CHAPTER 1

NATURE, HISTORY AND MAXIMS OF EQUITY

1. GENERAL HISTORY OF EQUITY

[1-1] Equity is the body of law developed by the English Court of Chancery before 1873 alongside the common law and for the purpose of 'softening the hard edges' or 'mitigating against the injustice or harshness caused by the rigidity'[1] of the common law. Equity was said to be the conscience of the Chancellor of the day and it differed as to the length of the Chancellor's foot. Principles of law based upon conscience have been criticised as being uncertain, as 'one Chancellor may have a long foot, another a short foot, a third an indifferent foot'.[2] There is force in the argument that the law of equity should be 'rule and principle based' instead of 'sense and feeling based' because common sense is vague and unpredictable.[3] However, it is judicial activism and the judicial sense of justice that promulgates and nurtures the development of the 'principle' of equity and without such conscience, there would not be the system of law of equity today.

[1-2] Before the enactment of the Supreme Court of Judicature Act 1873 (Imp) (the Judicature Act), equity was exclusively administered by the Court of Chancery. Common law courts (King's courts) did not recognise equitable rights and would not administer the principles of equity or award equitable remedies. Equally, equity had no power to decide disputes of legal rights and titles. The Judicature Act had the effect of fusing the administration of the principles of common law and equity so that judges in superior courts had both common law and equitable jurisdictions together, so that cases commenced in the common law court that required the intervention of equity would not be dismissed because the court lacked equitable jurisdiction (transfer was not an option opened to the court then). Where there are conflicts between the principles of common law and the principles of equity, the latter will prevail.

[1-3] Some judges, however, erroneously assumed that the Judicature Act fused the principles of common law and equity themselves so that the desired principles from each could be picked out and used together for a particular case. This assumption has led to a series of cases called 'fusion fallacies'. For example, common law remedies have been awarded for a breach of duty, which arises purely out of equity. In *Seager v Copydex Ltd*,[4]

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1 See *Wise Wave Investments Ltd v TKF Services Ltd* [2007] 4 HKLRD 762, [2007] HKCU 1451 at para 47 per A Cheung J. For the development of the law of equity in the United States, see Richard HW Maloy, 'Expansive Equity Jurisprudence: A Court Divided' (2007) 40 *Suffolk University Law Review* 641; and for Canada, see Dennis R Klinck, 'Doing 'Complete Justice': Equity in the Ontario Court of Chancery (2006) 32 *Queen's Law Journal* 45.

2 R Megarry, *Miscellany at Law* (London: Stevens, 1955) at p 139.

3 H Litton, 'Dogged by Dogma: Will Common Sense ever prevail in the law?' (2001) 31 *HKLJ* 35.

4 *Seager v Copydex Ltd* [1967] 2 All ER 415 (Eng CA).

managers of a marketing company were held to have breached the duty of confidence to an inventor who had disclosed his ideas about a new invention. Although the duty of confidence is purely an equitable duty, the court awarded common law damages such as the type that is awarded in torts. In *Cuckmere Brick Co Ltd v Mutual Finance Ltd*,[5] a mortgagee breached its duty of good faith to its mortgagor by failing to advertise the full potential of the property and the mortgagor was awarded common law damages for the loss of profits. One of the most famous examples of 'fusion fallacy' is the case of *Walsh v Lonsdale*,[6] where the tenant held an agreement for a lease which was void at law because it had not been sealed. When the tenant refused to pay rent, the landlord distrained the tenant's property, a right he was only entitled to exercise if a valid lease had been granted. With the justification that 'there is only one court, and the equity court prevails in it', George Jessel MR held that the tenant stood in the same position as if the lease had actually been executed because equity would have granted specific performance of the lease as a relief. Thus, the Master of the Rolls held that the landlord was entitled to exercise the right of distrainment. Although this case has been strongly criticised, especially for failing to recognise the discretion of awarding specific performance in equity, the rule it established has survived.

[1-4] The fact that these cases are called 'fusion fallacies'[7] does not suggest that equity and the common law cannot borrow from one another as they both develop. Mason P in the New South Wales Court of Appeal has even argued that the notion of 'fusion fallacies' is itself fallacious and historically unsound because the common law and equity systems had developed from one another long before the Judicature Act and have continued after its enactment.[8] Professor Michael Tilbury is also persuasive in arguing that 'what can be done with rules is more important than where they came from'.[9] Recent development in the law of tracing might be evidence that there is still a gap between common law and equity.[10]

2. Equity in Hong Kong

[1-5] The basis for the application of English equity law in the Hong Kong Special Administrative Region (HKSAR) can be traced to Article 8 of the Basic Law which states that:

> the laws previously in force in Hong Kong,[11] that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any

5 *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949, [1971] 2 All ER 633.

6 *Walsh v Lonsdale* (1882) 21 Ch D 9 (Eng CA).

7 See generally *Evans* at para [2.13]–[2.19]; *H & M* para [1-020]–[1-023]. For details, see JD Heydon and MJ Leeming, *Cases and Materials on Equity and Trusts* (8th ed, LexisNexis Butterworths: Australia, 2011) at para [1.19]–[1.39]; *Pettit* at pp 8–12. See also, Mark Leeming, 'Equity, the Judicature Acts and Restitution' (2011) 5 *J Eq* 199.

8 *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298, (2003) 197 ALR 626, (2003) 44 ACSR 390, [2003] NSWCA 10.

9 M Tilbury, *Civil Remedies: Principles of Civil Remedies — Vol One*, (Butterworths: Sydney, 1990), at pp 11–12. For a contemporary analysis and recent development on fusion, see Benjamin Mak, 'Forging the future of fusion' (2016) 22(4) *Trusts & Trustees* 433–437.

10 See, Benjamin Mak, 'Forging the future of fusion' (2016) 22(4) *Trust and Trustees* 433–437.

11 'Previously in force' means in force as of 30 June 1997: see Hong Kong Reunification Ordinance (Cap 2601), section 5.

> that contravene this Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region.

Thus, it is important to understand the history of the reception of English law in Hong Kong in colonial times to ascertain the application of the rules of equity as of the handover.

[1-6] Almost immediately after colonisation, the laws of England were introduced in Hong Kong.[12] From 1846 to 1966, a formula, later recast as section 5 of the Supreme Court Ordinance 1873, was used to apply all the laws of England which existed on 5 April 1843 (the cut-off date), except those which were considered not suited to the circumstances of Hong Kong. This formula not only incorporated the English statutes passed before the cut-off date but also common law and equity, together with their developments after the cut-off date. The Application of English Law Ordinance 1966 (Cap 88) declared that English legal principles and Imperial statutes were applicable in Hong Kong as of 7 January 1966,[13] subject to their modification in accordance with local circumstances.[14] English principles of equity might not be entirely suitable for Hong Kong as it has its own unique characteristics. Thus, these principles were only in force to the extent of their *applicability* to the circumstances of Hong Kong and could be modified accordingly. The test to determine the applicability of a rule can be strict, such as the test adopted by the Hong Kong courts, which held the English common law and equity to be inapplicable only if it caused injustice or oppression.[15]

[1-7] Although this Ordinance is now repealed,[16] it was operative on 30 June 1997 and it is therefore important in ascertaining the extent of the operation of common law and equity on this date.[17] The principles of common law and equity will continue to be enforced in Hong Kong courts, as provided in section 7 of the Hong Kong Reunification Ordinance (Cap 2601):

> Maintenance of previous laws
> (1) The laws previously in force in Hong Kong, that is the common law, rules of equity, Ordinances, subsidiary legislation and customary law, which have been adopted as the laws of the HKSAR, shall continue to apply.

The High Court of Hong Kong will continue to administer the principles of common law and equity and whenever there is conflict, the rule of equity will prevail.[18]

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12 See B Hsu, *The Common Law: In Chinese Context* (Hong Kong University Press: Hong Kong, 1992) at pp 7–19.

13 The Application of the English Law Ordinance (Cap 88) (rep) declared the extent to which English law was in force in the colony.

14 Application of the English Law Ordinance (Cap 88) (rep), section 3(1)(b).

15 *Wong Yu-Shi (No 1) v Wong Ying-kuen* [1957] HKLR 420, at pp 442–443, [1957] HKCU 38. Compared with a more flexible test as adopted by Lord Denning in *Nyali Ltd v A-G* [1956] 1 QB 1 at pp 16–17. See generally P Wesley-Smith, *An Introduction to the Hong Kong Legal System* (3rd ed, Oxford University Press: Hong Kong, 1998) at pp 37–44.

16 The Standing Committee of the National People's Congress did not adopt this Ordinance as the laws of the HKSAR in its Decision on 23 February 1997 because it was declared inconsistent with the Basic Law.

17 See P Wesley-Smith, 'The Content of the Common Law in Hong Kong' in R Wacks (ed), *The New Legal Order in Hong Kong* (Hong Kong University Press: Hong Kong, 1999) at p 23.

18 High Court Ordinance (Cap 4), section 16. There is no such equivalent provision in the District Court Ordinance (Cap 336) or the Hong Kong Court of Final Appeal Ordinance (Cap 484). However, the District Court has equitable jurisdiction to hear and determine various

as sole administratrix, was capable of giving a good discharge for the purchase money she received. Rhind J held that good title had been passed by Leung Yuk Chim to Hoi Wai Development Ltd; that a trust for sale was a statutory creation which only applied in respect of those persons died intestate after 7 October 1971, which was the date when the Probate and Administration Ordinance (Cap 10) came into effect. Where no trust for sale arose, section 15(2) of the Trustee Ordinance (Cap 29) had no application. Since Madam Yau died before 7 October 1971, the administration of her estate was to be governed by the common law. At common law, a sole administrator has full right and authority to dispose of land and give a good discharge for the purchase money and Leung Yuk Chim was selling in her capacity as personal representative and able to give a good discharge by virtue of her common law powers. In any event, if Leung Yuk Chim's capacity had changed to that of a trustee, she would still have been able to give a good discharge by virtue of section 15(1) of the Trustee Ordinance (Cap 29).

12. Trading Trusts

[14-88] Trading trusts[197] have been used as an alternative to limited liability companies as there are increasing regulations on companies. A trading trust is simply a trust which trades or is used as a vehicle to carry out a business as a going concern. The function of a trust is different from that of a company, in the sense that for a trust the business is actually undertaken in the names of the trustees of the trust who are personally liable for any trade debts; whereas for a company, directors of the company are not personally liable for debts incurred by the company. To afford limited liability protection to the trustee, the trustee of a trading trust is thus conducted using a limited liability company. A trading trust is usually a discretionary trust of which the trustee has power to select the beneficiaries and the amount of their interest.[198]

[14-89] The setting up of a trading trust is no different from other forms of express trusts, except that the trust deed gives the trustees specific powers regarding the establishment of a business and the general day to day aspects of running a business.

[14-90] A trustee's right of indemnity is conferred on the trustee of a trading trust. This means that the trustee can call on the trust assets to meet any liabilities or losses which the trustee may properly incur, in the course of running the business. However, it is common for trustees of trading trusts (especially if the trustee is a limited liability company) to try to relinquish their right to be indemnified from the trust assets, in order to protect the trust assets from claims by creditors of the business. Creditors would often not be aware of the effect of this restriction on the trustee's right to be indemnified. That is unfair on creditors who deal with trading trusts. Many limited liability companies that act as trustees have no assets of any substance, so that if the trustee company cannot meet its obligations arising from its trading operation, and cannot be indemnified from the trust assets, then the trading trust's creditors will be left with no securities to recover their debts. This unfairness is further exacerbated by the fact that income received by the trustee from its business operation, can, under the terms of the trading trust deed, usually

197 See generally, Kevin Lindgren, 'The birth of trading trust' (2011) 5 *J Eq* 1.

198 See Clive Turner, *Australian Commercial Law* (32th ed, Pyrmont, NSW: Thomson Reuters Law Book Company, 2019) at para [30-240].

be distributed to the beneficiaries of the trust, and is therefore not available to meet the liabilities incurred by the trustee in the business.[199]

13. Unit Trusts

[14-91] A unit trust is one that divides trust property into fractions which is owned by unit holders. It is an express, fixed trust constituted *inter vivo* and all the beneficiaries are ascertainable at any given time.[200] A share in a company does not confer ownership of the company's properties, but whether a unit trust carries with it a proprietary interest in all the property of the trust very much so depends on the wordings of the unit trust. If a unit holder has an absolute, vested and indefeasible interest in the capital and income of the trust property, only then it can be said that a unit trust holder has ownership of the trust asset.[201] Upon dissolution, each unit holder is entitled to an undivided share in the income of the trust and a fixed proportion of the trust property. The extent of this interest is determined by the proportion of the total units issued and held by the unit holder.

[14-92] A unit trust is the creation of the trustee and the manager, a transferee of properties and a delegate to whom certain powers have been vested. While the manager takes active control of the investment of the property in the trust and has a fiduciary role to play, unlike a settlor in a typical express trust, the manager does not have any property to settle. The manager is not a trustee even though he performs all the functions of the management of the trust assets that would have been done by the trustee in a typical trust. The manager has control over trust property but not title, which prevents him from being a trustee. However, the same control and his management duties would lead the court to characterise the manager as a fiduciary of the unit-holders. The trustee, the manager and the unit-holders are associating together for the purpose of investment. The unit-holders provide the capital whilst the trustee and the manager provide the management services. The manager makes investment decisions and the trustee implements the investment decision of the manager.

[14-93] Unit trusts has gradually become a marketable securities like company shares and are offered to the public in a trading platform.[202] It is not uncommon to use unit trusts as

199 See Jeffrey Kenny, 'Trading Trust Problems', (1998) Chartered Accountants Journal – NZ, March 98 Issue; Peter Agardy, 'Aspects of Trading Trusts' (2005) Vic Bar CLE Seminar; Peter Edmundson, 'Express limitation of a trustee's rights of indemnity' (2011) 5 J Eq 77. See also Hans Tjio, 'Lending to a Trust' (2005) 19 (2) *Trust Law International* 75.

200 See, *ElecNet (Aust) Pty Ltd v Federal Commissioner of Taxation* (2016) 259 CLR 73, (2016) 91 ALJR 214.

201 *CPT Custodian Pty Ltd v Commissioner of State Revenue* (2005) 224 CLR 98, (2005) 79 ALJR 1724. See, Anthony Mason, 'Discretionary trusts and their infirmities' (2014) 20(10) *Trusts & Trustees* 1039; KF Sin, *The Legal Nature of the Unit Trust* (Oxford: Clarendon Press, 1997) at pp 264–292. See also *Charles v Federal Commissioner of Taxation* (1954) 90 CLR 598, 28 ALJR 117, 10 ATD 328, 6 AITR 85; cf *Elkington v Moore Business Systems Australia Ltd* (1994) 13 ACSR 342 at p 349 per Bryson J.

202 The Hong Kong Securities and Futures Commission has issued a Code for Unit Trust and Mutual Fund which is to be implemented after 1 January 2019. The Commission is empowered under section 104(1) of the Securities and Futures Ordinance (Cap 571) to authorize collective investment schemes and unit trust is now so treated. Firstly, the minimum capital requirement for trust funds managers is now HK$10 million. Secondly, the trust fund manager must possess the requisite experience and resources as well as an appropriate oversight system to