



Editorial

The Commercial Unit ("CU") of the Department of Justice welcomes you to its first CU Review in the Spring of 2007.

Quarterly the CU aims to issue by E-mail to colleagues in Government a Review of some commercial law matters which may be of relevance or interest.

Busy people have little time or inclination to read legal dissertations. Our articles and case-law notes aim to be concise, topical and practical. This quarter our articles address cross-media ownership restrictions in broadcasting, a general competition law for Hong Kong, and the proposed asset-merger of the MTRCL and KCRC.

Our case-law notes include Choi Lai Ming (A Debtor) (recovery of civil service and civil servants' debts) and Jiangsu Golden Civil Building Group (when a guarantee/guarantor is discharged by a material variation of the underlying contract).

The contents of this and other CU Reviews are and will be found in the public domain, case law or legislation.

We are fortunate that Ms Tina Ko has kindly contributed a very appropriate cartoon – an industrious lawyer with full Out-tray, ambidextrous it seems in both languages. But he is not a two-handed lawyer "on the one hand on the other hand" ! Our aim as commercial lawyers should be to provide useful and accurate advice in a practical format.

We hope you enjoy or at least find useful the CU Review. The first page is indexed and a space is provided for any annotation or aide memoire you may find helpful.

We aim to publish the Summer CU Review in July/August 2007 and if you would like us to consider any commercial law subjects please inform us by end May 2007. In the next edition we propose to include articles on the Capital Investment Entrant Scheme, the Rewrite of the Companies Ordinance and on reviewing an important case on tendering, as well as information about the CU.

CHARLES BARR

What's inside

| | |
|---|---|
| Cross-Media Ownership Restrictions in Broadcasting | 2 |
| Recovery of Civil Service Debts – <i>Re Choi Lai Ming, a Debtor, Ex Parte: The Official Receiver [2006] 1 HKLRD 7</i> | 3 |
| General Competition Law for Hong Kong? | 4 |
| Asset-Merger of MTR Corporation Limited and the Kowloon-Canton Railway Corporation | 5 |
| When is a guarantor or surety discharged from his obligations by a variation in the underlying contract?– <i>Jiangsu Golden Civil Building Group [2007] 1 HKLR 1</i> | 6 |

Notes:

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|--|
| |
| |
| |
| |
| |
| |

Cross-Media Ownership Restrictions in Broadcasting

Overview

Under the Broadcasting Ordinance, Cap. 562 (“**the Ordinance**”), persons engaged in or associated with the business of a newspaper proprietor, sound broadcasting licensee, television broadcasting licensee or advertising agency are not allowed to exercise control of a domestic free or domestic pay TV licensee unless CE in C approves otherwise. They are referred to as “disqualified persons” (“**DPs**”) in the Ordinance. These restrictions on DPs (also commonly referred to as cross-media ownership restrictions) have attracted public attention due to recent acquisition of the publishing rights in a local newspaper by a person or persons connected with a broadcasting licensee.

Statement of the legal position

DPs shall not Exercise Control of a Licensee without CE in C’s approval. This may be illustrated by reference to newspaper proprietors who are one of the categories of DPs:

A “DISQUALIFIED PERSON”

- (a) Proprietor of Newspaper printed or produced in Hong Kong
- (b) Person who “exercises control” (defined) of proprietor in (a); or

- (c) “Associate” of proprietor in (a) or person in (b).

“Associate” is widely defined to **include**:

- an “associated corporation” (defined)
- a “voting controller” (defined) who “influences” (defined in relation to a corporation) the corporation and if an individual a “relative” (defined)
- a partner of the “voting controller” and if an individual a “relative” of the partner
- a partnership of which the “voting controller” is a partner
- a director or principal officer of the corporation or of an associated corporation holding voting control
- ditto partner

SHALL NOT “EXERCISE CONTROL”

- (a) director or “principal officer” (defined)
- (b) beneficial owner of more than 15% of the “voting shares” (defined)
- (c) “voting controller” (widely defined) of more than 15% of the “voting shares”
- (d) has the power by virtue of any relevant instrument to ensure that the affairs of the licensee are conducted in accordance with his wishes.

OF A “LICENSEE” (WITHOUT CE IN C’S APPROVAL)

“licensee” means a domestic free or domestic pay TV licensee.

Identification of DPs exercising control

The diagram below provides a visualisation of the restrictions on DPs and may help to identify the DPs exercising control of a domestic free/pay TV licensee (if any).

PRACTICAL TIP

Because the “exercise control” requirement **must** be satisfied as part of the restriction on DPs and is easier to apply than the meaning of “disqualified person”, start with this requirement first. If it is not satisfied, that is the end of the enquiry. If it is satisfied, the “disqualified person” requirement must be considered to see if it is satisfied.

DPs by reference to a newspaper proprietor

- (a) A proprietor of a *newspaper* (including magazine) printed or produced in Hong Kong
- (b) A person *exercising control* of a newspaper proprietor
- (c) An *associate* of a person who is a DP by virtue of (a) or (b) above

Persons exercising control of a licensee

- (a) A director or *principal officer* of the *licensee*
- (b) A beneficial owner of more than 15% of the *voting shares* in the *licensee*
- (c) A *voting controller* of more than 15% of the *voting shares* in the *licensee*
- (d) A person who otherwise has the power by virtue of any relevant instrument to ensure that the affairs of the *licensee* are conducted in accordance with the wishes of that person

DPs exercising control of a domestic free/pay TV licensee

Tony Tang Charles Barr

Recovery of Civil Service Debts – *Re Choi Lai Ming, a Debtor, Ex Parte: The Official Receiver [2006] 1 HKLRD 7*

In October 2005 in *Re Choi Lai Ming, a Debtor, Ex Parte: The Official Receiver*, the Court of First Instance decided that the Government was a secured creditor of Mr Choi (“C”) and had a fixed charge over his salary, pension and any sums of money due from the Government to him for the repayment of the outstanding loan advanced to him under the Government’s Home Financing Scheme (“Scheme”).

C was granted a loan under the Scheme for the purchase of his property in 1997. The terms and conditions of the Scheme were found in a number of documents executed by C in the process of applying for and obtaining the loan and in applicable CSRs.

In 2002, C was adjudged bankrupt. The sale proceeds of his property were insufficient to repay his outstanding loan.

The Court found that the CSRs authorised the Government to make deductions from C’s monthly salary. The authority to do so was irrevocable since C could not revoke it without being in breach of his arrangement with the Government. Similar arrangements also applied to C’s pension benefits.

The Court took the view that the legal effect of the rights and obligations between the parties under the Scheme satisfied the requirements of a security interest. There was a right given by a debtor (C) to the creditor (the Government) in an asset (his future salary and pension benefits) given by way of the grant of a security interest (a charge) for the purpose of securing an obligation (the loan).

It was given in security only, since the right would cease on the loan being repaid, and the debtor (C) was not free to dispose of the asset without regard to the security interest. The Court thus considered that the Government had a fixed charge over C’s salary and pension benefits for repayment of his outstanding housing loan.

The practical effect of the case is that the Government has priority over C’s unsecured creditors. It is now clear that despite C’s bankruptcy, the Government can continue to have recourse to his salary and, if necessary, pension and other sums due to him from the Government for repayment of his outstanding housing loan during the period of his bankruptcy and even after his discharge from bankruptcy.

C has not appealed.

Elen Lau

A General Competition Law For Hong Kong ?

The future regulation of anti-competitive conduct has been the subject of a public consultation paper “Promoting Competition – Maintaining our Economic Drive”. This builds upon experience of sector-specific regulation of such conduct under the Telecommunications Ordinance (Cap. 106) (“TO”) and the Broadcasting Ordinance (Cap. 562) (“BO”), and also the work of the Competition Policy Advisory Group as chaired by the Financial Secretary (“COMPAG”). It canvasses the case for various options for a cross-sector or sector-specific competition law drawing upon examples from overseas jurisdictions.

Sector-Specific or Cross-Sector?

COMPAG experience of complaints received covers a large number of sectors. And sector-by-sector regulation would raise definitional problems not existing as regards telecommunications and broadcasting, which are conveniently defined by their licensing regimes. Aside from the basic inequity of differential treatment between sectors, the most significant factor favouring a cross-sector approach is the problem under a sector-specific approach with the

bundling of goods and/or services across regulated and unregulated sectors, leaving regulators without jurisdiction over the latter.

Scope of Behaviour to be Covered by Competition Law?

The scale of Hong Kong markets has led to argument that “there may be limited business scope for multiple providers of certain products or services to co-exist, particularly those that require high levels of ‘sunk’ investment”. Thus the justification for regulating mergers and acquisitions (“M&A”) has been challenged in some quarters. On the other hand, a merger of competitors may, if not regulated, be an easy way to circumvent the spirit of the new regime. Both the TO and BO regulate M&A activity.

Types of Behaviour to be Regarded as “Anti-competitive Conduct” and the Approach to be Adopted in Defining Such Conduct?

The COMPAG appointed Competition Policy Review Committee in its July 2006 report recommended the regulation of 7 *specific* types of conduct: price-fixing, bid-rigging, market allocation, sales

and production quotas, joint boycotts, unfair or discriminatory standards and abuse of dominant position (e.g. predatory pricing below cost to drive out a competitor).

The larger jurisdictions of USA, EU (and hence UK) target anti-competitive conduct and also concentration of market power by merger regulation. The usual approach is to set out a basic prohibition with a non-exhaustive list of examples of such conduct. Such provisions may be subject to exemptions (often with conditions attached) and their interpretation supported by the issue of non-binding guidelines setting out the regulator’s understanding of the general prohibition. This is the TO and BO approach.

The flexibility of such an approach avoids the pitfalls of an overly technical/prescriptive regime and the resulting opportunities for lawyers to circumvent the spirit of the legislation on the basis of mere technicalities.

The debate promises to prove interesting!

David Grover

Asset-Merger of MTR Corporation Limited and the Kowloon-Canton Railway Corporation

The CU of the Department of Justice advises the Government on the proposed merger of the operations of the MTR Corporation Limited (“MTRCL”) and the Kowloon-Canton Railway Corporation (“KCRC”). On 11 April 2006, the Government signed a non-legally binding Memorandum of Understanding with MTRCL. Below are some of the major terms of the proposed merger:

(1) MTRCL will be granted a franchise to operate both the MTR and KCR railways for an initial period of 50 years from the date of the merger, subject to extension.

(2) Through a Service Concession Agreement, KCRC will grant to MTRCL the right to use its assets to operate the existing KCR railway lines as well as its other transport-related businesses such as bus operation in the North-west Transit Service Area.

(3) The Service Concession Agreement will be co-terminous with the franchise granted to MTRCL to operate the MTR and KCR railways.

(4) MTRCL will purchase a property package (comprising (i) the property development rights along East Rail, Ma On Shan

Rail, Light Rail and Kowloon Southern Link; (ii) KCRC’s existing investment properties related to East Rail and Light Rail; and (iii) KCRC’s property management business) and certain short-lived railway assets of KCRC, such as stores and spares via Sale and Purchase Agreement(s).

(5) MTRCL will pay to KCRC:

(i) an upfront payment of HK\$4.25 billion for the service concession and the acquisition of the short-lived railway assets;

(ii) a fixed annual payment of HK\$0.75 billion for duration of the service concession;

(iii) starting from the 4th year, variable annual payments on the basis of a banded revenue-sharing approach based on the revenue generated from KCRC system, viz.

➤ 10% sharing for revenue >HK\$2.5 billion and ≤ HK\$5 billion

➤ 15% sharing for revenue >HK\$5 billion and ≤ HK\$7.5 billion

➤ 35% sharing for revenue > HK\$7.5 billion

(iv) HK\$7.79 billion for the acquisition of the property package.

(6) The Operating Agreement between the Government and MTRCL (which sets out the service and safety requirements of the MTR railway and matters relating to fares) will be expanded into an Integrated Operating Agreement to cover aspects of regulation of KCR railways and the fare adjustment mechanism (FAM).

(7) All serving staff of the two corporations will be employed by MTRCL on their prevailing terms upon the rail merger.

(8) MTRCL will retain its English name after the merger and the Chinese name will be changed from “地鐵有限公司” to “香港鐵路有限公司”.

To provide the necessary legislative framework for the rail merger, amendments to the Mass Transit Railway Ordinance (Cap. 556) and the Kowloon-Canton Railway Corporation Ordinance (Cap. 372) have been introduced through the Rail Merger Bill - currently under scrutiny in the Legislative Council. To find out more about the proposed merger and the Rail Merger Bill, please access

http://www.legco.gov.hk/yr05-06/english/bc/bc03/papers/bc03_ppr.htm.

Mayanna To

When is a guarantor or surety discharged from his obligations by a variation in the underlying contract?

In Jiangsu Golden Civil Building Group (HK) Co Ltd v Chau Wa Kin [2007] 1 HKLR1 the Court of First Instance decided that the Guarantor or Surety was discharged when the underlying loan agreement between the creditor and the debtor was varied without his consent in two respects, namely (i) the amount of the loan was increased; and (ii) the Guarantor was required to pay the creditor all receivables under a Government contract.

The Court laid down 3 principles:

(1) Under the rule in *Holme v Brunskill* (1877-78) LR 3 QBD 495, unless there was an express reservation in the instrument preserving a creditor's rights against a surety, a material variation of the terms of the contract between the creditor and

principal debtor would discharge the surety. Whether a variation was material should be answered objectively. A variation that was potentially prejudicial when made, even though it ultimately had little effect on the surety's risk, would be material.

- (2) In determining whether there was an express reservation binding on the surety, generally the *contra proferentem* rule [the doctrine that the construction least favourable to the person putting forward a document should be adopted against him] of interpretation applied. This was particularly appropriate where, as here, the surety got no benefit under the guarantee.
- (3) The Guarantor had not contracted out of the protection offered by the rule in *Holme v Brunskill*.

The Guarantee did not allow the creditor and the principal debtor to enter into whatever arrangement or agreement including the enhancement of the debt, the amendment of repayment terms and indeed entirely new obligations, as occurred here, without reference to the Guarantor.

PRACTICAL TIP

Government frequently requires contracts to be guaranteed. Check and revise the wording of the Guarantee to ensure that the guarantor/surety has expressly contracted out of his *Holme v Brunskill* protection. If, however, the Government is giving the guarantee, it should remember the *Holme v Brunskill* protection.

Charles Barr

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Advice should be sought from CU before applying the information in the CU Review to particular circumstances.