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The Commercial Unit, Civil Division
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Editorial

Welcome to this edition of the CU Review, and from me, its new editor-in-chief, a big hello. I take on this job with the intention of maintaining the high standards previously set by the former editor-in-chief Charles Barr. It is a daunting task. I will do my best.

In this edition we feature three articles. The first article is our "old friend" – the Companies Ordinance Rewrite (now Part III). In this article we highlight the administration's proposals for the Companies Bill in two main areas – directors' duties and share capital. The second article is about the Film Development Fund Scheme which provided financial support to the production of the Hong Kong box-office hits "McDull Kungfu Ding Ding Dong (麥兜響噹噹)" and "Echoes of the Rainbow (歲月神偷)" – the latter won the Crystal Bear Award for the best feature film in the Generation section at the 60th Berlin Film Festival. The third article is about the application of common law and statutory rules on exemption clauses.

Three case reports are also included. The first relates to the question of whether a liquidated damages clause in a contract is an exhaustive remedy *(Baese Pty Ltd v R A Bracken Building Pty Limited)*. The second is a recent House of Lords decision on the interpretation of contracts *(Chartbrook Ltd v Persimmon Homes Ltd and Others)*. The third is the local Court of Appeal's decision allowing SFC's appeal against the sanctioning by the Court of First Instance of a scheme under section 166 of the Companies Ordinance for the purposes of the privatisation of PCCW Limited *(Re PCCW Ltd)*.

Yung Lap Yan

Notes:

The Companies Ordinance Rewrite – Part III : Towards the Draft Bill

Earlier editions of the CU Review[1] have detailed the background to the Companies Ordinance Rewrite. The first stage of the project involving research on legal and policy issues and consultation with advisory groups and with the public on specific issues was completed by 2008. For the second stage, much work has been done in the period from 2008 to the present to produce the draft Companies Bill ("CB") for general public consultation in early 2010.

The guiding principles

The law must rest on sound policy foundations. To ensure that the rewrite would be conducted on a rational and coherent basis, a set of guiding principles[2] for the rewrite was approved by the Standing Committee on Company Law Reform ("SCCLR") in the early stages of the rewrite process. The main objective of the rewrite is to modernise Hong Kong company law in order to enhance Hong Kong's competitiveness and attractiveness as a major international and financial centre. The guiding principles under this broad objective are:

- catering for small and medium enterprises – reducing compliance costs for private companies;
- enhancing corporate governance – taking into account the interests of stakeholders such as members and creditors, and building on the earlier recommendations of the SCCLR in the Corporate Governance Review 2000-2003;
- complementing Hong Kong's role as an international business centre – benchmarking Hong Kong against comparable jurisdictions while taking into account Hong Kong's unique business environment;
- encouraging the use of information technology – facilitating communications between companies and shareholders, and between the public and the regulators;
- attempting statutory statements – where appropriate, expressing case law principles in the Companies Ordinance, while bearing in mind the need to allow common law rules to evolve and develop;
- plain drafting and improved layout – simplifying and modernising the law to make it more readable and understandable;
- providing flexibility for future updating – using schedules, subsidiary legislation or non-statutory codes where appropriate, to facilitate regular updating of the law in the future.

Consultations with stakeholders and the public

Four advisory groups ("AGs") were established in 2006, comprised of representatives of relevant professional and business organisations, members of the SCCLR and representatives of relevant government departments and agencies, to advise on some of the more complex and controversial areas of company law:

- Advisory Group on Share Capital, Distribution of Profits and Assets and Charges Provisions ("AG1");
- Advisory Group on Company Formation, Registration, Re-registration and Company Meeting and Administration Provisions ("AG2");
- Advisory Group on Directors and Officers Related Provisions ("AG3");
- Advisory Group on Inspections, Investigation and Offences and Punishment Provisions ("AG4").

[1] CU Review Summer 2007; CU Review Spring 2008.

[2] SCCLR, Twenty-Fourth Annual Report 2007/2008, pp 8-10.

A Joint Government/Hong Kong Institute of Certified Public Accountants Working Group had also been established to review the accounting and auditing provisions of the Ordinance.

Following numerous meetings of the various AGs in 2006 to 2008, recommendations of the AGs were considered by the SCCLR, whose recommendations in turn formed the basis of the specific public consultations on the above areas of law conducted in 2007-2008. Two of the areas examined, and the administration's proposals for the CB in light of the consultations, are highlighted below.[3]

Reforms relating to directors' duties

There has been an ongoing debate as to whether codification of directors' duties is appropriate. The main arguments in favour are to provide certainty and clarity in the law, to improve accessibility, and to reform the law where necessary to promote good corporate governance. The main counter-argument is that a general statutory statement of the duties can potentially create more uncertainty, and yet if greater detail is attempted in the legislation, that can reduce flexibility and inhibit judicial development of the law. The views of the respondents in the consultation were divided, with a slight majority against codification. As codification remains controversial, and as there are other means of making the law more accessible (i.e. via the non-statutory guidelines), the administration has decided against comprehensive codification.

Importantly though, the administration has agreed to codify one of the duties – namely the directors' duty to act with due care, skill and diligence. There is uncertainty under the common law in Hong Kong whether the standard of care is purely subjective or whether there are objective aspects. The CB will incorporate the dual objective/subjective standard of care (adopted in overseas jurisdictions such as the UK and Australia). Under this approach, there is a minimum objective standard of care that all directors are expected to meet. The standard expected of a particular director can be higher than the minimum standard, depending on the particular abilities and experience of the director in question.

Reforms relating to share capital

In the area of equity finance (share capital), the antiquated concept of par or nominal value of shares will be abolished, as the requirement for par value no longer serves any useful function and can create unnecessary complexities for companies. Companies will also not be required to specify the authorised (i.e. maximum amount of) share capital, though they can elect to place a cap in the articles of association on the number of shares that the company can issue. The more radical proposal to replace the capital maintenance doctrine with a general solvency test to determine the validity of distributions to shareholders has not been taken up, in line with the majority view of consultation respondents. But greater flexibility will be incorporated into the CB, for example, with a new procedure for companies to reduce capital by satisfying a solvency test without the need to obtain court approval; and with companies being able to engage in share buy-backs either under the tests under the present law (i.e. where the company has distributable profits or alternatively funds the buy-back out of the proceeds of a fresh issue of shares) or under the new solvency test.

Draft Companies Bill

Public consultation on the draft CB is now underway and is divided into two phases. The first consultation paper was published in December 2009 and contains draft provisions on about half of the proposed bill.[4] The second consultation paper is to be released soon. Further details on the above and other reforms are available from these consultation papers.

Stefan Lo

[3] See Companies Ordinance Rewrite First Consultation Paper – Accounting and Auditing Provisions (Mar 2007) and Consultation Conclusions (Mar 2008); Second Consultation Paper – Company Names, Directors' Duties, Corporate Directorship, Registration of Charges (Apr 2008) and Consultation Conclusions (Dec 2008); Third Consultation Paper – Share Capital, Capital Maintenance Regime, Statutory Amalgamation Procedure (Jun 2008) and Consultation Conclusions (Feb 2009).

[4] Consultation Paper – Draft Companies Bill First Phase Consultation (Dec 2009).

Re PCCW Ltd
[2009] 3 HKC 292

In the case *Re PCCW Ltd*[1], the Court of Appeal allowed the Securities and Futures Commission's appeal against the sanctioning by the Court of First Instance of a scheme under section 166 of the Companies Ordinance (Cap 32) ("the scheme") for the purpose of the privatisation of PCCW Ltd, a listed company. For a section 166 scheme with members to come into effect, there must be approval by a majority in number and representing three-fourths in value of the members present and voting either in person or by proxy; and the scheme must also be sanctioned by the court. The requisite member approval had been obtained for the PCCW scheme, but before the meeting of members, share splitting had taken place (i.e. small amounts of PCCW shares were transferred to some 870 persons in order to boost the headcount in favour of the scheme). The judge at first instance sanctioned the scheme, and declined to hold that the share splitting, which is perfectly legal at law, had any relevance to the headcount test or the general discretion of the court in sanctioning a scheme.

On appeal, Rogers V-P mentioned that the judge had stated that the fact that most shares were held by HKSCC Nominees Ltd under the Central Clearing and Settlement System (which only counts as one member for the headcount test) gave an element of unreality to the headcount requirement and stated that no doubt that the matter will be reviewed in the course of the Companies Ordinance Rewrite. It seems to have been accepted by the Court of Appeal that votes cast by shareholders who had acquired shares by way of share splitting were to be counted as valid votes for the purposes of the headcount requirement, but that share splitting or share manipulation was a factor to be taken into account by the court in the exercise of its wide discretion whether or not to sanction the scheme. While the court should not simply look at whether a statutory majority has been achieved and should be slow to differ from the meeting, in the PCCW case the share splitting had the effect of distorting the requirement that the petitioner had to satisfy the court that the statutory majority were acting bona fide and not coercing the minority in order to promote their own interests adverse to those of the class as a whole. Barma J suggested that the legislation should be refined so as to enable the court to look into the true headcount position both for and against the proposal, as is the case under the Australian Corporations Act.

The Financial Services and Treasury Bureau has sought the public's views on whether to retain or abolish the headcount test in section 166 in a consultation paper issued in December 2009: Draft Companies Bill First Phase Consultation. The consultation period for the First Phase Consultation ended in March 2010, and the Bureau will consider the responses to the consultation in the coming months. A decision will then be made on whether the headcount test will be retained in the Companies Bill that is scheduled to be introduced into LegCo before the end of 2010.

Ted Tyler

[1] [2009] 3 HKC 292

Film Development Fund Scheme

Background

Homegrown "Echoes of the Rainbow (歲月神偷)" stole the limelight at the 60th Berlin Film Festival and won the Crystal Bear Award for the best feature film in the Generation section in the festival. This film, together with "McDull Kungfu Ding Ding Dong (麥兜響噹噹)" which was a Mainland box-office hit last July, were produced with the financial support from the Film Development Fund ("FDF"). Other film-related projects funded by the FDF include for example the financing of Hong Kong Entertainment Expo, Film Financing Forum, Film Awards Presentation, participation of local films in international film festivals and a teaching scheme to incorporate film animation into the secondary school syllabus. This article focuses on the FDF scheme for financing film production.

The FDF was first established by the Government in 1999 to finance projects conducive to the long-term development of the Hong Kong film industry (e.g. training of film personnel, promotion of local films in the Mainland and overseas, and promotion of film literacy in the local community). In July 2007, the Government injected HK$300 million into the FDF, and expanded its scope to partly finance small-to-medium budget film productions with a view to encouraging more commercial investment in film productions, creating a larger mass of film activity and more employment opportunities as well as assisting the Hong Kong film industry to revitalize and develop further.

The FDF is administered by the Secretariat of the Hong Kong Film Development Council ("HKFDC"). The Controlling Officer of the FDF is the Permanent Secretary for Commerce and Economic Development (Communications and Technology).

Film Production Financing - Eligibility and Financing Criteria and Assessment

The eligibility and financing criteria of the FDF scheme for financing film production include:-

(a) the applicant must be a film production company formed and registered under the Companies Ordinance (Cap 32). Among the applicant, the film producer and the film director regarding the proposed film project, one of the aforesaid or a combination of any two of the aforesaid must have produced a total of at least two feature drama films which have been released in Hong Kong commercial theatres;

(b) the proposed film must be a drama feature film produced for commercial theatrical exhibition at least in Hong Kong with a production budget not exceeding HK$15 million;

(c) the proposed film project must be shown to be commercially viable (i.e. among other things, to have secured third-party financing to the satisfaction of the Government);

(d) in any three of the five categories of main film crew and cast (namely, film producer, film director, scriptwriter, leading actor and leading actress), at least one person employed in each such category must be a Hong Kong permanent resident; and

(e) the proposed film project must be potentially capable of qualifying for a certificate for public exhibition in Hong Kong under the Film Censorship Ordinance (Cap 392).

Generally, FDF's funding support is capped at 35% of the production budget (i.e. HK$5.25 million) per approved film project. Under very special circumstances and after considering the recommendations of the Fund Vetting Committee ("FVC") set up under the HKFDC, the Government may contribute up to 40% of the production budget of the approved film project (i.e. HK$6 million).

In making an evaluation or assessment, the HKFDC will be assisted by the FVC and experts drawn from a panel of examiners (who are professionals with experience in film production, financing, distribution etc). Clear guidelines are set out for the members of the FVC and examiners to declare and avoid any possible conflict of interests. After consideration of the HKFDC's recommendations, the Government will decide whether or not to approve an application.

Further details can be found in the relevant Guide to Application on CreateHK's website at www.createhk.gov.hk.

Documentation

The core documentation for implementing the FDF scheme for financing film production includes:-

(a) Production Finance Agreement between the relevant production company ("ProdCo") and the Government. This agreement addresses matters such as production and delivery of the film to be funded, the amount and disbursement of government and other finance, recoupment by financiers on a pro-rata, pari-passu basis, intellectual property rights, insurance, government access, books and records, credits, film certification and qualification, distribution and marketing, events of default and termination;

(b) Deed of Charge whereby the relevant ProdCo charges in favour of the Government by way of first fixed charge the assets and properties described therein (including the relevant film and all related intellectual property rights);

(c) Inter-party Agreement among the Government, other financiers and ProdCo etc, which provides for the respective rights and obligations of the parties in relation to the relevant film and the priorities and ranking of the respective claims of the Government and other financiers; and

(d) Agreements with film directors, individual film producers, directors of photography, artists, writers, editors, lyricists, art and costume designers, composers and licence agreements concerning music etc.

Statistics

As at 30 March 2010, the FDF scheme for financing film production had received 23 applications, of which 14 involving a total funding of HK$38.77 million were approved.

Ada Ng

Baese Pty Ltd v R A Bracken Building Pty Limited

52 Build LR 130

Parties to a contract often agree to incorporate provisions fixing in advance the amount which is to be paid for a breach of the contract. While it is settled law that an amount so stipulated constitutes liquidated damages if it is in the nature of a genuine pre-estimate of damage which would probably arise from the breach, it is less clear whether a liquidated damages clause is an exhaustive remedy. This case provides an illustration.

Facts

The Plaintiff entered into a contract with the Defendant, a builder, for the construction of a house. The contract provided that the Defendant was to complete the construction by a specified date, subject to adjustment. There was delay in completion and the completion date was subsequently adjusted. The Plaintiff claimed damages for the delay in the nature of holding

costs by way of interest charges payable to financial institutions.

The contract provided for the appointment of an architect who should act as the Plaintiff's agent and as the assessor, valuer or certifier of "liquidated damages". Under Clause 10.14, the architect might give written notice to the Plaintiff and the Defendant within a specified period if he was of the opinion that the building works should have been completed at a date earlier than the actual completion date. If such notice was given, the Defendant had to pay the Plaintiff "*as Liquidated and Ascertained Damages*" a sum calculated at a rate set out in Item M of the Appendix to the contract. Item M was completed by putting the word "nil" as the dollar amount.

The Defendant asserted that the parties had agreed that the Plaintiff was only entitled to nil damages in the event of delay in completion of the building works, and that Clause 10.14 was an exhaustive statement of the consequence of the delay.

Decision

The Supreme Court of New South Wales held that it was a matter of construction of the contract whether Clause 10.14 was an exhaustive statement of the Plaintiff's entitlement in the event of a failure to complete the works on time. Giles J considered that Clause 10.14 did not have this effect. Clause 10.14 only enabled the Plaintiff to cause the architect, as its agent, to invoke the machinery whereby liquidated damages could be assessed to obviate the task of establishing an actual loss due to delay. Reliance was placed on the following wording of Clause 10.14:

"The Architect **may** give notice in writing to the [Defendant] and to the [Plaintiff] not later than twenty (20) days after the date on which the Works actually reached or are deemed to have reached Practical Completion that in his opinion the Works ought reasonably to have been brought to Practical Completion at some earlier date…**If such notice is given** then the [Defendant] shall pay…the [Plaintiff] a sum…" (our emphasis).

Hence, if the Plaintiff or the architect did not invoke the liquidated damages clause in Clause 10.14, the Plaintiff was entitled to rely upon his common law right to damages for the delay in completion. In other words, the Plaintiff had a right of election as to the remedy he would pursue.

Temloc Ltd v Errill Properties Ltd[1]

The facts of *Temloc* were similar to *Baese Pty*. The relevant contract contained a liquidated damages clause, which also referred to calculation of the liquidated damages at a rate set out in the appendix to the contract. In the corresponding appendix entry, the parties wrote "nil". Nourse LJ in the UK Court of Appeal said:

"*I think it clear, both as a matter of construction and as one of common sense, that if …the parties complete the relevant parts of the appendix…then that constitutes exhaustive agreement as to the damages which are …payable by the contractor in the event of his failure to complete the works on time*."

Temloc was distinguished in *Baese Pty* on the ground that the relevant contractual provision in *Temloc* provided that if the builder failed to complete the works by the completion date, "then the Architect **shall issue** a certificate to that effect". It further provided that subject to the issue of that certificate, the builder "**shall**" pay to the proprietor a sum calculated at a stated rate as liquidated damages. Giles J in *Baese Pty* took the view that such provision dealt generally with damages for non-completion, and was imperative. He considered that these were indications the UK Court of Appeal regarded sufficient to show that the parties had agreed the liquidated damages provision was intended to operate as an exhaustive remedy in that case.

Conclusion

Despite the criticism of the *Temloc* decision in ***Baese Pty***, the former has not been overruled. This difference in views was also noted in the Hong Kong Court of First Instance's decision in *Associated Engineers Ltd v Lee Shing Yue Construction Company Ltd*[2] where Keith J stated:

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1 (1987) 39 BLR 30
2 unreported, HCA 13014/1998

"*I am inclined to agree with the view expressed in Temloc Ltd v Errill Properties Ltd …that where there is an express provision for liquidated damages for delay, there is no room to imply a term to the contrary, even though this view has been doubted in at least one other common law jurisdiction.*"

It now seems that the starting point is to construe the relevant contractual provision to see **if liquidated damages are intended to be an exhaustive remedy**. If the liquidated damages clause is expressed to be the exhaustive monetary remedy, or in the absence of such wording, if no contrary intention can be ascertained, liquidated damages will be the exhaustive monetary remedy and general damages will be excluded.

Where the contract expressly provides for an option, it seems possible for the innocent party to elect to claim liquidated damages or general damages. How far this will be accepted by the local courts remains to be seen. It should be noted that if this option is recognised, once the innocent party makes a claim for liquidated damages, generally he will not be allowed to rely on any general damages. This is the case even if the amount of liquidated damages is insufficient to compensate him for the actual losses suffered.

Ada Chen

Chartbrook Ltd v Persimmon Homes Ltd and Others [2009] UKHL 38

This is a recent House of Lords ("HL") decision on interpretation of contracts under English law.

Facts

In 2001, Persimmon Homes Ltd ("P") and Chartbrook Ltd ("C") entered into a development agreement under which P agreed to construct a residential and commercial development on the land owned by C and then sell the units in the developments on long leases. P would receive the lease payment on its own account and pay C a fixed sum (the Total Land Value) and a further payment, the amount of which depended on the revenues generated by the residential element of the development ("Additional Residential Payment" or "ARP").

The definition of "ARP" over which the dispute turns, is "23.4% of the price achieved for each residential unit in excess of the Minimum Guaranteed Residential Unit Value ("MGRUV") less the Costs and Incentives ("C&I")."

C's case was that the ARP should be calculated as follows:

ARP = 23.4% x (Price achieved – MGRUV – C&I)

P's case was that the ARP should be calculated as follows:

ARP = (23.4% x Price achieved) – MGRUV – C&I

According to C's construction, C is entitled to a 23.4% share of the net proceeds of sale of each residential unit in excess of a minimum guaranteed amount. On the other hand, P's construction means that C is entitled to receive ARP only if 23.4% of the sales price amounted to more than the minimum guaranteed amount (including C&I). The difference of the two formula amounted to more than £3.5 million. As a result, C commenced proceedings against P

for payment and P counterclaimed for a declaration as to the proper construction of the agreement or for rectification.

C's interpretation was upheld by Briggs, J in the High Court for it accorded with the natural reading and ordinary syntax of the words used in the definition of the ARP. P argued unsuccessfully that they should be permitted to rely on evidence of the pre-contractual negotiations in relation to the construction of the contract on the ground that it demonstrated the parties' true agreement. Briggs, J's decision was upheld in the Court of Appeal (with Lawrence Collins LJ dissenting) but was overturned unanimously by the HL.

The HL held that C's interpretation made no commercial sense. On C's construction, ARP is always payable, because the price achieved for the development is bound to exceed the minimum guaranteed amount unless there is a severe property slump to such an extent that the price achieved for the development is lower than the MGRUV and C&I (which is very unlikely). Given that the ARP is intended to protect C from the downturn in the market and that the ARP is an additional payment over and above that guarantee to reward C for any extra value extracted from the development, C's interpretation does not make any commercial sense and was rejected by the HL.

Purposive approach in construing contract

The HL gave some helpful guidance on the extent of the purposive approach in construing contracts. It is not necessary to undertake the exercise of comparing the language with that of the definition in order to see how much use of red ink is involved. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant by using the language they did. In other words, the HL confirmed that there is no limit on the extent to which a court was allowed to correct a contract when there was a clear mistake.

Pre-contractual negotiation

P argued before the HL and the lower courts that they should be permitted to rely upon evidence of the pre-contractual negotiations in relation to the construction of the contracts on the ground that it demonstrated the terms of the parties' true agreement. In this case, it was unnecessary for the HL to have regard to the pre-contractual negotiations because the correct interpretation of the contract could be determined without reference to any pre-contractual negotiations.

The HL refused to alter the well-established principle that evidence of pre-contractual negotiation should be excluded. It emphasised that English law interprets contracts only by reference to words contained within the contract itself. The parties' pre-contractual correspondence should be excluded for the purpose of drawing inferences about what the contract meant. However, such evidence may be used for other purposes, for example, to establish that a fact which may be relevant as background was known to the parties, or to support a claim for rectification or estoppel.

Rectification

The HL stated that the availability of rectification of a contract should be extended. P argued and the HL accepted that in determining the parties' true consensus for the purposes of deciding whether an agreement should be rectified, the court should have regard to an objective reading of the documentation which evidences the consensus rather than the subjective accounts of the parties' understanding. HL commented that this approach to rectification would "go a long way towards providing a solution" to the problems that can be created by the rule preventing the use of pre-contractual negotiations in relation to construction.

It should be noted that while the HL's comments on the pre-contractual negotiations and rectification provide some important guidance, they are not deciding factors affecting the case outcome and hence are not binding on subsequent decisions.

Mayanna To

Can you exclude your liability?
Part 2 - A Case Law Study

In the Spring 2008 edition of the CU Review, we discussed the statutory provisions under the Control of Exemption Clauses Ordinance (Cap 71). In this edition, we would look at the cases on exemption clauses.

Common law

The common law controls exemption clauses by examining whether (i) the exemption clause is incorporated into the contract, and (ii) the exemption clause is expressed clearly without ambiguity.

In *Olley v Marlborough Court Limited*[1], the court held that a notice posted on one of the walls of a hotel bedroom stating that "the proprietors will not hold themselves responsible for articles lost or stolen, unless handed to the manageress for safe custody" did not exempt the proprietor's liability as it had not been incorporated into the contract for the hotel room.

In relation to the question of whether the exemption clause is expressed clearly without ambiguity, it is important to have regard to the contra proferentum rule, i.e. the court will construe the clause against the maker who seeks to rely on it.

In *Photo Productions Limited v Securicor Transport Limited*[2], a security guard of the Defendant started a small fire and burned down the factory. The Plaintiff claimed damages for £648,000 for breach of contract and/or negligence. The exemption clause provides that the Defendant would "under no circumstances be responsible for any injurious act or default by any employee of the [Defendant] unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the [Defendant] as his employer".

[1] [1949] 1 KB 532
[2] [1980] 2 WLR 283

The House of Lords held that the question whether, and to what extent, an exemption clause is to be applied to any breach, is a matter of construction of the contract.[3] It was held in that case that the words of the exemption clause were clear and adequate to cover the defendant's position.

Application of common law and statutory rules

Thirteen years later, the House of Lords discussed the application of the common law rules and the statutory rules on exemption and limitation clauses in the leading case of *George Mitchell Limited v Finney Lock Seeds Limited*[4]. The appellants who were seed merchants by mistake supplied autumn cabbage seeds instead of winter cabbage seeds as ordered by the respondents. The seeds were planted but were commercially useless and caused loss and damage to the respondents to the sum of £61,000. The price of the seeds was only £201.60. The appellants sought to rely on the exemption clause printed on the back of the invoice which limited the liability of the appellants to the price of the seeds and excluded all liability for any loss and damage arising from use of the seeds.

It was held unanimously that the limitation clause was effective under common law. However, it was held that the clause failed the statutory test in section 55 of the Sale of Goods Act 1979[5] in that it was unfair and unreasonable. The court looked at the circumstances of the case and apply the statutory guidelines to determine reasonableness. Lord Bridge said that "the court must entertain a whole range of considerations, put them in the scales on one side or the other and decide at the end of the day on which side the balance comes down." The

[3] [1980] 2 WLR 288
[4] [1993] 2 AC 803
[5] The Sale of Goods Act 1979 consolidated the Supply of Goods (Implied Terms) Act 1973 and the Unfair Contract Terms Act 1977.

onus is on the respondents to show that it would not be fair or reasonable for the appellants to rely on the clause to limit their liability. Those guidelines are also adopted in section 3 of the Hong Kong Control of Exemption Clauses Ordinance.

The decisive factor in the *George Mitchell case* was that there was evidence indicating "a clear recognition by the seedsmen in general that reliance on the limitation of liability imposed by the relevant condition would not be fair or reasonable." Another factor was that seed merchants could insure against the risk of crop failure caused by the wrong variety of seeds without materially increasing the price of seeds.

Smith v Eric Bush[6] is an example in tort. A non-contractual notice in a report by a building society surveyor disclaiming all liability for negligence in conducting the survey was held to be unreasonable as a duty of care was owed to the purchasers who would rely on the reports.

However, there are cases which show the reluctance of the court to interfere with the commercial terms. In *Monarch Airlines Limited v London Luton Airport Limited*[7], a term in the contract between an airline company and an airport operator limited the liabilities of the airport operator from any damages caused to the aircraft by any act, omission, neglect or default on the part of the airport operator except for intentional damage or damage done recklessly with knowledge that damage would probably result. The court held that the term was reasonable as it was accepted generally in the market and the parties could make insurance arrangement.

In *Watford Electronics Limited v Sanderson CFL Limited*[8], a dispute arose as the software system provided by Sanderson failed to perform. The contract has a provision as follows:

"Neither the Company nor the Customer shall be liable to the other for any claims for indirect or consequential losses whether arising from negligence or otherwise. In no event shall the Company's liability under the Contract exceed the price paid by the Customer to the Company for the Equipment connected with any claim."

Watford claimed a total of £5.5 million which included loss of profits. The Court of Appeal held that "...the term excluding indirect loss was a fair and reasonable one to include in this contract. The parties were of equal bargaining strength; the inclusion of the term was, plainly, likely to affect Sanderson's decision as to the price at which it was prepared to sell its product ...". Regard was given to the possibility that such indirect or consequential losses could be covered by insurance. The exemption clause was held reasonable and effective in excluding liability for the indirect and consequential losses.

The statutory test will remain the main consideration which the court will take into account when it is faced with an exemption or limitation clause. In commercial contracts between two parties of relatively equal bargaining strength, we would expect the court to be reluctant to intervene.

Agatha Ding

6 [1990] 1 A.C. 831
7 [1998] 1 Lloyd's Rep. 403
8 [2001] EWCA Civ 317

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