The company must keep an up-to-date register of directors.
- A Hong Kong company must appoint a company secretary. The company secretary may be an individual ordinarily resident in Hong Kong or a body corporate (eg, a company secretarial service provider) having its registered office or a place of business in Hong Kong. A director may also be the company secretary except where the company has only one director. The company must keep an up-to-date register of company secretaries.
- The company must have a registered office to which any official notices or communications may be sent. The registered office need not be the address from which the company operates. It may be an address provided by a service provider.
- The company would need to appoint a Hong Kong qualified independent auditor.

The process of incorporating a limited company in Hong Kong is generally straightforward. The company must file with the Companies Registry the signed articles of association and an Incorporation Form, together with a registration fee. The incorporation occurs once the Companies Registrar has issued a certificate of incorporation and thereafter the company may commence business. Every company in Hong Kong must also obtain a Business Registration Certificate, even if it is not actually carrying on business in Hong Kong. The Business Registration Certificate must be renewed either annually or every three years, at the election of the company. Depending on the nature of the business, there may be a requirement for additional authorisations to be obtained.

3.1.2 Acquiring and activating a shelf company

As an alternative to incorporating a new company, acquiring and activating a shelf company can offer a faster and more convenient option for businesses. A shelf company can be purchased from service providers in Hong Kong. It can be activated by effecting changes in shareholders, directors and company secretaries, and commencing business activities. The Companies Registry and the Business Registration Office should then be notified of the changes.

3.1.3 Branch office and registered non-Hong Kong company

A foreign business may also consider establishing a branch office in Hong Kong. A branch office is not a legal entity and has no existence separate from the foreign business it represents. The liabilities of a branch office are accordingly borne by its foreign parent company. A branch office will also need to apply for business registration. Where a foreign company intends to set up a branch office in Hong Kong, specific legal advice should be sought as to whether it amounts to a 'place of business' within the meaning of Hong Kong legislation.

A foreign company (a company incorporated outside Hong Kong) establishing a place of business in Hong Kong is required to be registered as a non-Hong Kong company under Part 16 of CO 622.

An Application for Registration of Registered Non-Hong Kong Company should be submitted to the Companies Registry. There must be an authorised representative appointed to accept,

on behalf of the company, service of any process or notices. The authorised representative must be a natural person resident in Hong Kong, solicitor corporation, corporate practice within the meaning of section 2 of the Professional Accountants Ordinance, or firm of solicitors or professional accountants.

3.1.4 Public company and listed company

A public company is a company that has no restriction on transfer of shares, no limit on the number of shareholders or no prohibition against a public subscription of shares. A public company is subject to additional reporting requirements under CO 622.

A company that fulfils the relevant requirements under the Main Board Listing Rules or GEM Listing Rules can apply to be listed on the Main Board or the GEM board (as applicable) of HKEX. The shares of a company listed on HKEX are freely transferable. Listed companies are subject to continuous obligations on financial reporting and disclosure, and are required to maintain high standards of corporate governance under the Listing Rules. The listing of companies and the activities of listed companies are supervised and regulated by HKEX and the Securities and Futures Commission (SFC).

3.2 Unincorporated businesses

Sole proprietorships and partnerships are common forms of unincorporated business. Neither of these are a separate legal entity. With the exception of a limited partner in a limited partnership, the sole proprietor and partners bear unlimited liability.

The formation and operations of partnership and limited partnership are governed under the Partnership Ordinance (Cap 38) and the Limited Partnership Ordinance (Cap 37).

It is possible to convert an existing unincorporated business into a limited company. This can be done by incorporating a limited company and transferring the business or assets of the business to the limited company. For any business transfer within the scope of the Transfer of Business (Protection of Creditors) Ordinance (Cap 49) (TB(PC)O), the transferee will automatically assume all of the debts and obligations arising out of the carrying on of the business by the transferor unless a notice is issued and advertised in the prescribed form and manner pursuant to the TB(PC)O or unless one of a limited number of alternative defences under the TB(PC)O is available.

3.3 Forms of business collaboration

3.3.1 Commercial cooperation

Businesses may use commercial contracts as the basis of their collaboration. This provides a high degree of flexibility regarding the ownership of underlying assets or rights and allows for bespoke commercial arrangements.

3.3.2 Joint ventures

Joint ventures allow multiple parties to pursue a common business objective. The structure of a joint venture is highly flexible and may take different forms, including incorporated business (ie, based on ownership interests in a joint venture entity), unincorporated business (eg, partnership or limited partnership) or by contractual arrangement.

3.3.3 Acquisitions

Acquisition may be conducted in the form of:

- acquiring a controlling interest in or the entire share capital of an established company; or
- purchase of the business or assets of the company.

The exact structure to be adopted for each acquisition depends on the commercial, legal and tax considerations of the parties involved. If the acquisition is done by way of purchase of business or assets of the company, the operation of the TB(PC)O as discussed above needs to be considered.

For an overview of the takeovers regime in Hong Kong, see Chapter 4 below.

3.3.4 Minority/venture investment

This is typically used when a venture investor acquires a minority stake in the early stage of a startup company. The venture investor provides growth capital and know-how on the development of the business in exchange for access to a unique technology or product. Minority investment provides the venture investor with the advantage of being able to engage in risky ventures with more limited exposure. This is especially common in the innovation and technology industry.

Chapter 4: Takeovers (friendly M&A)

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4.1 Introduction

M&A in Hong Kong is typically structured through the transfer of the target company's shares, or the target company's assets, to the purchaser. Generally, share transfers tend to be more common than asset transfers in Hong Kong. Various factors are relevant in determining which structure is preferable in a particular case. For example:

- a share transfer may not be appropriate if the purchaser only wants to purchase a small or specific part of the target company's business;
- in an asset transfer, the purchaser can choose to avoid the assumption of undisclosed or contingent liabilities; and

- a share transfer may be more appropriate if the target company's assets are not transferable, for example, non-transferable government licences or non-assignable agreements with third parties, subject, of course, to any change of control provisions.

The detailed discussion in this chapter is mostly focused on share transfers involving private companies incorporated in Hong Kong with limited liability. For takeovers and mergers involving companies listed in Hong Kong, the Code on Takeovers and Mergers and the Rules Governing the Listing of Securities on HKEX are applicable. An examination of such rules is, however, beyond the scope of this chapter.

4.2 Hong Kong company law

Company law in Hong Kong has developed through the interaction and interdependence of case law and statutory law.

The Companies Ordinance sets out the general rules and regulations governing Hong Kong companies (with certain provisions applying to overseas companies having a place of business in Hong Kong) and contains a number of specific provisions relating to matters that may impact upon M&A and how they can be structured, including, among other things, the following:

- the giving of financial assistance by a company for the purchase of its own shares is subject to certain restrictions and procedural requirements, including a solvency test, and board and shareholder approval (albeit that there is also a *de minimis* threshold in lieu of obtaining shareholder approval);
- a court-free procedure for two categories of intra-group amalgamations: vertical amalgamations (between a holding company with one or more of its wholly owned subsidiaries) and horizontal amalgamations (between two or more wholly owned subsidiaries of the same company); and
- restrictions on the amount that can be distributed by way of a dividend.

4.3 Other common legal issues

4.3.1 Sectoral regulation

In Hong Kong, consent from the relevant regulatory body is required for a change of ownership of companies operating in certain sectors of the economy, including radio and television broadcasting, banking, insurance and financial services.

4.3.2 Foreign exchange and investment restrictions

Hong Kong currently does not impose controls on the inflow and outflow of foreign exchange, or any restrictions on investment or repatriation of capital or remittance of profits or dividends to or from a Hong Kong company.

Unless one of the few regulated industries is involved, there are generally no approval requirements or restrictions on foreign ownership of Hong Kong companies.

4.3.3 Consent by third parties

In many M&As, consents, approvals or waivers from third parties are required under the articles of association of the target company or shareholders' agreements relating to the target company. For example, in an acquisition of some, but not all, of the shares of a company, the consent of the other shareholders may be required to waive pre-emptive rights or other restrictions on transfer under the articles of association of the target company. Existing agreements of the target company with creditors, landlords, debenture holders, mortgagees and other contracting parties may also require consent by these parties in the event of a change in control.

4.3.4 Stamp duty

Stamp duty is charged on the sale of Hong Kong stock. Currently, the rate is calculated at 0.2 per cent of the higher amount of consideration paid and the value of shares being transferred. It is normally paid in equal proportions by the seller and the purchaser, although there is no hard-and-fast rule. Relief is available (subject to certain conditions) in respect of intra-group share transfers between associated companies (90 per cent ownership being the applicable threshold).

4.4 Typical documentation

Core documentation involved in a sale and purchase of a company or a business in Hong Kong is similar to that used in many international jurisdictions and typically includes the following:

- a confidentiality letter in which the parties undertake to keep confidential the actual transaction and any information they may obtain during the due diligence process; in some cases, it may include a provision for exclusive negotiations for a particular period so that the purchaser knows that there will be no dual negotiations or auction type process;
- a letter of intent, a memorandum of understanding, a term sheet or heads of terms setting out the key commercial terms; normally, this document would not be expressed to be legally binding except for certain specific provisions, such as those relating to confidentiality, exclusivity and liability for costs in the event of an unsuccessful transaction;
- a due diligence questionnaire and report in relation to the business or company;
- a sale and purchase agreement that specifies the obligations and liabilities of each party in relation to the sale. This normally includes detailed representations and warranties regarding the business or company; in a share transfer, all the company's obligations and liabilities remain in the company, whereas in a business sale, subject to the Transfer of Businesses (Protection of Creditors) Ordinance, the purchaser will normally be able to pick and choose which assets it wishes to purchase and which liabilities it wishes to acquire;
- a disclosure letter in which the seller makes disclosures against the representations and warranties in the sale and purchase agreement; and
- instrument of transfer, and bought and sold notes if these are shares in a Hong Kong company.

4.5 Due diligence

In any M&A, in addition to financial and business due diligence, legal due diligence in some form is normally undertaken by the purchaser. Reports on title are sometimes prepared in relation to properties owned by the target company. Other items commonly investigated in a legal due diligence include the statutory books, major contracts, plant and machinery leases, service agreements, loan details, licences/permits and particulars of litigation.

The due diligence process usually involves the following steps: a questionnaire is submitted to the target company, teams of lawyers review documents and a legal due diligence report is prepared. The report may be comprehensive or simply detail disclosures made against warranties given in the contractual documentation. In answering due diligence enquiries, the seller must be careful to avoid any misrepresentation that may subsequently be relied upon by the purchaser to rescind the agreement and claim damages.

As part of the legal due diligence, searches of publicly available information may be made at the relevant government authorities (eg, the Hong Kong Companies Registry, the Hong Kong Land Registry, the Trade Marks Registry, the Official Receiver's Office and the Hong Kong Courts in respect of litigation and winding-up proceedings) to serve as an independent check against the information provided by the seller.

4.6 Sale and purchase agreement

The terms and conditions contained in a sale and purchase agreement will depend on the commercial negotiations of the parties and the circumstances of each particular case. Some of the common provisions typically found in sale and purchase agreements are further discussed below.

4.6.1 Parties

The parties to a sale and purchase agreement would normally be seller(s) (which would be the shareholder(s) of the target company selling the shares in a share transfer, or the company selling the assets in an asset transfer) and the purchaser. Depending on the circumstances, a guarantor may also be made a party to the agreement to guarantee the obligations of the seller (eg, under warranties) or the purchaser (eg, to pay part of the consideration in instalments after completion).

4.6.2 Conditions precedent

Where it is necessary to obtain regulatory and/or other consents or approvals before completion or for the purchaser to complete further due diligence (eg, an audit) after signing the agreement, the sale and purchase agreement will be made conditional upon the fulfilment or (if feasible) waiver of such conditions precedent. In this case, the signing of the agreement and completion of the transaction will not be simultaneous. There will be a period of time between signing and completion during which the conditions precedent are to be satisfied. This would normally give rise to questions, such as who will be responsible for the fulfilment of which conditions, the

conduct of the affairs of the target company during the period between signing and completion, and the allocation of risk regarding any adverse changes in the business of the target company during such period. These questions should be addressed in the sale and purchase agreement to avoid any doubt.

4.6.3 Consideration

The sale and purchase agreement will usually stipulate the amount of the consideration, the form it will take and the timing of the payment. The consideration will usually take the form of cash, shares or loan notes, or a combination.

4.6.4 Representations and warranties

The common law rule of *caveat emptor* (or 'purchaser beware') still applies to the acquisition of shares or assets in private companies in Hong Kong. In respect of a share transfer, there is no statutory protection by way of implied terms in favour of the purchaser. A purchaser will normally require comprehensive representations and warranties to be provided by the seller in the sale and purchase agreement, covering the seller's capacity and its title to the shares in the target company (and ownership of any shareholder's loan to be assigned), the target company's financial statements and related matters, business/trading, contracts, taxation, corporate matters, title to assets, land and properties, plant and equipment, insurance, intellectual property rights, goodwill, employment matters, environmental matters, banking and finance, regulatory and tax compliance, disputes and litigation, and the accuracy and completeness of information provided by the seller.

4.6.5 Restrictive covenants

The purchaser will usually seek to include in the sale and purchase agreement provisions that restrict the competitive freedom of the seller, such as non-compete covenants, non-solicitation clauses in relation to the target company's customers, suppliers or employees, confidentiality provisions prohibiting the seller from disclosing or using any confidential information about the target company and its customers, and provisions restricting the seller from using the same or similar name as the target company. In common law, restrictive covenants are *prima facie* unenforceable as they restrain trade and are therefore contrary to public policy. However, the courts are willing to uphold restrictive covenants that they consider to be reasonable in order to protect the legitimate interest of a purchaser, for example, where there are sensible limitations in broadly three typical aspects: the geographical area restricted, the duration of the restraint and the business activities prohibited.

4.6.7 Completion

The sale and purchase agreement will usually provide that completion takes place by the delivery of a properly executed instrument of transfer and the related sold note, the original share certificate(s), the books and records and other documents of the target company by the seller in exchange for the payment of consideration by the purchaser.

The seller will procure a board meeting of the target company to be held at completion for approving the following matters:

- (subject to due stamping, if required) the registration of the purchaser or its nominees as members of the target company in its statutory records and the issuance of a new share certificate to the purchaser or its nominees;
- the appointment of the purchaser's nominees as directors and officers;
- the acceptance of the resignations of the existing directors and other officers; and
- the alterations to the authorised signatories of the target company's bank accounts

After completion, the purchaser will attend to the stamping of the instruments of transfer and the bought and sold notes, after which the transfer can be reflected in the register of members, and such registration is determinative of legal title. The purchaser should also ensure that the register of directors of the target company is updated to reflect all changes pursuant to the sale and purchase agreement, and that all necessary filing forms – for example, those relevant to the change of directors and company secretary – are submitted to the Companies Registry by the prescribed deadlines.

Chapter 5: Foreign Investment

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5.1 Overview of Hong Kong's business and investment environment

As briefly indicated in Chapter 1, over the past decade Hong Kong has consistently been recognised as having one of the most business-friendly environments in the world. Unsurprisingly, the city's business-friendly environment also appeals to investors. Among enterprise groups with existing direct investment in Hong Kong, 71 per cent considered the overall investment environment of Hong Kong to be favourable in early 2019. In the information and communications sector, this figure was 85 per cent, while as many as 92 per cent of enterprises in the banking sector had a favourable view of the city's investment environment.

The continuing attractiveness of Hong Kong as a host state for investment is likewise reflected in recent figures regarding FDI. According to the UNCTAD *World Investment Report 2019*, Hong Kong's FDI inflows amounted to approximately US$115,662m in 2018, while for the same year the amount of outward FDI was US$85,162m (with mainland China being the most important destination for outflow).

A snapshot of Hong Kong's dispute resolution framework for commercial litigation, arbitration and mediation is provided in Chapter 13. For present purposes, it is worth noting that the PRC and the Permanent Court of Arbitration signed a host country agreement and a related memorandum of administrative arrangements in January 2019. The agreement and memorandum concern the conduct of Permanent Court of Arbitration-administered arbitration proceedings in Hong Kong,

which in turn has further enhanced the city's status as an international arbitration centre, including for investor-state arbitration.

The following section considers, at a high level, the foreign investment regulatory landscape in Hong Kong. An overview of Hong Kong's business environment more generally is contained in Chapter 2.

5.2 Restrictions on foreign investment

The Hong Kong government has always upheld a free market economy policy: Article 105 of the Basic Law of Hong Kong stipulates that the ownership of enterprises and investment from outside Hong Kong must be protected by law.

There are no general restrictions on the foreign ownership of companies in Hong Kong, except in respect of certain restrictions on voting control by non-Hong Kong residents and corporations in the telecommunications sector, as set out below.

5.2.1 Sound broadcasting

Under the Telecommunications Ordinance (Cap 106), an 'unqualified person' (ie, a person that is not ordinarily resident in Hong Kong and has not at any time been resident for a continuous period of seven years or more, or a company that is not ordinarily resident in Hong Kong) shall not have an aggregate of voting shares (to or in which the unqualified person directly or indirectly has any right, title or interest) of more than 49 per cent of the total number of voting shares in a sound broadcasting licensee.

5.2.2 Domestic free television programme service

Currently, under the Broadcasting Ordinance (Cap 562), an 'unqualified voting controller' (ie, a person that is not ordinarily resident in Hong Kong and has not at any time been resident for a continuous period of seven years or more, or a company that is not ordinarily resident in Hong Kong) of a licensee of a domestic free television programme service licence must not, without the prior approval of the Communications Authority, hold, acquire, exercise, cause or permit to be exercised: (1) two per cent or more but less than six per cent; (2) six per cent or more but not more than ten per cent; or (3) more than ten per cent in the aggregate, of the total voting control[9] of such licensee (the unqualified voting controller restriction).

Where the total voting control exercised by unqualified voting controllers would exceed, in aggregate, 49 per cent of the total voting control exercised in a poll by both qualified and unqualified voting controllers, the votes cast on the poll by unqualified voting controllers must, for the purpose of determining the question or matter, be reduced in accordance with a formula set out in the Broadcasting Ordinance.

9 Voting control means the control of or the ability to control, whether directly or indirectly, the exercise of the right to vote attaching to one or more voting shares of a licensee: (1) by the exercise of a right, where such exercise confers the ability to exercise a right to vote or to control the exercise of a right to vote; (2) by an entitlement to exercise such a right to vote; (3) under a duty or obligation; (4) through a nominee; (5) through or by means of a trust, agreement or arrangement, understanding or practice, whether or not the trust, agreement or arrangement, understanding or practice has legal or equitable force or is based on legal or equitable rights; or (6) as a chargor of voting shares of a licensee unless the chargee of the voting shares or the nominee of the chargee has given notice in writing to the chargor under the charge of an intention to exercise the right to vote attaching to such voting shares.

Further, an 'associate' (regardless of whether the associate is a qualified or an unqualified voting controller) of an unqualified voting controller is restricted from holding or acquiring voting control of the voting shares of a licensee if it appears that the purpose of holding or acquiring is to avoid the unqualified voting controller restriction or other restriction imposed on the unqualified voting controller.

Chapter 6: Restructuring and insolvency

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This chapter explains the options available under Hong Kong law to deal with financial distress. In essence, the two major options are liquidation and restructuring. The various types of liquidation and restructuring techniques are explained below.

In addition, as most businesses have international elements, how Hong Kong law facilitates cross-border insolvency and restructuring will also be explained.

6.1 Legal framework

Hong Kong insolvency law draws a distinction between corporate insolvency and personal bankruptcy.

Corporate insolvency law is mainly governed by the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (CWUMPO), whereas personal bankruptcy law is mainly governed by the Bankruptcy Ordinance (Cap 6).

Further, as Hong Kong's legal system is shaped by a unique constitutional framework known as 'one country, two systems', Hong Kong law maintains the use of common law and rules of equity.

The focus of this chapter is on corporate insolvency.

6.2 Liquidation

CWUMPO provides for several different procedures to wind up an insolvent company. The winding-up procedure can be invoked on either a 'compulsory' or a 'voluntary' basis:

- compulsory winding-up: the winding-up of a company pursuant to the order of the court; or
- creditors' voluntary winding-up: the winding-up of an insolvent company without a court order.

Upon a winding-up, the company will be managed and controlled by the liquidator. The liquidator will be under a statutory duty to gather and realise the company's assets in order to make a distribution to creditors in accordance with the priority set out in CWUMPO.

Upon completion of the winding-up process, the company will be dissolved.

6.2.1 Compulsory winding-up

A company can be wound up by the court on six principal grounds, which are set out in section 177 of the CWUMPO:

- the company has, by special resolution, resolved that the company be wound up by the court;
- the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- the company has no members;
- the company is unable to pay its debts;
- the event, if any, occurs on the occurrence of which the articles provide that the company is to be dissolved; or
- the court is of the opinion that it is just and equitable that the company should be wound up.

Of the six principal grounds, the two most commonly used grounds are that the company is unable to pay its debts and that it is just and equitable for the company to be wound up.

6.2.2 Creditors' voluntary winding-up

Creditors' voluntary winding-up occurs when:

- a company in a general meeting passes a special resolution for voluntary winding-up in the absence of a certificate of solvency;
- a company is not solvent in the opinion of its directors and the directors resolve to deliver a winding-up statement to the Registrar of Companies; or
- the liquidation of the company commences as a solvent members' voluntary liquidation, but the liquidator becomes of the opinion that the company is insolvent.

6.3 Restructuring

There are two statutory methods to effect a corporate rescue.

The first is the use of provisional liquidators. In the case of a compulsory winding-up, the court may appoint a provisional liquidator after a winding-up petition is presented (before any winding-up order is made). Upon such an appointment, further proceedings against the company would be barred; in essence an automatic stay. This feature has led to a practice in the early 21st century whereby provisional liquidators were appointed pending efforts to effect a corporate rescue.

Such a practice was restricted in 2006, when the Court of Appeal in *Re Legend International Resorts Ltd* [2006] 2 HKLRD 192 held that the appointment of a provisional liquidator must be for the purpose of winding up the company. But it has recently been clarified that, as long as provisional liquidators were appointed on conventional grounds (eg, asset preservation and investigation in order to wind up the company), they can be used to effect a corporate rescue (*Re China Solar Energy Holdings Ltd (No 2)* [2018] 2 HKLRD 338).

The second method is the scheme of arrangement procedure under CO 622. The scheme procedure provides that if: (1) a debt restructuring arrangement is reached between the company and a requisite majority of creditors (ie, a majority in number representing at least 75 per cent in value voting in favour of the scheme); and (2) the court sanctions the arrangement, it will be binding on all, including dissenting, creditors. This statutory mechanism offers a helpful alternative when a unanimous work-out cannot be achieved.

The scheme procedure is, in practice, the most popular restructuring technique and it is often coupled with the use of provisional liquidators.

6.4 International insolvency

Hong Kong does not have any statutory cross-border insolvency provisions. The Hong Kong court relies only on common law to manage cross-border insolvency cases.

Under the common law cross-border insolvency regime, the Hong Kong court ordinarily recognises and assists a liquidator appointed in the country of the company's incorporation where there are no public policy issues that would prevent recognition. This includes recognising a foreign liquidator appointed voluntarily. It is possible that the Hong Kong court will recognise an insolvency office holder appointed in a jurisdiction other than the company's place of incorporation, though this point has yet to be formally decided.

Hong Kong proceedings may be required to establish the foreign insolvency officer's authority to deal with assets in Hong Kong. Recognition of a foreign insolvency officeholder's position will, in itself, confer standing on the officer to represent the foreign company in the Hong Kong courts. The insolvency office-holder may bring proceedings in the Hong Kong courts in the name of the foreign company and generally administer the assets of the foreign company situated in Hong Kong.

However, the Hong Kong courts' power to assist a foreign insolvency office-holder is limited by the extent to which the type of order sought is available under the Hong Kong insolvency regime and common law or equitable principles: hence, the court has recently refused to grant the application of administrators appointed in England for an order restraining the sale of property subject to security, on the basis that no such statutory moratorium or equivalent power exists in Hong Kong (*Joint Administrators of African Minerals v Madison Pacific Trust* [2015] 4 HKC 215).

The common law recognition regime is often used to facilitate cross-border restructuring in Hong Kong. A typical example is the recognition in Hong Kong of offshore soft-touch provisional liquidators in respect of offshore-incorporated companies that are listed in Hong Kong. Upon recognition, the offshore provisional liquidators are granted powers to pursue restructuring in Hong Kong, typically by means of a scheme of arrangement.

Insolvency protocols have been used in cross-border insolvencies between insolvency representatives appointed by the Hong Kong court and the insolvency representatives in other jurisdictions to harmonise the parallel insolvency proceedings. The Hong Kong courts have power to permit Hong Kong insolvency officeholders to enter into such protocols with their counterparts.

Chapter 7: Employment, industrial relations, and work health and safety

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7.1 Basic employment rights

The main legislation in Hong Kong prescribing the minimum rights, benefits and protections for employers and employees are the Employment Ordinance, Minimum Wage Ordinance, Mandatory Provident Fund Schemes Ordinance and Employees' Compensation Ordinance.

Such minimum rights and protection granted to all employees include (but are not limited to) the payment of wages, restrictions on wage deductions, the granting of statutory holidays, statutory minimum wage and coverage by mandatory employees' compensation insurance taken out by employers for work-related injuries under the Employees' Compensation Ordinance (such insurance should not be confused with medical benefits, which employers are not statutorily obliged to provide). All employees between the ages of 18 and 65, subject to prescribed relevant income levels and limited exemptions, must be enrolled in a recognised mandatory provident fund scheme by their employers, who in turn must make regular contributions on behalf of their employees. Whether there is an employment relationship is entirely a question of fact. An employment relationship will depend on the substance of the relationship, instead of mere formality (eg, the existence or absence of an employment contract or independent contractor agreement).

The Mandatory Provident Fund Schemes Ordinance requires both the employer and employee to contribute five per cent of the employee's salary into a mandatory provident fund. Currently, the minimum relevant income is fixed at HK$7,100 (approximately US$910). This means that if the monthly relevant income of an employee is less than HK$7,100, the employee will not be required to make the employee's contribution, but his employer remains obliged to make the employer's contribution. The current maximum level of mandatory contribution required is HK$1,500 (approximately US$190) paid each month by both the employer and the employee. The employer and/or the employee may make additional voluntary contributions to the scheme if they wish.

All employees (including prospective employees) are also protected from discrimination. Hong Kong has four discrimination ordinances (Sex Discrimination Ordinance, Disability Discrimination Ordinance, Race Discrimination Ordinance and Family Status Discrimination Ordinance) which prohibit discrimination on the grounds of sex, marital status, pregnancy, disability, race and family status in certain fields, including employment. Discrimination on the basis of trade union membership also is protected by the Employment Ordinance. Although there is currently no legislative prohibition of discrimination on the ground of age in Hong Kong, the Labour Department of Hong Kong has issued practical guidelines for employers on eliminating age discrimination in employment. Although these guidelines are not backed up by legislation, they set forth best practice, and employers and employment agencies are encouraged to follow them on a voluntary basis.

Each of the discrimination ordinances provides that it is unlawful for an employer to discriminate against a job applicant on any of the relevant prohibited grounds:

- in the arrangements the employer makes for determining who should be offered employment;
- in the terms of employment offered to a job applicant; and
- by refusing or deliberately omitting to offer employment to a job applicant.

Furthermore, each of the discrimination ordinances provides that it is unlawful to publish or cause to be published an advertisement that indicates (or might reasonably be understood to indicate) an intention to discriminate on the aforementioned grounds. Employers, therefore, should not advertise job vacancies suggesting that applicants must be, for example, of a particular gender or marital status, unless such discrimination would not be unlawful under the applicable ordinance. For example, under the DDO, it would not be unlawful for an employer to refuse to employ an applicant on the ground of his or her disability if being a person without a disability is a 'genuine occupational requirement' or where the applicant's disability would prevent him or her from performing the 'inherent requirements' of the position; although, the employer and must consider if there could be reasonable accommodation.

In regard to trade union membership, the Employment Ordinance provides that it is an offence for employers to make an offer of employment conditional upon the applicant relinquishing his or her union membership, not becoming a member of a trade union or not associating with persons for the purpose of forming a trade union.

7.2 Employment contract

Parties cannot contract out of these ordinances. The ordinances cover all employees in Hong Kong, with limited exceptions (but these exceptions do not include part-time employees). They generally also apply to expatriates working in Hong Kong and employees with an employment contract from Hong Kong who are working abroad.

Although parties are free to choose the governing law of an employment contract, the chosen governing law must have sufficient connection with the employment or it may be deemed to be an attempt to contract out of the EO. In practice, employers are advised to comply with Hong Kong employment law standards.

Although not required, a written contract is usually entered into. In addition to the express terms that are included in writing in the contract or agreed verbally, a contract of employment also consists of a number of terms implied by legislation (which parties cannot exclude) or by common law (which parties may be able to vary or exclude by express agreement).

Depending on the particular industry or employer, there may also be trade unions that negotiate workplace agreements between employers and employees. However, if an employee wishes to be bound by such agreement, he or she must make such express provision in his or her employment contract to this effect. Further, the trade union movement in Hong Kong is not particularly strong (although there has been growth recently), and employers are not obliged by law to participate in collective bargaining as there is no collective bargaining law in Hong Kong.

7.3 Expatriates

Foreign employees must obtain a proper Hong Kong visa (eg, an employment, dependant or investment visa) to work in Hong Kong. To qualify for an employment visa, a person must possess skills, knowledge or experience relevant to the job that are unavailable locally. This test can generally be satisfied in the case of an intra-company or intra-group transfer. The applicant also needs to nominate a sponsor, which must be a Hong Kong company or a foreign company registered in Hong Kong. The sponsor is usually the employer company. It normally takes six weeks for the application to be processed. The government charges a nominal fee for the visa if the application is approved.

Expatriates who either enter Hong Kong with a work visa for employment of not more than 13 months, or those who are covered by overseas retirement schemes, are exempt from the mandatory provident fund system.

7.4 Termination

It is unlawful for an employer to dismiss an employee who is: (1) pregnant or on maternity leave; (2) on paid sick leave; (3) involved in giving evidence or information in any proceedings or inquiry; (4) involved in trade unions or their activities; or (5) injured and has not yet agreed his/her compensation for the work-related injury with the employer, or before the issue of a certificate of assessment. It is also unlawful to dismiss an employee in contravention of any of the various ordinances on discrimination (currently, there are four ordinances regulating discrimination in the areas of sex, race, disability, marital status, pregnancy and family status; a recently gazetted bill is seeking to also render discrimination on the ground of breastfeeding unlawful). In the event that such employees have to be terminated, settlement agreements should be reached.

An employer can otherwise terminate an employee's employment at any time by giving notice or payment in lieu (unless prohibited for any of the reasons stated above). However, employers must ensure that employees are terminated only for valid reasons as set out in the Employment Ordinance (eg, conduct, capability/qualification and redundancy), and that the minimum notice periods are observed.

In cases of serious misconduct, an employer may terminate an employee without notice or payment in lieu of notice (summary dismissal). However, if the summary dismissal was not justified, the termination will amount to wrongful termination and the employer will be liable to pay the employee his or her entitlements had he or she been lawfully terminated (ie, with notice).

The EO sets out a statutory regime governing an employer's obligations in situations of layoff and redundancy. Unless summarily dismissed for good cause, an employee is entitled to notice (or a specific payment in lieu of notice) in such situations.

In addition, employees who have been made redundant or who are laid off are entitled to severance pay if they have been employed for two years or more.

7.5 Work health and safety

The Occupational Safety and Health Ordinance (OSHO) obliges employers to ensure, as much as reasonably practicable, the health and safety of their employees at work, such as by providing and maintaining a workplace in a safe condition without any health risks; providing information as may be necessary to ensure the health and safety of employees at work; and providing or maintaining a means of access to and egress from the workplace that are safe and without any health risks.

The Occupational Safety and Health Regulations (the 'OSHO Regulations') additionally impose certain basic minimum standards to which all workplaces must conform, including in relation to cleanliness, ventilation, lighting, drainage and hygiene. The OSHO Regulations also impose specific duties on employers to maintain fire precautions and first aid facilities, such as to ensure that at least two employees are designated with the responsibility to provide and maintain the required first aid facility, and that at least one employee for each 150 employees employed in the workplace is trained in first aid.

An employer's statutory liability regarding health and safety extends only to its employees and not to third parties, such as subcontractors and agency workers who are working on the premises. However, liability may arise with respect to the employer as an 'occupier' to the extent that the third parties are working on premises that are not controlled by their own employer. In such cases, liability for health and safety issues lies with the employer as occupier of the premises.

The Factories and Industrial Undertakings Ordinance imposes an additional general statutory duty on employers of 'industrial undertakings' (defined as including, inter alia, work in a factory, mine or quarry, restaurant or construction) to ensure, as much as reasonably practicable, the health and safety of their employees.

Furthermore, the Factories and Industrial Undertakings (Safety Management) Regulation requires proprietors and contractors, with respect to construction sites, shipyards, factories and other designated industrial undertakings (eg, electricity and gas generation and transmission, and container handling), to develop, implement and maintain a safety management system.

Other than for 'industrial undertakings', there is no specific requirement for employers to have a written health and safety policy. All employers, however, would be well advised to do so as proof that they have complied with their general duty to provide the necessary information, instruction, training and supervision regarding employee health and safety.

There also is no express statutory obligation for employers, other than those in industrial undertakings, to undertake health and safety risk assessments, even though such assessments are necessary to show compliance with the general statutory duty of care. Without periodic assessments, it may be difficult for employers to demonstrate compliance with this obligation. It also should be noted that there is a specific duty under the OSHO Regulations to assess risks to health and safety in relation to manual handling operations and display screen equipment used in the office.

Generally speaking, other than sickness leave records, there are no specific health and safety records that an employer must keep.

Chapter 8: Taxation

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8.1 Outline

Hong Kong's tax regime evolved from the colonial income tax and duty ordinances bestowed by the UK on its colonies. Unlike most former British colonies, however, Hong Kong has preserved a largely territorial system of taxation, and prides itself on being an efficient and low-tax jurisdiction. Recent developments in international taxation, however, including the emergence of Organisation for Economic Co-operation and Development (OECD)-driven global consensus on the automatic exchange of financial account information and hostility to aggressive tax planning, have impelled the rapid evolution of Hong Kong's tax code. In terms of content, form and concept, Hong Kong's tax code bears marked similarities with other common law jurisdictions, most notably Malaysia and Singapore.

Direct taxation in Hong Kong is governed by the Inland Revenue Ordinance (IRO). There is no general income tax as such, but the IRO provides for a schedular system that taxes business and trading profits, income and other emoluments from employment, and income from immovable property situated in Hong Kong. The other principal tax in Hong Kong is stamp duty, which is governed by the Stamp Duty Ordinance. Stamp duty is most relevantly charged on the sale and purchase or other transfer of beneficial interest in immovable property in Hong Kong and Hong Kong stock. Finally, there are a number of relatively minor taxing statutes, such as the Rating Ordinance, which provides for a periodic tax on tenements of land in Hong Kong, and the Dutiable Commodities Ordinance, which charges customs and excise duty.

There is no GST, VAT, or other turnover tax in Hong Kong. It is often misstated that there is no inheritance tax or estate duty in Hong Kong; in reality, the Estate Duty Ordinance remains in force, but the effective rate is currently zero per cent.

The tax year in Hong Kong runs from 1 April to 31 March of the following calendar year. The public body charged with the collection of tax and the application of Hong Kong's tax laws is the Inland Revenue Department. Certain revenue-gathering functions are also performed by the Ratings and Valuation Department and the Customs and Excise Department.

By the standards of other developed jurisdictions, tax administration and compliance in Hong Kong are relatively simple and light-touch.

8.2 Profits tax

Commercially speaking, the most important tax in Hong Kong is profits tax, which approximates tax on corporate profits in other jurisdictions. The charge to profits tax is paradigmatically territorial. Generally, in order to be chargeable to profits tax, a person must: (1) carry on a trade, profession or business in Hong Kong; (2) derive Hong Kong source profits; and (3) such profits must be the profits of the trade, profession or business carried on in Hong Kong. Those

three conditions are cumulative: if any one condition is not met, no charge to tax may arise. Consequently, the notion of tax residence is of limited relevance in the context of domestic Hong Kong taxation: profits sourced outside of Hong Kong and arising to a Hong Kong resident person will in the ordinary course not be taxable.

The most difficult concept in understanding the charge to profits tax is that of 'source'. The judicial consensus is that the source or profits is a hard, practical matter of fact to be understood in commercial rather than technical or legal terms. One looks to what the person has done to earn their profits and where they have done it, discounting antecedent or incidental matters. Put another way, one must identify the operations of the taxpayer that in substance give rise to the profits; the locality where the taxpayer conducts those operations will in most cases be taken to be the source of their profits.

Certain receipts are deemed to be chargeable to profits tax irrespective of their locality, of which the most relevant are as follows:

- royalties for the use or the right to use intellectual property rights in Hong Kong;
- interest arising to financial institutions in Hong Kong and Hong Kong source interest arising to corporations carrying on a trade or business in Hong Kong;
- sums for the right to use movable property in Hong Kong; and
- grants, subsidies and other financial assistance in connection with a trade or business carried on in Hong Kong.

Capital gains are expressly exempt from tax; note, however, that assets usually regarded as capital assets, such as securities or immovable property, may be treated as trading stock, and the gains thereof consequently charged to profits tax, if and to the extent that the vendor disposes of such assets in the ordinary course of its trade or business.

Dividends are in general not taxable. There is no WHT in Hong Kong, save in the case of royalties arising to a non-resident for the use or the right to use intellectual property rights in Hong Kong.

The deductions regime is very generous: all expenditure and outgoings incurred in the production of taxable profits (even if not wholly and exclusively so incurred) are deductible in ascertaining the assessable profits of the taxpayer. A crucial limitation to the generosity of the general deduction provision is that capital expenditure is not deductible. There are exceptions to that prohibition for, among other things:

- plant and machinery, which are eligible for depreciation allowances;
- the acquisition of trademarks, patents and certain intellectual property rights;
- environmentally friendly machinery and installations; and
- the construction of commercial and industrial buildings.

Hong Kong now offers a wide range of competitive tax incentives, including:

- reduced rates of profits tax for corporate treasury centre and aircraft-leasing businesses;
- total exemption from profits tax for bona fide widely held collective investment schemes carrying out financial transactions in or through Hong Kong; and
- super-deductions of up to 300 per cent of expenditure for R&D undertaken in Hong Kong.

Since 2018 the IRO has contained a comprehensive transfer pricing and permanent establishment regime consistent with the OECD Model Convention. Arrangements between associated parties are expected to be carried out at arm's length, and the Inland Revenue Department has extensive powers to make transfer pricing adjustments.

Profits tax is charged at the standard rate of 16.5 per cent for corporations and 15 per cent for unincorporated businesses. A lower rate of profits tax of 8.25 per cent for corporations and 7.5 per cent for unincorporated businesses is available for the first HK$2m of assessable profit, subject to certain conditions, the most relevant of which is that only one taxpayer in a given set of associated taxpayers may elect to be taxed at the two-tiered rate. WHT on royalties ranges from 16.5 per cent to 2.25 per cent, subject to the application of any applicable double taxation treaty.

8.3 Salaries tax

Salaries tax is charged on the income and other emoluments from employment arising to a person in a Hong Kong employment. A sum is from employment if it is a reward for past, present or future services of an employee in employment, or otherwise for acting as an employee. Broadly speaking, a person who renders services in employment in Hong Kong for more than 60 days will be chargeable to salaries tax with respect to the income and emoluments he or she derives from employment, though under certain circumstances he or she may be assessable on a pro rata basis as a function of the proportion of a given tax year he or she spent in Hong Kong as opposed to abroad. Again, the notion of tax residence is of limited relevance in the context of salaries tax: one in practice looks to the place where the employment contract was made and services in employment rendered. A person who spends 60 days or fewer rendering services in Hong Kong will not be chargeable to salaries tax.

The charge to salaries tax includes bonuses, perquisites and other emoluments from employment. Gains arising from the grant of shares or the exercise of options are taxable, as are other benefits in money or money's worth, though a benefit in kind will usually not be taxable if it is not capable of being converted into cash. An important exception to that rule is that accommodation provided by an employer to an employee is taxable, albeit on a highly favourable basis. The taxable value of accommodation provided by an employer is deemed to be, variously, four per cent, eight per cent or ten per cent of the employee's taxable income from employment, depending on the size of the accommodation, irrespective of the actual market rent of the property.

Hong Kong does not operate a pay-as-you-earn withholding system of salaries taxation. In the ordinary course, employees are exclusively responsible for filing their own tax returns and for accounting for any tax due.

Director's fees are chargeable to salaries tax to the extent that the company is centrally managed and controlled in Hong Kong. Pensions sourced in Hong Kong are likewise chargeable to salaries tax.

Broadly speaking, salaries tax is charged at progressive rates of up to 17 per cent or at a flat rate of 15 per cent, whichever yields the lower amount of tax.

8.4 Property tax

Property tax is charged on consideration in money or money's worth received for the right to use immovable property in Hong Kong at the flat rate of 15 per cent.

8.5 Stamp duty

Ad valorem stamp duty is a tax on instruments, that is, documents, not transactions. It is most notably charged on:

- the sale and purchase or other transfer of beneficial interest in immovable property situated in Hong Kong;
- the sale and purchase or other transfer of beneficial interest in Hong Kong stock; that is, stock the transfer of which is required to be registered in Hong Kong, which most relevantly includes shares in a company incorporated in Hong Kong or otherwise listed on HKEX; and
- the issue of bearer bonds.

The rates of stamp duty for the transfer of Hong Kong stock are relatively modest: 0.2 per cent on the higher of the consideration or value of the stock transferred. Technically, 0.1 per cent is borne by each of the vendor and the purchaser. There is no stamp duty on the issue, redemption or cancellation of Hong Kong stock.

Stamp duty on the transfer of immovable property can, in view of Hong Kong's overheated property market, be especially onerous. The transfer of residential property is subject to rates considerably higher than those applicable to commercial property. Standard *ad valorem* stamp duty is charged at rates of between 1.5 per cent to 15 per cent on the higher of the consideration given or the value of the property transferred. In addition, special stamp duty is payable at rates of up to 20 per cent if the property is sold within 36 months of its acquisition. Further, buyer's stamp duty at a flat rate of 15 per cent is payable where the purchaser of a residential property is a person other than a Hong Kong permanent resident acting on his/her own behalf. It would follow that rates of stamp duty of up to 50 per cent of the transfer consideration or the value of the property may be charged.

Relief for intra-group transfers is available where the transferor and the transferee are bodies corporate and are 90 per cent associated; that is, one is the direct or indirect owner of 90 per cent of the issued share capital of the other or 90 per cent of the issued share capital of both is owned, directly or indirectly, by the same body corporate.

It is not possible to avoid stamp duty by orally transferring property: both immovable property and Hong Kong stock require an instrument in writing in order to transfer legal title and, in the case of immovable property, beneficial title. Such documentation requirements are in practice symbiotic with stamp duty.

8.6 Tax disputes

Hong Kong has a common law judicial system. Tax appeals arise from a determination of the Commissioner of Inland Revenue or a final adjudication of the Collector of Stamp Revenue, as the case may be, which may be appealed, respectively, to the Board of Review or to the District Court. The Board of Review has original jurisdiction over all tax appeals relating to the IRO and is a judicial tribunal; its proceedings are not open to the public and its judgments are published in an anonymised format. Subsequent appeals may be brought to the Court of First Instance (CFI) or Court of Appeal and, thence, to the Court of Final Appeal (CFA). Historically, there has been a marked preference for out-of-court settlement of tax disputes in Hong Kong, though it should be noted that the higher courts have been consistent in applying orthodox and generally pro-taxpayer interpretations of cardinal principles of Hong Kong tax law.

The assessing practice of the various revenue-gathering bodies in Hong Kong has, in recent times, become more aggressive, in part because of the rapid integration of OECD measures targeting transfer pricing irregularities, treaty abuse and aggressive tax planning.

Revenue clearance may be obtained from the Commissioner of Inland Revenue on matters relating to the chargeability of any person to tax under the IRO through the so-called advance ruling process.

8.7 Anti-avoidance

The IRO contains both general and specific anti-avoidance provisions. Generally, transactions or arrangements that are shams or contrivances, or that have as their principal purpose or one of their principal purposes the gaining of a tax advantage, are disregarded for the purposes of ascertaining a person's liability to tax to the extent necessary to negate the advantage that would otherwise have been obtained by the taxpayer. The Ramsay principle also applies to the construction of revenue statutes in Hong Kong.

Chapter 9: Intellectual property

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Hong Kong is a focal point of the generation of works of intellectual property. The 2019 Global Innovation Index published by the World Intellectual Property Organization (WIPO) ranked Hong Kong as the 13th most innovative economy in the world. In support of innovation, Hong Kong has devised a sophisticated legal framework to protect intellectual property rights.

There are seven main categories of protected intellectual property rights under the laws of Hong Kong (consisting of legislation and the common law). This chapter will provide a general overview of the scope of protection of each of the main categories.

9.1 Trademarks

Registration, validity and protection of trademarks are governed by the Trade Marks Ordinance (Cap 559) (TMO). In addition, the Trade Descriptions Ordinance (Cap 362) also provides for criminal liability arising from the use of false trade descriptions, misleading information and false marks in respect of goods provided in the course of trade.

The TMO sets out detailed requirements for the registration of trademarks in Hong Kong. Section 3 of the TMO defines a 'trademark' as 'any sign which is capable of distinguishing the goods or services of one undertaking from those of other undertakings and which is capable of being represented graphically'.

There are 'absolute' and 'relative' grounds for refusal of registration. The absolute grounds include objections based on the signs not satisfying the definition under section 3 of the TMO (therefore not being apt to perform the function of a trademark in distinguishing the goods or services of one undertaking from another), are lacking in the inherent qualities of a trademark, such as being devoid of distinctiveness, or are descriptive. On the other hand, the relative grounds include, inter alia, prohibition of registration of trademarks that are identical or similar to an earlier trademark in respect of identical or similar goods or services (section 12 of the TMO). The relative grounds of objection to an application for registration mirror the grounds for a registered proprietor alleging infringement of its mark by the use of another sign (section 18 of the TMO).

'Well-known trademarks' that are entitled to protection under the Paris Convention do not require registration for protection. Whether a mark qualifies as a well-known mark is to be tested with a number of factors as stipulated in section 4 and Schedule 2 of the TMO. Under section 12(4) of the TMO, the use of a mark similar to a well-known mark, even in relation to dissimilar goods or services, would still attract liability for infringement. The ultimate question is not whether there exists any likelihood of confusion, but whether the use of the conflicting mark is without due cause, and would take unfair advantage of, or be detrimental to, the distinctive character or repute of the well-known trademark.

Unregistered signs are also protected by the common law doctrine relating to passing-off. A business's goodwill is protected against acts of misrepresentation that cause damage.

The principles on infringement of trademarks and passing-off have been succinctly summarised in the Hong Kong CFA decision *Tsit Wing (Hong Kong) Co Ltd & Ors v TWG Tea Company Pte Ltd* (2016) HKCFAR 20.

9.2 Copyright

In Hong Kong the Copyright Ordinance (Cap 528) (CO 528) is the principal statute concerning protection of copyright and related rights, such as moral rights and rights against use of devices that circumvents copyright. CO 528 provides for both civil and criminal liabilities, the latter being enforceable by the Customs and Excise Department endowed with extensive powers of investigation and prosecution of alleged infringements.

Copyright is defined under the CO 528 as a property right comprising both economic rights and moral rights that is generated by the operation of law, not by registration.

In general, copyright subsists in a work if the work is original, is recorded in a material form, falls within any of the descriptions of work (eg, literary, dramatic, musical or artistic works, sound recordings, films, broadcasts or cable programmes, or typographical arrangement of published editions), and is created by an author who satisfies the qualification requirements or is published in Hong Kong or elsewhere.

Copyright is defined negatively as a right to do acts within Hong Kong that are restricted to be exercised exclusively by the owner or a person with his licence or consent. A copyright owner or its exclusive licensee can take civil legal action against any person who infringes the copyright in the work. Acts of infringement are defined broadly as primary acts, for example, making, publishing or copying, and secondary acts, such as selling, distributing and importing. The former requires no proof of knowledge of infringement on the part of the infringer, whereas reliance on secondary infringing acts requires proof that the infringer has committed the acts knowing such acts would infringe copyright.

The CO 528 provides for a fair dealing exception as a defence to infringement, and a plea of lack of knowledge as defence to damages for infringement.

9.3 Registered designs

A design registration system was created under the Registered Designs Ordinance (Cap 522) (RDO) in Hong Kong. Pursuant to the RDO, applications for registration are made directly to the Hong Kong Designs Registry, and will be subject to a formalistic examination without verification of novelty in relation to prior art. Persons aggrieved by the registration may apply for opposition or rectification.

Pursuant to section 2 of the RDO, any design applied to an article in any industrial process that consist of features of shape, configuration, pattern or ornament with aesthetic appeal may be registered in relation to the article.

In order for a registration to stand up to challenge, it must be a novel design as of the date of the application. Novelty can be defeated by a design of any article previously published anywhere in the world (including in another design registration) that is not substantially different from the subject design. Infringement of a registered design within the territory is established by showing the use of a design that differs only in immaterial details or in features that are variants commonly used in the trade on the same article as registered.

9.4 Patents

Patents in Hong Kong are governed by the Patents Ordinance (Cap 514) (PO), updated by the Patents (Amendment) Ordinance 2016 and the Patents (General) (Amendment) Rules 2019 (with commencement date of 19 December 2019). Three types of patents may be granted under the PO: (1) standard patents (R) (available under the PO 2008 and 2016, for a maximum term of 20 years);

and (2) short-term patents (available under the PO 2008 and 2016, for a maximum term of eight years); and (3) standard patents (O) (available under the PO 2016, for a maximum term of 20 years). The main difference for the newly introduced standard patents (O) is that both formality and substantive examinations are mandatory for a successful application, whereas for standard patents (R) and short-term patents, only formality examination is required. In other words, the new patent system under PO 2016 supplemented by the 2019 rules essentially comprises an original grant patent system that creates a direct route for seeking standard patent protection in Hong Kong with a maximum term of 20 years as an alternative to the 're-registration' route. Original grant patent applications are subject to substantive examination by the registry for determining the patentability of the underlying inventions.

The substantive requirements for registration of patents in Hong Kong include, inter alia, patentable subject matter, susceptibility of industrial application, novelty and inventive step.

9.5 Confidential information

Confidential information is protected under the general common law principles. In summary, the law prevents breach of confidence when the information in question has the necessary quality of confidence, the person in breach has an obligation of confidence, and there is a 'breach' of confidence.

Defences include, inter alia, consent, miscellaneous immunities and disclosure in public interest. The scope of the public interest defence has been thoroughly examined in *The University of Hong Kong v Hong Kong Commercial Broadcasting Co Ltd and Anor* [2016] 1 HKLRD 536 at sections 50–53 in the context of interlocutory injunction; and *The University of Hong Kong v Hong Kong Commercial Broadcasting Co Ltd and Anor* [2016] 4 HKLRD 113 at sections 37–49 in the context of trial. In summary, the court held that there is a constitutionally guaranteed freedom of expression as provided for under Article 16 of the Bill of Rights and Article 27 of the Basic Law in Hong Kong, but the freedom is not absolute. It is qualified by, inter alia, the need to respect the right of others to confidentiality. The test is not whether the matters disclosed would interest the public or be of interest to the public or even 'newsworthy', but whether it is in the public interest that disclosure should be made and the confidence breached. The disclosure must be shown to be required in the public interest. More particularly, where there is justification for disclosure, the disclosure should be to one who has a proper interest to receive the information.

9.6 Private information

The focus is on the 'nature of the information', and whether there is any 'reasonable expectation of privacy', as outlined in *Sima Sai Er v Next Magazine Publishing Ltd and Ors* (unreported, HCA 1500/2014, 8 August 2014) at section 7.

Interaction between the misuse of private information and breach of confidence has been discussed in *Sim Kon Fah v JBPB & Co* [2011] 4 HKLRD 45 at sections 38–45. There may have been an issue that the misuse of private information was shoehorned under the cause of action of breach of confidence:

'42. The second development in the law of breach of confidence identified and discussed by Lord Hoffmann relates to the impact brought upon this branch of the law by art.8 (right to respect for private and family life) and art.10 (right to freedom of expression) of the European Convention and s.6 of the Human Rights Act 1998. The legal development in this regard, including the emergence of what has been described as a tort of "misuse of private information" (per Lord Nicholls of Birkenhead in ***Campbell v. MGN Ltd***, para.14) which has been "shoehorned" into the law of confidence (per Lord Philips of Worth Matravers MR in ***Douglas v. Hello! Ltd (No 3)***), whilst interesting, has no application to the matter before me and thus it is not necessary for me to trace the development in English law or consider how such development may impact upon Hong Kong law.'

9.7 Layout designs

The Layout-Design (Topography) of Integrated Circuits Ordinance (Cap 445) (the 'Layout-Design Ordinance') provides for the rights and protections in relation to layout designs.

Layout design is defined as the three-dimensional disposition, however expressed, of the elements of an integrated circuit and of some or all of the interconnections of an integrated circuit, or such a three-dimensional disposition prepared for an integrated circuit intended for manufacture.

Like copyright, originality is also an essential requirement as per section 2 of the ordinance.

Chapter 10: Financing

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The main ways in which a company can raise funds in Hong Kong are debt finance (whereby investors make available capital for a limited period in return for interest) and equity finance (whereby investors make available capital in consideration for shares in the company).

The focus in this chapter will be on debt finance, which in turn comprises bank lending and raising finance on the capital markets.

10.1 Bank lending

10.1.1 Overview of the legal and regulatory framework

The provision of financial services in Hong Kong is governed by statute, common law, and an array of rules and regulations legislated by government bodies and regulatory authorities.

The main pieces of Hong Kong legislation regarding the activities of banks and money lenders are the Banking Ordinance (Cap 155) (BO), the Securities and Futures Ordinance (Cap 571) (SFO) and

the Money Lenders Ordinance (Cap 163) (MLO), while the main regulatory bodies are the Hong Kong Monetary Authority (HKMA), the SFC and, insofar as money lending is concerned, the Hong Kong Companies Registry and the Commissioner of Police. Various industry bodies likewise perform regulatory functions and frequently publish industry-specific guidelines or codes of conduct.

In general terms, money lending activities in Hong Kong can fall into one of two categories:

Lending by an 'authorised institution' (as defined in the Banking Ordinance)

There are three types of authorised institutions, namely banks, restricted-licence banks and deposit-taking companies, each of which has a different scope of permitted activities under the BO. Regulatory oversight of the BO rests with the HKMA, which, among other things, has the power to issue guidelines to approve, suspend or revoke banking licences. Virtual banks also fall within this lending category and are subject to the same application procedure and supervision requirements as conventional banks. As of 24 February 2020, the HKMA had issued eight banking licences to virtual banks in Hong Kong.

Lending by a person that is not an 'authorised institution' or lending by any person to an 'authorised institution'

Loans falling within this category are covered by the MLO and are regulated by the Hong Kong Companies Registry and the Commissioner of Police. Among other things, the MLO requires persons carrying on a lending business to be licensed. Schedule 1 of the MLO sets out certain types of loans and persons that are exempt from this requirement. If a lender that is not exempt makes a loan otherwise than in compliance with the MLO, it will not be entitled to recover any principal or interest or enforce any security in respect of that loan; however, a court may grant relief to the extent it considers equitable.

Further, if a person (including an authorised institution) carries on a business in a 'regulated activity' (as defined in the SFO), that person must also comply with the licensing requirements under the SFO. This means that banks engaging in regulated activities must be registered with the SFC as 'registered institutions', while non-bank entities must be licensed as 'licensed corporations'. In the context of lending, the most relevant type of regulated activity is securities margin financing (which means providing a financial accommodation in order to facilitate the acquisition of securities listed on any stock market and, where applicable, the continued holding of those securities); however, it is noteworthy that there is an exemption for authorised institutions engaging in securities margin financing. Furthermore, lending activities that involve any dealing in securities (eg, bonds, notes or other securities), futures contracts or leveraged foreign exchange contracts, may amount to one or more regulated activities (eg, dealing in securities, dealing in futures contracts or leveraged foreign exchange trading).

Additional requirements apply under the MLO. If a court finds a loan transaction to be extortionate, that is, one that requires the debtor to make grossly exorbitant payments, or which otherwise grossly contravenes ordinary principles of fair-dealing, the court may reopen the transaction so as to do justice between the parties. In addition, any person who lends money at an effective rate of interest exceeding 60 per cent per annum commits an offence. The foregoing requirements apply regardless of whether the creditor is a money lender under the MLO or not, but do not apply to loans to companies with a paid-up share capital of at least HK$1m (or equivalent).

As indicated at the outset, the regulatory regime for financial services in Hong Kong is detailed, comprising numerous rules and regulations on matters such as capital adequacy, transparency, liquidity, and systems and controls. Given the complexity of the legal and regulatory framework, it is vital that persons seeking to navigate it do so with the benefit of adequate legal advice as may be required.

10.1.2 Lender liability regimes

A lender may incur liability in accordance with ordinary principles of Hong Kong contract law, which in turn has adopted many English law principles. In general, a claimant may recover damages if it can demonstrate that the lender has breached the loan agreement, and that such breach has caused the claimant to suffer a loss. Whether a breach has occurred, in turn, would depend on the terms of the loan agreement, as construed in accordance with the rules on contractual interpretation.

Other types of liability may arise. For instance, if a financial institution has acted in an advisory capacity to the borrower in connection with the loan transaction, it may, depending on the circumstances, incur liability for misrepresentation, or negligent or unsuitable advice. Further, the lender may become liable for market misconduct or mis-selling if, having made a recommendation or solicitation, it commits a breach of duty of care and the claimant incurs a loss as a result of that breach. A lender found to have committed market misconduct can incur civil liability, but could also be found criminally liable or face regulatory sanctions.

10.1.3 Exchange controls

There are no foreign exchange controls in Hong Kong that would prevent the repatriation of enforcement proceeds or other payments to a non-Hong Kong-based lender under a loan agreement with a Hong Kong-based counterparty.

10.1.4 Taking security

Under Hong Kong law, a company can grant security over all its present and future assets under a single security agreement. It is also possible for a company to grant security over specific assets (eg, real property, shares, receivables, bank accounts, equipment, inventory, intellectual property, insurances, ships and aircraft) or generic classes of assets.

Security in Hong Kong can secure both *present* and *future* obligations. In addition, security interests may be *fixed* or *floating*. There are several important differences in the legal regimes applicable to fixed and floating charges:

- Fixed charges are usually taken over specific and identifiable assets. Typically, the chargor will be restricted under the terms of the relevant security agreement from disposing of assets subject to a fixed charge (or, in the case of credit balances, from making withdrawals), except with the approval of the secured creditor, until the security interest has been discharged.
- By contrast, a floating charge does not attach to specific assets but 'floats' over a generic class of assets that fluctuates from time to time. It is only upon the occurrence of certain events that the floating charge 'crystallises' and is converted into a fixed charge. A floating charge has the advantage of allowing the chargor to deal with its assets in the ordinary course of business

unless and until crystallisation occurs. A floating charge will be crystallised if the terms of the security agreement specify that on a certain event it will crystallise (eg, when the chargor defaults or the floating charge assets are threatened by execution), upon the appointment of a receiver by the secured creditor or the court, when the chargor commences winding up, or upon the chargor ceasing to do business.

- Generally speaking, a fixed charge provides greater protection to the secured creditor than a floating charge in several respects. A floating charge ranks behind a fixed charge and, upon distribution of a chargor's assets in the case of insolvency, also ranks after certain statutorily preferred creditors (eg, employees and tax authorities). A floating charge granted within the 12 months (or two years, in the case of a connected person) preceding the onset of insolvency of the chargor may be invalid except to the extent of money paid to the chargor, or property or services supplied to it, at the time of or after the creation of the charge.

In terms of perfection, all companies incorporated in Hong Kong are required under CO 622 to register the following security interests with the Hong Kong Companies Registry:

- a charge on uncalled share capital of a company;
- a charge created or evidenced by an instrument that, if executed by a natural person, would require registration as a bill of sale;
- a charge on land (wherever situated) or on any interest in land, except a charge for any rent or other periodical sum issuing out of land;
- a charge on book debts of a company;
- a charge on calls made but not paid;
- a charge on instalments due, but not paid, on the issue price of shares;
- a charge on a ship or any share in a ship;
- a charge on an aircraft or any share in an aircraft;
- a charge on (1) goodwill; (2) a patent or a licence under a patent; (3) a trademark; or (4) a copyright or a licence under a copyright; and
- a floating charge on a company's undertaking or property.

The registration requirement also applies to all non-Hong Kong companies registered in Hong Kong that have property in Hong Kong, where such property is subject to a security interest falling within the list set out above.

Registration with the Hong Kong Companies Registry must generally be effected within one month after the date of creation of the security. Failure to file within the statutory time frame under CO 622 will (unless court approval is obtained to register 'out of time') render the charge void against the liquidator and creditors of the chargor/debtor, but does not prejudice the underlying contract or obligation giving rise to the debt. If the charge is not registered within the statutory timeframe, the beneficiary of the charge may decide at that point in time whether or not the debt is to become

immediately payable. In addition to the charge becoming void, the relevant chargor/debtor and any responsible persons may be found to have committed an offence and be liable to a fine.

In addition to registration at the Companies Registry, registration at a specialist register may also be desirable or necessary for priorities as against subsequent mortgagees and purchasers. These specialist registers include, for example, the Hong Kong Land Registry, the Hong Kong Intellectual Property Department and the Registrar of Ships.

Further, where security is granted over contractual rights (eg, by way of a security assignment over receivables), the giving of notice to the counterparties of the underlying contract, while not essential to the effectiveness of the security, may nonetheless be desirable for various reasons. For instance, the provision of notice prevents the counterparty from discharging the assigned debt by payment to the assignor, fixes priorities between competing secured creditors, and limits set-offs from arising between the counterparty and the assignor.

10.1.5 Guarantees

As a general principle, directors of a company are required to act in the company's best interests. In the context of guarantees, this means that the giving of the guarantee must be of commercial benefit to the company. This is a question of fact and depends on the specific facts of any given transaction. Downstream guarantees are typically easier to justify than upstream or cross-stream guarantees, and for this reason it is market practice to arrange for shareholder resolutions to be passed by third-party guarantors in respect of any upstream or cross-stream guarantees. A guarantee given without corporate benefit in violation of the directors' duties may be set aside if the creditor is not acting in good faith (eg, the creditor knew of the breach of directors' duty). Directors may also be personally liable.

10.1.6 Financial assistance

Under Hong Kong law there are rules on financial assistance that prohibit a company from providing financial assistance for the purpose of an acquisition of its own shares or for the acquisition of shares in a holding company (which is itself also incorporated in Hong Kong and of which the company is a direct or indirect subsidiary), unless an exception applies. Such financial assistance may take many forms, including by way of the granting of guarantees and security.

Any company or directors who give unlawful financial assistance are criminally liable. Previously, transactions amounting to unlawful financial assistance were void. CO 622 now provides that the validity of the financial assistance and of any contract or transaction connected with such assistance is not affected only because of contravention of sections in connection with unlawful financial assistance of CO 622.

10.2 Debt capital markets

10.2.1 General overview

In Hong Kong the rules relating to the offer of debt securities are primarily governed by the CWUMPO, SFO and BO. In May 2013 the regulation of public offers of structured products in the form of shares or debentures was transferred by statute from the prospectus regime under the CWUMPO to the regime for public offers of investment under the SFO. The term 'structured products' is broadly defined and includes notes that are linked to securities, commodities, indices, properties, interest rates, currency exchange rates or futures contracts; however, there are also certain exclusions from the definition.

There are no specific listing requirements in Hong Kong for the issuance of Hong Kong dollar-denominated debt securities. If relevant debt securities are listed on HKEX, the SFO requires the issuer to maintain a register in Hong Kong of interests in its shares and short positions, as well as a register of its directors' and chief executives' interests in its shares and short positions. However, exemptions to this requirement can be obtained from the SFC.

It is not necessary for Hong Kong dollar-denominated issues to be governed by Hong Kong law, although the standard Hong Kong selling restrictions will apply. Further, there are no maturity restrictions, and while no fixed minimum denomination is specified in the relevant regulations, a minimum denomination may be imposed if SFC authorisation is required in connection with the issue.

10.2.2 Regulatory requirements

Companies (Winding Up and Miscellaneous Provisions) Ordinance

The requirements of the CWUMPO regarding the registration and content of prospectuses must be complied with if the issue of 'debentures' (which is defined to include debenture stock, bonds and any other debt securities of the company, whether or not constituting a charge on the assets of the company) that are not a 'structured product' as defined in the SFO amounts to an 'offer to the public'.

These requirements can be avoided (for Hong Kong and non-Hong Kong incorporated issuers) if the documents containing or relating to offers of debentures fall within Part 1 of Schedule 17 of the CWUMPO. Such offers include the following:

1. an offer to 'professional investors' as defined in the SFO;
2. an offer to no more than 50 persons;
3. an offer in respect of which the total consideration payable does not exceed HK$5m; or
4. an offer in respect of which the minimum principal amount to be subscribed or purchased is no ess than HK$500,000 or its equivalent in another currency

Together, these offers make up the Schedule 17 Safe Harbours.

Offers referred to in (1) and (2) may be combined. It should be noted that in relation to a number of the offers falling within the Schedule 17 Safe Harbours (including the offers referred to in (2), (3) and (4) above), a specific statutory warning legend, as set out in Schedule 18 of the CWUMPO, is required to be included in the relevant documents. In addition, certain other exemptions (in respect of foreign issuers, offers to 'persons whose ordinary business is to buy or sell shares') are also available.

Banking Ordinance

The issue of debt securities may amount to 'taking deposits' under the BO given that 'deposit' is broadly defined to mean a loan of money at interest, at no interest or at negative interest, or repayable at a premium or repayable with any consideration in money or money's worth. This, in turn, can give rise to certain concerns regarding compliance with the BO, as:

1. only authorised institutions can carry on a business of taking deposits in Hong Kong; and
2. unless the issuer is an authorised institution, the issue of an invitation or other offering material in Hong Kong may amount to 'advertising for deposits' from the public in breach of the BO.

These concerns can be addressed in a number of ways, for instance by ensuring that dealers act as principals and are either authorised institutions in Hong Kong or banks incorporated or established outside Hong Kong that are not licensed under the BO. Furthermore, the concern in (1) may be overcome if it can be shown that the issuer is not carrying on in Hong Kong a business of taking deposits.

Securities and Futures Ordinance

It is an offence under the SFO for a person to issue (or to have in their possession for the purposes of issue), whether in Hong Kong or elsewhere, an advertisement, invitation or document that, to his or her knowledge, is or contains an invitation to the public to enter into (or offer to enter into) an agreement to acquire, dispose of, subscribe for or underwrite securities ('securities' for the purposes of the SFO exclude debentures of unlisted Hong Kong-incorporated private companies), structured products or shares, unless the issue is authorised by the SFC.

This can be avoided if the advertisement, invitation or document relates to an offer falling within the Schedule 17 of the Safe Harbours in respect of the issue of 'debentures' that are not structured products, or if an exemption is available under the SFO. Alternatively, approval for the advertisement or invitation can be obtained from the SFC. Certain exemptions are available if the issue (or the possession for the purposes of issue) of any advertisement, invitation or document is made by an entity licensed or registered to carry out certain regulated activity. Other relevant exemptions apply in respect of an advertisement or invitation that:

- is made with respect to securities or shares that are, or are intended to be, disposed of to persons outside Hong Kong only; or
- relates to securities or shares that are, or are intended to be, disposed of to 'professional investors' only.

10.3 Equity capital markets

Under Hong Kong law, the main pieces of legislation concerning the offer of shares to the public are the CWUMPO and SFO.

In general, if an offer of shares is made to the public (which is not being listed on HKEX), then the offering circular must, subject to any applicable exemptions:

- be approved by the SFC;
- contain certain information prescribed by the CWUMPO in relation to prospectuses; and
- be registered with the Registrar of Companies in Hong Kong.

Companies (Winding Up and Miscellaneous Provisions) Ordinance

The requirements of the CWUMPO regarding the registration and content of prospectuses must be complied with if the issue of 'shares' amounts to an 'offer to the public'.

It is market practice for most international offers of shares not involving a listing in Hong Kong to structure the offer and distribution of the offering circular so that the full burden of Hong Kong legal and regulatory requirements does not apply. To this end, issuers may seek to rely on certain statutory exemptions, including the Schedule 17 of the Safe Harbours (see section 10.2.2 (Companies (Winding Up and Miscellaneous Provisions) Ordinance) above), the effect of which is that offering circulars can be distributed in Hong Kong without the need for regulatory approval or compliance with the prospectus content and registration requirements.

Securities and Futures Ordinance

In addition to the rules under the CWUMPO relating to the offer of shares to the public, as seen in section 10.2.2 (Securities and Futures Ordinance) above, the SFO makes it a criminal offence for a person to issue advertisements or invitations in connection with offers of shares to the public under certain circumstances. The exemptions set out above equally apply in connection with the issue of shares to the public.

Further, as mentioned in section 10.1.1 above, the SFO prohibits any person from carrying on business in a 'regulated activity' in the absence of a relevant exemption or registration. This prohibition extends to persons based overseas but marketing (directly or through an agent) their services to the public in Hong Kong. One of the regulated activities is 'dealing in securities' (a Type 1 regulated activity), which includes marketing securities ('securities' for the purposes of the SFO exclude shares of unlisted Hong Kong-incorporated private companies) to Hong Kong persons but specifically excludes where a person, as principal, performs the act by way of dealing with institutional professional investors, or (generally speaking) where a person performs the act through a licensed securities dealer (noting, however, that there are certain carve-outs to this).

Chapter 11: Privacy laws and data protection

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This chapter considers, at a high level, the data protection regime in Hong Kong.

11.1 Regulatory framework

The main legislation relating to data protection is the Personal Data (Privacy) Ordinance (Cap 486) (PDPO). The Office of the Privacy Commissioner for Personal Data (PCPD) is an independent statutory body set up to oversee the enforcement of the PDPO. While it is not made clear on the face of the legislation, the PDPO is not generally considered to have extraterritorial application and so is only considered to apply to data users who control the collection, holding, processing or use of 'personal data' from within Hong Kong.

'Personal data' means any data:

- relating directly or indirectly to a living individual;
- from which it is practicable for the identity of the individual to be directly or indirectly ascertained; and
- in a form in which access to or processing of the data is practicable.

The PDPO does not currently regulate the transfer of personal data to places outside of Hong Kong (see section 11.5 for further discussion).

11.2 The six data protection principles

Generally speaking, data users must not do any act, or engage in any practice, that contravenes any of the six data protection principles set out in Schedule 1 of the PDPO, unless an exemption applies.

The data protection principles are summarised by the PCPD as follows:

1. Personal data must only be collected for a lawful purpose directly related to a function or activity of the data user. The data collected should be necessary and adequate but not excessive for such purpose. The means of collection should be lawful and fair.
2. Data users must take all practicable steps to ensure that personal data is accurate and is not kept longer than is necessary for the fulfilment of the purpose for which the data is used.
3. It is prohibited to use personal data for any new purpose that is not or is unrelated to the original purpose when collecting the data, unless with the data subject's express and voluntary consent. A data subject can withdraw his/her consent previously given by written notice.
4. Data users must take all practicable steps to protect the personal data they hold against unauthorised or accidental access, processing, erasure, loss or use. Among other things,

data users should have particular regard to the nature of the data, the potential harm if those events were to happen, and measures taken for ensuring the integrity, prudence and competence of persons having access to the data.

5. Data users must take all practicable steps to ensure openness of their personal data policies and practices, the kind of personal data held and the main purposes for holding it.

6. Data subjects have the right to request access to and correction of their own personal data. A data user should give reasons when refusing a data subject's request to access to or correction of his or her personal data.

Apart from the high-level principles, the PDPO also prescribes rules in relation to the use and provision (including to third parties) of personal data for direct marketing purposes and third-party processing of personal data.

11.3 Third-party processing of personal data

Currently, the PDPO does not regulate data processors (a person who processes personal data on behalf of another person and does not process the data for any of the person's own purposes) but places the obligation to protect personal data on data users.

If a data user engages a data processor, whether within or outside Hong Kong, to process personal data on the data user's behalf, the data user must, under data protection principles 2(3) and 4(2) respectively, adopt contractual or other means to: (1) prevent any personal data transferred to the data processor from being kept longer than is necessary for processing of the data; and (2) prevent unauthorised or accidental access, processing, erasure, loss or use of the data transferred to the data processor for processing.

In an information leaflet on Outsourcing the Processing of Personal Data to Data Processors issued in 2012 (which is non-binding), the PCPD indicated by way of example the types of obligations that could be imposed on a data processor by contract:

- security measures required to be taken by the data processor to protect the personal data entrusted to it and obligating the data processor to protect the personal data by complying with the data protection principles;
- timely return, destruction or deletion of the personal data when it is no longer required for the purpose for which it is entrusted by the data user to the data processor;
- prohibition against any use or disclosure of the personal data by the data processor for a purpose other than the purpose for which the personal data is entrusted to it by the data user;
- absolute prohibition or qualified prohibition on the data processor against subcontracting the service that it is engaged to provide;
- immediate reporting of any sign of abnormalities;
- data user's right to audit and inspect how the data processor handles and stores personal data; and
- consequences for violation of the contract.

11.4 Direct marketing

For the purposes of the PDPO, 'direct marketing' is defined as offering or advertising goods, facilities or services, or soliciting donations or contributions by communications addressed or directed to a specific person by name. Therefore, direct marketing does not include communications that are not directed to a specific individual (eg, a telemarketer who calls randomly generated phone numbers; although, that could separately be subject to the Unsolicited Electronic Messages Ordinance (Cap 593)).

The PDPO requires the data user to provide the following information to the data subject before using personal data for direct marketing purposes:

- the intention to use their personal data for direct marketing and that it can only do so with the data subject's consent;
- the types of personal data it proposes to use for direct marketing; and
- the classes of marketing subjects to which the proposed direct marketing will relate.

In addition, the data user must not use personal data in direct marketing without the data subject's written consent. The PDPO also requires the data user to notify the data subject when using personal data in direct marketing for the first time, while the data subject may require the data user to cease using personal data in direct marketing at any time.

11.5 Cross-border transfer of data

Section 33 of the PDPO, which has not yet come into force, prohibits the transfer of personal data outside of Hong Kong, except in certain circumstances (including, eg, where consent has been given, or the transfer is to a place that has laws substantially similar to the PDPO).

There is no clarity as to when (if ever) section 33 will be brought into force. Therefore, the PDPO does not currently regulate the transfer of personal data to places outside of Hong Kong. However, as a matter of good practice, certain local regulators (eg, HKMA) require their regulated entities to treat section 33 of the PDPO as if it were in force.

11.6 Proposed changes

On 20 January 2020 the Constitutional and Mainland Affairs Bureau presented a paper to the Legislative Council proposing the following changes to the PDPO (the 'Paper'):

- Introduction of a mandatory breach notification: this would require data users to notify both the PCPD and the relevant data subject within a specified timeframe in the event of a data breach.
- Certainty around data retention periods. Data users would be required to maintain a clear retention policy specifying: (1) a maximum retention period for different categories of personal data; (2) legal requirements that may affect the retention period (eg, taxation, employment or medical requirements); and (3) how the retention period will be counted. Currently the PDPO

is not specific in this regard and requires data users to take all practicable steps to ensure that personal data is not kept 'longer than is necessary'.

- Enhanced powers to sanction. The PCPD would be conferred power to directly impose administrative fines for any contravention of the PDPO instead of first having to issue an enforcement notice. The Paper contains proposals to increase the level of fines that may be imposed for criminal liability, and links the level of fines to the annual turnover of the data user. The Paper suggests that data users be classified with different scales according to turnover and that those scales be matched to different levels of administrative fines.
- Regulation of data processors. As noted above, the PDPO does not currently regulate data processors. The proposals would expand the PDPO's regulatory reach to cover data processors.
- Amendments to the definition of personal data. The Paper proposes expanding the definition of 'personal data' to cover information relating to an 'identifiable' natural person.

However, there is no clear timeframe as to when concrete amendments will be tabled for the Legislative Council's debate and approval.

Chapter 12: Competition law

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12.1 Overview

The primary source of competition law in Hong Kong is the Competition Ordinance (Cap 619) (CO 619) and its related subsidiary legislation.[10] CO 619 applies to all sectors of the economy in Hong Kong and is principally enforced by the Competition Commission (the 'Commission'). The Communications Authority shares concurrent jurisdiction with the Commission to enforce CO 619 in respect of undertakings operating in the telecommunications and broadcasting sectors.

CO 619 primarily prohibits conduct that has the object or effect of preventing, restricting or distorting competition in Hong Kong. Such conduct includes horizontal and vertical anti-competitive arrangements between undertakings and abuses of a substantial degree of market power. CO 619 also prohibits mergers that have or are likely to have the effect of substantially lessening competition in Hong Kong (currently only applicable to mergers involving a telecommunications carrier licence holder). In short, CO 619 prohibits three types of anti-competitive conduct under: (1) the First Conduct Rule; (2) the Second Conduct Rule; and (3) the Merger Rule, which will be explained further below.

The prohibitions apply to anti-competitive conduct, whether the arrangement was made or given effect to within or outside Hong Kong, if it has the object or effect of harming competition in Hong Kong.

10 CO 619 came into full effect on 14 December 2015.

Substantial sanctions for contravention of the competition rules may be imposed by the Competition Tribunal (the 'Tribunal'), including pecuniary penalties up to ten per cent of the turnover of the relevant undertaking obtained in Hong Kong for each year in which the contravention occurred, up to a maximum of three years, disgorgement of profits, injunctions and director disqualification orders for a period up to five years. A list of the sanctions that may be ordered is set out in Schedule 3 of CO 619.

CO 619 includes a leniency regime. The Commission may agree with a person that it will not bring or continue proceedings in the Tribunal for a pecuniary penalty in exchange for the person's cooperation in an investigation or in proceedings under CO 619.

Standalone private enforcement actions are not permitted.[11] However, a party may raise a contravention of the conduct rules as a defence to a private civil action.[12] Follow-on private actions for damages resulting from any conduct that has been determined to be a contravention of a conduct rule may be brought before the Tribunal.[13]

12.2 The First Conduct Rule

The First Conduct Rule prohibits any agreement, concerted practice or decision where the object or effect is to prevent, restrict or distort competition in Hong Kong.[14] This includes horizontal arrangements between competitors and vertical arrangements, such as resale price maintenance in a distribution agreement.

Conduct involving price fixing, market sharing, output restriction and bid-rigging (or any combination of these activities) constitutes 'serious anti-competitive conduct'.[15] Where conduct falls within 'serious anti-competitive conduct', the Commission is not required to issue a warning notice to the undertaking before bringing proceedings in the Tribunal.[16] In addition, the general exclusion for agreements of lesser significance (ie, agreements between undertakings with a combined global turnover of less than HK$200m) does not apply to 'serious anti-competitive conduct'.

Where the contravention of the First Conduct Rule does not involve 'serious anti-competitive conduct', the Commission must issue a warning notice to provide the undertaking with an opportunity to cease the contravening conduct within a specified period. If the undertaking complies with the warning notice, it is protected from prosecution. If the undertaking continues or repeats the contravening conduct after the expiry of the specified period, the Commission may bring enforcement proceedings without further notice, but not in respect of any contravening conduct that precedes the specified period.

Conduct subject to the First Conduct Rule may be excluded or exempt from its application by virtue of: (1) the general exclusions under section 30 of CO 619 and Schedule 1; (2) the exemptions granted on public policy grounds under section 31 or to avoid conflict with international obligations

11 *Loyal Profit International Development Limited v Travel Industry Council of Hong Kong* (unreported, HCMP 256/2016, 27 April 2017).

12 *Taching Petroleum Company Limited v Meyer Aluminium Limited* [2019] HKCT 1 where the defence raising price fixing and exchange of pricing information was transferred to the Tribunal under section 113 CO 619. Hon Au-Yeung J refused to stay the remainder of the High Court action, ordering instead that both sets of proceedings should be tried together before the same judge constituting the Tribunal.

13 S 110 of CO 619.

14 S 6 of CO 619.

15 This term is defined in s 2 of CO 619.

16 S 82 of CO 619.

under section 32; or (3) the disapplication of certain provisions of CO 619 to statutory bodies, specified persons and persons engaged in specified activities as provided for in sections 3 and 4 of CO 619.

Agreements may be exempt from the First Conduct Rule on an individual basis or via a block exemption. On 8 August 2017 the Commission issued a Block Exemption Order in respect of vessel sharing agreements in the liner shipping industry, excluding such agreements from the application of the First Conduct Rule by virtue of the economic efficiencies generated by them. The exemption is for five years and is subject to certain conditions.

On 17 May 2019 the Tribunal handed down two landmark decisions relating to cartel conduct. These decisions are the first two successful enforcement actions brought by the Commission.

In *Competition Commission v Nutanix Hong Kong Limited* [2019] HKCT 2, the Tribunal found all but one of the five respondent IT firms liable for contravening the First Conduct Rule by engaging in bid-rigging in respect of a tender for the supply and installation of a Nutanix cloud-based server system for the Young Women's Christian Association in 2016. A previous tender had failed as BT Hong Kong Ltd (BT) was the only company that submitted a bid and the Young Women's Christian Association's procurement policy required a minimum of five bids. To assist BT in winning the second tender, Nutanix agreed with BT that it would obtain 'dummy' or 'non-genuine' bids from its channel partners to make up the required number. BT's completed bid was provided to an employee of Nutanix who prepared bids for SiS International Ltd (SiS), Innovix Distribution Ltd (Innovix) and Tech-21 Systems Ltd (Tech-21) with substantially higher bid prices than BT.

The Tribunal held that each of the vertical bilateral arrangements between Nutanix and BT, and Nutanix and Tech-21, as well as the trilateral arrangement among Nutanix, BT and Innovix, constituted 'serious anti-competitive conduct' and a breach of the First Conduct Rule. However, the acts of a junior employee who had no authority to commit SiS to any expenditure or set the price for any deal could not be attributed to SiS. The junior employee in question had essentially gone rogue in submitting the 'dummy' bid and was not acting in the course of his employment or as part of SiS.

Importantly, the Tribunal ruled that the criminal standard of proof beyond reasonable doubt applied to enforcement proceedings involving a pecuniary penalty. This sets Hong Kong as the only common law jurisdiction that applies the criminal standard of proof in competition law proceedings.

In *Competition Commission v W Hing Construction Co Ltd & Ors* [2019] HKCT 3, the Tribunal found all ten respondents, who were renovation contractors licensed by the Hong Kong Housing Authority, liable for contravening the First Conduct Rule by engaging in market sharing and price fixing. The respondents were found to have entered into arrangements whereby:

- each respondent was allocated four floors in each of the three buildings in an estate and the respondents had agreed to: (1) refrain from actively seeking and accepting business from tenants on floors allocated to other respondents; and (2) direct tenants on the floors allocated to the other respondents to their allocated contractor (the 'Market Sharing Arrangement'); and
- the respondents jointly produced and distributed a promotional flyer to tenants that set out, among other matters, the prices for ten types of commonly requested decorative works and

the service packages and prices for the four types of flats available at the estate (the 'Price Fixing Arrangement').

The Tribunal held both the Market Sharing Arrangement and Price Fixing Arrangement restricted competition by object in breach of the First Conduct Rule, and constituted 'serious anti-competitive conduct'.

The 'efficiency defence' raised by some of the respondents was rejected. Those respondents had claimed that the arrangements enhanced overall economic efficiency by allowing the contractors to work on multiple flats on the same floor on account of the time saved from having to wait for lifts to move equipment and materials from floor to floor, and should be excluded from the application for the First Conduct Rule under section 30 and Schedule 1 of CO 619.

The Tribunal held that the burden was on the relevant respondents to bring themselves within the exclusion by establishing the efficiency defence on the balance of probabilities. Notwithstanding the lower standard of proof applied, the Tribunal found that the conditions for the efficiency defence had not been made out.

The Tribunal further ruled that two respondents who had allowed their subcontractors to use their names in return for a fee to independently carry out the decoration works were liable for the acts of their subcontractors, notwithstanding their lack of knowledge of and participation in such acts. Of note is the fact that the Tribunal appeared to have adopted a liberal interpretation of what constitutes a 'single economic unit', holding that the relevant contractor and subcontractor formed part of the same undertaking by reason of the 'unity' of their conduct on the market.

12.3 The Second Conduct Rule

The Second Conduct Rule prohibits the abuse of a substantial degree of market power where the object or effect is to prevent, restrict or distort competition in Hong Kong.[17] CO 619 specifically refers to two examples of 'abuse', namely: (1) predatory behaviour towards competitors; and (2) production, markets or technical developments to the prejudice of consumers.

The Second Conduct Rule only applies where an undertaking has a substantial degree of market power in the relevant market. There is no guidance from CO 619 or the Commission as to an indicative market share safe harbour or presumptive threshold over which a substantial degree of market power may be presumed. However, CO 619 provides that the following matters (among others) may be taken into consideration, namely: (1) the market share of the undertaking; (2) the undertaking's power to make pricing and other decisions; and (3) any barriers to entry for competitors into the relevant market.

Examples of abusive behaviour may include predatory pricing, anti-competitive tying and bundling, margin squeeze, refusal to supply and exclusive dealing.

Conduct by an undertaking the turnover of which is lower than HK$40m is excluded from the Second Conduct Rule. In addition, CO 619 provides for other exclusions and exemptions with respect to the application of the Second Conduct Rule, namely: (1) compliance with legal requirements;

17 S 20 of CO 619.

(2) services of general economic interest; (3) mergers; (4) public bodies and international obligation exemptions;[18] and (5) the disapplication of certain provisions of CO 619 to statutory bodies, specified persons and persons engaged in specified activities as provided for in sections 3 and 4 of CO 619.

12.4 Mergers

Under the Merger Rule, mergers that have or are likely to have the effect of substantially lessening competition in Hong Kong are prohibited. The scope of application of the Merger Rule is currently limited to mergers relating to undertakings directly or indirectly holding carrier licences issued under the Telecommunications Ordinance (Cap 106).

Chapter 13: Dispute resolution

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The predominant dispute resolution mechanisms for commercial disputes in Hong Kong are litigation before the Hong Kong courts and Hong Kong seated arbitration. Both methods are addressed in this chapter. There are other mechanisms considered as feasible alternatives, such as mediation, conciliation, expert determination and adjudication. Save mediation, which is addressed briefly in section 13.3 below, these alternatives are not discussed further here.

13.1 Litigation before the Hong Kong courts

13.1.1 Overview

Depending on the value in dispute, civil and commercial matters in Hong Kong are generally commenced either in the District Court (for claims with a monetary value between HK$75,000 and HK$3m) or the CFI (for claims with a monetary value exceeding HK$3m). The CFI has unlimited jurisdiction over civil matters and organises specialist lists for particular types of disputes (eg, the construction and arbitration list for cases concerning, among other things, building and other construction work, as well as applications relating to arbitration). Depending on the nature of a dispute, there are also specialist courts and tribunals with jurisdiction over specific subject matters (eg, the lands tribunal and the competition tribunal); however, these are usually less relevant to large commercial disputes.

The procedural steps for disputes before the CFI are governed by the Rules of the High Court (Cap 4A) (RHC). The civil litigation process before the District Court is governed by the Rules of the District Court (Cap 336H) (RDC), which are to a large extent consistent with the Rules of the High Court. Both the RHC and RDC set forth detailed rules concerning all aspects of the proceedings,

18 Ss 31 and 32 of the CO 619.

including matters relating to evidence and document production, summary judgment and interlocutory injunctions.

In terms of timing, the Hong Kong courts generally allow the matter to proceed to a relatively speedy judgment, particularly if uncontested. The length of time to judgment will depend on the arguments raised by the defendant in its defence (if any); although a full trial can, if necessary, proceed within 18 to 24 months for a standard commercial matter.

13.1.2 Appeals

There are two levels of appeal in the Hong Kong court system: the Court of Appeal and the CFA. Appeals against decisions of the CFI are heard by the Court of Appeal, while the CFA is the highest appellate court in Hong Kong and decisions handed down by it are binding on all Hong Kong courts.

Appeals can normally only be made with leave of the court. Leave to appeal to the Court of Appeal will not be granted unless:

- the appeal has a reasonable prospect of success; or
- there are some other reasons in the interests of justice why the appeal should be heard.

While appeals against decisions of the CFI can relate to matters of law or fact, an appeal will not normally involve a full rehearing (eg, of witnesses), and so the grounds of appeal are usually limited to questions of law rather than fact.

13.1.3 Costs

As well as determining the substantive issues in dispute between the parties, the court will normally also make an order regarding the costs incurred by the parties in respect of the litigation. The general rule is that the unsuccessful party pays the costs of the successful party. However the court has complete discretion in this matter and may decide to make a different order. For instance, if one of the parties has conducted the litigation improperly or unreasonably, then the court may penalise that party by making it pay more or receive less (as appropriate) by way of costs. One factor the court will consider in assessing the conduct of the parties is whether one of the parties unreasonably refused to take part in settlement negotiations or mediation at an earlier stage of the dispute.

The amount of the costs to be recovered will be 'taxed' (ie, assessed) by the court if the parties are not able to agree. In practice, the court rarely makes an award of costs which is equal to the costs the successful party actually incurred; typically, recovery will be in the order of between 50 per cent and 70 per cent of actual costs.

13.1.4 Enforcement of foreign judgments

There are two main regimes for the enforcement of foreign judgments in Hong Kong: the statutory regime and the common law regime.

The statutory regime under the Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319) applies – to the exclusion of the common law regime – to judgments handed down in certain

Commonwealth countries, as well as the 'superior courts' of certain states listed in the Foreign Judgments (Reciprocal Enforcement) Order (Cap 319A). As of 1 May 2020 the relevant Commonwealth countries were Bermuda, Brunei, India, Malaysia, New Zealand, Singapore and Sri Lanka, while the list of other states comprised Australia, Belgium, France, Israel, Italy and the Netherlands.

Under the statutory regime a judgment creditor may apply to the CFI at any time within six years after the date of the foreign judgment (or the last appeal judgment in respect of it) to have that judgment registered. A registered foreign judgment is of the same force and effect as if it had been a judgment originally given in Hong Kong.

Under the common law regime, a foreign judgment is treated as constituting a cause of action against the judgment debtor, and as such may be sued upon summarily by the judgment creditor in the Hong Kong courts. The Hong Kong courts will generally enter judgment in favour of the judgment creditor without re-examining the merits of the foreign judgment, provided that certain requirements are satisfied. These requirements include, among other things, that:

- the foreign court rendering the judgment was of competent jurisdiction;
- the foreign judgment is final and conclusive; and
- the foreign judgment is for a fixed sum of money not being a tax, fine or penalty.

With respect to mainland China, the CFA observed in *First Laster Ltd v Fujian Enterprises (Holdings) Co Ltd* (2012) 15 HKCFAR 569, at paragraph 43, that:

> '[a]lthough the HKSAR and the PRC are part of one country, for the purposes of the conflict of laws they are separate districts, and a judgment of the Supreme People's Court is a foreign judgment, and will be enforced or recognised in Hong Kong only if it fulfils the conditions for enforcement or recognition at common law'.

Nonetheless, several mutual arrangements between Hong Kong and the mainland are in place to allow for the reciprocal recognition and enforcement of judgments in civil and commercial matters. Of particular importance among these is the arrangement made in 2006 for the recognition and enforcement of judgments in civil and commercial matters pursuant to choice of court agreements (the Choice of Court Arrangement), which is implemented under Hong Kong law in the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597). Pursuant to the Choice of Court Arrangement, a mainland judgment given by a designated court on or after 1 August 2008 may be enforced in Hong Kong by registration in the CFI if:

- the judgment is final and conclusive, and is enforceable in the mainland;
- the judgment is for the payment of a sum of money (not being a tax, fine or penalty) arising from a commercial agreement; and
- the parties have entered into a 'choice of Mainland court agreement' on or after 1 August 2008.

On 18 January 2019 the Hong Kong government and the SPC signed the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Court of the Mainland and of the Hong Kong Special Administrative Region (the '2019 Arrangement'). The 2019 Arrangement removes some of the limitations to which the current enforcement regime is subject.

Unlike the Choice of Court Arrangement, it is not limited to monetary judgments and does not depend on the existence of a choice of court agreement under a commercial contract. Further, it sets out jurisdictional grounds for recognition and enforcement purposes.

At the time of writing, the 2019 Arrangement had not yet entered into force. Upon becoming effective, it will supersede the Choice of Court Arrangement, which will continue to apply in respect of judgments made before the date of commencement of the 2019 Arrangement.

13.1.5 Sovereign and crown immunity

In *Democratic Republic of the Congo v FG Hemisphere Associates LLC* [2011] HKCFA 41, a 3:2 majority of the CFA held that *state immunity* not only covers sovereign acts, but also states' commercial activities. The decision, which was preceded by an interpretation issued by the National People's Standing Committee to the same effect, confirmed that the concept of absolute immunity applies in Hong Kong. Importantly, the majority of the court further held that a foreign state cannot waive its immunity by agreement in advance of proceedings on the basis that state immunity could be waived only after the commencement of proceedings.

Notwithstanding that certain exceptions may apply, the decision in *FG Hemisphere* means that private parties dealing with foreign state or state-affiliated entities would be well advised to take into account the immunity enjoyed by foreign states from proceedings before the Hong Kong courts and, if necessary, to seek legal advice.

Where the PRC or an entity affiliated to it is involved, the doctrine of crown immunity applies instead. Whether an entity is part of the PRC and therefore entitled to invoke crown immunity is a question of fact. While the amount of control that the state is able to exert over an entity is a material factor, other factors are also relevant (eg, the object and functions of the entity), and as such it is important, in the context of crown immunity as in relation to state immunity, to obtain legal advice if required.

13.2 Hong Kong seated arbitration

13.2.1 Arbitration Ordinance

The primary arbitration legislation in Hong Kong is the Arbitration Ordinance (Cap 609) which creates a unitary regime governing both domestic and international arbitration. The Arbitration Ordinance is based on the UNCITRAL Model Law on International Commercial Arbitration[19] and is regularly amended to keep pace with key developments in the international arbitration sphere. For instance, the most recent set of amendments, which were introduced in 2017 and came into operation on 1 January 2018, clarified that disputes over intellectual property rights are capable of resolution by arbitration, and that the enforcement of awards involving intellectual property rights did not contravene Hong Kong public policy.

The object of the Arbitration Ordinance is to facilitate the fair and speedy resolution of disputes and the avoidance of unnecessary expenses. Further, the statute is based on the principles that parties

19 The Model Law can be accessed at www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf accessed 24 March 2020.

should be free to agree on the resolution of their disputes and that arbitral proceedings should be free from court interference save as expressly provided in the Arbitration Ordinance.

Another key feature of the Arbitration Ordinance is the protection of confidentiality in arbitration and related court proceedings. To this end, the legislation prohibits parties to the arbitration from disclosing information concerning the proceedings or award unless otherwise agreed between the parties or unless one of the limited exceptions under the Arbitration Ordinance applies. These exceptions allow the disclosure by a party of confidential information if such disclosure is:

- made to protect or pursue a legal right or interest of the party;
- required by law to be made to a governmental or regulatory body, court or tribunal; or
- made to a professional or other adviser of the parties.

The Arbitration Ordinance further provides for a wide range of interim relief by empowering a tribunal to grant an order for an interim measure at the request of a party to:

- maintain or restore the status quo pending determination of the dispute;
- take action that would prevent (or refrain from taking action that is likely to cause) current or imminent harm or prejudice to the arbitral process;
- provide a means of preserving assets out of which an award may be satisfied; or
- preserve evidence that may be relevant and material to the resolution of the dispute.

In addition to being able to recognise and enforce interim measures granted by Hong Kong, as well as foreign-seated arbitral tribunals, Hong Kong courts are empowered to grant interim measures in support of arbitration proceedings commenced in Hong Kong and elsewhere.

13.2.2 Hong Kong International Arbitration Centre

The HKIAC, one of the world's leading arbitral centres, is based in Hong Kong. A 2015 study revealed that the HKIAC is the third most preferred and used arbitral institution worldwide, and the most favoured arbitral institution outside of Europe. Since then, Hong Kong has consistently ranked among the top four seats of arbitration in the world.

Under the Arbitration Ordinance, the HKIAC enjoys a statutory role as the body for the appointment of arbitrators and the determination of the number of arbitrators, in the absence of agreement between the parties.

In November 2018 the HKIAC 2018 Administered Arbitration Rules (the '2018 Rules') entered into force. The 2018 Rules, which apply to arbitration commenced after 1 November 2018, introduced a number of amendments to the former set of rules relating to, among other things:

- the use of technology: this has been identified as a factor to be considered by tribunals in the determination of the procedure of the arbitration;
- the emergency arbitrator procedure: in addition to introducing a cap on emergency arbitrator fees and shortening the time limits under the emergency arbitrator procedure, the 2018 Rules

allow parties to file an application for the appointment of an emergency arbitrator up to seven days before a notice of arbitration is submitted to the HKIAC;

- third-party funding: the 2018 Rules introduced a requirement for funded parties to disclose the existence of a funding agreement and the identity of the funder; and
- a new early determination procedure: under the 2018 Rules, a tribunal is empowered, if so requested, to decide points of law or fact by way of early determination on the basis that such points are manifestly without merit or manifestly outside the tribunal's jurisdiction, or would not allow – even if assumed to be correct – an award to be rendered in favour of the other party.

13.2.3 Enforcement of arbitral awards

Hong Kong is not a state and thus cannot of its own be a Contracting State to the New York Convention. However, following the transfer of sovereignty over Hong Kong to the PRC in 1997, the government of the PRC extended the territorial application of the New York Convention to Hong Kong, subject to the reservations originally entered by the PRC on its accession to the Convention.

As such, awards made in Hong Kong can be enforced with relative ease in more than 160 states that are Contracting States to the New York Convention. Conversely, the Arbitration Ordinance provides that awards made in Contracting States can be enforced by action in the court, or in the same manner as awards rendered in Hong Kong or in non-New York Convention states.

Awards made in Hong Kong or non-New York Convention states are enforceable under the Arbitration Ordinance in the same manner as a court judgment; however, only with leave of the court. Leave is not granted automatically. Grounds on which enforcement can be refused are set out in the Arbitration Ordinance and include, for instance, the incapacity of a party to the arbitration, the invalidity of the arbitration agreement, certain procedural irregularities or a conflict with Hong Kong public policy. In practice, however, leave to enforce will only be refused in unusual cases, and if so, it may nonetheless be possible to enforce an award through an action on the award at common law.

The enforcement of Hong Kong awards in mainland China and vice versa is not governed by the New York Convention, as they are not awards made in the territory of another New York Convention state. The same reasoning applies to the enforcement of awards between Hong Kong and Macao. For this reason, the enforcement regime in Hong Kong is complemented by arrangements with the mainland and Macao, respectively, for the reciprocal enforcement of arbitral awards, which provide for enforcement on largely similar terms to the New York Convention.

13.3 Mediation

A significant aspect of the Hong Kong civil justice system is that parties are encouraged to settle their disputes amicably; indeed, 'to facilitate the settlement of disputes' is one of the underlying objectives of the RHC and RDC. In line with this objective, the Hong Kong legal system has developed a robust framework for mediation with the Mediation Ordinance (Cap 620) at its centre. The aim of the Mediation Ordinance is to promote, encourage and facilitate the resolution of disputes by mediation, and to protect the confidential nature of mediation communications.

In addition to administering arbitration, the HKIAC also offers mediation services and has a division – the Hong Kong Mediation Council – specifically dedicated to mediation. However, in recent years an increasing number of mediation institutions and mediation-related bodies have come into existence in Hong Kong, with examples including the Hong Kong Institute of Mediators and the Hong Kong Mediation Accreditation Association Limited. The latter, founded in 2012, is the premier accreditation body for mediators in Hong Kong. The HKMAAL accredits mediators and provides training courses while seeking to promote 'a culture of best practice and professionalism' in Hong Kong mediation.

The proliferation of mediation institutions has been accompanied by the promulgation of the Hong Kong Mediation Code, which has been adopted by a number of mediation service providers (including the HKIAC, Hong Kong Mediation Accreditation Association Limited and Hong Kong Mediation Centre) and aims to serve a quality assurance function by providing a common standard among mediators.

Further, on 7 August 2019 the UN Convention on International Settlement Agreements Resulting from Mediation (the 'Singapore Convention') was signed by 46 states (including the PRC, Singapore and the US) and will come into force on 12 September 2020. The Singapore Convention – noting in its preamble the increasing use of mediation as an alternative to litigation and its role in the development of harmonious international economic relations – establishes a cross-border enforcement mechanism for the enforcement of settlement agreements resulting from mediation. Notwithstanding that the PRC is a signatory to the Singapore Convention, it does not follow that the Convention will apply in Hong Kong following its entry into force, as the Basic Law of Hong Kong provides that international agreements do not automatically apply in Hong Kong on ratification by the PRC. While the future of the Singapore Convention in Hong Kong is therefore currently uncertain, if and when its application is extended to Hong Kong, it is likely to further corroborate the position of Hong Kong as a leading international dispute resolution centre.