

# ACUMINOUS

2019 FIFTH ISSUE

## DIRECTORS' DUTIES

The recent Hong Kong judgment of *Moulin Global Eyecare Holdings Limited (in liquidation) v Olivia Lee Sin Mei* [2019] HKCFI 1715 reminds non-executive directors, in particular those with a professional background, of their duty of care and the potential consequences they may face if they fail to discharge their fiduciary duties. In this issue, we will highlight the duties of directors under the laws of Hong Kong and the Listing Rules and why the Moulin case matters to all listed companies' directors.

### Executive Summary

NEDs and INEDs are expected to keep up to date with the listed company's business affairs, contribute to the board's strategic objective setting and scrutinise the listed company's performance. Directors who failed to discharge their duties may not only be disciplined by the Stock Exchange but may also be held personally liable for the loss of the Company. In the Moulin case, Olivia Lee, a NED and principal legal adviser of the listed company, was found to have ignored red flags concerning the conduct of the management and the solvency of Moulin, and as a result was held personally liable for the losses of Moulin which amounted to around HK\$464 million in aggregate. This decision underscores that NEDs will be held accountable if they failed to discharge their fiduciary duties with the required skill and standard of care.

### Directors' duties

Directors, whether they are executive directors (**EDs**), non-executive directors (**NEDs**) or independent non-executive directors (**INEDs**), are subject to the same legal duty under the Listing Rules and the laws of Hong Kong. All directors should be capable of seeing company and business issues on a broad perspective. However EDs and NEDs have different roles and functions, hence the manner in which their duties should be discharged may potentially be different.

EDs are normally involved in the daily business operations and are responsible for ensuring the accountability of the management to the board and the shareholders. NEDs and INEDs are not involved in the day to day management of the listed company but are expected to be familiar with the business affairs and able to contribute to the board's strategic objective whilst providing an independent view of the company. They should be involved in scrutinising the listed company's performance in achieving agreed corporate goals and objectives, and supervising performance reporting. They should also provide

constructive challenge, strategic guidance, offer specialist advice and hold management to account.

Directors will risk facing disciplinary proceedings if they fail to discharge their duties and responsibilities. As NEDs and INEDs are expected to keep up to date with the listed company's business affairs, not having sufficient understanding or information from the listed company in relation to the relevant transactions is not defensible reason for a failure in discharging their responsibilities.

### Existing Listing Rules

The board of directors are collectively responsible for its management and operations. The Stock Exchange expects all directors, both collectively and individually, to fulfil fiduciary duties and duties of skill, care and diligence to a standard as required under the Hong Kong law. This means that every director must, in discharging his duties as a director: (a) act honestly and in good faith in the interests of the listed company as a whole; (b) exercise his power for proper purposes; (c) be accountable to the listed company for the application or misapplication of its assets; (d) avoid actual and potential conflicts of interest and duty; (e) disclose fully and fairly his interests in contracts with the listed company; and (f) apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the listed company.

Delegating their functions is permissible but does not absolve them from their responsibilities or from applying the required levels of skill, care and diligence. Directors must take an active interest in the listed company's affairs and obtain a general understanding of its business. Directors should maintain a high level of integrity with a high degree of familiarity with the listed company's affairs and they should conduct regular reviews of the financial status of the listed company and follow up on anything untoward that comes to their attention.

Directors are reminded that if they fail to discharge their duties and responsibilities, they may be disciplined by the Stock Exchange and may also attract civil and/or criminal liabilities under Hong Kong law or the laws of other jurisdictions. The Stock Exchange will consider the facts and evidence on a case by case basis and may impose sanctions as the Stock Exchange deems appropriate in accordance with the Listing Rules.

### **The Moulin case**

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Moulin Global Eyecare Holdings Limited (in liquidation) (**Moulin**) was listed in Hong Kong in 1993. Thereafter, Moulin's business was run by a family group of shareholders, with a 40% shareholding, and who exercised control of the board and executive management. Olivia Lee (**Olivia Lee**) had been the principal legal adviser to Moulin since 1996 and was also Moulin's NED between 8 December 2000 and 1 November 2004. Moulin was later wound up by the Hong Kong court on 5 June 2006.

The High Court considered that Olivia Lee's knowledge of Moulin's internal operations and business transactions far exceeded what the title of NED would normally suggest. This also meant that Olivia Lee ought to have noticed and investigated the red flags from the acquired knowledge of matters concerning the solvency of Moulin during the course of her tenure as a director. The court identified the following key red flags Olivia Lee failed to take further action when she approved Moulin's accounts, dividends and management share repurchases and was in breach of her duty of care and skill:

- a complaint by a customer in 2000 involving manipulation of accounts between the customer and the Group when conducting audit confirmations;
- the payables which ought to have been easily paid (E.g. the outstanding legal fees of Olivia Lee's law firm) were significantly delayed and Olivia Lee failed to question the Group's solvency;
- Moulin had granted cash advances of around HK\$233 million to third parties, representing 17.43% of the Group's net assets, on an unsecured basis as at 31 March 2001. Olivia Lee was aware that (a) the Group had no moneylender's licence at the relevant time and there was no commercial rationale to engage in moneylending activities; (b) the Group, as of 31 March 2002, increased its interest-bearing bank

borrowing by HK\$420 million; and (c) Olivia Lee was aware that one of the purported borrowers was not an independent third party, but a member of senior management of the Group.

- Moulin's accountants had raised concerns about significant transactions not being verifiable and not been able to obtain free access to the Moulin's financial records. As a result, three of the "Big 4" accountancy firms resigned between 2002 and 2005.

In subsequent proceedings brought against Olivia Lee on behalf of Moulin by its liquidator, the High Court held that Olivia Lee was negligent in her failure to investigate and allowed executive management to declare dividends and effect share repurchases when Moulin was insolvent, contrary to its Bye-Laws and the Bermuda Companies Act 1981 causing Moulin to incur significant losses. The High Court further found that Olivia Lee was personally liable for such losses and the relevant interests (approximately HK\$464 million in aggregate).

### **Conclusion**

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Whilst NEDs do not actively participate in the listed company's day-to-day operations, they are expected to carry out their duties of care which include monitoring and scrutinising the listed company's performance and reporting. NEDs, as equal board members, are expected to give the board, and any committees on which they serve the benefit of their skills, expertise, background and qualifications through regular attendance and active participation.

The Moulin case should serve as a stark reminder to NEDs that an appropriate degree of care and skill is expected particularly professionals which have in-depth knowledge of the listed company's affairs. Any identified irregularities and potential misconduct of listed companies should be handled with reasonably investigated based on professional judgment. Directors should seek to consult experienced professionals at an earlier stage to handle the situation swiftly if they identified any irregularities and potential misconduct of listed company.

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