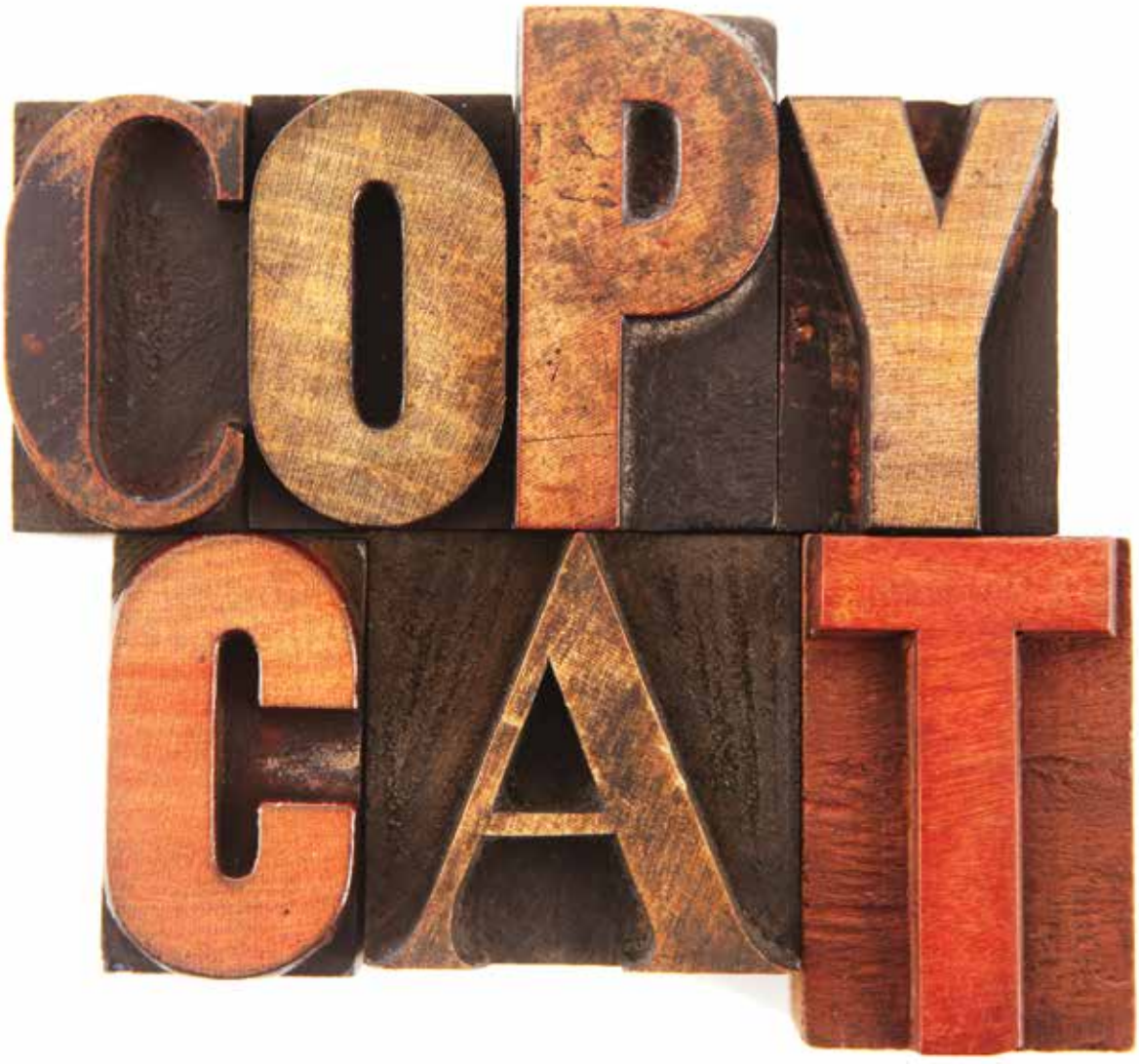
Shadow companies: new CFI judgments

In two recent cases, Hong Kong's Court of First Instance (CFI) calls for proactive measures against shadow companies.



In two recent Hong Kong cases, *Power Dekor (Hong Kong) Ltd v Power Dekor Group Co Ltd* (1 HKLRD 845/2014), and *Exxon Mobil Corporation* v *USA Exxon Mobil Oil Ltd & Others* (HCA 2188/2013), Zervos J of the Hong Kong Court of First Instance reopened the debate about shadow companies in Hong Kong. Despite changes to the Companies Ordinance in 2010, aimed specifically at dealing with the shadow companies problem, Zervos J's judgments in effect expressed the view that the amendments do not adequately deal with the problem and called for proactive measures to be taken by the Companies Registry of Hong Kong to deal with the root of the problem.

The legal issues

The two cases involved similar factual and legal issues. In each case, the claimant had an established reputation in Hong Kong, whereas the defendant was an unrelated company incorporated in Hong Kong with a name very similar to the claimant's household brand. The defendants were typical 'shadow companies' in Hong Kong, which exhibit the following characteristics:

- they are largely inactive companies and do not have substantial business activities in Hong Kong
- their directors and shareholders typically reside overseas, very often in the People's Republic of China
- they engage secretarial companies based in Hong Kong to serve as their company secretary
- they use the address of their company secretary as their registered office address, and
- many of them use, or are suspected of using, their Hong Kong company name as a front to give legitimacy to infringing activities taking place in the People's Republic of China or overseas.

Under the current company registration regime in Hong Kong, the Companies Registry is not required to examine a proposed company name at the time of incorporation of the company to see if it may conflict with another person's rights to the name (or part of it). Unless the proposed company name is identical to an existing Hong Kong company name, or contains restricted words such as 'bank' or 'trust', the Companies Registry will not raise any objection and will approve the proposed name.

If a trademark owner objects to a new company name that has been approved by the Companies Registry, it is essentially left with two options:

(i) to complain to the Companies Registry (within 12 months of the incorporation of the company) on the ground that the company name adopted by the newly incorporated company is too like the name of an existing company in Hong Kong, or

(ii) to commence civil proceedings in Hong Kong on the grounds of passing off (and possibly trademark infringement if the defendant company uses an identical or confusingly similar mark in the course of trade in Hong Kong).

Prior to the amendment to the Companies Ordinance in 2010, pursuing option (ii) involved quite an expensive and complex process. While a large number of these lawsuits ended up with a default judgment in favour of the claimant, the judgment would not automatically lead to a change of name of the shadow company, given that the Companies Registry did not have the power to act upon a court order to enforce a name change in the event that the defendant failed to comply.

The only effective solution that led to an eventual change of the company name, involved joining the shareholders of the shadow companies as parties to the proceedings and seeking an order from the court that the claimants' solicitors be authorised to sign a special resolution

Highlights

- the Court of First Instance (CFI) judgments in effect express the view that the changes to the Companies Ordinance in 2010 do not adequately deal with the shadow companies problem
- the Companies Registry is not required to examine a proposed company name at the time of incorporation of the company to see if it may conflict with another person's rights to the name (or part of it)
- the CFI judgments call for proactive measures to be taken by the Companies Registry to deal with the root of the problem

> “Zervos J’s judgments highlight the fact that there is more work to be done in Hong Kong to finally solve the company name hijacking problem”

on behalf of the shareholders to effect a name change, in the event they failed to comply. These extra steps took time and incurred costs for the claimants, especially as, typically, the shareholders of shadow companies reside overseas and provide fake addresses making service of process difficult and expensive.

The CFI recommendations

As a result of joint lobbying by the IP community and the Companies Registry, changes to the Companies Ordinance were made in 2010 in advance of the major overhaul of the Companies Ordinance in 2014. The 2010 amendments deal with the enforcement of judgments against shadow companies when only the company and not the shareholders also are sued. They give the Companies Registry the power it did not have prior to 2010 to act upon a Hong Kong court order to direct a shadow company to change its company name to one not including the objectionable name or mark. If the shadow company fails to comply, the Companies Registry will then proceed to replace the objectionable part of the company name with its registration number. The amendment, however, does not deal with the root of the problem which is the incorporation of companies which adopt company names that incorporate a third party’s trademark.

Zervos J seized upon this in the two recent cases. He expressed concern over the fact that the defendants were able to register the companies successfully with the Companies Registry despite having names so similar to some well-known brand names or trademarks. The learned judge commented that the unscrupulous individuals behind these shadow companies might be able to use the fact of incorporation to pass themselves off as the claimants in their business pursuits in the People’s Republic of China to deceive potential customers.

The learned judge acknowledged the changes brought about by the Companies Ordinance amendment of 2010, but felt that the legislative provisions do not go far enough to deal with the problem. Zervos J called for greater scrutiny in the approval process, as well as legislative changes enabling the Companies Registry to take more effective measures, including the power to refuse the adoption of a company name that incorporates a third party’s trademark, or to deregister a company name that is the same as, or too like another. In *Power Dekor*, Zervos J directed that a copy of his judgment be referred to the Companies Registry.

The implications

Zervos J’s concerns are shared by many in the IP community and may reopen the discussion on company name hijacking. Despite the 2010 amendment to the Companies Ordinance, the problem remains. Shadow companies continue to be incorporated in Hong Kong and brand owners have to expend time and money to deal with the problem by commencing court proceedings in Hong Kong. While realistically it would be difficult to see further amendments to the Companies Ordinance being made in the near future, especially given the recent overhaul of this ordinance, Zervos J’s remarks are to be welcomed as they highlight the need to deal with the problem at source.

How this can be done is another matter – should the Companies Registry employ IP experts to vet company names, or should an objection period be set up whereby proposed company names could be published and interested third parties could object? Any such process or proposal would take time to agree and vet, but Zervos J’s judgments highlight the fact that there is more work to be done in Hong Kong to finally solve the company name hijacking problem.

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