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Editorial

Kung Hei Fat Choi. The CU Review Editorial Board wishes you a happy, healthy and prosperous Year of the Dragon.

In this edition we feature three articles. The first article is about two recent decisions on directors' duties and the proposed reform in the Companies Bill on this topic. The second article discusses the common law doctrine of frustration where a contract may be discharged if after its formation supervening events occur making its performance impossible or illegal or radically different from that which was undertaken by the contract. The third article is about the proposed amendments to the Competition Bill which is now under the scrutiny of the Legislative Council.

This edition also features three case reports. The first case is about how effective an entire agreement clause can be to exclude previous representations, promises or assurances made during the course of negotiation. The second case concerns a related issue – whether evidence of pre-contractual negotiations is admissible in construing a contract. The third case is about whether a cause of action is time-barred under the Limitation Ordinance.

Yung Lap-yan

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

Directors' Duties

This article discusses recent developments on the law of directors' duties. We will first discuss some recent cases on directors' duties, to be followed by an examination of the proposed reform to the directors' duty of care, skill and diligence in the Companies Bill 2011 ("the CB").

Recent Decisions

(i) Duties in relation to Creditors

A recent decision of the Court of Final Appeal has confirmed the application in Hong Kong of directors' duties concerning the interests of creditors where a company is insolvent. In *Tradepower (Holdings) Ltd v. Tradepower (Hong Kong) Ltd*[1], Tradepower (Holdings) Ltd ("Holdings") owned 3749 of 3750 "A" shares in its subsidiary, Tradepower (Hong Kong) Ltd ("THK"). The remaining "A" share was held by Girvan Ltd ("Girvan"). Mr. Sonnenberg and Mr. Divine were the only directors and shareholders of Holdings and Girvan. They were also directors of THK. The 3749 "A" shares of THK held by Holdings were subsequently converted into "B" shares, which carried no real rights in substance. After the conversion, there was effectively a disposition of Holdings' interests to Girvan for no consideration. When Holdings was wound up, the liquidator sought to recover against the directors for misfeasance. The court held in favour of the liquidator, with one of the grounds being that there was a wrongful disposition by the directors of Holding's assets when the company was insolvent which could not be ratified by the shareholders. The court cited the following principle from the New Zealand decision of *Nicholson v. Permakraft*:[2] "[C]reditors are entitled to consideration … if the company is insolvent, or near insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency". In the overseas case law, this duty to have regard to the interests of creditors is seen as part of the fiduciary duty to act in good faith in the interests of the company. Ordinarily this duty requires the directors to act in the interests of the shareholders, but when the company is in the vicinity of insolvency, the duty requires directors to consider the interests of creditors instead. Any purported shareholder ratification of the directors' breach of the duty is ineffective.

[1] (2009) 12 H.K.C.F.A.R. 417.
[2] [1985] 1 NZLR 242 at 249.

(ii) Directors' Liability for Mistakes in Financial Statements

In the classic English case of *Re City Equitable Fire Insurance Co Ltd*,[3] the court laid down a subjective standard of care which does not require directors to exhibit a greater degree of skill than may reasonably be expected from a person with their knowledge and experience. The court also held that having regard to the exigencies of business, directors may delegate to others, and that in the absence of grounds for suspicion, directors may trust that the duties have been properly performed. However, under modern overseas case law, it has been held that while directors may delegate, they are still under a duty to supervise and to guide and monitor the management of the company: e.g. *Daniels v. Anderson*.[4] In both England[5] and Australia,[6] objective elements in the standard of care have been adopted both in statute and under the common law.

The modern approach is illustrated by the recent Australian decision in *Australian Securities and Investment Commission v. Healey*,[7] where the court held that directors may be liable for mistakes in the accounts, even where both the company's management and auditors had failed to pick up the errors. In this case, the company failed to classify certain liabilities as current and failed to disclose certain post balance sheet date events in its financial statements. The court held that although directors can rely on expert advice, they cannot abdicate their own fundamental responsibility to review and approve the company's financial statements. Moreover, directors must have sufficient knowledge of conventional accounting practice, and must apply that knowledge based on information they received as directors. If directors detect an apparent error, they must ask questions of management or auditors. On the facts of the case, the court found that the directors knew or should have known of the relevant financial principles. Earlier board papers had disclosed the existence of the current liabilities, and the board knew of the post balance sheet events. However, no director asked any questions of management or the auditors about the obvious errors in

[3] [1925] Ch. 407.
[4] (1995) 16 A.C.S.R. 607.
[5] Companies Act 2006 s. 174.
[6] Corporations Act 2001 s. 180.
[7] (2011) 278 A.L.R. 618.

the accounts. The directors were accordingly held to have breached the duty of care.

Companies Bill

As noted in an earlier edition of the CU Review,[8] the CB codifies the duty of care. The reform is aimed towards improvement of corporate governance in Hong Kong. The CB formulation of the duty is modelled on s. 174 of the UK Companies Act 2006. In the CB, the test determining whether a director has fulfilled his duty is twofold. Clause 456 provides that a director owes a duty to the company to exercise reasonable care, skill and diligence that would be exercised by a reasonably diligent person with:

(a) 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; and

(b) the general knowledge, skill and experience that the director has.

Paragraph (a) sets an objective minimum standard that is expected of all directors. That standard may be raised by the subjective aspect under paragraph (b) if the particular director has any special knowledge, skills and experience.

Before the 2006 Act in the UK, this dual objective/subjective test had already been applied under the UK insolvency regime [9] and under the common law. Earlier UK cases may shed some light on the standard of care required under the CB provision. For example, in *Re Produce Marketing Consortium Ltd*,[10] it was accepted that the requirement to have regard to the functions carried out by the director in question in relation to the company involves having regard to the particular company and its business, so that the general knowledge, skill and experience postulated will be much less extensive in a small company in a modest way of business, with simple accounting procedures and equipment, than it will be in a large company with sophisticated procedures. The objective test looks at the knowledge and experience that may reasonably be expected of a person in the same position as the director. This enables the court to take into account differences in responsibilities of different categories of directors and of differences in the nature of the company concerned.

Natalie Wong
Stefan Lo

[8] CU Review Summer 2010.
[9] Insolvency Act 1986 s. 214(4) (in the context of wrongful trading).
[10] (1989) 5 B.C.C. 569.

The Doctrine of Frustration in the Law of Contract

Under the doctrine of frustration a contract may be discharged if after its formation events occur making its performance impossible or illegal, and in certain analogous situations.

Traditionally, most contractual duties were regarded as absolute and supervening events provided no excuse for non-performance.

In *Paradine v Jane*[1], a tenant was sued for rent and pleaded that he had for about two years of his tenancy been dispossessed by act of the King's enemies. The plea was held bad because a party is bound to make good his duty under contract.

This approach has produced hardship in some cases thereby giving rise to the doctrine of frustration.

The case that established the doctrine of frustration was *Taylor v Caldwell*[2]**.** In that case a music hall that was hired out by the defendants for giving concerts was destroyed by an accidental fire six days before the concert. Blackburn J held that the contract was discharged and the defendants were not liable in damages because "*the parties must from the beginning have known that it could not be fulfilled unless … some particular specified thing continued to exist*", and in the circumstances the contract was "*subject to an **implied condition** that the parties shall be excused in case, before breach, performance becomes impossible from perishing of the thing without the fault of the contractor.*"

The doctrine of frustration has since been extended to cases in which performance became impossible otherwise than through the perishing of a specific thing; and even to cases where performance did not become impossible at all.

In *Krell v Henry*[3] the defendant hired a flat in Pall Mall for watching the processions planned for King Edward VII's coronation. The contract was held to be frustrated when the illness of the King caused the coronation to be postponed. Though performance was not physically impossible, the doctrine of frustration was held to apply "*to cases where the event which*

[1] (1647) Aleyn 26.
[2] (1863) 3 B&S 826.
[3] [1903] 2 K.B. 740.

renders the contract incapable of performance is the cessation or non-existence of an express condition or state of things, going to the root of the contract, and essential to its performance."

Contrast this result however with that of Herne Bay Steamboat Co v Hutton,[4] where an individual hired a steamboat for the purposes of travelling to Spithead to cruise round an assembled fleet, and to witness the naval review of King Edward's coronation. The courts held that following the cancellation of the coronation, the entire purpose of the contract had not been frustrated, as the cruise was still possible.

In both the Krell case and the Herne Bay Steamboat case, the test applied was not the implied term test expounded in the Taylor v Caldwell case which was often faulted for being 'artificial', but one based on the finding of radical change in circumstances brought about by the supervening event.

The leading case to apply the new test is Davis Contractors v Fareham UDC.[5] There the court decided that it would not be true to say that both parties would intend for an implied term to cover particular situations. In what has become generally accepted as the classical statement of the modern law on frustration Lord Radcliffe said "... ***frustration occurs whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. It was not this that I promised to do***."

In the more recent The Super Servant Two case[6], Bingham LJ summarised the following as propositions on the law of frustration established by the highest authority that are not open to question:

1. The doctrine of frustration was evolved to mitigate the rigour of the common law's insistence on literal performance of absolute promises. The object of the doctrine was to do what is reasonable and fair, as an expedient to escape from injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances.

2. Since the effect of frustration is to kill the contract and discharge the parties from further liability under it, the doctrine is not to be lightly invoked, must be kept within very narrow limits and ought not to be extended.

3. Frustration brings the contract to an end forthwith, without more and automatically.

4. The essence of frustration is that it should not be due to the act or election of the party seeking to rely on it. A frustrating event must be some outside event or extraneous change of situation.

5. A frustrating event must take place without blame or fault on the side of the party seeking to rely on it.

Recent trend has seen some narrowing of the scope of the doctrine of frustration by the courts so as – in the interest of certainty – not to release parties from their contractual obligations too easily. An important limitation of the doctrine is that economic hardship, or "bad bargain" will not render a contract frustrated. This attitude of the courts is best summed up by Lord Roskill when he said in The Nema case[7] that the doctrine of frustration was "*not lightly to be invoked to relieve contracting parties of the normal consequences of imprudent commercial bargains*."

The following is a non-exhaustive list of supervening events that potentially give rise to frustration: -

1. Impossibility, e.g. subject matter of contract is destroyed or unavailable. A classic example would be Taylor v Calwell;

2. Purpose of the contract has been frustrated, e.g. Krell v Henry**;**

3. Illegality, e.g. where a contract becomes illegal as a result of the wartime prohibition against trading with the enemy[8];

4. Incapacity or death. This generally only applies to the performance of personal services. A contract may become frustrated where a person or persons under contract become unavailable to perform through illness, death or other reasons, e.g. a contract was held to have been frustrated where a piano player became ill prior to a concert he was contracted to play in[9].

Vivian Cheung

[4] [1903] 2 KB 683.
[5] [1956] A.C. 696.
[6] J Lauritzen AS v Wijsmuller BV, [1990] 1 Lloyds Rep 1.
[7] [1982] A.C. 724 at 752.
[8] Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd [1943] A.C. 32.
[9] Robinson v Davison (1870-71) LR 6 Ex 269.

Proposed Amendments to the Competition Bill

Background

In July 2010, the Government introduced the Competition Bill ("Bill") into the Legislative Council ("LegCo"). The Bill contains prohibitions upon broadly speaking anti-competitive agreements ("first conduct rule") and the abuse of a substantial degree of market power ("second conduct rule"). The conduct rules involve the application of legal principles and economic analysis and are in keeping with international best practice.

Concessions

Concerns raised about the Bill have resulted in the following amendments being proposed by the Government:

First Conduct Rule

A less stringent regime will be applied to conduct which is **not** hard-core or, to use the terminology of the Bill, **not** "serious anti-competitive conduct". "Serious anti-competitive conduct" will be defined in the Bill to mean any conduct which:

"consists of any of the following or any combination of the following-

(a) fixing, maintaining, increasing or controlling the price for the supply of goods or services;

(b) allocating sales, territories, customers or markets for the production or supply of goods or services;

(c) fixing, maintaining, controlling, preventing, limiting or eliminating the production or supply of goods or services;

(d) bid-rigging."

All conduct other than serious anti-competitive conduct will not incur any sanction under the first conduct rule **unless** the Competition Commission ("Commission") first issues a warning notice requiring the contravening undertaking to cease the contravening conduct within a specified period. No enforcement action can be taken prior to expiry of the period or in relation to conduct that precedes the period.

Serious anti-competitive conduct remains subject to sanction without prior warning.

Infringement Notices

Clauses 65 to 77 of the Bill provide for a procedure under which the Commission may issue an infringement notice to an undertaking which the Commission has reasonable cause to believe has contravened a conduct rule. The notice will contain an offer, which the concerned undertaking is not obliged to accept, not to bring legal proceedings if the undertaking makes a commitment to comply with the requirements specified in the notice. Such requirements may include taking or refraining from taking certain action and as originally drafted paying a sum of up to HK$ 10 million to the Government. The Government now proposes to remove the power to require such a payment.

De Minimis Arrangements

It is a common practice in other jurisdictions with a competition law to provide de minimis arrangements so that agreements between and abuse of a substantial degree of market power by undertakings with market share or turnover below specified thresholds, are generally not considered to have an appreciable impact on competition and are not subject to enforcement action by the competition authorities.

The Government originally intended to deal with de minimis arrangements by means of administrative guidelines issued by the Commission so as to retain flexibility. In view of LegCo demands for certainty and curtailment of the future Commission's discretion, the Government has now decided to include the arrangements in the Bill as follows:

(a) for the first conduct rule, all agreements between undertakings with a combined turnover not exceeding HK$100 million in the preceding financial year (or the preceding calendar year if the undertakings do not have a financial year) will be excluded from the application of the first conduct rule. It is proposed to adopt turnover as the threshold because it is more easily determined than market share which requires a definition of the relevant market for each and every agreement. The threshold of HK$100 million can be amended through subsidiary legislation. It should be noted that this exclusion does **not** apply to serious anti-competitive conduct since such conduct almost always has an appreciable adverse effect on competition.

(b) for the second conduct rule, the de minimis threshold proposed is HK$11 million. It is felt that SMEs with a lower turnover are unlikely to enjoy substantial market power (except perhaps in a specialised small market).

Pecuniary Penalty

The maximum pecuniary penalty that may be imposed for a contravention of a conduct rule is proposed to be reduced from 10% of global turnover of the infringing undertaking for each year in which the contravention continued to 10% of Hong Kong turnover for a maximum of 3 years.

Standalone right of private action

In other jurisdictions such as the EU, UK and USA, standalone private rights of action (i.e. civil action for damages without the need for a prior finding of a contravention of prohibition) are regarded as making an important contribution to the enforcement effort independently of the enforcement resources and priorities of any competition authority.

Due to concerns that such a right might lead to vexatious litigation, it is proposed to remove from the Bill this standalone right to claim compensation for a contravention of the conduct rules **without** a prior finding of contravention by the Competition Tribunal. Thus it will not be possible to enforce a conduct rule or seek compensation for its contravention without the involvement of the Commission.

It will, however, still be possible to pursue a follow-on right of private action for compensation for loss or damage as a result of contravening conduct if the Competition Tribunal has made a prior finding of contravention of a conduct rule.

Merger Exclusion

It has always been the Government's intention that merger control should only apply to the telecommunications industry. Schedule 7 of the Bill prohibits a merger of the holders of carrier licences that has, or is likely to have, the effect of substantially lessening competition in Hong Kong. This regime reflects the current regime in the Telecommunications Ordinance, Cap. 106 section 7P.

There are doubts as to whether merger transactions in other sectors would nevertheless be caught by the first conduct rule or the second conduct rule. In the interests of certainty, mergers have therefore now been expressly excluded from the ambit of the first conduct rule and the second conduct rule.

Way Forward

It is hoped that the above concessions will facilitate successful passage of the Bill through LegCo in the current term.

David Grover

AXA Sun Life Services PLC v Campbell Martin Ltd [2011] EWCA Civ 133

It is common to include an entire agreement clause in a commercial agreement in order to exclude previous representations, promises or assurances made during the course of negotiations. This commentary will discuss the effect of such clause.

The case

Through various agreements, AXA appointed Campbell Martin and other companies (the "Companies") as its authorised representatives in providing insurance products to customers. The terms of appointment with each of the Companies were set out in a standard form agreement. The agreements included an entire agreement clause (clause 24) which stated that *"(i) This Agreement and the Schedules and documents referred to herein constitute the entire agreement and understanding between you and us in relation to the subject matter thereof. (ii) Without prejudice to any variation as provided in clause 1.1, (iii) this Agreement shall supersede any prior promises, agreements, representations, undertakings or implications whether made orally or in writing between you and us relating to the subject matter of this Agreement (iv) but this will not affect any obligations in any such prior agreement which are expressed to continue after termination."*[1]

When the agreements were terminated, AXA claimed money due under the agreements from the Companies. The Companies relied on AXA's misrepresentations and breach of collateral warranties and implied terms in their defence and counter-claim. AXA in turn relied on clause 24 and claimed that any misrepresentations had been excluded. The preliminary issues for the

[1] For convenience of exposition, clause 24 was broken up into four parts by Lord Justice Rix, numbered (i) to (iv); the numbering does not appear in the original.

claims included whether, on its true construction, clause 24 precluded the Companies from relying on the misrepresentations/collateral warranties/implied terms. The trial court decided against AXA on the preliminary issues. AXA appealed.

Construction of the entire agreement clause

The UK Court of Appeal considered that whether clause 24 excludes misrepresentations is a question of construction; it depends on the precise words of the clause and of the agreement as a whole. The Court held that, on its true construction, clause 24, being an entire agreement clause, does not exclude or supersede misrepresentations or liability for it.

Lord Justice Rix pointed out that clause 24 as a whole is concerned only with matters of agreement and not with misrepresentations at all. He observed that : (a) Parts (i), (ii) and (iv) of clause 24 are all concerned with identifying the parties' contractual arrangements rather than misrepresentations; (b) although the word "representations" does appear in part (iii), it is sandwiched between words of agreement such as "promises", "agreements" and "undertakings"; (c) the provisions surrounding clause 24 are also concerned with matters of contractual agreement (such as severability and variations); and (d) the clause does not state that no representations have been made, or that no reliance has been placed on any representations, or that liability for (mis)representations is excluded, each of which is a traditional way of avoiding liability for misrepresentations. He noted that the essence of agreement is what the parties had agreed. On the other hand, the essence of misrepresentation is the inaccurate statement made by one party to the other party which has been relied on by the other party in entering into the agreement between them and which might give the other party a right to rescind/cancel the agreement or claim compensation. Thus, misrepresentation and the exclusion of misrepresentation or liability for it are simply not the business of clause 24 at all.

Having considered various authorities, Lord Justice Rix considered that whilst the past cases are only authority for each clause's particular wording, there are certain themes which deserve recognition. Among them is that the exclusion of liability for misrepresentation must be clearly stated.

In summary, misrepresentation as a whole was not excluded by clause 24. As for implied terms (such as AXA would process all business submitted to it with reasonable care and without any unreasonable delay), the Court accepted that they are to be implied in order to give business efficacy to the agreements. Being intrinsic provisions of the agreements, the implied terms are within the expression "This Agreement and the Schedules and documents referred to herein" in part (i) of clause 24. Hence, they could not be excluded. The effect of clause 24 was limited to excluding what would otherwise be collateral warranties.

Practical tips

The AXA case is important in that it serves as a reminder of the dangers of relying on standard, boilerplate versions of an entire agreement clause to exclude liability for misrepresentation. Notwithstanding that an entire agreement clause is able to exclude any promise or assurance made in the course of negotiations between the contracting parties (which in the absence of such a clause might have effect as a collateral warranty), a statement that the contract supersedes any prior agreement or representation will not by itself absolve a party of any liability for misrepresentation. In this regard, the AXA case provides guidance on the drafting of an effective exclusion of misrepresentation clause.

To exclude liability for misrepresentation, the words in the contract must amount to an agreement that representations are withdrawn, overridden or of no legal effect so far as any liability for misrepresentation is concerned. It can be done by a provision which states the parties' agreement that there have been no representations made; or there has been no reliance of any representations; or by an express exclusion of liability for misrepresentation.

Lily Man

Urban Renewal Authority v Agrila Ltd [2010] 1 HKLRD 578

The extent to which evidence of pre-contractual negotiations is admissible in construing a contract was considered by the Court of Appeal in *Urban Renewal Authority v Agrila Ltd*.

Facts

The Urban Renewal Authority, formerly known as the Land Development Corporation (the "Plaintiff") and Agrila Limited (the "First Defendant") were parties to a joint venture for the redevelopment of a site in Central. In 1989, they entered into certain Heads of

Agreement ("HA") which contemplated the sale of units in the new development upon its completion and the equal division of profits after a guaranteed payment to the Plaintiff and reimbursement to the First Defendant.

In 1997, the parties varied the HA by way of a Restructuring Agreement ("RA"). The RA set out the appropriate amount and payment date of the "Guaranteed Profit". The parties then entered into a Supplemental Agreement ("SA") to postpone the payment date of the balance of the "Guaranteed Profit" which was linked to the date of the Certificate of Compliance to be issued (the "Certificate"). Under the RA, it was the First Defendant's obligation to use its best endeavours to obtain the Certificate by a certain date. However, the Certificate was issued on the Plaintiff's application. The First Defendant objected to the Plaintiff's unilateral application for the Certificate and refused to pay the balance of the Guaranteed Profit.

The dispute led to a settlement agreement headed Agreement and Indemnity (the "Indemnity"). The Indemnity provided, inter alia, that in consideration of the Plaintiff agreeing to waive all interest accrued on the balance of the Guaranteed profit and in "full and final settlement of the obligations and liabilities of [the First Defendant]" under certain provisions of the RA, the First defendant undertook to complete the "Outstanding Works" as specified in the Indemnity and to reimburse the Plaintiff for all costs and expenses required to complete such works.

Legal Issues

One of the issues was whether the Indemnity discharged the obligation (if any) on the part of the First Defendant to make resumption payments. The First Defendant purported that prior to the Indemnity, it had no obligation to make resumption payments and that even if it had, such an obligation was compromised under the Indemnity. The Plaintiff sought to strike out certain witness statement (the "Statement") made on behalf of the Defendants concerning the discussions[1] between the parties some time before the execution of the Indemnity which allegedly shed light on the party(ies)' objective. The Plaintiff whose summons was dismissed appealed to the High Court; the judge allowed the appeal. The Defendants then appealed to the Court of Appeal.

In dismissing the Defendants' appeal, the Court of Appeal held that the Statement fell squarely within the "exclusionary rule". The Court considered that the Statement was part and parcel of the pre-contractual negotiations, it being common ground that it was only subsequent to those negotiations that solicitors were instructed to draft the Indemnity. Citing Lord Wilberforce's judgment in *Prenn v Simmonds*[2], the Court found it inappropriate to admit evidence of pre-contractual negotiations on the basis that they could show the aim or objective of entering into the agreement, less still the aim or object of one party. It would be dangerous to admit evidence of one party's objective, even if that is known to the other party, as it would be a matter of speculation how far it was the common intention to realise that particular objective. The proposition that previous documents might be looked at to explain the aims of the parties was true in a limited sense only i.e. the commercial or business object of the transaction, objectively ascertained, might be a surrounding fact.

The Court recognised that the House of Lords in *Chartbrook Ltd. v Persimmon Homes Ltd.*[3] had affirmed the exclusionary rule. Some important distinctions were highlighted viz. a distinction should be drawn between (i) using evidence of what was said or done during the course of negotiating the agreement for the purpose of drawing inferences about what the agreement meant; and (ii) using such evidence for other purposes e.g. to establish a fact which may be relevant as background was known to the parties, or to support a claim for rectification or estoppels. Whilst category (i) fell within the exclusionary rule, category (ii) represent the exceptions to the rule. Another distinction should also be drawn between (a) statements made in the course of pre-contractual negotiations that reflected the aspirations of one of the parties (which would be drenched in subjectivity and might, if oral, be disputed); and (b) a provisional consensus that might throw light on the meaning of the contract which was eventually concluded. Category (a) fell within the exclusionary rule whilst category (b) fell outside it. This was so even though it meant that the parties would be held bound by a contract in terms which, upon a full investigation of the course of negotiations, a reasonable observer would not have taken them to have intended.

1 The certified translation of the Chinese characters in the relevant part of witness statement read, "There is no delay and owing, there are no other further money toing and froing."

2 [1971] 1 WLR 1381 at 1385D

3 [2009] 3 WLR 267

Comments

In preparing a contract, reliance should not be placed upon pre-contractual negotiations to infer the meaning of the contractual terms. Contractual provisions should be laid down and defined as clearly as possible. Where fundamental matters are agreed in principle prior to the making of a contract, such matters should best be recorded in a consensual form and signed by the parties concerned. Notes of negotiation meetings kept by one party will be of little value in this regard.

Elsa Po

Ng Choi Sang v Chu Yu Tin [2009] 4 HKLRD 747

Facts

In about 1994 or 1995, the Plaintiff and the Defendant entered into two funding agreements (the "Agreements"), under which the Plaintiff advanced loans to finance subcontracting works undertaken by the Defendant and such loans were to be repaid only when the Defendant received payments from the respective principal contractors. The loans in the Agreements were subject to payment of interest and management fee at specified rates.

In August 1998, the Plaintiff and the Defendant agreed to vary the Agreements by a variation agreement (the "Variation Agreement"), under which the interest rate and the management fee rate were reduced and the repayment term was revised such that the revised interest, the revised management fee and the unpaid principal of loans were all payable on demand instead of conditional upon payments by the principal contractors.

The Plaintiff contended that he demanded payment from the Defendant in July 2004, but conceded that "repeated chasings" had been made and the Defendant "repeatedly represented that he needed more time", and the Plaintiff therefore "did not demand for repayment and repeatedly gave him more time".

On 30 September 2005, the Plaintiff issued a writ against the Defendant claiming repayment of the outstanding loans, together with interest and management fee made under the Agreements and the Variation Agreement. The Defendant denied liability on the grounds (amongst others) that:

(i) the Plaintiff's cause of action was time-barred by section 4(1)(a) of the Limitation Ordinance (Cap.347) (the "LO"); and

(ii) the Plaintiff was a "money lender" within the meaning of section 2(1) of the Money Lenders Ordinance (Cap.163) (the "MLO"), and since the Plaintiff had failed to comply with the memoranda requirements under section 18 of the MLO with respect to the Agreements, those Agreements were unenforceable.

Decision

The Court of First Instance (the "CFI") dismissed the Plaintiff's claims and held that:

(i) the Plaintiff's claims against the Defendant were time-barred under section 4(1)(a) of the LO

- Notwithstanding the Plaintiff's contention that he demanded payment from the Defendant in July 2004, the CFI concluded that the Plaintiff had demanded payment from the Defendant before 30 September 1999, six years before the issue of the writ in this action on 30 September 2005. The CFI considered it inherently improbable that, having agreed to a reduction in interest and management fee, the Plaintiff would have made no demand at all for more than a year from the date of the Variation Agreement (i.e. from August 1998 to 30 September 1999). The CFI also took into account the Plaintiff's concession that "repeated chasings" had been made against the Defendant, and such "chasings" constituted demands for repayment.

- Section 4(1)(a) of the LO provides that: "The following actions shall not be brought after the expiration of 6 year from the date on which the cause of action accrued, that is to say… actions founded on simple contract…"

- The CFI held that the limitation of time in this case began to run and ran continuously upon the failure of the Defendant to pay on demand, i.e. before 30 September 1999. The CFI relied on one of the general principles of the legislation on limitation, set out in *Tito v Waddell (No 2)*[1] and discernible as early as *Prideaux v Webber*[2], that once time begins to run, it runs continuously, and that this

[1] [1977] Ch. 106 at 246

[2] (1660) 1 Lev 31

principle can be ousted only by a statutory provision.

- The CFI rejected the Plaintiff's argument that limitation did not accrue on the demands he had made more than 6 years before the issue of the writ because the Plaintiff had granted the Defendant indulgence in making repayment. There was no statutory provision on the effect of giving of time to pay on the limitation period.

(ii) the Plaintiff was a money lender, and the loans were caught by the MLO, meaning that Agreements were not enforceable and the loans were not recoverable

- The CFI continued to deal with the issue of whether the Plaintiff was a money lender for the sake of completeness, notwithstanding that the Plaintiff's claims had already been held time-barred.

- The CFI found that the Plaintiff was plainly a money lender within the meaning defined in section 2(1) of the MLO, whose business (whether or not he carried on any other business) was that of making loans. There was no evidence to show that Paragraph 5 in Part 2 of Schedule 1 to the MLO, which exempted a loan made by a person whose ordinary business did not primarily or mainly involve the lending of money in the ordinary course of that business, was applicable to the Plaintiff's loans. The CFI relied on the following facts in making its findings: (a) the Plaintiff's money-lending was so frequent that a form and a system had been devised to compute and record the amount due; (b) the numerous loans to the Defendant had nothing to do with the Plaintiff's construction business; and (c) the management fee was a devise used by the Plaintiff to boost his income from his money-lending and was interest.

- The CFI further found that: (a) the Plaintiff had failed to comply with the requirements in section 18(1) of the MLO in respect of the Agreements, and they were therefore not enforceable; and (b) the Plaintiff was not a licensed money lender, and hence the loans made by him were not recoverable pursuant to section 23 of the MLO. The Agreements being not enforceable and the loans being not recoverable, the parties could not convert any of the Agreements to an enforceable agreement and convert the loans to recoverable loans by the Variation Agreement.

- The Plaintiff could not rely on the saving provisions of sections 18(3) and 22 of the MLO as the circumstances relied on to invoke these provisions had not been pleaded by the Plaintiff and it was not open to him to raise such a case at trial. In any event, having regard to the Plaintiff's unclear computation of the amount of loans lent and interest and management fee charged, the CFI was not satisfied that the Plaintiff had made good the inequitable requirement in these provisions.

Christie Kwong