



Fiduciary Duties and Legal Liabilities of NGO Directors
非政府機構董事的信託義務及法律責任

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HKCSS

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Overview

- Part I
 - Overview of legal forms
 - What are fiduciary duties?
 - 3 Ds
 - Potential legal liabilities of NGO directors

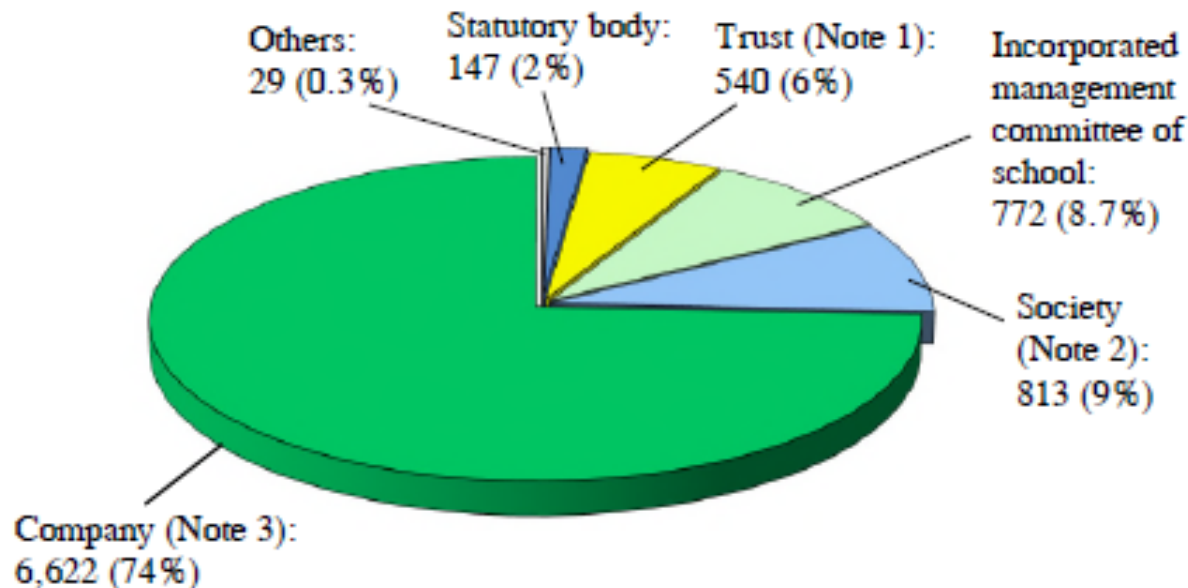
Overview

- Part II
 - The Myth: 不受薪, 不上身?
 - Organizational Form – Society / Trust
 - Protective Strategies



Overview of Legal Form

**Legal forms of 8,923 tax-exempt charities
(30 September 2016)**



Source: Report of the Audit Commission, 2017

Specific legal responsibilities will arise from the ordinance under which the NGO is established.

- Trust – Trustee Ordinance (Cap. 29)
- Company limited by guarantee/ Company limited by shares – Companies Ordinance (Cap.622)
- Society – Societies Ordinance (Cap. 151)

Members of Governing Body – Who Are They?

- Trust – Trustees (individual / trustee company)
- Company – directors (executive committees, governors)
- Society – office bearer (幹事) (e.g. president, vice president, secretary)

Directors

- Definition
 - Pursuant to Section 2 of Companies Ordinance (Cap 622), director includes any person occupying the position of director (by whatever name called)
- Minimum no. of persons:
 - Company limited by guarantee – 2
 - Company limited by shares – 1

Directors

- **Qualification:**
 - Any individual aged 18 or above who is not incapacitated, regardless of nationality; or
 - In case of a private company rather than a member of a listed company, a body corporate can become a director, provided that the company must have at least one director who is a natural person.

Members of Governing Body's Responsibilities

- Collective legal responsibility for the governance of the NGO
 - Introduction of Lump Sum Grant in 2002
- Mrs Carrie Lam (the Director of Social Service) provided a
“Reference Guide for NGO Boards”
- Introduced 3Ds

What are Fiduciary Duties (信託責任) of an NGO member of the governing body?

3Ds:

- Duty of care, skill and diligence
- Duty of loyalty
- Duty of obedience



3Ds – Duty of Care, Skill and Diligence

- Common law concept/ case law (普通法概念/案例)-
- Duty of care (有責任謹慎行事)
 - attend meetings
 - be prepared to make informed decisions
 - request additional information if required
 - carry out duties in a reasonable and responsible manner

3Ds – Duty of Loyalty

- 有責任忠誠行事
 - must make decisions in the best interests of the NGO solely
 - not any group he/she represents
 - never for personal gain

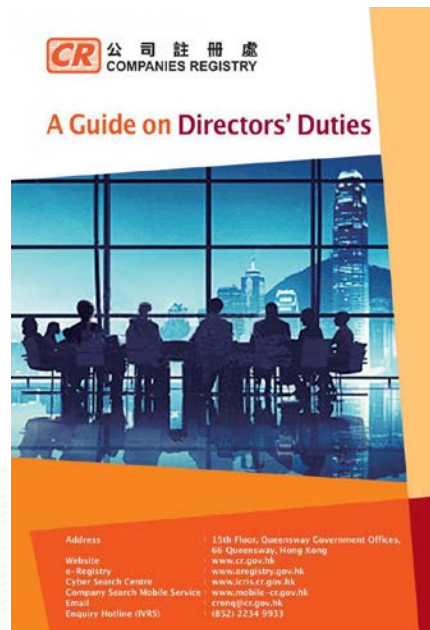
3Ds – Duty of Obedience

- 有責任循規行事
 - be faithful to the NGO's mission
 - not permitted to act in ways that are inconsistent with the central goals of the NGO
 - examine all documents about NGO's mission and operation



Directors' Duties

A Guide on Directors Duties by Companies Registry



- A useful summary: A Guide on Director's Duties
- Recap on director's responsibilities and liabilities
- Fiduciary duty in case of charitable trusts
- All directors must exercise reasonable care, skill and diligence

Non-Exhaustive List of Principles of Equal Importance

- Principle 1: to act in good faith for the company's benefit
- Principle 2: to use power for a proper purpose for the member's benefit
- Principle 3: to delegate powers with proper authorisation

Non-Exhaustive List of Principles of Equal Importance

- Principle 4: Duty to exercise care, skill and diligence
 - Section 465 Companies Ordinance (Cap 622) New test
 - judge acts of a director objectively and subjectively
 - director's conduct compared to a reasonably diligent person with the general knowledge, skill and experience that may be expected of a person carrying out the functions carried out by the director in relation to the Company section 456(2)(a) Companies Ordinance (cap 622)
 - new Companies Ordinance mandates a minimum standard e.g. care, skill & diligence
 - no excuse for limited corporate management experience

Non-Exhaustive List of Principles of Equal Importance

- Principle 5: to avoid conflict between personal interest and interest of company
- Principle 6: not to enter into transactions when directors have an interest
- Principle 7: not to gain advantage from use of position as a director

Non-Exhaustive List of Principles of Equal Importance

- Principle 8: not to make unauthorised use of company's property or information
- Principle 9: not to accept personal benefit from third parties
- Principle 10: to observe the company's constitution resolutions
- Principle 11: duty to keep accounting records

What NOT to Do:

- use of the board member position for personal gain
- operating against the advantage of the NGO in self-interest
- inattention, negligence or incompetence

What NOT to Do:

- not demanding sufficient information to evaluate actions
- allocating insufficient time to know that NGO
- not treating their involvement as a serious commitment with responsibilities and risks

What if Fiduciary Duties are Breached?

- *Poon Ka Man Jason & Ors v Cheng Wai Tao & Others [2016]*
 - CFA examined the scope of a director's positive duty of loyalty to act in the best interest of the company
 - Jason and Ricky were, amongst others, business partners of Japanese noodle restaurants under Smart Wave. Itamae Sushi was opened in 2004 by Smart Wave. Ricky opened more restaurants with himself as a sole shareholder and sole director.
 - Ricky had diverted business opportunities and profits through establishment of "Itacho" for which he was held liable to account for all profits made until Smart Wave ceased its operations in 2010.

Who are Liable?

Section 3, Companies Ordinance (Cap 622) – Responsible Person

What is a responsible person under the Companies Ordinance?

- is a director or officer of the company and “authorities or permits, participates in, or fails to take all reasonable steps to prevent” contravention of the provisions under Companies Ordinance
- is liable for any contravention of the Companies Ordinance
- includes a shadow director, who gives instructions and directions to the company even though he may not formally hold the position of a director
- The new Companies Ordinance (made effective March 2014) increases exposure for directors
 - a director is liable if he authorised or permitted the contravention or failed to take reasonable steps to prevent the contravention

Duties Under the Companies Ordinance: Duty of Care, Skill and Diligence (Sections 465 and 466)

- It means exercising care, skill and diligence in the performance of their functions and the exercise of their powers as a director



Duties Under the Companies Ordinance: Duty of Care, Skill and Diligence (Sections 465 and 466)

- In deciding whether a director of a company has breached the duty of care, skill and diligence owed by him to the company, his conduct is compared to the standard that would be exercised by a reasonably diligent person having –
 - (1) The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (objective) (客觀)
 - (2) The general knowledge, skill and experience that the director has (subjective) (主觀)

Director's Personal Liability = Liable if Fiduciary Duties are Breached

- Governance liabilities
- Operational liabilities
- Failure to comply with relevant law and ordinance such as data protection

- Procedural types of offences e.g.:
 - Preparing financial statements
 - Keeping required registers and business records
 - Missing Companies Registry filings
 - Knowingly or recklessly providing misleading, false or deceptive material in any return, report, financial statements
- Increased penalties –
 - Company and responsible person subject to fines of up to \$50,000 and \$1,000 per day
 - Imprisonment

Recruiting Members of NGO Governing Body

- A minimum standard cannot be adjusted downwards for inexperienced directors or because the director is not being remunerated
- Standard adjusted upwards if the director has special knowledge, skill or experience
- Appoint more qualified persons
- Due diligence of directors
- Obtain a referral letter upon the appointee's approval before confirming appointment

Are Members of NGO Governing Body Paid?

- No, they cannot take a remunerated position if they are charities with S.88 Inland Revenue Ordinance tax exemption status
- BUT they can hire employees

The Myth: 不受薪, 不上身?

- When joining an NGO governing body, you take on a set of responsibilities and duties defined by law
- The members of the board, charged with exercising responsibility over the organisation and its resources, are considered fiduciaries

The Myth: 不受薪, 不上身?

- Fiduciaries are held to a standard known as the test of reasonableness and prudence (合理和審慎測試)
- How would you treat your own resources?

The Myth: 不受薪, 不上身?

- Collective and Shared Responsibilities
 - The board as a collective entity is responsible and liable for what happens in and to the organisation
 - It must ensure that the organisation operates in compliance with the law and its own policies

The Myth: 不受薪, 不上身?

- Meeting – what is the quorum (法定人數)
- If the quorum is defined with less demanding parameters and a majority vote of those present is required, it is possible that a few board members will end up making major decisions for the organisation
- If legal action ensues, it can often be traced back to an inattentive, passive or captive board

The Myth: 不受薪, 不上身?

Advice:

- board members should attend meetings regularly
- make independent decisions, (rather than simply voting with the majority)
- before approving any meeting minutes, review the document carefully

The Myth:不受薪, 不上身?

- As government regulators grow more aggressive in demanding accountability, boards must become correspondingly more vigilant and active in establishing and implementing sound policies.

The Myth: 不受薪, 不上身?

- This situation arises when board members have been passive or otherwise inactive in overseeing the activities of the non-profit organisation and, consequently, may have failed to adhere these charges, board members must demonstrate that they appropriately discharged the requisite duties
- Ignorance is not an acceptable excuse when a legal problem demands the board's attention

The Myth: 不受薪, 不上身?

- NGO member of governing body has same legal liability as for profit companies' governing body

Case Study

Member of governing body signing:

*For and on behalf of
XXX Charity Foundation*

Director / Authorised Person

- What does it mean?
- Have authority?
- What can go wrong?

What can go wrong?

- Cheque maybe dishonoured because:
 - Insufficient funds
 - Irregular signature
 - Alterations
 - Post dated cheque
 - Stale cheque (expired)
 - Frozen account

Consequences of a dishonoured cheque

- Penalty
 - Penalty is levied on both drawer and payee by their respective banks
 - If the dishonoured cheque is against repayment of loan, in such case, the person will additionally have to pay late payment charges

Consequences of a dishonoured cheque

- Damage to credit history
 - Financial institution report your payment activities to credit bureaus
 - It is a good practice to avoid your cheques from being bounced

Consequences of a dishonoured cheque

- Potential legal liabilities
 - Have the directors exercise reasonable care, skill and diligence?
 - **Subjective test:** general knowledge, skill and experience that director has

Consequences of a dishonoured cheque

- **Objective test:** general knowledge, skill and experience that may be reasonably expected of a person carrying out the functions of the director of that company
 - Did the director sign the cheque without checking the amount of transaction which result in insufficient fund in the account?
 - Was the director informed that their bank accounts might be frozen?
 - Was the director an authorised signatory of the bank account?
 - Did the director check the details of such transaction before signing the cheque?

Organisational Form – Society

- Advantages:
 - Cost is minimal
 - A Society is free of the statutory controls which companies are subject to, and can be inexpensive to run
 - There is no fee for registering under the Societies Ordinance
 - Set up process is simple and hassle-free
 - Minimal formalities are required and administrative complexity can be kept to a minimum

Organisational Form – Trust

- Some private foundations, for example, are trusts
- *the trustees have a fiduciary duty* - to act in the best interest of the trust
- Trustees of the trust do NOT have the protection against personal liability afforded by the corporate form

Organisational Form – Trust

- But the trust form may be used to protect the founder's privacy
- The identity of the governing board, and perhaps the amount of assets and funding, may be shielded from public view
- NGO taking the form of a trust requires the execution of a trust agreement or a declaration of trust



Protective Strategies-Why Do We Need Protective Strategies?

- In a litigious society, anybody can sue anybody, even frivolous cases cost money
- Organisation can undertake some fundamental protective strategies
- Board members can implement an action program to help ward off or, if necessary, defend against personal liability

Protective Strategies-Proactive Governance

- First step before action is awareness
- NGO can only take measures to improve safety if they understand what they need to focus on
- Keep an eye on the general trends happening in your area
- Recognise the fundamental duties and responsibilities
- Develop a basic understanding of the legal framework
- Show good intentions by being accountable for their own actions

Protective Strategies-Proactive Governance

- Members of the board should make informed decision
- Tips: use consent agenda
 - If time is not of the essence with a specific issue, it is better to table the discussion and make a more educated decision during the next board meeting after more research has been conducted

Protective Strategies-Indemnification: sections 468 & 469 of Companies Ordinance

- Means that one party promises to protect another party from losses resulting from risks while carrying out specified duties
- Board members are usually indemnified by the organisation against judgements incurred when they are acting in the service of the organisation

Protective Strategies-Indemnification: sections 468 & 469 of Companies Ordinance

- Check if you are indemnified by the NGO
- Some of the NGO may only indemnify the board member only for court costs and not for the judgement
- Indemnification cannot cover criminal acts and certain wilful acts that violate civil law



Protective Strategies-Indemnification: sections 468 & 469 of Companies Ordinance

- S.469 CO – company is prohibited from indemnifying the director for liability to itself or an associated company (公司被禁止彌償其董事對其本身或其關聯公司的法律責任)
- S.469(2) - prohibits company from indemnifying directors for fines and penalties, as well as “any liability incurred” in criminal proceedings where the director is convicted and derivative claims brought by company or associated company in which judgment given is against the director (不得提供任何彌償有關董事繳付罰款形式繳付的款項；或在刑事法律程序中判處的法律責任)



Protective Strategies-Indemnification: sections 468 & 469 of Companies Ordinance

- S. 468(3) – company is prohibited from indemnifying directors for breach of due care and skill to the company
(如公司藉着某條文，直接或間接向該公司的董事提供彌償，以彌償該董事在與關乎該公司的疏忽、失責、失職，則該條文屬無效)

Protective Strategies-Insurance

- Directors' and Officers' insurance covers employment-related suits, such as allegations of intentional acts
- D&O policy is a must for a NGO – it reimburses the organisation for any indemnification expenses it may have suffered and provides direct payments to those insured when the organisation is not reimbursing them

Protective Strategies-Insurance

- Questions to ask about D&O
 - Who is covered (all board members?)
 - Who is excluded
 - How is loss defined
 - Are lawyers' fees included?
 - Are defense costs reimbursed or paid as incurred



Q&A



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