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The Commercial Unit, Civil Division
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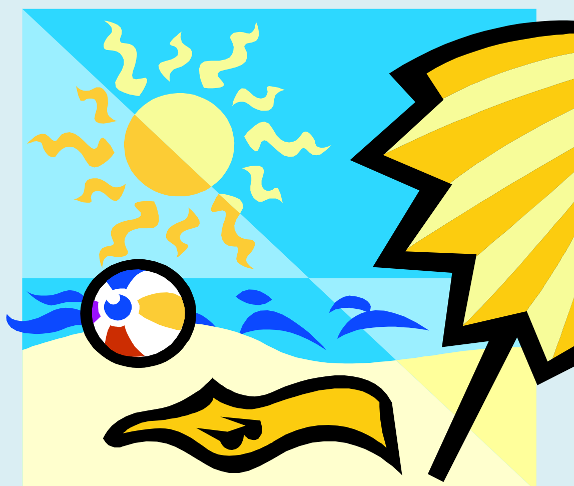

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Editorial

In this edition we feature three articles. The first article is about the Companies Ordinance Rewrite (now the fourth article in the series). In this article we set out some highlights from the consultation conclusions on the issues of the "headcount test" and "financial assistance" and the Administration's decisions on such issues. The Companies Bill 2011 was gazetted on 14 January 2011 and introduced into the Legislative Council on 26 January 2011. A Bills Committee has been formed to examine the Bill. The second article is about the statutory backing to the listing requirements concerning price sensitive information. To cultivate a continuous disclosure culture among listed corporations in Hong Kong, FSTB has recently proposed to give statutory effect to certain requirements concerning the disclosure of price sensitive information by listed corporations. Sanctions, including a regulatory fine of up to $8 million, may be imposed for breaches of the disclosure requirements. The third article is about the proposed establishment of the Financial Dispute Resolution Centre as a platform for consumers who have monetary disputes with financial services providers to settle the disputes in a one-stop, affordable and impartial way.

This edition also features three case reports. The first case is about whether a pre-allotment exercise or an agreement not to compete among the bidders of a public auction is regarded as criminal at common law. The second case is about the enforcement of an equitable proprietary interest in a property in favour of a person who provides purchase price for the property, without enforcement of the underlying illegal contract which led to its creation. The third case is about variation of contract and whether inaction by a contracting party can amount to consideration for a promise.

Yung Lap-yan

The Companies Ordinance Rewrite: An Update

Introduction

This article provides an update on developments on the Companies Ordinance Rewrite since the last report on the Rewrite in the Summer 2010 edition of the CU Review. The draft Companies Bill (the "CB") was published in two stages in 2009-2010 for public consultation.[1] Consultation conclusions were issued in the second half of 2010.[2] The CB is now before the Legislative Council.

Some highlights from consultation conclusions

Headcount Test

The "headcount" test for approval of a scheme of arrangement has been one of the more controversial company law issues in the business sector in recent years.[3] Currently, under section 166(2) of the Companies Ordinance (the "CO"), for a scheme of arrangement to go ahead, it is necessary for there to be approval of both a majority in number of the members or creditors (as appropriate) (the "Headcount Test") and a majority representing three-fourths in value of the members or creditors.

The Headcount Test has been criticised on various grounds. For example, there could be abuse where a member in favour of the scheme would split his shares by transferring portions of his shares to a number of nominees, purely to increase the number of members voting in favour of the scheme. A similar ploy could be adopted by members who wish to vote down the scheme. Other reasons for abolishing the Headcount Test include: (1) the Headcount Test does not reflect the usual principle of "one share one vote" in decisions of shareholders in general meetings of a company; and (2) the Headcount Test does not reflect the views of the body of shareholders, because most shares of listed companies are held beneficially through HKSCC Nominees Ltd, and the beneficial holders cannot in reality be counted under the Headcount Test unless legal title to the shares is transferred to them in time for the meeting (something which is seldom done).

A majority of the respondents in the public consultation favoured abolition of the Headcount Test, but the Securities and Futures Commission, amongst others, favoured its retention. The Government has decided to retain the Headcount Test as a protection for minority shareholders. But the court will have a new discretion to sanction a scheme despite the Headcount Test not being satisfied. Where there is share-splitting that leads to approval of a scheme by members, the court will still be able to take that into account in exercising its power to refuse to sanction a scheme.

Financial assistance

The CO prohibits a company from providing financial assistance for the purpose of acquisition of the company's shares: section 47A. The statutory provisions have been criticised for being overly complex, being too wide in its coverage (with commercially unobjectionable transactions potentially caught), and being unnecessary (with other provisions or rules which cover the original mischief targeted by the prohibition). The draft CB provisions significantly relaxed the prohibition by introducing new "whitewash" procedures that allow any company to provide financial assistance provided that the company is solvent (and provided that other specific statutory requirements are complied with). However, the Government also raised the question of whether the prohibition should be abolished for private companies entirely (as is the case in the United Kingdom under the Companies Act 2006).

A slight majority of respondents in the public consultation favoured abolition, but others were concerned whether, if abolished, there would be adequate protections for minority shareholders. To ensure adequate minority protection, the Government has decided to retain the prohibition for private companies (as well as public companies), pending the introduction of other general statutory protections

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[1] Consultation Paper – Draft Companies Bill First Phase Consultation (Dec 2009); Consultation Paper – Draft Companies Bill Second Phase Consultation (May 2010).

[2] Consultation Conclusions – Draft Companies Bill First Phase Consultation (Aug 2010); Consultation Conclusions – Draft Companies Bill Second Phase Consultation (Oct 2010).

[3] See also the case note on *Re PCCW Ltd* [2009] 3 HKC 292 in the CU Review (Summer 2010 edition).

(namely insolvent trading provisions[4]). The CB will still provide for whitewash procedures, based on a solvency test, as exceptions to the prohibition.

Some interim reforms already enacted: Companies (Amendment) Ordinance 2010

There were some particular areas of statutory reform which the Government was keen to implement immediately rather than leaving the changes to the Rewrite. These were proposed as an amendment to the CO, and were enacted in the Companies (Amendment) Ordinance 2010 (the "C(A)O"). The C(A)O is not to be confused with the CB, as the former provides amendments to the current CO for a few specific matters only, while the CB is to implement the actual Rewrite. The changes effected by the C(A)O include:

- New power for the Registrar to direct companies to change their name if there has been a court order restraining the company from using the name: section 22(3B). This is intended to deal with the problem of "shadow companies" where companies selling counterfeit products have been incorporated in Hong Kong with names that infringe trademarks of well-known brands.
- Standing to bring a statutory derivative action is expanded to include members of related companies. This means that "multiple derivative actions" can also be brought under the CO Pt. IVAA in addition to the common law. For example, a member of a parent company can now seek to bring a statutory derivative action on behalf of the subsidiary.
- A new Pt. IVAAA (sections 168BAA-168BAI) is introduced to enable electronic communications by a company with its members and others.
- A new section 346A which allows electronic filing of documents with the Registrar – such as electronic applications for incorporation of a company.

The above provisions have commenced operation.[5]

4 These are proposed to be introduced with new provisions on corporate rescue: see the Review of Corporate Rescue Procedure Legislative Proposals Consultation Paper (Oct 2009), and Consultation Conclusions (Jul 2010).

5 The only provisions of the C(A)O which have not commenced operation are the provisions dealing with scripless securities. These will only come into effect once the main provisions for scripless in the Securities and Futures Ordinance are enacted.

Progress on the Companies Bill

The Companies Bill 2011 was gazetted on 14 January 2011 and introduced into the Legislative Council on 26 January 2011. A bills committee has been set up and has commenced its review of the Bill. The Government aims to have the Bill passed by the middle of 2012 and the new legislation commenced in 2014. The two year period between enactment and commencement is to afford companies sufficient time to adjust to the requirements of the new regime.

Stefan Lo

Statutory Backing to the Listing Requirements concerning Price Sensitive Information

Currently, listed corporations in Hong Kong are obliged under the non-statutory Listing Rules to disclose price sensitive information to the public. As the Stock Exchange of Hong Kong (the "SEHK") which administers the Listing Rules does not have the power to impose fines or criminal penalties on corporations for non-compliance with the Listing Rules, its lack of regulatory teeth has been a concern to the market and the general public.

To cultivate a continuous disclosure culture among listed corporations, the Financial Services and the Treasury Bureau recently proposed to give statutory effect to certain requirements concerning disclosure of price sensitive information by listed corporations.

Inside Information

The Securities and Futures (Amendment) Bill 2011 (the "Amendment Bill") which was tabled before the Legislative Council on 29 June 2011 provides amongst other things that a listed corporation must disclose price sensitive information (referred to as "inside information" in the Amendment Bill) to the public as soon as reasonably practicable after such information has come to its knowledge.

Inside information, in relation to a corporation, means specific information that is about –

(i) the corporation;

(ii) its shareholder or officer; or

(iii) its listed securities or their derivatives, and

is not generally known to the persons who are accustomed or would be likely to deal in the corporation's listed securities but would if generally known to them be likely to materially affect the price of such securities.

Inside information is the same type of information currently prohibited from being used for dealing in securities in Part XIII (Market Misconduct) and Part XIV (Offences relating to Dealings in Securities and Futures Contracts etc.) of the Securities and Futures Ordinance, Cap. 571 (the "SFO").

Statutory Obligations of Listed Corporations and their Officers

The Amendment Bill provides that inside information has come to the knowledge of a listed corporation if –

(i) information has, or ought reasonably to have, come to the knowledge of the corporation's officer[1] in the course of performing functions as an officer of the corporation; and

(ii) a reasonable person acting as an officer of the corporation would consider that the information is inside information.

The disclosure must be made in a manner that can provide for equal, timely and effective access by the public.

If a listed corporation breaches the statutory disclosure requirements and

(i) the breach is a result of the intentional, reckless or negligent conduct of its officer; or

(ii) its officer fails to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation from breaching the disclosure requirements,

the officer is also in breach of the disclosure requirements.

Safe Harbours

A listed corporation is not required to disclose any inside information if the disclosure would constitute a breach of a restriction imposed by an enactment or a court order. Furthermore, no disclosure is required if and so long as -

(a) a listed corporation has taken reasonable precautions for preserving the confidentiality of the inside information; and

(b) the confidentiality of the information is preserved, and one or more of the following applies:

    (i) the information concerns an incomplete proposal or negotiation;

    (ii) the information is a trade secret;

    (iii) the information concerns the provision of liquidity support from a central bank (including the Exchange Fund) to the listed corporation; or

    (iv) the disclosure is waived by the Securities and Futures Commission (the "SFC").

Waivers

The SFC may grant waivers in relation to the disclosure requirements if the SFC is satisfied that the disclosure is prohibited or contravenes a restriction imposed by:

(i) the legislation of a place outside Hong Kong;

(ii) a court order of a place outside Hong Kong;

(iii) a law enforcement agency outside Hong Kong; or

(iv) a government authority outside Hong Kong.

To allow for flexibility, rules to prescribe further safe habours would be made by the SFC. The rules will be subsidiary legislation under the SFO and will be subject to the Legislative Council's negative vetting.

Investigation, Enforcement and Determination

The SFC will be the enforcement authority. It will, upon receipt of a referral from the SEHK or upon detection of a possible breach at its own initiative, carry out investigation of the case. If, after investigation, it appears to the SFC that a breach has taken place, the SFC may bring proceedings to determine whether a breach has indeed occurred and if so the identity of the person in breach.

As the Market Misconduct Tribunal (the "MMT") is well experienced in handling cases concerning "inside

[1] In the SFO, an "officer" in relation to a corporation means a director, manager or secretary of, or any other person involved in the management of, the corporation.

information", the MMT's jurisdiction will be extended to allow it to deal with breaches of the disclosure requirements.

Civil Sanctions

The following sanctions may be imposed by the MMT for breaches of the disclosure requirements:-

(i) disqualification from being a director or otherwise involved in the management of a listed corporation for up to five years;

(ii) a "cold shoulder" order (i.e. deprivation of access to market facilities) for up to five years;

(iii) a "cease and desist" order (i.e. an order not to breach the statutory disclosure requirements again);

(iv) a regulatory fine up to $8 million on the listed corporation and/or its directors and/or the chief executive of the list corporation (but not other officers);

(v) payment of Government's costs and expenses reasonably incurred in relation to the proceedings;

(vi) payment of the SFC's costs and expenses reasonably incurred in relation to the proceedings and/or the investigation;

(vii) a recommendation order that a person be disciplined by any body of which that person is a member;

(viii) an order that the listed corporation appoints an independent professional adviser to review its procedures or advise it on matters relating to its compliance with the disclosure requirements; and

(ix) an order that the officer undergoes a training programme approved by the SFC on compliance with the disclosure requirements, directors' duties and corporate governance.

Private Actions

The Amendment Bill also provides for private action for damages to be brought by a person who has suffered financial loss as a result of those breaching the disclosure requirements. The claimant can rely on the findings of the MMT to take civil actions to seek compensation from those who have breached the disclosure requirements.

Beverly Yan
Elen Lau

Establishment of the Financial Dispute Resolution Centre (the "FDRC")

Background

The Securities and Futures Commission (the "SFC") and the Hong Kong Monetary Authority (the "HKMA"), in their reports submitted to the Financial Secretary (the "FS") in December 2008 on the issues arising from the Lehman Brothers-related products, recommended that the Government should examine the establishment of a dispute resolution mechanism for the financial industry in Hong Kong.

Both the SFC and HKMA recommended that an independent dispute resolution scheme that provides quick, simple, customer friendly service should be in place.

The Need for a Financial Dispute Resolution Scheme (the "Scheme")

At present, a consumer who is dissatisfied with the financial services received can make his/her complaint either direct to the financial services provider, or to the relevant regulators and consumer bodies. While the regulators and consumer bodies may look into the conduct and practices of the financial services provider, they may not be able to adjudicate on any financial remedy for the consumer. One conceivable remedy available to the consumer would be to bring the case to court if the financial services provider is not prepared to voluntarily offer any monetary settlement to the satisfaction of the consumer.

In the event that the consumer and the financial services provider are unable to reach any agreement, there is at present no mechanism that can bring about an out-of-court dispute resolution. It is for this reason that the Government proposes to roll out the Scheme which will be administered by the FDRC. The FDRC is intended to be a platform for consumers who have monetary disputes with financial services providers to settle those disputes in a one-stop, affordable and impartial way. The goal of the Scheme is: "mediation first, arbitration next".

Consultation

In February 2010, the Financial Services and the Treasury Bureau of the Government published a consultation document on the "Proposed Establishment of an Investor Education Council and a Financial Dispute Resolution Centre". The public and relevant professionals were invited to submit their views during the three-month consultation period, which ended on 8 May 2010.

The Proposal

Under the proposal, financial institutions, such as banks or brokers that are licensees or regulatees of the SFC and HKMA should join as members of the Scheme. Consumers, whose attempts at resolving a dispute with the relevant financial institutions have failed, may choose to bring the matter to the FDRC rather than the courts. If the FDRC accepts the consumer's claim, the consumer and the relevant financial institution will participate in mediation as a first step in an attempt to settle the dispute. The FDRC will hire a team of mediators to assist the financial institution and consumer in reaching a voluntary and confidential settlement.

Where mediation is unsuccessful, the FDRC may assist the claimant to bring the case further to arbitration if the claimant so wishes. An arbitrator would make an award; and an arbitration award is final and binding on both parties.

For FDRC charges, both claimants and financial institutions have to pay for the processing of claims. Financial institutions have to pay a higher level of charges so as to encourage them to do their utmost in handling complaints.

For mediating a claim of less than HK$100,000, a fixed charge of HK$500 per case for the claimant and HK$5,000 per case for the financial institution is proposed. When the claimed amount is between HK$100,000 and HK$500,000, the claimant has to pay a fee of HK$2,000 while the financial institution has to pay HK$10,000.

For arbitration, the fee is HK$5,000 for the claimant and HK$20,000 for the financial institution. The maximum claimable amount under the Scheme is set at HK$500,000.

Set-up of the FDRC

The Scheme is to be operated by the FDRC, which will be established as a company limited by guarantee. The Board of Directors will be appointed by the Government to ensure the independence and impartiality of its dispute resolution procedures.

The annual budget of the FDRC is estimated at HK$50 million. For the first three years of operation, the Government, SFC and HKMA will provide the start-up costs and recurrent costs of the FDRC of about HK$15 million. After that, the fixed costs would be shared among the financial sectors (such as banks, brokers and fund houses) depending on the sector-specific caseload in the past three years.

Relationship with Regulators

The FDRC does not have investigation powers as the regulators. Should there be systemic regulatory breaches by the financial institutions, the FDRC will alert the regulators. The FDRC will not issue any fines, impose penalties, or take disciplinary actions. This is to avoid any duplication of effort and blurring of their respective roles. The investigation of regulatory breaches and any subsequent disciplinary action remain the statutory duties and powers of the regulators. In essence, the regulators deal with regulatory breaches while the FDRC deals with monetary disputes.

What next

The consultation period for the Scheme is now closed. The Government in late 2010 said the FDRC would be set up by mid-2012. In a briefing by government official at the regular monthly financial affairs panel meeting in January 2011, legislators raised a number of concerns over the proposed FDRC. Examples include the FDRC's lack of investigative and disciplinary powers. The lack of legal procedures to compel banks or brokers to pay customers may well result in banks or brokerages refusing to reach a settlement. There are also concerns about banks or brokerages sending staff with legal background to attend the mediation process and if this happens, it might be unfair to an investor who has no legal background.

Later this year the Government will need to seek legislators' approval for the funding. It will be interesting to see how various issues will be resolved. However, the reality may be that because the claim limit involved is relatively small (being capped at HK$500,000), many of the disputes may well be settled during the initial negotiations between the investor and the financial institution or at the mediation stage.

Danny Yuen

HKSAR v Chan Wai Yip and Others
[2010] HKEC 1923

The Case

The 19 defendants in this case were the tenants or assistants to the tenants of cooked food stalls at the former Tai Po Temporary Market (the "Old Market"). In 2004, the defendants and other tenants were required by the Food and Environmental Hygiene Department ("FEHD") to move from the Old Market to the newly built Tai Po Hui Market (the "New Market"). They were given priority to bid for stalls at the New Market in a restricted auction. The bid price would become the rent to be paid. The upset prices for these stalls were fixed at 75% of the market rent assessed by the Rating and Valuation Department.

Before attending the auction, the defendants had attended a pre-allotment exercise held amongst themselves. The exercise was conducted by way of the drawing of lots. The numbers drawn in the first round would determine the sequence of the draw in the second round. A number drawn in the second round would be the number of the stall in the New Market allotted to the drawer of that number. The defendants also agreed amongst themselves that each of them would only bid for the stall which had been allotted to him in this manner and would not compete with another defendant.

The auction was held on 21 July 2004 and was attended by 36 eligible bidders, including the defendants. A total of 40 cooked food stalls were put up for auction. There were no competitive biddings during the auction and the stalls were knocked down to all the 36 bidders at the upset prices.

At trial and the Court of Appeal (the "CA"), the prosecution relied on the pre-allotment and the agreement not to compete as the constituents of the common law offence of conspiracy to defraud. It did **NOT** rely on any **"aggravating feature"** such as fraud, misrepresentation, violence, intimidation or inducement of a breach of contract.

After trial, apart from the 1st defendant who had pleaded guilty, all the defendants were convicted and each sentenced to imprisonment ranging from 9 to 12 months. The defendants appealed against both conviction and sentence.

The CA allowed the appeals and quashed the convictions.

The CA having considered a body of previous English authorities covering a period of over 100 years leading to the House of Lords' decision in *Norris v Government of the USA*[1] *("Norris")* held that in the absence of any **"aggravating feature"** such as fraud, misrepresentation, violence, intimidation or inducement of a breach of contract, a price fixing agreement or an agreement in restraint of trade was not **by itself** regarded as criminal at common law and that there was no aggravating feature as such in this case. Further, the CA took the view that it was for the legislature and not the judiciary to decide what conduct was to be treated as so unacceptable as to attract criminal sanctions.

Tang VP opined in paragraph 78 of the judgment that if FEHD had wanted to protect itself, it could have required suitable **written warranties** from a potential bidder and that if the warranties were untrue, one of the necessary **"aggravating features"** in *Norris* would be available.

The Government appealed to the Court of Final Appeal (the "CFA").

The CFA dismissed the appeal.

In his judgment, Mr Justice Litton NPJ agreed with Tang VP's obiter dictum in the CA that if FEHD had wanted to protect itself, it could have required suitable **written warranties** from a potential bidder.

Sir Anthony Mason NPJ who delivered the principal judgment of the CFA did not make any reference to Tang VP's obiter dictum – though he did follow the long line of English cases (including *Norris*) and hold that an agreement not to compete is not **by itself** regarded as criminal at common law.

The Competition Bill in Hong Kong

The Government has submitted the Competition Bill (a cross-sector competition law) into the Legislative Council. The Bill is now under the scrutiny of the Bills Committee.

[1] [2008] 1 AC 920

The first conduct rule in clause 6 of the Bill prohibits anti-competitive agreements, concerted practices and decisions such as bid-rigging.

Under the Bill, contravention of the first conduct rule is **NOT** a criminal offence. It only attracts civil penalties including for example pecuniary penalties not exceeding 10% of the global turnover of the undertakings in breach. It is not the Government's policy to make contravention of the first conduct rule (or indeed any competition rule) a criminal offence in the Bill.

Express Warranty of No Collusion

In view of the decisions of the CA and CFA in this case and the Government's policy not to criminalise contravention of a competition rule in the proposed Competition Bill, if Bureaux/Departments wish to have better protection in the form of criminal sanction in similar cases in the future, it is advisable that they consider requiring potential bidders and tenderers of Government auctions and tenders to give an express warranty of no collusion in the future. The Department of Justice has prepared a standard warranty of no collusion. If assistance is required, please contact the Department of Justice.

Yung Lap-yan

Tang Wai Cho v Tang Wai Leung [2011] 1 HKLRD 1

This case illustrates the enforcement of an equitable proprietary interest (which is presumed to have been created under the principles of resulting trust) in favour of a person who provides purchase money for a property, without enforcement of the underlying illegal contract which led to its creation.

Facts

The plaintiff ("P") paid the entire purchase price of a property, which was registered in the name of his younger brother, the defendant ("D"). Without P's consent or knowledge, D mortgaged the property to obtain credit facilities for himself. When D defaulted, P redeemed the mortgage and repaid stamp duties chargeable on the property.

P brought proceedings seeking a declaration that he was the beneficial owner of the property and D held the property on resulting trust for him. In the middle of the trial, D sought (inter alia) to strike out P's claim arguing it was based on an illegal contract, in that D was registered as the sole owner of the property, but he was to hold it on P's behalf so that P could avoid liability in matrimonial and tax matters ("D's Application"). D's Application was dismissed and he appealed.

Decision

The court dismissed the appeal.

Illegality and Resulting Trust

The court, applying the House of Lords decision in *Tinsley v Milligan*[1], held that as a starting point, the court would not lend its aid to a claimant who formed his cause of action under an illegal contract. However, a claimant might at law enforce his property rights under an illegal contract if:

(a) he did not need to rely on that contract for any purpose other than providing the background to his claim to a property right; and

(b) he could show an intention to retain an equitable interest in the property, e.g. by establishing a resulting trust.

A resulting trust may arise by operation of law where one person provides purchase money for a property and the conveyance is taken in the name of another. There is then a presumption that the equitable interest in the property has been intended to result or revert to the person providing the money or, in the case of his previous death, to his representatives. But as the doctrine of resulting trust is based on the unexpressed but presumed intention of the parties, it might not arise where the relation existing between them is such as to raise the presumption of advancement. The presumption of resulting trust may also be rebutted by evidence of a contrary intention.

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1 [1994] 1 AC 340.

The presumption of advancement applies for example where a married person makes a purchase of property in his or her spouse's name or where a parent of a child makes a purchase of property in the name of the child, the purchase is presumed to be intended as a gift in favour of the spouse or the child. The presumption of advancement may be rebutted by evidence of a contrary intention. Generally, the presumption of advancement bars the presumption of resulting trust.

In the present case, P did not need to rely on the illegal contract to establish his claim because a resulting trust arose as a matter of law when he provided for the entire purchase price. In so doing, he acquired a resulting beneficial interest in the property. There was no evidence to rebut the presumption of a resulting trust. The parties were brothers and no question of presumption of advancement arose.

In *Tinsley v Milligan*, two single women ("T" and "M") used funds from their business to purchase a property. The property was registered in the sole name of T for assisting in a fraud practised on the social assistance scheme, but on the understanding that T and M were both beneficial owners. Subsequently, M repented and disclosed the fraud. T moved out and brought proceedings against M claiming sole ownership of the property. M counterclaimed for a declaration that the property was held by T on trust for the parties in equal shares.

The House of Lords ruled in favour of M and held that a claimant to an interest in property was entitled to recover if she was not forced to plead or rely on an illegality. This was the case even though the title on which the claimant relied was acquired in the course of carrying through an illegal transaction. M had established a resulting trust by showing that she had contributed to the purchase price of the property and that there was a common understanding that T and M owned the property equally. There was no necessity to prove the reason for the conveyance into the sole name of T. This was irrelevant to the defendant's claim.

Ada Ng

Chong Cheng Lin Courtney v Cathay Pacific Airways Ltd [2010] HKEC 1748

Facts

In 1979, the Plaintiff ("P") joined Cathay Pacific Airways ("CP") as a cabin attendant and signed an employment contract (the "Contract") which contained the following clauses:

Clause 25A: (a) an employee could resign by giving one month's notice or one month's pay in lieu; and (b) an employee who was required to resign or retire by CP would be given one month's notice or one month's pay in lieu, except (c) where he/she was dismissed for cause "without notice or benefit".

Clause 26: employees in categories (a) and (b), but not (c), were entitled to a "retirement grant".

In 1991, CP issued a handbook dealing with housing, medical and travel benefits (the "Handbook"). The Handbook included provisions for a retiree travel benefit (the "RTB") scheme involving travel concessions for staff and eligible dependants for pleasure purposes to encourage loyalty of its employees.

In 1993, before reaching the normal retirement age of 40, P was dismissed by CP by giving one month's payment in lieu of notice and paying a retirement grant.

P applied for the RTB after the dismissal. CP rejected the application. CP maintained that the RTB provisions, which were not contained in the Contract, never formed part of the Contract and accordingly had no contractual force. At first instance, P successfully argued that the RTB provisions had contractual force. CP appealed.

Decision

The Court of Appeal ("CA") dismissed the appeal and affirmed that the RTB provisions had become part of the Contract by means of variation and had contractual force.

To be enforceable, the variation must itself be an agreement with contractual force which requires: offer and acceptance, intention to be legally bound, and consideration.

Offer and acceptance

CA found that offer and acceptance could be readily inferred from conduct of the parties who did not argue on the issue.

Intention to be legally bound

CP argued that the benefits stated in the RTB provisions did not form part of the Contract but were only discretionary benefits which CP reserved the rights to withhold from P or any of its employees.

CA took the view that both CP and P *intended* that the RTB provisions be legally bound:

First, the RTB provisions were in the Handbook which dealt with P's overall remuneration package which was of day-to-day relevance to the continuing relationship between CP as the employer and P as the employee.

Second, the Handbook clearly spelt out the eligibility requirement and the circumstances under which those benefits should be withheld but did not spell out that the benefits were discretionary.

Third, CP and its employees including P had consistently observed the provisions in the Handbook.

Consideration

CP argued that P provided no fresh consideration for the variation as P was merely performing her pre-existing obligations under the Contract made in 1979.

The general rule is that past consideration is not good consideration. The consideration for a promise must be given in return for the promise. If an act alleged to constitute the consideration has already been done before, and independent of, the giving of the promise, it is said to amount to "past consideration", and that past act does not in law amount to consideration for the promise.

For example, if a television set is guaranteed by a seller *after* the buyer has paid for it, the guarantee is not contractually binding on the seller as the buyer's consideration for the promise of guarantee is past. Similarly, an employer's promise to provide retirement benefit to a former employee is not binding if the sole consideration for the promise is the service *previously* rendered by the former employee.

In this case, CA noted that the rigour of the general rule as to consideration has been ameliorated and the law must not depart from the reality of everyday life for no good reason. Having concluded that the RTB provisions were indeed intended by both parties to have contractual force and honoured by both parties on that footing, CA said that it would take very compelling reasons for the court to hold that what were regarded as contractual by the parties actually had no contractual force in law for want of consideration.

Although the Contract between CP and P was signed in 1979 and the promise for RTB was made in 1991, CA ruled that that the necessary consideration for the promise in this case was supplied by *P not exercising her contractual right in the Contract to leave CP*. P's non-exercise of her legal right was beneficial to CP which wanted employee loyalty and intended to compete with other airlines for cabin attendants and thus provided the necessary consideration.

Commentary

Subsequent to this case, it should be expected that the court is ready to find consideration for a variation of a contract if the parties have all along observed the variation as if it has contractual force.

Further, as long as a contracting party (X) obtains practical benefits from the performance of the pre-existing contract by the other party (Y), it seems to be immaterial whether or not Y has actually given a new promise. Y's inaction (non-exercise of contractual right) which is beneficial to X could be sufficient consideration.

Nevertheless, in case there is any doubt as to whether a variation of a contract is supported by consideration, it is still advisable to pay a nominal sum (say, $1) as consideration for the variation or execute the variation as a deed under seal.

Boyce Yung

Editors : Yung Lap Yan
Beverly Yan
Ada Chen

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