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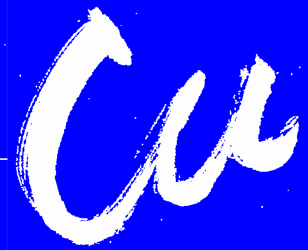

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Editorial

In this edition we feature three articles. The first article is about the major amendments to the Mandatory Provident Fund Schemes Ordinance (the "MPFSO") which introduce a statutory prohibition against conduct of MPF sales and marketing activities by unregistered MPF intermediaries and establish a statutory framework for the regulation of registered MPF intermediaries. In addition, one of the amendments is to section 16 of the MPFSO, the effect of which is that the retirement benefits of an MPF scheme member deriving from mandatory contributions will be preserved in the MPF scheme for his benefit and will not be made available to his creditors if he goes bankrupt. The second article is about the doctrine of ultra vires in company law and the objects clause in the memorandum of association of a company. The third article is about the right of termination of a contract by an innocent party to the contract.

This edition also features three case reports. In the first case, the plaintiffs claim under an insurance policy against the insurance company for business interruption loss caused by the outbreak of SARS in 2003. The main issue before the CFA was the date on which SARS became a "notifiable" human infectious or contagious disease. The second case is about an individual director's right to inspect company's documents both at common law and under the Companies Ordinance. The third case is about the legality concerning the charging of compound and overdue interest by a bank.

Yung Lap-yan

Major amendments to the Mandatory Provident Fund Schemes Ordinance (the "MPFSO")

A. Regulation of MPF Intermediaries

Background

At present, the Mandatory Provident Fund Schemes Authority (the "MPFA") operates an administrative regime for Mandatory Provident Fund ("MPF") intermediaries which relies, in practice, on the regulatory efforts of the Hong Kong Monetary Authority (the "HKMA"), the Insurance Authority (the "IA") and the Securities and Futures Commission (the "SFC") (collectively referred to as the frontline regulators (the "FRs")) for the supervision of MPF intermediaries under the Banking Ordinance (Cap.155), the Insurance Companies Ordinance (Cap. 41) and the Securities and Futures Ordinance (Cap. 571) respectively.

In the aftermath of the 2008 global financial crisis, there are concerns that financial institutions may impose overly aggressive targets on their employees and intermediaries which may be driven to resort to inappropriate practices. With rising public expectation towards investor protection and in anticipation of more proactive and intensive sales and marketing activities targeting at about 2.5 million MPF scheme members after the launch of the Employee Choice Arrangement (the "ECA"), the MPFA proposed to strengthen the regulation of the sales and marketing activities of MPF intermediaries. The Mandatory Provident Fund Schemes (Amendment)(No. 2) Bill 2011 was introduced into the Legislative Council in mid-December 2011 and passed on 21 June 2012 (the "Amendment Ordinance"). Both the Amendment Ordinance and the ECA will come into effect on 1 November 2012.

Objectives of the Amendment Ordinance

The Amendment Ordinance introduces a statutory prohibition against conduct of MPF sales and marketing activities by unregistered MPF intermediaries and establishes a statutory framework for the regulation of registered MPF intermediaries.

Major features of the amendments

1. Institution-based regulatory approach

   (a) The MPFA will be the authority to register MPF intermediaries with powers to make rules on conduct requirements and to issue guidelines on matters concerning compliance with the statutory requirements. The MPFA will handle all complaints concerning MPF sales and marketing activities and will be empowered to impose disciplinary sanctions against non-compliant MPF intermediaries.

   (b) The HKMA, IA and SFC will continue to supervise and investigate the registered MPF intermediaries whose core businesses are in banking, insurance and securities respectively. There will be a regular liaison mechanism between the FRs and the MPFA to enhance communication and consistency in the regulatory approach.

2. Registration and Regulation of MPF intermediaries

   (a) All MPF intermediaries who conduct sales and marketing activities in relation to MPF products are required to apply to the MPFA for registration. Anyone who fails to register in carrying out the above activities commits an offence. The maximum penalty is a fine of $5 million and 7 years' imprisonment.

   (b) All registered MPF intermediaries need to comply with the conduct requirements which include:

      - to act honestly, fairly, in the best interests of the client, and with integrity;
      - to exercise a reasonable level of care, skill and diligence;
      - to disclose necessary information to the client; and
      - to avoid conflict of interest.

   They will also need to comply with the MPFA's rules of conduct. The rules of conduct will provide guidance as to how to comply with the conduct requirements. In addition, they are required to complete continuing training courses within a specified timeframe in order to remain registered. The MPFA will plan and design relevant

training programmes to enhance the standards of MPF intermediaries.

They will be subject to disciplinary sanctions for non-compliance with the above conduct requirements. The sanctions that may be imposed include reprimand, fines [1], and revocation or suspension of registration.

B. Amendment to section 16 of the MPFSO

Subsidized Schools Provident Fund

Under the Subsidized Schools Provident Fund Rules made under the Education Ordinance (the "Rules"), a subsidized school teacher is required to contribute to the Subsidized Schools Provident Fund (the "Fund") and for each contribution made, the Government will pay to the Fund a Government donation at a specified rate.

In *Re Ng Shiu Fan*[2], Ng Shiu Fan was employed by a subsidized school for 28 years. He made the provident fund contributions to the Fund as it was mandatory. He was the sole supporter of his family and a single parent. He was bankrupt on his own petition in 1998 and was discharged from bankruptcy in 2002. During his bankruptcy, he continued to make the provident fund contributions. The Official Receiver (the "OR") informed him that the provident fund benefits payable to him under the Rules (the "Benefits") on his retirement would be remitted to the OR. He wrote back to the OR raising his objection. When he retired in 2005, the Benefits were remitted to the OR. Mr Ng sought a refund of the amount from the OR. The OR applied to the court for directions as to whether the Benefits formed part of Mr Ng's estate under the Bankruptcy Ordinance and if so, whether section 85(3) of the Education Ordinance[3] prevents the Benefits from automatic statutory vesting in the OR.

The Court of First Instance ruled that the Benefits formed part of Mr Ng's estate and that section 85(3) of the Education Ordinance was unable to prevent the Benefits from automatic vesting in the OR. This means that the OR is entitled to the Benefits which would otherwise be due to Mr Ng. Mr Ng appealed to the Court of Appeal (the "CA"). The CA allowed the appeal and ruled that Mr Ng is entitled to the proportion of the Benefits attributable to his service and contribution after his discharge from bankruptcy.

Section 16 of the MPFSO

In considering the appeal, the CA also reviewed the MPFSO and commented that it did not believe that section 16 of the MPFSO would prevent the accrued benefits in a registered MPF scheme which are derived from mandatory contributions from vesting in a trustee in bankruptcy.

In order that the original legislative intent behind section 16 of the MPFSO was put beyond doubt, section 16 of the MPFSO was amended in 2011. The effect is that the retirement benefits of an MPF scheme member deriving from mandatory contributions will be preserved in the MPF scheme for his benefit and will not be made available to his creditors if unfortunately he becomes a bankrupt.

Danny Yuen and Agatha Ding

Companies' objects and the ultra vires doctrine

In company law, the doctrine of ultra vires relates to the capacity of a company. An ultra vires transaction is one which is beyond the company's capacity and is void. However, the term "ultra vires" is sometimes also used in the context of the authority of persons (e.g. directors) to act for the company. Here, it is said that where a person acts without authority, the act is ultra vires and not binding on the company, though the company has the capacity to adopt the transaction. To avoid confusion, the term "ultra vires" is, in the company law context, best confined to the former sense, relating to corporate capacity. This article discusses "ultra vires" in that narrower sense.

[1] The MPFA may order the MPF intermediary to pay a pecuniary penalty not exceeding the greater amount of either (a) $10,000,000 or (b) 3 times the amount of the profit gained or loss avoided by the MPF intermediary as a result of the failure.

[2] CACL 298/2008.

[3] Section 85(3) of the Education Ordinance provides :
"Subject to any rules made under subsection (1), no contribution or donation to or dividend or interest on a dividend from a provident fund shall be assignable or transferable or liable to be attached, sequestered or levied upon, for or in respect of any debt or claim whatsoever."

Common Law Doctrine of Ultra Vires

Prior to amendments made to the Companies Ordinance (the "CO") in 1997, it was compulsory for all companies incorporated under the CO to have a clause in the memorandum stating the objects of the company. Under the ultra vires doctrine, the effect of the objects clause was to restrict the capacity of the company such that transactions entered into by the company outside the scope of the objects clause would be void[1].

The rationale of the doctrine was to protect shareholders and creditors of a company by ensuring that the company's funds would not be dissipated in unauthorised activities. However, the doctrine gave rise to difficulties. Any third party dealing with the company would need to check the memorandum to ensure that the transaction is within the company's objects. Otherwise the risk is run that the transaction might be void. While checking the memorandum is not unusual for larger transactions, it is not practical for either consumers or businesses to do so for every dealing with a company. Also, even if the shareholders and directors desire to enter into a particular transaction that is outside the objects clause, the company cannot enforce the transaction if the company neglected to amend the objects clause before the transaction was entered into. To overcome these difficulties, it became common for objects clauses to be drafted to cover every conceivable business or activity. Yet such lengthy objects clauses defeated the original purposes of the ultra vires doctrine.

Statutory Abolition of the Ultra Vires Doctrine

To avoid the above difficulties, the Standing Committee on Company Law Reform recommended abolition of the ultra vires doctrine by adoption of provisions based on the Ontario Business Corporations Act 1982[2]. This proposal was implemented by amendments to the CO (effective 10 February 1997) introducing new provisions and removing the requirement for objects clauses for most companies. Section 5A(1) provides: "A company has the capacity and the rights, powers and privileges of a natural person." Under section 5(1A), it is optional for companies to have an objects clause (except that objects clauses are still compulsory for charitable and other companies that are allowed to dispense with the word "Ltd" in the company name under section 21).

Although section 5A only equates a company's capacity with that of a natural person, under section 16(2) a company also has the capacity to exercise all the functions of a body corporate. Pursuant to the 1997 amendments, there is now no restriction on a company's capacity. This is illustrated by the case of *Re Tang Muk Kwai*[3], where, in the context of a company without an objects clause, it was held that the company would, by virtue of section 5A, have the same power as a natural person to take up a grant of probate.

Under section 5B(1), a company that has an objects clause must not act outside of its objects. Under section 5B(2), a member can restrain the doing of an act that contravenes section 5B(1), but this right is qualified such that proceedings cannot be brought to restrain an act to be done in fulfilment of any legal obligation arising under a previous act of the company. Under section 5B(3), an act of a company is not invalid by reason only that it contravenes section 5B(1). The court in *Re Tang Muk Kwai* left open the question of the extent to which the ultra vires doctrine is abolished in respect of companies which have an objects clause. The better view is that the ultra vires doctrine is abolished for all companies. Regardless of whether the memorandum sets out the objects, the company has capacity as set out in section 5A(1). The restrictions under the objects and section 5B only impose limitations on the authority or power of persons acting for the company to engage in particular acts.

The effect of section 5B(3) is that a transaction is not void merely because it contravenes a company's objects clause. However, neither directors nor the company's agents would have actual authority to act in breach of the objects clause. The third party dealing with the company could enforce the transaction based on apparent authority of the persons acting for the company, but a third party cannot rely on the apparent authority if the third party is aware of the lack of authority or is reckless or turns a blind eye to the circumstances relating to the lack of actual authority[4]. Under section 5C, a person will not have constructive notice of the contents of the memorandum merely because the memorandum is lodged with the Registrar. However, there could be special circumstances in a particular case where a third party would not be able to enforce a transaction against the company that is in breach of the objects clause on the basis that the third party is not entitled

[1] *Ashbury Railway Carriage & Iron v Riche* (1875) LR 7 HL 653.

[2] SCCLR, *Annual Report 1992/93*, at 34-44.

[3] [2011] 1 HKLRD 858.

[4] *Kasikornbank Public Co Ltd v Akai Holdings Ltd (in liq)* (2010) 13 HKCFAR 479.

to rely on any apparent authority of the company's agent.

Statutory Corporations

The ultra vires doctrine can still apply for statutory corporations in Hong Kong. A recent overseas example is the English decision of *Standard Chartered Bank v Ceylon Petroleum Corp*[5]. The case dealt with a Sri Lankan corporation created by statute, but the relevant law is the same as Hong Kong common law. The corporation's objects, as set out in the relevant Act, was, inter alia, "to carry on the business as an importer, exporter, seller, supplier or distributor of petroleum", and "such other business as may be incidental or conducive to the attainment of the [above] objects". The corporation entered into oil derivative transactions with the claimant to protect itself from rises in oil prices. When the claimant sought to enforce payments under the transactions, the corporation argued that the transactions were ultra vires and void. The court held that the hedges were conducive or incidental to the corporation's business as set out in the objects and were accordingly not void. However, the court accepted that if the transactions were speculative transactions in nature rather than hedges, then they would have been ultra vires.

Stefan Lo and Natalie Wong

Can the innocent party terminate the contract?

Contract termination is probably the last thing that crosses the parties' minds when they enter into a contract. However, reality tells us, time and time again, that breaches do occur and not all contracts are completely and perfectly performed. In such events, what are the remedies available to an innocent party?

As a matter of general principle, a breach of contract always entitles the innocent party to the right to sue for damages. At common law, the innocent party can only have the right to terminate a contract under the following two situations:

(i) **repudiation** of the contract before the contract is due for performance or has been fully performed; or

(ii) **fundamental breach** of the contract in the sense of violating a promise that is of major importance in the context of the whole contract.

Repudiation

A party repudiates a contract if he indicates by words or conduct that he does not intend to honour his obligations when they fall due in the future. It may be perplexing to say that a contract is capable of breach before the time is due for its performance, but the principle makes sense as illustrated in the leading case of *Frost v Knight*[1], a case on the breach of a promise of marriage. The defendant, having agreed to marry the plaintiff upon the death of his father, broke off the engagement during the latter's lifetime. The plaintiff sued the defendant successfully for damages.[2] The court, in concluding that the defendant's conduct of reneging on his promise to marry the plaintiff amounted to an anticipatory breach, held that he had a subsisting (as opposed to future) obligation to have the contract kept open and effective until the arrival of the time for performance, because the plaintiff would meanwhile have to decline all offers of marriage while waiting until the death of the defendant's father.

Whilst repudiation may either be express or implied, the court has been taking a cautious approach in finding or inferring its existence. Even if there is an express statement of refusal to proceed with the contract, the party making it may *bona fide*, albeit erroneously (e.g. on the basis of misinterpretation of the contract), believe that he is justified to do so, in such event the statement may not amount to repudiation entitling the innocent party to terminate the contract, especially if the refusal is not an absolute refusal and the mistake is open to correction. To establish repudiation, the innocent party needs to show that the defaulting party has made his intention not to perform his contractual obligations clear beyond reasonable doubt, having regard to the nature of the contract, the actual circumstances and the motives of the defaulting party.

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5 [2011] EWHC 1785.

1 (1872) LR 7 Exch 111.

2 Although actions for breach of promise of marriage have already been abolished in the United Kingdom by the Law Reform (Miscellaneous Provisions) Act 1970, the principles laid down in *Frost v Knight* are still of general application.

Fundamental breach

An innocent party is also entitled to terminate a contract if the other party, in the absence of repudiation, commits a fundamental breach. A breach may be regarded as "fundamental" on the basis of the importance that the parties have attached to the violated term, and/or the seriousness of the consequences resulting from the breach. Still, it is not easy to determine with precision how "fundamental" the breach needs to be to warrant the discharge of the contract, and it goes without saying that each case must be considered on its own facts and circumstances.

The case of *Ellen v Pop*[3] illustrates this principle. The plaintiff master, described as an "auctioneer, appraiser and corn factor" in the contract, agreed to take on the defendant apprentice to learn the trades. He abandoned his trade as a corn factor during the contractual period, whereupon the defendant absented himself on the ground that the plaintiff's abandonment of one of the stipulated trades discharged him from any further obligation to perform the contract. The plaintiff sued the defendant for breach of contract. However, the court held that the defendant was discharged from further liability because the plaintiff had, by his abandonment, intentionally made it impossible for the essential object or the substantial benefit of the contract to be attained, i.e. to maintain the "master and apprentice" relationship with the master actually carrying on the three trades specified while the apprentice learns.

Effect of repudiation or fundamental breach

The existence of a wrongful repudiation or a fundamental breach does not automatically bring a contract to an end. Instead, the innocent party has an option of either:

(i) **affirming the contract**, i.e. treating the contract as still in force; or

(ii) **terminating the contract**, i.e. treating the contract as having been finally and conclusively discharged.

If the innocent party chooses to treat the contract as still in force and, having been fully informed of all relevant facts, makes it clear that he refuses to accept the breach as a discharge of the contract, the effect is that the contract continues in existence for the future, and both sides have to perform their contractual obligations.

If the innocent party chooses to treat the contract as discharged, he must convey his choice to the party in default. After doing so, his choice will be regarded as final and cannot be withdrawn. The effect is that the contract is terminated for the future, and the previous existence of the contract is relevant only with regard to the acts and defaults of the parties prior to termination. The party in default is liable for damages arising from any breaches before termination as well as the relevant breach leading to termination of the contract, but he is excused from any further obligation to perform the contract.

Contractual provisions for termination

The abovementioned general rules are applicable in the absence of and subject to any contrary agreement between the parties. The parties may expressly provide in their contract an option to terminate the contract which extends beyond the parties' right of termination in the areas of repudiation and fundamental breach. This right of termination may be exercisable upon a breach of contract by the other party (e.g. a minor breach), upon the occurrence or non-occurrence of a specified event other than breach, or simply without cause and at the will of the party having such right. Since the parties are free to incorporate whatever terms they wish for the termination of their contract, these express contractual provisions for termination are generally enforceable.

Christie Kwong

[3] (1851) 6 Exch 424.

New World Harbour View Hotel Co Ltd and Others v ACE Insurance Ltd and Others (FACV No. 12 of 2011)

In *Re Etherington and the Lancashire and Yorkshire Accident Insurance Company*[1] Vaughan Williams LJ commented that the *contra proferentem* principle (i.e. an ambiguity in a contract shall be construed against the drafter of the contract) "strongly applies" to insurance policies. Is this the case for all disputes arising from the interpretation of insurance policies? The Court of Final Appeal (the "CFA") in the recent *New World Harbour View's* case demonstrates how the principles on construction of a term of a contract should be applied and whether these principles will apply differently in insurance contracts.

The case

The plaintiffs ("Ps") were 10 companies within a group of companies involved in convention centres, hotels, car parks and related business. Each was insured under one of two almost identical "Composite Mercantile Policies" (the "Policies") issued by the defendants ("Ds") as insurers. Ps claimed under the Policies against Ds for business interruption loss caused by the outbreak of Severe Acute Respiratory Syndrome ("SARS") in 2003.

The main issue before the CFA was the date on which SARS became a "notifiable human infectious or contagious disease" within the meaning of clause 14.5 of the Policies, which provided that the Policies extended to insure "actual loss sustained by the insured … resulting from … notifiable human infectious or contagious disease occurring within 25 miles of the premises (i.e. in Hong Kong)".

Both the Court of First Instance (the "CFI") and the Court of Appeal (the "CA") ruled that "notifiable" in clause 14.5 imports a legal or mandatory requirement to notify. However, Ps appealed to the CFA and argued that the words "notifiable … disease" mean infectious or contagious disease which are so serious as to warrant notifications to the authorities (the "Argument"). Thus, there is no requirement for a legal or statutory obligation to notify. Further, Ps contended that the clause should be construed *contra proferentem*.

[1] [1909] 1 KB 591 at 596.

Analysis

The CFA pointed out that the Argument suffers from the absence of a clear and objective criterion by which it can be determined whether the disease is so serious as to be notified. When is a disease so serious that it is appropriate or necessary to notify? The CFA considered that this is a question on which medical minds might be expected to differ.

The CFA took the view that the interpretation which should be adopted in the case of an insurance contract, as with other commercial contracts, is that which gives effect to the context, not only of the particular provision but of the contract as a whole, consistently with the sense and purpose of the provision. In arriving at the true interpretation, the court will read the words and expressions of the contract as ordinary commercial people would understand them in their context, preferring in appropriate cases that understanding to any technical legal meaning that the words or expressions may otherwise have.

The CFA noted that the Cambridge Advanced Learner's Dictionary defines "notifiable" as "a disease or offence that must be reported to public health or legal organisations". Likewise, the Oxford English Dictionary supports the view taken in the CFI and the CA. However, the definitions in the Oxford English Dictionary Online and the Shorter Oxford Dictionary appear to contemplate that there may be some cases where the seriousness of a disease is enough to make it notifiable, even though there is no mandatory obligation to do so.

On the other hand, well-known medical dictionaries state that "notifiable" or "notification" signifies an obligation or requirement to notify and in most cases, they specify requirement as a matter of legal obligation. The CFA pointed out that although medical dictionaries offer definitions which reflect the understanding of the medical community, in this context, it should be accepted that the understandings of commercial people and the medical community

would coincide. In such a context, commercial people would look to the medical understandings and expect and intend their words to be understood accordingly. So in clause 14.5 the expression "notifiable human infectious or contagious disease" should be understood as meaning an infectious or contagious disease *which is required by law to be notified to an authority*. This reading is consistent with the dictionary meanings (or most of them) and gives effect to the immediate context.

The CFA also considered that the meaning of the word "notifiable" is clear and certain. The reason is that at the time of contract, the parties would have been well aware of the statutory regimes in many jurisdictions (including the Quarantine and Prevention of Diseases Ordinance, Cap. 141) which require the notification of specified serious infectious or contagious diseases, and the parties would have contracted with that knowledge in mind. Against this background, it cannot be doubted that commercial people would read the words in question as referring to infectious or contagious diseases which are required by law to be notified to a public authority.

Mr Justice Bokhary PJ added that although the word "notifiable" is sometimes capable of the meaning for which Ps contended, the question of construction is "not as to the extension of which [the term to be construed] is capable, but of the sense in which it ought to be understood in the particular context with which it is to be reconciled." Once due regard is paid to the context, it becomes clear that the word "notifiable" in clause 14.5 bears the meaning which the CFI and CA attributed to it. The *contra proferentem* rule does not therefore enter the picture.

Ps' appeal is accordingly dismissed.

Lily Man

Tsai Shao Chung v Asia Television Ltd
[2012] HKEC 952

Facts

Tsai Shao Chung (the "Plaintiff"), a director of the Defendant, Asia Television Ltd ("ATV"), obtained an order from the Court of First Instance (the "CFI") under section 121(3) of the Companies Ordinance (Cap. 32)[1] and under the common law, requiring ATV to provide him with full access to various ATV documents including books of accounts, board papers, management committee meeting minutes, material contracts, business plans and proposals, and other documentation withheld by the management of ATV. ATV appealed against the order to the Court of Appeal (the "CA").

The order was sought in the context of two ongoing legal actions against other ATV's shareholders on the control of ATV which had been instituted by the Plaintiff's father ("F") and a company of F, who had a substantial interest in ATV.

[1] Section 121(3) of Cap. 32 provides that "[t]he books of account shall be kept at the registered office of the company or at such other place as the directors think fit, and shall at all times be open to inspection by the directors…."

Decision

Inspection right of directors

The CA affirmed the CFI's decision that a director's right to inspect company books and documents is well-established. The right arises both under the statute (section 121(3) of Cap. 32) and at common law. It is conferred for the purpose of enabling the director to carry out his duties as a director for the benefit of the company. The directors' duties are owed to the company not just collectively as a board, but individually by each director. The right is a corollary to the duties owed by each director individually to the company and is given to each director in order that each director may properly discharge those duties.

The CFI pointed out that a director is not required to proffer reasons for inspection. The burden of showing that the inspection is sought for an improper purpose rests with the party resisting the inspection.

Construction of articles of association on director's inspection right

ATV argued that Article 159 of ATV's Articles of Association only permits inspection by the board as a

whole, or pursuant to a decision of the board as a whole, but not by a director individually.

The CA, in agreement with the CFI, rejected ATV's construction of Article 159. Applying a purposive construction, the CA held that Article 159 does not exclude the right of an individual director to inspect the company's documents but instead permits inspection both by the individual director and by the board as a whole.

The courts also disagreed with ATV's view that the alleged restriction under Article 159 was procedural in nature. They took the view that the alleged restriction would amount to a substantive deprivation of the director's right of inspection and not merely a procedural restriction of it. The courts stressed, if necessary, they would conclude that ATV's construction of Article 159 was contrary to public policy and the restriction on the right of inspection void.

Use of materials for improper purpose

ATV complained that the inspection was sought for the improper purpose of passing on information and materials obtained by the Plaintiff to assist F and F's company in their legal actions, which are brought for the personal interests of F and are not connected with the business of ATV.

The CA noted that the CFI, after considering ATV's state of affairs (including its financially-straitened situation, the Plaintiff's dissatisfaction with the management and the fact that the ATV directors had been given little or no information relating to its affairs), was satisfied that the Plaintiff was seeking inspection of the documents in order to enable him to carry out his duties as a director of ATV. The CA further pointed out that there is no evidence constituting "clear proof" to satisfy the court "affirmatively" that the grant of the right of inspection would be detrimental to the interests of the company (see *Ng Yee Wah v Lam Chun Wah*)[2].

Having reviewed the relevant shareholders' agreements concerning ATV, the CFI considered that these agreements in fact permitted the passing of information concerning ATV to those who were ultimately interested in ATV (including F), which made good commercial sense in the light of their substantial investments in ATV. The CA was also of the view that the shareholders' agreements permitted information emanating from ATV to be passed to those holding the economic interest in the shares of ATV.

The CA held that it has not been demonstrated that there has been any misuse of any documents passed to F by the Plaintiff or that any harm will be caused to ATV by the release of information concerning it by the Plaintiff to F. Absent such evidence, there is no basis for refusing to grant to the Plaintiff an order for the inspection of the company's documents.

Scope of inspection

ATV contended that the inspection order was too broad and some of the categories of documents covered could not be regarded as books of account or accounting records under section 121(3) of Cap. 32.

The CA held that since the application is made under both the common law and the statute, the scope of inspection can potentially cover any documents belonging to the company: corporate materials, corporate records and accounts, corporate information and accounting and other records of the company.

The CA approved the CFI's approach to the ambit of the inspection order: "as long as the documents could reasonably be thought to be of assistance to a director seeking to carry out his duties, they are susceptible to being inspected at the application of the director concerned…". Applying this definition, the CA affirmed the CFI's conclusion that "all of the documents sought are documents which the [Plaintiff] could reasonably regard as being likely to assist him in carrying out his duties as a director of ATV".

Boyce Yung

[2] [2005] HKEC 1183.

Bank of East Asia Ltd v Yip Chi Wai
[2011] 5 HKLRD 761

This case is a good illustration of the approach generally adopted by the courts in cases involving disputes about (1) interest rate; and (2) the contractual right and legality concerning the charging of compound and overdue interest by a bank.

Facts

B was engaged in the banking business and Ds were its clients. D1 and D2 served respectively as the company secretary and director of D3.

In 1997, D1 and D2 entered into facility letters for personal instalment loans with B ("1997 Facility Letters"), stipulating an interest rate of 9.25% p.a., and that the interest rate was subject to fluctuation and B had the discretion to adjust it. The 1997 Facility Letters did not specify the formula by which B determined the interest rate, namely, prime rate plus 0.5% ("P+0.5%"). Further, D1 and D2 undertook to repay loans (including overdraft ("OD") loans) provided by B to D3.

In 2004, D3 defaulted in repaying the OD loans, and accepted from B three loans for its debt restructuring: (1) invoice financing loan, (2) OD facilities and (3) non-revolving term loan under a facility letter. In 2005, D1, D2 and D3 ("Ds" collectively) defaulted in repaying their loans.

Except for interest on D3's OD facilities, all interest was computed on simple interest basis, with inclusion of overdue interest. For the OD facilities, interest was computed on compound interest basis with no overdue interest.

B took out an originating summons to recover payment in arrears involving the loans to Ds. Ds took no issue on the outstanding principals of the loans, but argued that (1) other than the facility documents, B had verbally agreed with Ds that the interest rate for the personal instalment loans was subject to fluctuation, adjustable, and was lower than that stated in the 1997 Facility Letters; and (2) B had no contractual right to charge compound interest and overdue interest, and the overdue interest was illegal.

Decision

The Court held that:

Interest rate prescribed by the 1997 Facility Letters and the verbal agreement

- on the evidence the interest rate for D1's and D2's personal instalment loans was P+0.5% (subject to fluctuation), although the formula was not specified in the 1997 Facility Letters. Given D1's experience in business and similar formulas for determining interest rates were very common in the lending business, D1's argument that he knew nothing about prime rate was unconvincing. B lowered the interest rate to 5.5% for the majority of periods. Such an adjustment matched perfectly with the decrease of the prime rate and the P+0.5% formula. If B had indeed verbally undertook that the interest rate was subject to fluctuation, it had already been carried out. D1 could not prove his case on such a verbal agreement being reached and the overcharging of interest.

The right and legality of charging compound interest

- B had the contractual right to charge compound interest on D3's OD facilities, although the facility documents were silent on this. B issued a monthly statement to D3 every month from 1997 (when the account began to have a negative monthly balance) until the filing of the defence in 2009, showing B's charging of compound interest on which D3 had never disputed. It showed Ds knew and acknowledged B's method of handling the OD facilities and charging compound interest. The banking industry's usage of keeping accounts and charging compound interest on OD facilities had become an implied contractual term concerning D3's OD facilities.

The right to charge overdue interest

- B could charge overdue interest on D3's invoice financing loan at the rate specified in the "Scale of Charges on Bills Transaction" provided to Ds before they signed the facility documents. Although the facility documents entitled B to charge overdue interest for the personal instalment loans and non-revolving term loan, B failed to prove the rate for overdue interest and the method for determining the rate for such loans, and therefore could not charge overdue interest on such loans.

Legality of charging overdue interest

- the overdue interest charged at 5% p.a. on D3's invoice financing loan was valid liquidated damages ("LD") (i.e. genuine pre-estimate compensation for the loss incurred by D3's overdue repayment). Laying down overdue interest with a borrower to ensure its timeous repayments is a reasonable and necessary safeguard adopted by banks. From any perspective in today's commercialized society and loan market, such overdue interest cannot be regarded as outrageous, exorbitant or unreasonable.

Comment

The judgment provides a good illustration of the approach generally adopted by the courts for deciding whether a clause charging overdue interest is a valid LD (i.e. genuine pre-estimate compensation) clause or an unenforceable penalty clause. The fact that the overdue interest clause involves compensating a lender by a sum exceeding its loss is an indicia of a penalty clause, but it is not conclusive. The Court stressed that freedom of contract and contracting parties' respective bargaining powers identified in *Philips Hong Kong Ltd v A-G of Hong Kong*[1] were also relevant. In that Privy Council case, Lord Woolf stated that unless the parties' bargaining powers were profoundly unequal, it would normally be insufficient to establish that a provision is objectionably penal by merely showing that the application of the provision could result in a larger sum being recovered by the injured party than his actual loss; and even in such situations, as long as the agreed compensation was not extravagant in the light of all the circumstances of the breach, the provision could still be regarded as a genuine pre-estimate compensation.

This case also provides a useful reminder of the importance for lenders to adopt the prudent approach of including in facility documents express and clear terms about their right to charge the requisite types of interest and the rates thereon, and to make such documents readily available to prove their case.

Ada Ng

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

[1] [1993] 1 HKLR 269.