

## 1.1 Introduction

The Hong Kong SAR legal system is described as a common law system. The term 'common law' can be confusing because it is used to describe several different aspects of the legal system. Figure 1.1 may help you to understand the general uses of the term.

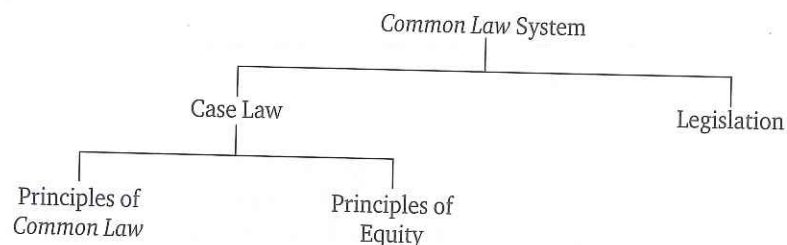


Figure 1.1 The common law system

Under the *Sino-British Joint Declaration* on the question of Hong Kong which was signed between the Chinese and British governments in 1984 and the *Basic Law* (BL), which took effect on 1 July 1997, it was agreed that the common law system will be maintained in the HKSAR: Article 8 of the BL provides that 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 if it contravenes the BL, and
- ◆ subject to amendment by the HKSAR legislature.

Article 8 is reinforced by Article 18 and Article 160 which provide that the laws, i.e., legislation, previously in force in Hong Kong prior to 1997 are adopted as the laws of the Region except for those declared in breach of the *Basic Law*.

The BL was enacted by the National People's Congress in accordance with the Constitution of the People's Republic of China. It comprises 160 articles and three annexes. It also forms a part of the law in Hong Kong and is the constitutional document for the HKSAR (see A101 and A104 at [www.elegislation.gov.hk](http://www.elegislation.gov.hk)).

All the systems and policies practised in the HKSAR must be based on the provisions of the BL, including its social and economic systems, the system for safeguarding the

fundamental rights and freedoms of its residents, and the executive, legislative and judicial systems (BL art. 11).

The key feature of the BL is 'one country, two systems', whereby the Mainland's socialist system and policies will not be practised in Hong Kong and the systems and way of life in Hong Kong are to remain unchanged for 50 years (BL art. 5). The Central People's Government is however responsible for foreign affairs relating to the HKSAR and the HKSAR's defence, but the HKSAR is authorised to conduct certain matters of external affairs on its own (BL arts. 13 and 14).

### ▶ A Common Law System

You can see from the figure that in a common law system there are two primary sources of law: case law and legislation. Case law is the law which has evolved over many centuries from the decisions made by judges. In fact, case law is sometimes described as 'judge-made' law. Legislation, as you will recall from the introduction to Part 1 of this book, is the law made under the authority of the government. Legislation is sometimes described as 'written law' because the relevant law is found in a particular document, rather than in a number of decided cases as in case law.

Common law systems operate in many countries, including the United Kingdom, the United States, Canada, Singapore, Malaysia, New Zealand, Bermuda, the Cayman Islands, and Australia.

An alternative to a common law system is a civil code. In this type of legal system, a code, or some other form of legislation, is the only source of law. The judges are required to interpret the code, but their judgments are not a source of law. This type of system operates, for example, in France and Germany, and is adopted in the People's Republic of China (PRC).

### ▶ The Principles of Common Law

You can see from Figure 1.1 above that case law may be concerned with either the principles of common law or the principles of equity.

The *principles of common law* are based upon the customs of the people and evolved from the common law courts, which were primarily concerned with the strict

application of the law. The *principles of equity* evolved from courts concerned more with justice and fairness than with the strict application of the law. The development of these two courts will be explained later in this chapter.

Although not shown in Figure 1.1, the term 'common law' is also used to describe the whole concept of *case law*. When it is used in this context, it includes all of the case law — that is, the principles of both common law and equity.

The purpose of this chapter is to provide an understanding of:

- ◆ the sources of Hong Kong law
- ◆ the doctrine of precedent
- ◆ the system of Hong Kong SAR courts
- ◆ the creation of legislation and delegated (subsidiary) legislation
- ◆ the interpretation of legislation
- ◆ the resolution of business disputes.

## 1.2 Sources of Law

As mentioned previously, in a common law system there are primarily two sources of law: case law and legislation. However, there is a source which underlies case law and may also affect legislation, and that is custom. Customs formed the basis of the principles of the common law and continue to play an important role in the development of those principles.

We shall now consider each of these three main sources of Hong Kong law.

### ► Case Law

Case law arises when a dispute is taken to the courts to be resolved. The judge or judges who hear the dispute will keep a record of that case. That record is described as a *judgment*. The judgment of every case then forms a part of the law.

A judgment may be concerned with the development of existing case law or with the interpretation of legislation. Whichever its purpose, the judge will compare the facts

and points of law before him with the facts and points of law from previous cases in order to come to a decision which is *consistent with* previous decisions.

The process of considering previous cases is explained further in section 1.3 below. What needs to be explained here is that an over-emphasis on being consistent gave rise to the two branches of case law: the *common law* and the *law of equity*.

The common law principles which evolved in England between the 11th and 15th centuries were applied by the judges of that time irrespective of justice and fairness. Their only concern was to be consistent in the application of the principles. This meant that whilst people were treated equally by the common law, they were not always treated fairly, or equitably. This situation eventually led to the creation of a separate system of courts in which the principles of equity — that is, justice and fairness — were applied.

When the courts of equity were first established, the judges considered the circumstances of each particular case and provided a remedy which they believed was just and fair in those particular circumstances. However, this resulted in uncertainty as to the decision of the courts and led to inconsistent decisions.

In order to counter this criticism, the judges in the equity courts began to be consistent in their application of remedies and so developed the 'principles of equity'. By the 17th century, the principles of equity were as strictly defined as the common law.

The development of two sets of principles and two separate court systems inevitably produced conflicts. However, these conflicts were eventually resolved.

The conflict as to whether the principles of common law or of equity should prevail was resolved in 1615 when the English courts declared that 'equity will prevail'. This meant that in the event of a conflict in applying the two sets of principles, the principles of equity should be applied.

The conflict arising from the fact that the common law and equity had also developed separate court systems was resolved in England in 1873 when all the courts were directed to apply the principles of both common law and the law of equity. However, although the courts will apply both sets of principles, the application and development of these principles still remain separate.

The Hong Kong system is basically the same as in other countries with a common law system: since the enactment of the *Supreme Court Ordinance* in 1873, the principles of both the common law and the law of equity have been applied in every Hong Kong court. In addition, in the event of conflict, 'equity will prevail' (see the *High Court Ordinance*, s.16).

Prior to 1997 the *Application of English Law Ordinance* applied the English common law and law of equity to Hong Kong so far as they were applicable to the circumstances of Hong Kong or its inhabitants, and 'subject to such modifications as such circumstances require'. This meant that where the common law and the law of equity were not appropriate to Hong Kong, Hong Kong could make its own case law independent of the law that applied in England. This Ordinance was not adopted as a law of the HKSAR and was repealed. Case law is now protected and upheld by the *Basic Law* (see above).

## ► Legislation

The term 'legislation' describes the laws which are created by the legislature. A particular piece of legislation is described as a statute or an ordinance.

Legislation has a major advantage over common law and the law of equity in that new principles of law can be formulated and enacted without reference to existing principles. This is particularly important in any modern society which is developing rapidly and which needs to frequently review its laws.

An ordinance may come into existence for one of the following three reasons:

- ◆ An ordinance may *codify* existing case law. Reading a large number of cases can be a laborious task. *Codification* is the process of rationalising the cases and presenting them in the form of an ordinance. The objective is to make the law more readily accessible and comprehensible. A number of the ordinances that we shall consider in this book were codified in England at the end of the last century and enacted in Hong Kong soon after. For example, the *Bills of Exchange Ordinance* was enacted in 1885, the *Partnership Ordinance* in 1897, and the *Sale of Goods Ordinance* in 1896.
- ◆ An ordinance may *consolidate* existing law. You will recall that case law may concern the development of existing case law or the interpretation of legislation (see above). *Consolidation* is the process of either clarifying existing principles

and bringing together case law and legislation, or of revising an ordinance as opposed to adding 'amendment' ordinances. In either case, the objective of consolidating, like the objective of codifying, is to make the law more readily accessible and comprehensible.

A consolidating ordinance does, however, take a considerable amount of time to draft and to pass through the legislature and so tends to be implemented infrequently.

- ◆ An ordinance may *create* new law. You will recall from the introduction to this part of the book that the law may be used to bring about changes to the social system in which we live. In recent years there has been a great increase in this form of legislation — for example, the *Smoking (Public Health) Ordinance*, the *Noise Control Ordinance*, the *Water Pollution Control Ordinance*, and the *Mandatory Provident Fund Schemes Ordinance*.

New laws are introduced not only to bring about change but also to regulate and accommodate our increasingly advanced society — the *Electronic Transactions Ordinance*, the *Human Reproductive Technology Ordinance*, the *Electronic Health Record Sharing System Ordinance* and the *Protection of Endangered Species of Animals and Plants Ordinance* are just a few examples of this type of regulatory legislation.

## ► Customs

The customs which existed in England in 1066, when the common law system was first developed, form the basis of the present common law principles. Since then, the English judges have continued to consider the customs and practices prevailing at the time of their decisions.

It has already been mentioned that prior to 1 July 1997 the English common law and law of equity applied only in so far as they were appropriate to Hong Kong. If the English provisions were contrary to an established Hong Kong custom, they were not appropriate and were not followed. The *Basic Law* provides that customary law, as part of the laws previously enforced in Hong Kong, will be maintained (BL, art. 8).

Many of the customs found in Hong Kong are based upon Chinese *customary law*. Chinese customs relating to marriage, divorce, and, until recently, inheritance have been upheld by the Hong Kong courts and have also influenced the content of legislation. For example, in *Yu Cho Wah v Ho Chi Kwong* (1999) the court considered expert evidence on Chinese customary law and recognised that under Chinese

customary law a daughter who is not married at the date of her father's death has a right of dowry on her marriage.

In *Leung Lai Fong v Ho Sin Ying* (2009) CFA, the court was required to determine whether the term 'mother', for the purposes of the *Intestates' Estates Ordinance*, Cap 73, refers to a natural mother or legal mother. Under Chinese law and custom the latter is determined by status.

It was held that the Ordinance came into effect in 1971 and that the customary law concept does not play a part in intestate succession (i.e., succession in the event of death without a will) after that date.

### The Law Merchant

The customs of the 14th century merchants and traders who travelled around Europe gave rise to a source of law known as the law merchant. Courts were established in towns visited by such merchants who gave effect to their customary practices (albeit their customs were substantially different from the English common law).

The merchants and traders needed quick decisions and a court which was familiar with the problems of international traders. The law merchants were an international development and existed in many countries. In England, they existed alongside the common law courts as a distinct source of law.

By the 18th century, most of the merchant's courts had ceased to function, but the principles established by them have continued to be upheld by the English common law courts. Many of those principles were codified in England at the end of the 19th century and enacted in Hong Kong soon after. For example, both the *Sale of Goods Ordinance* and the *Bills of Exchange Ordinance* are derived from the law merchant precedence.

## 1.3 The Doctrine of Precedent

The case law system is often criticised for being cumbersome and difficult to access. The cases are recorded in many volumes of law reports, and searching for a case can take a considerable amount of time. However, the case law system operates on the basis of the doctrine of precedent and has the advantage of providing both consistency and flexibility.

Before we can consider the doctrine of precedent, you need to understand:

- ◆ what 'case law' comprises
- ◆ the ranking of the courts.

### Case Law

It has been stated above that the judge or judges who hear a dispute will keep a record of each case. That record is described as a judgment. The judgment is a statement of the reasons for the decision and will include:

- ◆ findings of fact
- ◆ statements of law applied to the legal problems raised by those facts
- ◆ statements of law made 'by the way'
- ◆ the decision.

### Findings of Fact

The material facts of a case are established in the course of the court hearing. Those facts are described as 'findings of fact' or as 'facts found'.

The findings of fact form the basis on which the case will be either *followed* or *distinguished* in the future. If the facts of a later case are identical to those of an earlier one, the decision in the first case will be followed. If the facts of a later case are similar to those of an earlier one, the degree of similarity will determine whether the first case is followed or distinguished. If a later case is distinguished from an earlier one, the decision will be different from the earlier case.

### Statements of Law

In every case resolved by the courts, a principle of law is applied to the legal problem (the point of law) which is raised by the findings of fact. The principle of law is applied in order to solve that problem and reach a decision.

The reason for applying a particular principle of law will be explained in the course of the judgment and is known as the *ratio decidendi*, or simply as the *ratio*.

transfer certain property to the stronger party for a consideration which is grossly inadequate. It is in these circumstances that the law of equity recognises undue influence.

In *Bank of China (HK) Ltd v Wong King Sing* (2002), the judge explained that the rationale for the defence of undue influence is to prevent victimisation; it is there to protect people from being forced, tricked or misled in one way or another into entering into a disadvantageous transaction.

Undue influence is presumed when a contract is made between the following parties:

- ◆ doctor and patient
- ◆ solicitor and client
- ◆ parent and child
- ◆ religious adviser and follower.

In each of these cases, if the weaker party subsequently challenges the validity of the contract, the stronger party will have to prove that independent advice was given to the weaker party, otherwise the contract will be set aside.

Where there is no presumption of undue influence, the weaker party will have to prove that he has entered into a contract whilst being unduly influenced. For example, there is no presumption of undue influence between a banker and his customer. However, a customer may prove that a certain contract with the bank was not formed freely and willingly and that he was unduly influenced by a banker.

In *Lloyds Bank Ltd v Bundy* (1975), an elderly farmer, inexperienced in business matters, mortgaged his only asset, which was his home, a farm, to the bank in order to secure his son's overdraft. The bank subsequently sought to possess the farm and to sell it, in order to pay off the son's overdraft.

It was held that there was a relationship of trust and confidence between the farmer and the bank manager, i.e., a fiduciary relationship. The former had relied on the bank manager for advice. It was clearly in the bank's interest that the farmer provided the security, and the bank had failed to advise the farmer to gain some independent advice. The mortgage was set aside.

However, the courts have subsequently stressed that a banker-customer relationship does not necessarily give rise to undue influence. The customer will have to show that a relationship of trust and confidence exists between them and that he relied on

the advice of the banker. If the banker-customer relationship is new, it is difficult to show such a relationship.

In *Chekiang First Bank Ltd v Fong Sin Kin* (1997) CA, Fong who was illiterate and aged 61, granted a charge over a unit she owned in a factory building to the CF Bank as security for a loan granted to M (a school friend of Fong's daughter). Fong executed the charge at the offices of a solicitor who was representing all three parties having been given a full explanation of what was happening. The CF Bank brought proceedings to recover the loan from Fong who in defence argued that the execution of the charge was procured by undue influence. It was held that there was no undue influence on the part of the bank. No relationship of trust and confidence came into existence between Fong and the bank. There were no acts on the parts of the solicitors which could be constructed as coercion, domination or pressure.

Hong Kong's Court of Final Appeal has had the opportunity to review the law relating to undue influence and in particular the UK House of Lords' case of *Royal Bank of Scotland plc v Etridge No 2* (2001) where it was explained that there are two distinct categories of cases. One in which undue influence is presumed and the other in which it is not and where the issue is whether the evidence (on a balance of probabilities) justifies a conclusion that the transaction in question was procured by undue influence. The House of Lords also explained that the standard required when put 'on inquiry' was not to investigate the existence of undue influence but to take reasonable steps to ensure that the implications of the transaction are understood.

In *Li Sau Ying v Bank of China (Hong Kong) Ltd* (2005), Li became friends with Y in 1992 and owed her money. Li entered into a series of mortgages and remortgages as advised by Y and in 1996 granted a mortgage over her flat to the bank as security to the bank for the indebtedness of a company (S). S was controlled by X, a business associate of Y. Li had no interest in S. The 1996 mortgage was signed at the bank's solicitors where the salient terms were explained to Li. The mortgage repayments were not made and the bank sold the flat.

The Court of Final Appeal held that Li and Y's relationship did not fall within the categories where undue influence is presumed and on the evidence Y had not unconscionably abused the trust and confidence Li had in him. The bank had also taken reasonable steps to satisfy itself that Li understood the implications of the mortgage.

In *Royal Bank of Scotland plc v Etridge No 2* (2001), the House of Lords held that in any case where the relationship between the surety (i.e., a person agreeing to be liable for another person) and the debtor is non-commercial, unless the creditor

takes reasonable steps to make clear to the surety the risks involved, the creditor may be held to have constructive notice if the surety has been induced by undue influence, misrepresentation or other wrongdoing of the debtor to agree to be a surety. (The Hong Kong courts also applied this decision in *Wing Hang Bank Ltd v Kwok Lai Sim* (2009)).

Ordinarily a bank will rely on confirmation from a solicitor that the surety has been appropriately advised. However a person requested to act as surety needs to be sure that the solicitor giving them advice is truly independent. The Law Society has issued guidelines to solicitors dealing with how to handle transactions where the possibility of undue influence may arise.

It should be noted that the relationship of husband and wife is not, without more, one of undue influence. But over the last several years there have been a number of cases where a claim of undue influence has been proved by a wife (W) who has contracted with a bank so as to provide the bank with security for her husband's (H) business transactions.

In *Barclays Bank v O'Brien* (1994) HL, the family home was charged to the bank when it was first purchased and the bank required a second charge over W's share of the home to secure H's business transactions. W signed the documents at the bank without reading them and without any explanation from the bank manager or anyone else. H had told her the money was being borrowed only for a short time, and that only a small amount was being borrowed. These explanations were not true. H's business failed to repay the loan and so the bank sought possession of the home. W claimed that H had exercised undue influence to cause her to enter into the contract and that the bank knew this to be the case.

It was held that W was entitled to set aside the charge. The bank knew the parties were husband and wife and should have enquired as to the circumstances in which W had agreed to sign the charge. The bank was fixed with constructive notice of H's misrepresentation because it had failed to warn W of the consequences or to recommend that she take independent advice.

In *Re Lai Lin Shan, ex p Hong Kong and Shanghai Banking Corp Ltd* (2002), while W and H appeared to be directors and shareholders of a company (CL) and W also the company secretary, CL was managed solely by H. W signed two personal guarantees in favour of HSBC in respect of monies owing by CL being assured by H that she was signing bank credit re-arrangement documents. HSBC had sent H the blank guarantee forms and asked

him to obtain W's signature. The judge held that W had established undue influence by H but that HSBC had not been put on inquiry because of W's shareholding and directorship. The judge proceeded to make a bankruptcy order against W. W appealed.

The Court of Appeal held that the judge's finding of undue influence by H was correct and that HSBC was put on inquiry; W's shareholding was only 30% yet the guarantees were for the whole amount of CL's debt and CL's documents did not indicate that she was an active director. The bankruptcy order was set aside.

However, if independent legal advice is given to W, or if she is not a 'weaker party' because her knowledge of financial matters is equal to that of H, or if W receives all or part of the loan money, the court will not set the contract aside.

In section 3.2 above we considered *Bank of China (HK) Ltd v Jan Speed Auto Service* in relation to an unsuccessful claim of *non est factum*. W, the wife of the owner of JSA, signed documents granting mortgages of the family home to secure finance for JSA. The bank sought to recover JSA's debts and W claimed to be unduly influenced by the solicitor's clerk who was present at the time of her signature and the bank. W had had experience in respect of mortgaging property to raise finance. The solicitor's clerk had also clearly explained the nature of the documents to her. It was held that there was no undue influence.

In Hong Kong, given the close-knit setting in a Chinese family, what has been said above in respect of a husband and wife, may be applied to a mother and her child. In *Bank of China (HK) Ltd v China HK Textile Co Ltd* (2011) a mother was requested by her two sons to provide financial assistance to their business and signed a legal charge of her home. She had previously created two similar charges. The Court of Appeal commented on the relevance of the cases concerning a husband and wife. But there was no suggestion of impropriety on the part of the sons and so no evidence of undue influence.

### 3.6 Illegality

Even if all the requirements for forming a contract are met and a legally binding contract is apparently formed, the courts will not uphold a contract which is illegal or contrary to public policy. In addition, a contract may be declared unenforceable by a particular statutory provision.

A contract is illegal if it is contrary to a rule of common law or a statutory provision. A contract is contrary to public policy if it falls within one of the invalidating grounds as being 'injurious to public welfare'.

A contract may be illegal for two reasons:

- (a) It is contrary to the law to form such a contract — for example, if A and B agree that A will steal certain goods and B will pay him \$x. It is contrary to the law to form such a contract, and the contract is illegal.
- (b) One or both of the parties intend to contravene the law in performing the contract — for example, if A hires his car to B for \$x and, unbeknown to A, B intends to use the car to smuggle cigarettes from the mainland to Hong Kong. The contract of hire is lawful, but smuggling is illegal. The contract of hire will be illegal if the car is used for smuggling the cigarettes.

### ► Contracts Illegal at Common Law

The following categories of contract are regarded as illegal at common law because they involve some kind of moral wrongdoing:

- ◆ contracts to commit a crime or tort (civil wrong) — for example, a contract to assault someone or a contract to cause a nuisance
- ◆ contracts that are sexually immoral

In *Lee Hoi-pang v Chan Shuen alias Chan Sin* (1980), L sued to recover \$12,000 which he had paid to C for being introduced to a Thai woman. He claimed that the transaction was a marriage brokerage contract and that, contrary to an express term of that agreement, the Thai woman failed to marry him and left him.

It was held that the agreement was not a marriage brokerage contract but was one designed to promote future illicit sexual intercourse. The agreement was therefore illegal and unenforceable.

- ◆ contracts to corrupt public life — for example, a contract to bribe an official
- ◆ contracts of trading with an enemy in wartime
- ◆ contracts to 'stifle a prosecution' or which are prejudicial to the administration of justice.

In *Richarvey Ltd v Victor Fung* (1980), Fung agreed to transfer his interest in a flat to R Ltd, his former employer, in consideration of R Ltd releasing Fung from all claims of his suspected receipt of secret commissions and benefits, including a car, whilst employed by R Ltd. Fung failed to transfer his interest in the flat and claimed that the consideration for the agreement was illegal because R Ltd had agreed not to report the alleged offences to the ICAC.

It was held that the agreement to transfer the flat was legally binding. R Ltd had given no undertaking not to report Fung to the ICAC, nor to stifle a prosecution, nor to keep silent, nor to give false evidence.

If a contract is declared illegal at common law, then as a general rule the contract is void and so neither party can sue on the contract. Any goods, money, or property that has been handed over cannot be recovered.

However, if a contract as formed is not contrary to the law but, in performing the contract, one of the parties contravenes the law (category (b), above), the innocent party will be able to recover if he repudiates the contract as soon as he is aware of the illegality. For example, if, when A discovers that the car he has hired to B is being used to smuggle cigarettes from the mainland, A repudiates the contract of hire, A is entitled to claim the hiring fee from B.

### ► Contracts Illegal by Statute

A contract is described as 'illegal by statute' when an ordinance declares a certain activity to be an offence or to be prohibited. In some instances the resulting contract is said to be illegal. For example, if an ordinance requires one of the contracting parties to have a licence to trade or to be registered, contracts made in the absence of a licence or registration are illegal.

In *Yim Wai-tsang v Lee Yuk-har* (1973), Yim, the head of a Chinese moneylending association, sued Lee, a member of the association, for contributions due under the rules of the association. Lee refused to pay, on the grounds that the association was illegal because it had not registered under the *Societies Ordinance*.

It was held that the association was illegal and that Lee was not liable to pay the contributions.

Similarly, in *Johnson Stokes & Master v Boucher* (1989), JSM, a firm of solicitors, sued B for unpaid fees for professional services. Boucher argued that JSM was an unlawful society because it was not registered under the *Societies Ordinance* and that therefore it could not recover any fees from him.

The hire-purchase arrangement was developed as a device which would achieve two purposes:

- ◆ to make it easier for consumers to buy goods and thereby increase sales
- ◆ to ensure that the provider of the credit arrangement has security.

Hire-purchase gives the supplier of credit greater protection than any other credit arrangement, because the relationship between the supplier of the credit and the person in possession of the goods is based upon a *contract of hire*. Until the 'buyer' — that is, the hirer and potential buyer — has paid all the hire-purchase instalments and exercises his option to purchase, the supplier of the credit remains the owner of the goods.

If the 'buyer' fails to pay the hire-purchase instalments, or otherwise acts in breach of the agreement — for example, by failing to maintain the goods — the supplier of the credit is entitled to recover his goods.

In addition, if the 'buyer' purports to pledge (pawn) the goods or to sell them to another party, the supplier of the credit can recover them even if that other party is not aware of the hire-purchase agreement and has acted honestly.

In this section of Chapter 7, we shall consider:

- ◆ the features of hire-purchase
- ◆ the contractual relationships in a hire-purchase arrangement
- ◆ the relationship between the 'buyer' and the retailer
- ◆ terminating a hire-purchase contract.

### ► The Features of Hire-purchase

The features of hire-purchase were recognised by the courts at the end of the last century in the case of *Helby v Matthews*, and following that decision the hire-purchase industry was born.

In *Helby v Matthews* (1895) HL, Helby, a dealer, agreed to let a piano on hire-purchase to B in return for 36 instalments of 50p per month. The agreement stated that:

- ◆ B would become the owner of the piano on payment of the last instalment
- ◆ B could end the agreement at any time and return the piano to Helby

- ◆ if B terminated the agreement, his only liability was to pay the arrears of rent
- ◆ if B was in breach of the agreement, Helby could take back the piano.

Four months after the start of the agreement, B pledged the piano with a pawnbroker, M. Helby sought to recover the piano from M.

It was held that B could return the piano at any time without incurring a penalty and was therefore the hirer of the piano and not a buyer. B was therefore not a 'buyer in possession' and ownership had not transferred to the pawnbroker. Helby was therefore entitled to recover the piano from the pawnbroker, M.

The first part of this decision — that B was merely a hirer because he could return the piano at any time without incurring a penalty — is a feature which distinguishes hire-purchase from a *conditional sale*.

Both hire-purchase and conditional sale contracts may require payment of the contract price by instalments. The important point of distinction is that in the case of hire-purchase, the 'buyer' is not bound to purchase the goods. The 'buyer' has an option which may or may not be exercised. In the case of conditional sale, the buyer must fulfil whatever condition is specified in the agreement and does not have the right to terminate the agreement or have an option to buy. A conditional sale is a *contract of sale*.

In *Sun Hung Kai Credit Ltd v Szeto Yuk-mei* (1986), SHKC supplied a public light bus to 'a hirer' under an agreement which was expressed to be a hire-purchase agreement. The hirer paid the first two instalments but then terminated the agreement, and SHKC pursued Szeto as guarantor.

In the course of deciding whether the guarantee was valid (see Chapter 8.4), it was held that the purported hire-purchase agreement gave the hirer no right to terminate the agreement and no option to purchase the bus. The agreement was therefore a conditional sale.

The second part of the decision in *Helby v Matthews* — that B was not a 'buyer in possession' and ownership had not transferred to the pawnbroker — is a feature of hire-purchase which ensures that the rule of *nemo dat* applies and the supplier of credit can recover his goods.

You will recall from Chapter 5.6 that, as a general rule, where goods are sold by a person who is not their owner, the buyer does not become the owner of the goods (s.23 of the *Sale of Goods Ordinance*). This rule is often referred to by the Latin



words *nemo dat*. Its full name is '*nemo dat quod non habet*' — a person cannot sell what he does not have.

There are, however, a number of exceptions to this rule. If the circumstances of a sale fall within any of the exceptions, the original owner loses his claim to the goods and the buyer is regarded as the true owner.

One of the exceptions to the *nemo dat* rule is where a buyer who is not the owner of goods, but is in possession of them, sells them. A buyer in this situation is described as a buyer in possession. If a 'buyer in possession' sells the goods in his possession, the original owner loses his claim to the goods and the ultimate buyer is regarded as the true owner (s.27(2) of the *Sale of Goods Ordinance*).

In relation to hire-purchase, the case of *Helby v Matthews* established that the 'buyer' — that is, the hirer and potential buyer — is not a 'buyer in possession'. This means that if the 'buyer' sells the goods which are in his possession under a contract of hire-purchase, the finance company remains the owner of those goods and can recover them from a person who buys them from the 'buyer'.

Another exception to the rule of *nemo dat* is *estoppel*. This arises where the original owner's words or conduct stop him from denying that the person in possession of certain goods is selling them with his authority. If the words or conduct amount to a representation, the original owner loses his claim to the goods and the buyer is regarded as the true owner (s.23(1) of the *Sale of Goods Ordinance*).

In relation to hire-purchase, it has been established that giving the 'buyer' possession of goods, and in the case of a car, naming the 'buyer' in the car registration book, is not a representation by the finance company that a 'buyer' has authority to sell.

In *WOC Finance Co Ltd v Fullrate Enterprises Ltd* (1982), W was in possession of a car under a hire-purchase agreement with WOC. W was required to register the vehicle in her own name and consequently was named in the registration book as the owner. W purported to sell the car to FE, and WOC sought to recover the car from FE. FE argued that because W was named in the registration book. WOC had represented that W was in a position to deal with the car as owner.

It was held that giving someone possession of a car and car registration book in his name does not put that person in a position to give ownership of that car to a third party. These two events do not amount to *estoppel*.

### ▶ The Contractual Relationships in a Hire-purchase Arrangement

It has already been stated that hire-purchase contracts are usually offered by finance companies, as opposed to retailers, and that retailers will sell the goods selected by the 'buyer' to the finance company. The hire-purchase arrangement therefore usually includes two contracts:

- ♦ a contract of sale between the retailer and the finance company
- ♦ a contract of hire with an option to purchase between the finance company and the 'buyer'.

The *Contracts (Rights of Third Parties) Ordinance* (see Chapter 2.3) may affect these relationships. The description which follows assumes that it is not relied upon. In practice it is likely to be expressly excluded.

Figure 7.1 may help you to understand the relationships between the parties in a hire-purchase arrangement.

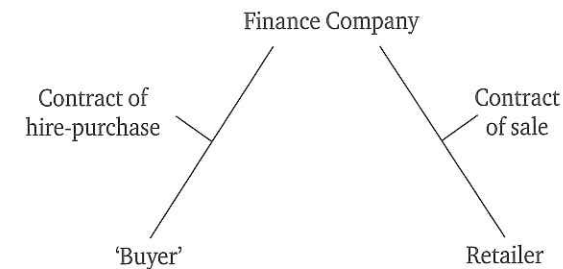


Figure 7.1 The relationship between the parties in a hire-purchase arrangement

### *The Contract of Sale between the Retailer and the Finance Company*

The contract of sale between the retailer and the finance company is governed by the ordinary principles of contract law which were discussed in Part 2 of this book and by the *Sale of Goods Ordinance*, which we considered in Chapter 5.

The contract may include clauses exempting the retailer from breach of the implied terms as to title, description, merchantable quality, and fitness for purpose. However, you will recall from Chapter 5.4 that the *Control of Exemption Clauses Ordinance* invalidates any exclusion of liability in respect of title. A finance company buying a

car does not 'deal as a consumer', and consequently exemption clauses relating to description, merchantable quality, and fitness for purpose will be valid provided they are reasonable (s.11 of the *Control of Exemption Clauses Ordinance*).

In practice, a finance company will often require the retailer to give some form of recourse in respect of either the goods proving to be defective or the 'buyer' failing to pay the required instalments. For example, the retailer may be required to give the finance company a guarantee that the buyer will pay the required instalments or undertake to repurchase the goods if the 'buyer' fails to pay the instalments. The validity and effectiveness of such guarantees are considered in Chapter 8.

### *The Contract of Hire-purchase between the Finance Company and the 'Buyer'*

In Hong Kong there is no hire-purchase legislation. A bill was drafted many years ago but was not enacted. More recently there has been discussion of the need to introduce statutory control. Meanwhile, hire-purchase contracts are, for the most part, governed by their terms and by the ordinary principles of contract law which were discussed in Part 2 of this book.

The contract between the finance company and the 'buyer' is usually a lengthy standard form document containing many express terms, including:

- ◆ the amount of deposit required (if any)
- ◆ the amount and number of instalments
- ◆ the minimum number of instalments to be paid before the agreement may be terminated
- ◆ the date when each instalment must be paid and the consequences of failing to pay on time
- ◆ the conditions and the sum payable to exercise the option to purchase
- ◆ an obligation to keep the goods in good condition and if necessary to repair them
- ◆ an obligation to insure the goods
- ◆ permission for the finance company to inspect the goods
- ◆ in the case of a vehicle, an obligation to pay the relevant road tax
- ◆ a prohibition on selling, assigning, or parting with possession of the goods

- ◆ the consequences of paying off the instalments ahead of schedule — that is, an accelerated payment clause providing an interest rebate
- ◆ the consequences of terminating the agreement and of default.

The contract between the finance company and the 'buyer' is a contract of hire. It is not a contract of sale, and consequently it is *not* governed by the *Sale of Goods Ordinance*. However, terms similar to those implied by the *Sale of Goods Ordinance* as to title, description, merchantable quality, and fitness for purpose are implied into a hire-purchase contract by the common law.

In addition, a hire-purchase contract will contain clauses which attempt to exempt the finance company from all forms of liability and in particular from liability in the event the goods prove to be defective.

You will recall from Chapter 6.5 that exemption clauses in contracts for the supply of goods which relate to the common law implied terms as to title, description, merchantable quality and fitness for purpose are governed by s.12 of the *Control of Exemption Clauses Ordinance*. This section places the 'buyer' of goods on hire-purchase in effectively the same position as a buyer of goods under a contract of sale.

This means that a consumer who finances the purchase of goods under a contract of hire-purchase is as well protected as a consumer who finances the purchase of goods by paying cash, drawing up a cheque, or using a credit card or charge card. If there is any exemption from liability for breach of the implied terms as to description, merchantable quality, or fitness for purpose, and the 'buyer' under a contract of hire-purchase 'deals as a consumer', the exemption clause is invalid.

The only difference is that in the case of hire-purchase an exemption from liability for breach of the implied term as to title is subject to the test of reasonableness (see Chapter 6.5).

### *The Relationship between the 'Buyer' and the Retailer*

There is no contract between the retailer and the 'buyer'. Prior to the *Control of Exemption Clauses Ordinance*, if goods bought under a hire-purchase contract proved to be defective, the "buyer's" only claim was against the retailer for breach of a collateral contract. You will recall from Chapter 2.6 that a collateral contract is a

statement made in the course of negotiating a contract which is not a term of the contract but exists alongside the main contract.

In *Andrews v Hopkinson* (1957), a car dealer, Hopkinson, described a secondhand car as 'A good little bus. I would stake my life on her.' Relying on this statement, Andrews decided to buy the car on hire-purchase. Hopkinson sold the car to a finance company who accepted Andrews's hire-purchase proposal. One week later Andrews was injured in a collision caused by a serious defect with the car. Andrews sued the dealer on the basis of a collateral contract.

It was held that there was a collateral contract between Hopkinson and Andrews. The consideration for the contract was the promise that the car was sound, in return for promising and entering into the main contract. Hopkinson was liable to compensate Andrews.

This means that if the 'buyer' of goods on hire-purchase terms is persuaded to buy the goods because of some statement made by the retailer and that statement proves not to be true and the goods are not as promised, the 'buyer' may claim damages from the retailer for breach of collateral contract. This may prove to be more satisfactory than pursuing the finance company for breach of the supply contract. However, if there is no such statement by the retailer, the 'buyer' will have no choice but to sue the finance company.

### ▶ Terminating a Hire-purchase Contract

You will recall from Chapter 2.6 that the express terms of a contract can broadly be divided into two categories: conditions and warranties. *Conditions* are the vital or major terms, and if they are broken the innocent party is entitled to repudiate or discharge the contract and claim damages. *Warranties* are said to be minor terms which, if broken, entitle the innocent party to damages.

You will also recall that the word 'condition' is often used to describe all the terms of a contract. However, the use of the term 'condition' does not mean that the term is a condition in the legal sense.

Whether the 'buyer' or the finance company is entitled to repudiate a hire-purchase contract will therefore depend on whether the term alleged to be broken is in fact a condition.

A question which has been the subject of a number of decisions is whether failure to pay one or two instalments under a contract of hire-purchase is a breach of condition resulting in the contract being repudiated, or a breach of warranty giving rise to a claim for damages.

In *United Merchants Finance Ltd v Tang Woon-wing* (1980), Tang obtained possession of a van from UMF under a hire-purchase agreement and agreed to pay 36 monthly instalments of \$388. Tang paid ten instalments but within one month of his failing to pay the 11th instalment UMF repossessed the van. UMF gave Tang seven days to pay the arrears, but they were not paid and so they sold the van and claimed damages from Tang for repudiating the agreement.

It was held that failure to pay one or two instalments would not usually amount to repudiation by the hirer. The hirer did not show an intention to abandon the agreement. UMF were entitled only to damages for Tang's failure to pay the 11th instalment.

If the 'buyer' under a hire-purchase agreement wants to terminate the agreement, he should carefully examine the terms of his contract. In most hire-purchase contracts there will be a clause stipulating the amount to be paid by the 'buyer' before he may terminate. This type of clause is described as a 'minimum payment clause'.

The 'buyer' may discover that he has to pay the full price for the car and a further amount to compensate the finance company for depreciation in the value of the goods. The 'buyer' will be bound by such a clause because, in the absence of legislation to control the content of hire-purchase agreements, the court's powers to strike out contractual terms are very limited.

If a 'buyer' acts in breach of a hire-purchase contract and is brought to court by the finance company, the court may then consider whether the minimum payment provision is a penalty or liquidated damages. You will recall from Chapter 4.3 that if the parties to a contract make a genuine attempt to estimate the likely loss, the damages are said to be liquidated and the courts will uphold the relevant figure. If the parties have not made a genuine attempt to establish the likely loss, it is described as a penalty and will not be enforced.

In *Sun Hung Kai Credit Ltd v Szeto Yuk-mei* (above), SHKC sought to recover various sums under the hire-purchase agreement on the basis that they were genuine liquidated damages clauses and not a penalty. This point was not disputed, but some of the clauses concerned with the calculation of damages were held to be void for uncertainty, since no formula was provided for calculating the charges.

for the month of May. The cardholder will receive his statement early in June, requiring him to pay on 30 June. The cardholder will thereby have obtained approximately six weeks of credit, i.e., he has obtained possession of goods for six weeks before he is required to pay for them.

In addition, the cardholder may choose to pay the balance shown in his statement in full, in which case there is no charge for his credit (except the annual fee he pays for his card), or he may choose to pay it by instalments. If he pays by instalments, he is charged interest each month on the outstanding amount.

The contract between the bank and the cardholder will also specify the consequences and procedures in the event of the cardholder losing his card.

In *OTB International Credit Card Ltd v Michael Au* (1980), Au's credit card was stolen, along with other items of property, from his car. On discovering the theft he telephoned OTB. Details of the loss were recorded by OTB, and Au was asked to confirm the loss in writing. Au confirmed the loss the following day. Meanwhile, the card was used to make purchases of \$3,216. Au refused to pay for those purchases. One of the terms and conditions agreed for use of the card was that in the event of loss or theft, the holder must give written notice to OTB and the cardholder would be liable for purchases until such notice was received.

It was held that the clause in the contract was a reasonable one and that Au was bound by the terms of his contract.

The contract will also specify the consequences of failing to pay the amount owed to the bank. In Chapter 4.5 we considered *Hang Seng Credit Card Ltd v Tsang Nga Lee* where a clause of the contract dealing with the costs of recovering the bank's debt was held to be unconscionable.

### ***The Contract between the Bank and the Seller***

The contract between the bank and the seller authorises the seller to accept payment in the form of a duly completed credit card voucher / electronic transaction. It is a contract for a financial service.

When the seller submits his vouchers / transaction details to the bank, a certain percentage will be deducted from their value as the charge to the seller for using the service. This means that if a voucher / transaction detail specifies the price of the goods sold as \$100, the seller who is bound to pay a five percent charge to the bank will only receive \$95.

### ***The Contract between the Seller and the Cardholder***

The contract between the seller and the cardholder is a contract for the sale of goods. You will recall from Chapter 5 that a contract of sale is defined by way of two requirements:

- ♦ the terms of the contract must provide for transferring the ownership of the goods from the seller to the buyer
- ♦ the goods must be exchanged for money.

With respect to the first part of the definition, when a credit cardholder uses his card to purchase goods, ownership of the goods will pass to the cardholder. The goods may be delivered to him at some later time, but as a general rule the ownership of goods passes when the contract is made (see Chapter 5.5). In addition, when a cardholder uses his card, he is not acquiring the goods as security but is entering into a contract of sale.

With respect to the second part of the definition, whilst a credit card voucher is not money itself, it is regarded as representing money. The use of a voucher therefore satisfies the definition.

The contract between the seller and the cardholder is a contract for the sale of goods and is therefore governed by the *Sale of Goods Ordinance* (see Chapter 5).

### **► Charge Cards**

A charge card is distinguished from a credit card by the fact that the cardholder does not have the option of paying the balance as recorded in his monthly statement by instalments. Otherwise, the contracts between the bank, the seller, and the cardholder are as explained above.

### **► 'In-house' Cards**

An 'in-house' card can only be used 'in-house', i.e., in the shops which issue them. There are many forms of 'in-house' shopping cards. In most cases, credit is granted to the cardholder because the buyer will take possession of the goods before he is required to pay for them. If he receives a statement of the balance of his account at the end of each month and is required to pay that amount, the card is, in fact, a

Note: There are restrictions on disclosing a director's address and ID/passport number (see section 12.3 above and ss.47–60).

A more detailed search conducted in respect of information pertaining to a particular company requires the payment of fees and may reveal various documents including its articles, special resolutions and the information which, according to the *Companies Ordinance*, must be sent to the Registrar.

The documents concerning a company's financial position are typically of particular interest and include:

- ◆ charges requiring registration under Part 8, Cap 622
- ◆ every prospectus issued by or on behalf of the company under Cap 32
- ◆ annual returns, which includes the address of its registered office, the address where the register of members and register of debenture holders are kept if they are not at the registered office, particulars of members and the company's issued share capital, its debts in respect of all registered charges, and particulars of the directors and secretary.

A company's annual return, except for those falling within the reporting exemption, must be accompanied by its reporting documents, i.e., its financial statements, directors' report, and auditors' report (see Cap 622, Sch 6).

On payment of a fee, a copy or certified copy of any document or information on the Companies Register may be obtained from the Registrar (s.45(4)). A certified copy is admissible in evidence in court (s.46).

## 12.5 The Consequences of Registering a Company

### ► The Effects of Registration

Besides the option of obtaining limited liability, the main effects of registering a company are as follows:

- ◆ A company is a legal entity distinct from its members.
- ◆ A company has perpetual succession.

- ◆ A company is capable of exercising all the functions that an individual could exercise.
- ◆ A company has a registered name and number.

### *A Company is a Legal Entity Distinct from its Members*

A company is a corporate body. It is a legal person and has a legal personality which is distinct or separate from the personality of its shareholders. The consequences of recognising a company as an entity which is distinct from its members were clarified by the courts at the end of the 19th century.

In *Salomon v Salomon & Co Ltd* (1897) HL, Salomon had for many years carried on business manufacturing boots. He registered a company and sold the business to the company for £39,000. Of this, £9,000 was paid in cash, 20,000 shares were allotted to Salomon and his family as fully paid at £1 each, and the balance of £10,000 was treated as a loan by Salomon to the company secured by a charge on the company's assets.

The company went into liquidation. The assets were sufficient to satisfy the charge, but the unsecured creditors received nothing.

It was held that Salomon was entitled to be paid before the unsecured creditors. The company was duly registered and was not an agent or trustee of Salomon but a separate legal entity. Salomon could therefore contract with and be a secured creditor of the company.

Thus, it was firmly established that a company is a legal person; it is an artificial person with a legal personality distinct from its members. This principle of separate legal personality is described as the *corporate veil*; as a general rule, once a company is registered, the courts will not look behind the corporate veil to see who is actually in control or why the company was formed.

However, there are circumstances in which both the *Companies Ordinances* and the courts will look behind the corporate veil. For example, Cap 32, s.40 provides that if a prospectus contains an untrue statement, the directors of the company will be personally liable for the loss suffered by a shareholder who subscribed for shares on the faith of the prospectus. Similarly, the courts will lift the veil if a company is formed as a device to avoid the law.

In *Gilford Motor Co Ltd v Horne* (1933), Horne had been employed as managing director of GMC and had covenanted not to solicit customers of GMC after leaving its employment (see Chapter 9.3). Horne set up a company in which he and an employee were the sole shareholders, to solicit customers of his former employer, GMC.

It was held that Horne and the company, as his agent and under his direction, had committed breaches of the restrictive covenant and an injunction was granted against both Horne and the company.

### ***A Company Has Perpetual Succession***

Because the company is a separate legal body, it will continue to exist despite a change in its members/shareholders, i.e., owners. It is said to have perpetual succession; it will continue to exist until it is finally wound up and dissolved, and it is not affected by either the death or the bankruptcy of its members.

### ***A Company is Capable of Exercising All the Functions That an Individual Could Exercise***

It was mentioned earlier that a company can make contracts, take legal action, be sued, and own property in the same way as a natural person. It can also commit crimes and torts, i.e., civil wrongs.

However, a company does not have a voice or a signature in quite the same form as a natural person. A company may enter into an oral contract or a contract which is required to be in writing by the actions of its agents, i.e., its directors and employees.

A contract which requires a signature will be signed by an agent 'for and on behalf of ... Co Ltd'. A contract which is in the form of a deed generally requires a seal and may be sealed with the company's own seal (see below) but, alternatively, the signature of the company's director(s) is now sufficient (Cap 622, s.127(3)).

### ***A Company Has a Registered Name***

The registration process ensures that a company has a name which is neither the same as the name in the Index of Company Names kept by the Registrar nor the same as any statutory company (Cap 622, s.100). A company's name must be stated in its articles (s.81), and must be displayed in legible characters at its registered office and every business venue of the company that is open to the public. The name must also be mentioned in legible characters in any business letter, notice, contract, bills of exchange, order, invoice, receipt, letter of credit and on any website of the company) (see s.659 and the *Companies (Disclosure of Company Name and Liability Status) Regulation*, Cap 622B).

A company is also required to have a 'common seal'; a metallic seal on which its name is engraved in legible characters (s.124).

### **▶ Trading as a Company as Compared with a Partnership**

The consequences of registering a company, which we have just considered, result in certain advantages in trading as a company limited by shares as opposed to trading as a partnership (see Chapter 11). In summary:

- ♦ The liability of the members for the company's debts is limited to the amount of their respective shareholdings. Partners are usually jointly and severally liable for the debts of the partnership. Members of the company who are also its officers may, however, be required to give personal guarantees in order that funds may be available to the company, thus effectively losing the benefit of limited liability.
- ♦ A company has perpetual succession and is not affected by the death, bankruptcy, retirement, or mental disorder of any member. A partnership will be dissolved in such circumstances unless the partnership agreement makes provision for such an event.
- ♦ A company can obtain finance and create a floating charge by way of security, i.e., a charge on a class of assets. No other form of business organisation can create such a charge.
- ♦ Ownership of property is vested in the company, and the company contracts in its own name. A partnership can contract in the name of the firm, but the partners own the property of the firm and are liable on its contracts.

In general, the disadvantages of a company limited by shares, as compared with a partnership, are that the officers of the company are controlled by the *Companies Ordinances*, Cap 32 and Cap 622. Partners, on the other hand, may carry on any business they please so long as it is not illegal, and they may make whatever arrangements they like for running the partnership. You will recall from Chapter 11 that the provisions of the *Partnership Ordinance* apply, for the most part, only if the partners have not made some other arrangements.

The major disadvantage of registering a company is that companies are required to disclose certain information to the public. This leads to administrative expenses in the form of registration and filing fees and, as all companies are bound to have their accounts audited annually, also to audit fees.

Reasonable care, skill and diligence is defined to mean the care, skill and diligence that would be exercised by a reasonably diligent person with —

- ◆ 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 (an objective test), and
- ◆ the general knowledge skill and experience the director has (a subjective test).

### ► The Effect of a Breach of Duty

If a director acts, or proposes to act, in breach of his duties, he may disclose that breach to the shareholders in a general meeting and ask them to ratify, i.e., approve of, the transaction. If the majority of shareholders approve of his actions, the matter is closed provided there is no fraud on the minority (see section 12.7 below).

However, the shareholders may decide not to ratify. In that event, they may decide to pursue the following remedies:

- ◆ an injunction
- ◆ rescission
- ◆ damages
- ◆ an account of the profits.

An injunction is appropriate where a breach is anticipated but has not yet occurred. The injunction may prevent the breach.

You will recall from Chapter 3 that by the remedy of rescission the parties are restored to the positions they held before the breach. Rescission is appropriate where a director has failed to disclose his personal interest in a contract which he has entered into on behalf of the company; that contract may be avoided at the option of the company. You will also recall that rescission is barred when the parties cannot be restored to their original positions, a third party has acquired rights to any property concerned, the injured party has shown an intention to continue with the contract, or there has been a delay in bringing an action.

Damages are the appropriate remedy where a director is in breach of the statutory duty of care, skill and diligence or if rescission is barred.

Where a director has misapplied the company's funds and has made a profit for himself or has lost the funds, an order to account will render the director personally liable to the company for those funds.

However, if it appears to the court that the director acted honestly and reasonably, and having regard to all the circumstances of the case, he ought fairly to be excused, then he may be fully or partly relieved from liability on such terms as the court thinks fit (s.903). A director may also apply to the court for relief (s.904).

As a final point on the question of directors' duties, it should be stressed that a director cannot escape his liability by relying on an exclusion clause. Any provision in a company's articles or in any contract with the company which excludes a director from liability for negligence, default, breach of duty, or breach of trust is void. An indemnity against such liability is, as a general rule, also void. The company may, however, take out insurance for a director against such liability and may pay the costs incurred by a director if he successfully defends such an action (s.468).

## 12.7 The Rights of Minority Shareholders

As a general rule, the powers to manage a company and to make day-to-day decisions are usually granted to its board of directors. However, the *Companies Ordinances* require that certain decisions must be taken by the company's shareholders. In addition, the company's own articles may specify that particular decisions must be made by its shareholders.

Shareholders are given an opportunity to make those decisions either by voting at general meetings of the company or by signifying approval of written resolutions in accordance with s.548.

A company is required to conduct an annual general meeting (AGM) in respect of each of its financial years. As a general rule a private company must conduct its AGM within 9 months after the end of its accounting reference period and otherwise it is 6 months.

If the AGM is conducted as an actual meeting it provides the shareholders with an opportunity to question the directors on any matter, but in particular on the company's accounts, the auditors' report, and the directors' report.

would be likely to injure your neighbour'. In other words, the duty of care arises in circumstances where damage is foreseeable. For example, if X drives his car carelessly, it is foreseeable that he will cause an accident.

The duty of care is owed to persons who are described as being a 'neighbour'. The legal answer to the question 'who is my neighbour?' is 'persons who are so closely and directly affected by my act that I ought to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question'. In other words, everyone owes a duty of care to persons they ought to foresee being affected by their activities. For example, X drives his car carelessly and causes an accident which injures a pedestrian. X should have foreseen that both fellow road users and pedestrians could be affected by his carelessness.

Similarly, if a person leaves a door to his third floor flat partially open and rain thereby enters his flat he should have foreseen that persons occupying lower floors could be affected by that rainwater. You will recall that these were the circumstances of *Born Chief Co v Tsai George*, above. The Court of Appeal held that T must have foreseen that flooding might be caused with an open door: the possibility of flooding should reasonably have been within the knowledge of 'anyone living in Hong Kong'.

Allegations of negligence often arise in respect of accidents in shops and restaurants resulting in claims under the *Occupiers Liability Ordinance* but also under the common duty of care owed to customers as visitors to the premises.

In *Cham Cheung Sing v Yung Pak Wa* (2007), Yung owned a restaurant at premises consisting of the ground floor and a cockloft. Yung was not licensed to operate the cockloft as part of the restaurant but it was practice of the restaurant to serve customers in the cockloft if the ground floor was full. Cham and his family had dinner in the cockloft. On leaving Cham slipped at the top of a metal staircase which adjoined the restaurant's cockloft to the ground floor and was severely injured. The stairs were narrow, wet and strewn with food. The stairs were also obstructed by boxes. In considering the common duty of care the court explained that Yung owed a general duty of care to his customers using the staircase to ensure that it was safe as an access and egress to and from the cockloft. Yung should exercise a reasonable degree of care and vigilance and, in particular, ensure that the staircase was clean and uncluttered and place warning notices at both the bottom and the top of the stairs.

It was held that Yung was liable to Cham under the *Occupiers Liability Ordinance* and in negligence. Yung's appeal in 2010 was dismissed by the Court of Appeal.

Today the concept of neighbourhood is generally described as proximity. In other words, the question which has to be asked is whether there is sufficient proximity between the parties such that one owes a duty of care to the other.

In most situations, the existence of a duty of care is not disputed. For example, it would not be disputed that one road user owes a duty to drive carefully to other road users, or that an agent owes a duty to his principal to act with due care and skill.

The existence of a duty of care may be disputed in situations which have not previously been considered by the courts. The court will then need to consider:

- ◆ whether damage is foreseeable
- ◆ the proximity between the parties.

However, these are not usually regarded as two separate requirements; whether damage is foreseeable is one of the ingredients of a proximate relationship.

In *Yuen Kun-yeu v Attorney-General* (1987) PC, YKY lost money deposited with a registered deposit-taking company which went into liquidation. YKY claimed damages in negligence from the Commissioner of Deposit-taking Companies, arguing that the Commissioner owed him a duty of care and that the duty had been breached because the Commissioner knew or ought to have known that the affairs of the deposit-taking company were being conducted fraudulently and to the detriment of depositors.

It was held that the Commissioner did not owe YKY a duty of care in negligence because there was not a sufficiently close and direct relationship between the Commissioner and would-be depositors.

The Privy Council considered the fact that the *Deposit-taking Companies Ordinance* (since repealed and replaced by the *Banking Ordinance*) gave the Commissioner the power to regulate and control such companies. YKY alleged that the Commissioner had failed to exercise his powers under the Ordinance and that he should not have registered the company in question or should have revoked its registration before he made his deposit so as to save him from losing his money. This raised an important issue, because if the Commissioner owed such a duty to members of the public, many other bodies would owe a similar duty of care. This could result in a 'flood' of actions being brought before the courts. It was argued that if the Commissioner and other similar bodies are to owe such a duty of care to the public, the duty should be contained in legislation.



The decision in *YKY's* case was based largely on the question of proximity. In the following case, the degree of control which the defendant had over the situation which developed was considered as part of the question of proximity.

In *Mobil Oil Hong Kong Ltd v Hong Kong United Dockyards Ltd* (1989), HUD operated a dry dock. A damaged ship was accepted into the dock for repair, but when a typhoon approached, the ship was moved to HUD's buoy. The ship broke loose in the typhoon and damaged MO's shore-based terminal. The ship was negligently prepared for the typhoon — certain basic precautions required by the Director of Marine were not taken. It was argued that HUD was liable because the damage was foreseeable and they should have made good the omissions of the ship's owners because of the degree of control they had over the ship.

It was held that HUD was not liable in negligence to MO. They had not assumed sufficient control over the ship, nor was there a sufficiently close and direct relationship of proximity to impose a duty of care on HUD.

The House of Lords has also emphasised a third requirement — whether it is *just and reasonable* to impose a duty of care. Reasonableness is determined according to commercial practicality, fairness, and public policy.

In *Caparo Industries plc v Dickman* (1990) HL, CI bought shares in a company whose accounts had been audited by Dickman. CI relied on the company's published accounts and eventually bought so many shares that it was required to make a takeover bid for the company. CI then discovered that the accounts did not reflect the company's financial position and sued Dickman (the auditor). The question to be decided by the court was whether Dickman owed a duty of care to CI.

It was held that Dickman was not liable to CI because there was insufficient proximity between them. Dickman only owed a duty of care to the company whose accounts he was auditing. He did not owe a duty of care to the company's shareholders or potential investors. The court emphasised the need to establish the three elements — foreseeable damage, proximity, and reasonableness — in deciding whether to impose a duty of care.

However, the courts have stressed that the three requirements — foreseeability, proximity, and reasonableness (commonly known as the *Caparo* test) — should not be regarded as rigid rules but as interdependent factors to be taken into consideration in deciding whether a special relationship giving rise to a duty of care exists between the parties.

The UK courts adopted this approach in determining whether a duty of care arose in the context of professional services on the grounds of 'assumption of responsibility'.

In *White v Jones* (1995) HL, B had previously quarrelled with his two daughters and so executed a will which excluded them. They were later reconciled and B gave written instructions to his solicitors on 17 July to include both daughters in his will. B died on 14 September before the new will had been prepared. The two daughters brought an action for damages for negligence.

It was held that where a solicitor accepts instructions to draw up the will and as a result of his negligence an intended beneficiary was reasonably foreseeably deprived of a legacy, the solicitor will be liable. The solicitor had assumed responsibility for drawing up the will and thereby had a special relationship with the beneficiaries and consequently owed a duty to those beneficiaries to act with due expedition and care.

The Hong Kong Court of Final Appeal considered these authorities in a case concerning an independent contractor. As a general rule a person who engages an independent contractor (as distinct from an employee, see Chapter 9.2) is not vicariously liable for torts committed by that contractor. But a person who employs an independent contractor may be liable for his own negligence.

In *Luen Hing Fat Coating and Finishing Factory Ltd v Wann Cheun Ming* (2011), the factory engaged L, an independent contractor, to repair a certain machine. L and his worker, W, went to the factory, did the repair and then borrowed the factory's trollies and jacks in order to reinstall the machine. This procedure was unsafe, the machine fell and W's legs were crushed. The question to be decided by the court was whether the factory owner owed a duty of care to W.

The Court of Final Appeal held that a duty of care was owed because the three requirements of the *Caparo* test were satisfied; the injuries suffered were foreseeable because the use of the trollies was dangerous, there was proximity between the factory owner and W because W was lawfully on the premises and the loan of the equipment, and it was fair, just and reasonable to impose liability. The factory owner had allowed a dangerous operation to take place and knew or ought reasonably to have known that the trollies were to be used to do work by an unsafe method creating a danger to 'life and limb'.

This decision has recently been followed in relation to circumstances that similarly pose a potential danger to life and limb, in other words 'an accident waiting to happen'.

In *Lam Pak Keung v Ip Tsz Ping* (2016), Lam was a manual labourer and Ip a forklift driver. They were both employed by Chan and worked at Hung Hom Freight Terminal. The Terminal was leased to Lucky Guy (LG) who had an office at the Terminal and four employees. CCTV monitors were in LG's office. LG gave instructions to Chan's employees, fined staff who were late for work or damaged goods and generally supervised Chan's employees. There was no separation of areas of work for forklift trucks and no traffic control system. Lam was badly injured by a forklift truck that Ip left in gear and unattended. Chan was uninsured. Lam (an independent contractor) sought damages for his injuries from LG.

The Court of Appeal held that, given the working environment, the harm suffered by Lam was foreseeable. That Lam worked in close proximity to LG's office and was supervised by LG's staff and that it was fair and reasonable to impose liability on LG. The working environment was lacking in supervision or control over safety. Furthermore, LG had loaned the forklift trucks to Chan which they knew or ought to have known would be used in an unsafe system of work. LG was negligent and liable to compensate Lam.

### ► Breach of Duty

Once a legal duty of care has been established, the plaintiff has to prove that the defendant has in fact breached that duty. This is decided by means of a test which is described as the '*reasonable man*' test. The defendant is judged not by what he did, but by what a reasonable man would have done in the same situation. If the defendant has professional qualifications, he is judged by the standard of a reasonable man with such qualifications. Otherwise, he is judged by what the courts consider are the standards of an ordinary reasonable person.

In *Wharf Properties Ltd v Eric Cumine Associates, Architects, Engineers & Surveyors* (1991) PC, WP were lessees of a waterfront property at Tsim Sha Tsui. They decided to redevelop the site to a hotel/office/residential complex — known as Ocean Centre and Harbour City. ECA were a firm of architects, engineers, and surveyors. WP retained ECA to design and supervise the construction of the development. WP sued ECA for professional negligence on the grounds that ECA should have known that the government had changed the rules on density controls, that certain statements ECA made about plot ratios were in error, and that ECA had failed to claim exemption from density restrictions, certain bonuses, and concessions.

It was held that ECA had not in any respect fallen short of the standards of reasonably competent and skilful architects in Hong Kong. ECA had acted in accordance with professional practice and were not negligent.

If a defendant does not act as the reasonable man would have acted, he will be 'at fault'. It was mentioned in the introduction to Part 6 of this book that negligence is sometimes described as 'fault-based liability'. If a defendant has acted in breach of his duty the damage is his fault and he will be liable to compensate the plaintiff.

It can be difficult to prove that the defendant was 'at fault' and has breached his duty of care. The courts will consider a range of factors, including:

- ◆ whether such a loss has been suffered before
- ◆ whether reasonable and practical precautions had been taken
- ◆ the practices of the relevant industry or profession.

In *So Che Yin v MTR Corp Ltd* (2008), So was injured while standing on an escalator in Kwai Fong MTR station which was operated by the MTR when the escalator suddenly stopped. The MTR's records showed no other person were injured, that the escalator was maintained on a regular basis. A loose screw had become jammed in the lower landing of the escalator and this had triggered the braking device. So alleged that the MTR was negligent.

It was held that, on the evidence, there was no basis for finding negligence by the MTR, i.e., that it had failed to ensure that the escalator was functioning properly and safely at the time of the accident. The MTR was not in breach of its duty of care and were not liable for her injuries.

Compliance with a general practice of a profession is strong evidence that reasonable care has been exercised; however, it is not conclusive.

In *Edward Wong Finance Co Ltd v Pomay Investments Ltd and Johnson Stokes & Master* (1984) PC, EWF agreed to lend \$1,355,000 to enable a company to purchase the ground floor of a factory building. The loan was to be secured by a mortgage and the personal guarantees of the company's directors. EWF instructed JSM to act for them in respect of the mortgage. In accordance with the usual practice at that time, the solicitor acting for the owner of the factory undertook to forward all the relevant documents within ten days of receiving the mortgage proceeds. JSM sent a cheque to the solicitor, but he left Hong Kong with the money. EWF argued that JSM had not exercised due care and skill in performing their duty.

It was held that the risk of loss to EWF by placing the money with the factory owner's solicitor was a foreseeable risk and a risk which could have been avoided. By following the general practice without taking precautions, JSM had failed to exercise the standard of care which they owed to EWF and so were negligent.