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What's inside

Editorial

In this edition we feature three articles. The first article is about the major amendments to the trust law regime in Hong Kong. The Administration introduced the Trust Law (Amendment) Bill 2013 into the Legislative Council in February this year. The article sets out the major amendments to be made to the Trustee Ordinance and the Perpetuities and Accumulations Ordinance. The second article talks about the amendments to be made to the common law doctrine of privity of contract by the Contract (Right of Third Parties) Bill 2013. The third article is about the indoor management rule at common law and its statutory version in section 117 of the new Companies Ordinance.

This edition also features three case reports. The first case is about the petition to wind up Yung Kee Holdings Limited, a company incorporated under the laws of the British Virgin Islands, under sections 168A and 327 of the Companies Ordinance. The second case is about the construction of inconsistent terms in an insurance policy. The third case illustrates how the acceptance of a repudiatory breach can affect the plaintiff's claim of specific performance of the contract.

YUNG Lap-yan

Major Amendments to the Trust Law Regime

The trust law regime in Hong Kong is mainly based on common law, supplemented principally by the Trustee Ordinance, Cap. 29 (the "TO") and the Perpetuities and Accumulations Ordinance, Cap. 257 (the "PAO"). The TO and the PAO have not been substantially reviewed or amended since their enactment in 1934 and 1970 respectively. With a view to modernising our trust law to bolster Hong Kong's competitiveness as a major asset management centre, and having regard to the proposals put forward by the trust industry and the recent reform in the United Kingdom and Singapore, the Administration introduced the Trust Law (Amendment) Bill 2013 (the "Bill") into the Legislative Council in February this year. The major amendments to the TO and the PAO are set out below.

Enhancing Trustees' Default Powers

Trustees' powers under the TO are default in nature, i.e. subject to the terms of the trust instrument. The Bill proposes to enhance such powers.

Collective Power to Appoint Agents, Nominees and Custodians

Under the TO, trustees have the power to collectively employ agents to exercise their discretion in administering overseas trust properties, but not for those in Hong Kong. There are also limited powers for trustees to appoint custodians but no express power to appoint nominees for the trust.

The Bill empowers trustees to appoint agents to exercise their discretion for both Hong Kong and overseas trust properties. Trustees are also given a general power to appoint agents, nominees and custodians under the Bill.

Individual Trustee's Power of Delegation

Section 27 of the TO empowers an individual trustee to delegate the exercise of his discretion in administering the trust property. To protect the interests of beneficiaries, the Bill clarifies that if a trust has more than one trustee, the exercise of the power of delegation should not result in the trust having only one trustee administering the trust, unless that trustee is a trust corporation.

Power to Insure

The TO provides trustees with fairly restrictive powers to insure trust property. The Bill proposes to remedy this by empowering trustees to insure the trust property against the risk of loss or damage caused by any event and by removing the restrictions on the amount of insurance that trustees may take out.

Trustees' Remuneration

At common law, subject to the express authorization by the trust instrument, trustees are not remunerated as allowing trustees to receive remuneration may give rise to conflicts between their fiduciary duties and personal interests. Furthermore, unless expressly authorized, professional trustees are not permitted to receive remuneration for services that are capable of being provided by lay trustees.

Where the trust instrument has provided for remuneration, the Bill empowers a professional trustee to, subject to inconsistent terms in the instrument, receive remuneration out of trust funds, even if the services are capable of being provided by a lay trustee. Where the trust instrument is silent on remuneration, the Bill also empowers a professional trustee to receive reasonable remuneration out of the trust funds. The Bill also proposes checks and balances, including restrictions on the application of the provision to trustees of charitable trusts.

Checks and Balances

Statutory Duty of Care

At common law, trustees owe beneficiaries a duty of care in the investment of trust funds and the appointment of agents. The standard of care expected is that of an ordinary prudent man of business acting in the management of his own affairs. A higher standard is expected of professional or paid trustees.

The Bill proposes a clear statement of the standard of care to be expected of trustees, replacing the common

law duty of care when trustees exercise certain powers including the power of investment, the power of appointment of agents and the power to insure. This statutory duty of care is default in nature and may be excluded or modified by the trust instrument or any enactment. The proposed standard is that a trustee must exercise such care and skill as is reasonable in the circumstances, having regard to:-

(a) any special knowledge or experience that the trustee has or that is held out by the trustee as having; and

(b) if the trustee is acting in the course of a business or profession, any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

Exemption Clauses

Case law has established that a trustee's exemption clause can validly exempt trustees from liability of all breaches of trust except fraud. To better protect beneficiaries, the Bill proposes that where a trustee acts in a business or profession and is remunerated, the terms of a trust must not relieve, release or exonerate the trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence.

Beneficiaries' Rights to Appoint and Retire Trustees

Under the common law, beneficiaries of full age and capacity and are absolutely entitled to the trust property may act together to terminate the trust. Since there may be cases where the beneficiaries wish to replace the trustee without terminating the trust, the Bill provides beneficiaries with the right to appoint and direct the retirement of trustees by way of a court-free process.

Other Proposals

Abolition of the Rule against Perpetuities ("RAP") and the Rule against Excessive Accumulations of Income ("REA")

At common law, RAP dictates that the interest in trust properties must vest in the beneficiaries during a period not later than 21 years after the termination of the life of a specified individual, otherwise the interest may fail. The PAO provides for an alternative fixed period of 80 years. The PAO also restricts the period for which the income of a trust may be accumulated.

The Bill abolishes the antiquated and complex RAP and REA for trust taking effect after the commencement date of the Bill and allows settlors to set up perpetual trusts in Hong Kong. The Bill however retains certain restrictions on accumulations of income for new charitable trusts.

Anti-forced Heirship Rules

Forced heirship rules are mandatory rules found in some civil law jurisdictions requiring part of a testator's estate be reserved for his heirs. If there are insufficient assets in the estate to satisfy the indefeasible portions of such heirs, property in trust set up by the testator during his lifetime may be clawed back to make up for the shortfall. The Bill introduces a statutory provision to the effect that foreign forced heirship rules will not affect the validity of a lifetime transfer of movable assets to a trust which is expressed to be governed by Hong Kong law.

Elen Lau

No Party No say? Privity and Its Reform

Two fathers entered into a contract agreeing to give the son of one of the fathers some money for him to marry the daughter of the other father. The contract provided that the son could sue the fathers for the money. The children got married. After the fathers passed away, the executor of the daughter's father refused to pay the son. The son sued the executor but his action was dismissed.

Doctrine of Privity

The above is not a celebrity gossip but was what actually happened in *Tweddle v Atkinson*[1]. The son lost the case because he lacked privity. The doctrine has two aspects, namely, a third party:

(1) cannot acquire rights under a contract even if it is so intended by the parties to the contract; and

(2) cannot be imposed with contractual liabilities.

[1] (1861) 1 B&S 393

The rule, particularly its first aspect, has been criticised for being artificial and rigid, ignoring the parties' intention even when they want their agreement to benefit a third party. Different exceptions such as agency and trust have been developed to get around the doctrine. In *Dunlop Pneumatic Tyre Co. Ltd. v Selfridge & Co. Ltd.*[2], the appellants sold tyres to Dew & Co., which agreed to obtain an undertaking from the next purchaser that it would not sell below the appellants' list price. Dew & Co. sold the tyres to the respondents and obtained the above undertaking from the respondents, though the respondents did not comply with such undertaking. The appellants sued them for breach of their contract with Dew & Co. The House of Lords held that since the appellants were not party to the contract, unless they could prove that they were undisclosed principal, their action was bound to fail. The appellants' appeal was dismissed as they could not establish that they were principal.

In *Les Affréteurs Réunis Société Anonyme v Leopold Walford (London) Limited*[3], the brokers negotiated a charterparty entered into between the charterers and the shipowners. The shipowners promised in the charterparty to pay commission to the brokers. The brokers sued the shipowners to claim for such commission. The House of Lords held that the charterers were trustee for the brokers and the shipowners' promise could thus be enforced by the brokers, even if they were not party to the charterparty.

Legislation and reform

Ad-hoc exceptions to get around the doctrine may be technical and may not offer certainty as their applicability depends on the facts of each case. Various common law jurisdictions have resorted to legislation, for instance, the Contracts (Rights of Third Parties) Act 1999 was enacted in England to address the argument against the first aspect of the doctrine.

In Hong Kong, the Law Reform Commission recommended a reform of the doctrine in 2005. A consultation paper on Contract (Rights of Third Parties) Bill 2013 and the draft bill (the "Bill") were issued by the Department of Justice in October 2012, with a consultation period that ended on 31 December 2012. The Bill does not aim to abolish the whole doctrine but only serves to provide an exception to its first aspect. Highlights under the Bill are:

(a) a third party can enforce a contract provided that this is the parties' intention;

(b) the parties' intention is established either (i) by express provision in the contract; or (ii) where the contract contains a term that purports to confer benefit to a third party, unless on a proper construction of the contract, the term is not intended to be enforceable by the third party;

(c) the third party intended to be benefited must be expressly identified in the contract;

(d) parties generally cannot, without the third party's consent, rescind or vary the contract if the same would extinguish or alter the rights of the third party. However, such restriction can be done away by the parties expressly stating in the contract that rescission and variation need not be subject to the consent of the third party. The effect of such restriction can also be overridden by setting out the circumstances in the contract where third party's consent will be required. As a check and balance, the third party must be aware of, or reasonable steps must have been taken to bring to the notice of the third party regarding the limitation or even removal of the restriction. The court is empowered with a wide discretion to order the rescission or variation of contract without the third party's consent if it is just and practicable to do so;

(e) to avoid double liability, if the promisor has already performed its obligation to a third party, its obligation to the promisee will be discharged to the extent of such performance; and

(f) the new ordinance does not apply to (i) cases where parties include an opt-out clause to the effect that the new ordinance shall not apply to their contract; (ii) contracts entered into before the commencement of the ordinance; and (iii) certain specific types of agreements, including negotiable instrument, letter of credit and memorandum and articles of association of a company having the effect as a contract under the Companies Ordinance (Cap. 32).

[2] [1915] AC 847
[3] [1919] AC 801

In practice, parties may get around the new ordinance by incorporating an opt-out clause referred to in paragraph (f)(i) above in their contract. Parties should also consider expressly providing in the contract that a term is to benefit a third party if this is so intended. If they do not intend a term to benefit a third party, they should also expressly state so in the contract to prevent it from being construed otherwise.

Finally, a hypothetical question: how would *Tweddle v Atkinson* be held if the contract is entered into in Hong Kong after the new ordinance commences? As the contract has expressly provided that the son can sue the fathers and that it has no opt-out clause, it is likely that the son will win the case this time.

The Bill is currently planned to be introduced to the Legislative Council in the latter half of the legislative year 2012-2013, and may not come into force until late 2013 or early 2014.

Quinnci Wong

The Rule in Turquand's Case and the New Statutory Protection in Section 117 of the New Companies Ordinance

Under the common law, the rule in *Turquand's* case[1] (indoor management rule) ("*Turquand's* Rule") protects third parties in their dealings with a company by ensuring that their transactions with the company are binding on the company notwithstanding irregularities within the company such as failures to comply with procedural requirements of the company's constitution. A statutory version of the indoor management rule has now been enacted, in section 117 of the new Companies Ordinance ("new CO"). This article examines the new section 117 and its interaction with *Turquand's* Rule.

Turquand's Rule

Turquand's Rule provides that where a third party deals with the company in good faith, he is entitled to assume that the company's internal procedures required to give effect to the transaction have been duly complied with. The third party is not required to undertake an inquiry to determine whether the company's internal rules have been complied with, such as whether proper notice was given for a board meeting that authorized the transaction.

However, *Turquand's* Rule will not apply where the third party has actual knowledge of the irregularity or has been put on inquiry (that is, having constructive notice)[2]. It is also generally thought that the rule does not apply in relation to forged documents[3]. For *Turquand's* Rule to apply there is still a need for the person acting for the company to have authority within the law of agency[4]. A person purporting to act as an agent of the company with no actual or ostensible authority cannot bind the company.

Statutory Protection in section 117 of the new CO

Section 117 of the new CO provides that in favour of a third party dealing with a company in good faith, the power of the company's directors to bind the company, or to authorize others to bind the company is free of any limitation under the articles (or other relevant document[5]). Under section 118, a transaction involving directors or their associates is voidable at the instance of the company, and so directors or their associates will not be entitled to rely on section 117 if the company rescinds the transaction. Section 119 provides that section 117 does not apply to "exempted companies", namely companies which have been granted a licence to dispense with "Ltd" in their name under section 103 of the new CO and which are charities exempted from tax under section 88 of the Inland Revenue Ordinance (Cap. 112). However, section 117 can be relied upon by the third party dealing with an exempted company if (a) he was unaware (at the time of the act) that the company is an exempted company; or (b) the company received full consideration for the act done, and the third party was unaware that the act in question was not permitted by any relevant document of the company or was beyond the powers of the directors.

1 *Royal British Bank v Turquand* (1856) 119 ER 886
2 *European Asian Bank v Reicar Investments Ltd* [1988] 1 HKLR 45
3 *Ruben v Great Fingall Consolidated* [1906] AC 439
4 *Northside Developments Pty Ltd v Registrar-General* (1990) 176 CLR 146 at 198
5 Section 117(6) defines relevant documents to mean (a) the company's articles; (b) any resolutions of the company or of any class of members of the company; or (c) any agreements between the members, or members of any class of members, of the company.

The Scope of section 117 of the new CO and Comparison with Turquand's Rule

Section 117 covers much of the same ground as *Turquand's* Rule, but is narrower in some respects. For example, section 117 only applies where the limitation on the power to bind the company is set out in the articles, or resolutions of the company or agreements between the members. Hence, section 117 does not apply where limitations as to directors' powers are contained in bye-laws of the board or where limitations as to agents' powers are set out in some internal management arrangement or in the terms of the appointment of the agents.

Section 117 also only applies if the third party deals with the company through the company's directors or a person authorised by the directors. Section 117 is based on section 40 of the UK Companies Act 2006 ("UKCA 2006"). Before section 40 was enacted, its predecessor provision, i.e. section 35A of the Companies Act 1985 ("UKCA 1985") referred to the power of the "board of directors" being free from limitations, rather than the power of the "directors". A question arose under section 35A as to the test to apply to determine whether the board is acting so as to come within section 35A. Where the board is inquorate, is the quorum requirement a limitation on the board's power or a necessary condition to be satisfied before the board can be said to have been constituted? In *Smith v Henniker-Major & Co*[6], Rimer J. upheld the latter interpretation and although his decision was upheld in the Court of Appeal, only one judge did so on the basis of the first instance reasoning[7]. Robert Walker L.J. held that a third party who deals with an inquorate board may nevertheless rely on section 35A, with the quorum requirement simply being a limitation contained in the company's constitution. As to the change of wording from "board of directors" in section 35A of UKCA 1986 to "directors" in section 40 in UKCA 2006, there is nothing in the explanatory memorandum or Hansard which reveals the legislative intention. The reference to the power of the "directors" may have been intended to reflect explicitly the view of Robert Walker L.J. in *Smith v Henniker-Major & Co*. However, more generally, there is still the question of what test to apply to determine whether the acts are acts of "the directors" so as to come within the statutory provision. In the above case, Robert Walker L.J. had suggested that for the statutory provision to apply, there must "be a genuine decision taken by a person or persons who can on substantial grounds claim to be the … directors acting as such"[8].

On the other hand, section 117 is more beneficial to third parties than *Turquand's* Rule. Section 117(2)(b) provides for a presumption of good faith on the part of the person dealing with the company. While a person who is not acting in good faith cannot rely on *Turquand's* Rule, section 117(2)(b) makes it clear that it is for the other party (usually the company) to prove that there is bad faith. Section 117(2)(c) further provides that a person dealing with a company is not to be regarded as acting in bad faith by reason only of the person's knowing that an act is beyond the directors' powers. While knowledge of the irregularity will generally preclude a third party from being able to rely on *Turquand's* Rule, under section 117(2)(c) the mere fact of knowledge will not necessarily mean that the third party loses the benefit of the protections in section 117.

Section 117 does not displace the common law principles. *Turquand's* Rule can still be relied upon as an alternative to section 117 and will still be important, in particular, in the situations where the circumstances are outside the scope of section 117.

Stefan Lo and Natalie Wong

6 [2002] BCC 544

7 [2002] BCC 768, CA. Carnwath L.J. supported Rimer J's reasoning, Robert Walker L.J. dissented on this point, Schiemann L.J. came to the same decision as Carnwath L.J. but on different grounds.

8 [2002] BCC 768 at paragraph 41

Re Yung Kee Holdings Ltd
[2012] 6 HKC 246

Facts

This was a petition to wind up Yung Kee Holdings Limited ("Company") under sections 168A and 327 of the Companies Ordinance (Cap. 32) brought by the Petitioner who held 45% shares of the Company against the Respondent who effectively held 55% shares. The Company was incorporated under the laws of the British Virgin Islands ("BVI") as an investment holding company, a passive holder of all the issued shares in Long Yau Ltd ("Long Yau"), another BVI incorporated company which was the majority shareholder of 8 direct and indirect "Yung Kee" subsidiaries ("Group").

The Petitioner alleged that the affairs of the Company had been conducted in a manner unfairly prejudicial to him as a member and sought relief under section 168A of Cap. 32 to wind up the Company. Alternatively, the Petitioner sought a winding-up order under section 327(3)(c) of Cap. 32 to wind up the Company on just and equitable grounds. By an Amended Petition, the Petitioner subsequently added an alternative plea for the Respondent to buy the 45% shares in the Company from him or to sell him his 55% shares.

The relief under section 168A is available to, amongst others, a "non-Hong Kong company", which as defined in section 332 means "a company incorporated outside Hong Kong … which has established a place of business in Hong Kong".

In response, the Respondent issued a summons to strike out the Petition on the grounds that (1) the court had no jurisdiction under section 168A of Cap. 32 to entertain the Petition as the Company had no place of business in Hong Kong; and (2) as to the winding up order sought under section 327(3)(c), the court had no jurisdiction, or would not be in a position to exercise a discretionary jurisdiction for the Company's lack of sufficient connection with Hong Kong.

Decision

Although it was found that the Respondent's conduct and its consequences taken as a whole were unfairly prejudicial to the Petitioner's interest in the Company, the Court dismissed the petition. The relief sought under section 168A was denied because the Company had not established a place of business in Hong Kong; and that under section 327(3)(c) was also denied because the Company had no sufficient connection with Hong Kong.

Reasoning

Relief under Section 168A

In order to invoke section 168A of Cap. 32, the Petitioner must demonstrate that the Company had established a place of business in Hong Kong. To be considered having established a place of business in Hong Kong, a company was required to have a place to carry on business within the jurisdiction and its business activities should have sufficient substance to require that it had a permanent establishment in Hong Kong. A place of business did not have to be in a particular form, but some degree of regularity or permanence is required.

Based on the following matters, the Company was found not to have established a place of business in Hong Kong but was merely a passive investor in another BVI company, Long Yau:

(1) The Company –

i. was incorporated in and had its registered office in the BVI;

ii. was an investment holding company;

iii. had only one asset, which was its 100% shareholding in Long Yau;

iv. never played any role or function in the business or operations of the two operating companies in the Group;

v. had no office and had not leased any premises in Hong Kong;

vi. had no income other than dividends from Long Yau;

vii. had no current or continuing liabilities and no creditors in Hong Kong;

viii. had no employees in Hong Kong;

ix. had no bank account in Hong Kong;

x. had not had any financial dealings and did not maintain any form of financial records or accounts in Hong Kong;

xi. had not negotiated or entered into any contracts in Hong Kong nor solicited any business here, either directly or through an agent;

xii. the Company did not trade or run any business but left all the business operation to the subsidiaries or sub-subsidiaries of Long Yau;

xiii. was not registered under Part XI, and the Petitioner had no idea whether registration was required; and

xiv. had not been paying any dividends, but dividends were directly paid by Long Yau instead.

(2) The Company's corporate affairs had been administered by a registered agent in the BVI as required under BVI law.

(3) Throughout its history, none of the Company's directors or shareholders, or the Company's Hong Kong professional advisers had ever advanced a view or advised that the Company should be registered under Part XI of Cap. 32.

(4) The current group structure was that the Company was the ultimate offshore holding company at the top of a corporate structure involving a number of subsidiary layers and corporate entities, some offshore and some Hong Kong-incorporated.

(5) The Petitioner had explicitly acknowledged that "the Company was an investment holding company and had not conducted any business in its own right".

Relief under Section 327(3)(c): Winding-up on just and equitable ground

Section 327(3)(c) of Cap. 32 gave the court a discretionary jurisdiction to wind up an unregistered company on the just and equitable ground. Harris J applied the three core requirements for the court to exercise its jurisdiction as established in *Re Beauty China Holdings Ltd*[1], viz. : (1) sufficient connection with Hong Kong but did not necessarily have to consist in the presence of assets within the jurisdiction; (2) reasonable possibility that the winding-up order would benefit those applying for it; and (3) the court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

Applying *Re Beauty China Holdings Ltd*, Harris J found that there was insufficient connection between the Company and Hong Kong to justify the Court's exercise of its discretion to accept jurisdiction over a dispute between the Company's shareholders. The Company was found neither to have a place of business nor to be operating any business in Hong Kong. The affairs of the operating subsidiaries in Hong Kong which included a well-known restaurant in Hong Kong were not the affairs of the Company.

Harris J further held that the shareholders in a BVI company could take their dispute to the courts in which the Company was incorporated for remedies, which were for all practical purposes the same as those available here under sections 168A and 327(3)(c) of Cap. 32.

Vivian Cheung

[1] [2009] 6 HKC 351

Hua Tyan Development Ltd v Zurich Insurance Co Ltd [2012] 4 HKLRD 827

An insurance policy is a contract between the insurer and the insured and is subject to the rules of construction which apply to any contract at common law. The disputes which are likely to arise in the construction of insurance policies may be identified as falling into any of these categories: first, disputes as to the meaning of specific words relating to the cover provided; second, disputes as to whether a particular clause was intended to apply in the events which have happened; third, an apparent contradiction between different clauses in the same policy[1]. This commentary will discuss resolution of the third type of disputes.

The claim

The plaintiff insured ("P") obtained cargo insurance policies issued by the defendant insurer ("D") through a broker, who acted for both parties, including a policy ("the Policy") covering a cargo of round logs ("the Cargo"). P brought a claim against D, and alternatively the broker (for breach of alleged broker's duties), for USD1.5 million being the value of the Cargo lost after the vessel, named "Ho Feng 7" (the "Vessel"), carrying it sank. The Vessel had a deadweight tonnage ("DWT") of some 8,960. In denying P's claim, D alleged that P had breached a condition that the Vessel's DWT must not be less than 10,000 ("the DWT Condition") and/or was guilty of material non-disclosure on this issue, which would entitle D to avoid the Policy.

One of the issues was whether the DWT Condition formed part of the Policy or whether its inclusion was an error.

Inconsistency in Policy terms

The Court of First Instance (the "Court") accepted the undisputed evidence that the particulars, including the DWT, of a named vessel are relatively easily available through the Internet. In short, by naming a vessel in a policy, the insurer would be able to know such particulars as the DWT of the vessel, and non-disclosure of such particular would not be an issue.

In this case, it is common ground that Ho Feng 7's DWT was less than that prescribed by the DWT Condition, and Ho Feng 7 was expressly named in the Policy. The Court pointed out that there is a clear inconsistency in that Ho Feng 7 was the vessel expressly named in the Policy, but at the same time the Policy stipulated that the vessel's DWT must not be less than 10,000.

In trying to resolve the inconsistency in the Policy terms, the Court quoted the following passage on the rule of construction: "*Where the different parts of an instrument are inconsistent, effect must be given to that part which is calculated to carry into effect the real intention of the parties as gathered from the instrument as a whole, and that part which would defeat it must be rejected.*"[2] *(emphasis added)*

The Court held against D in P's favour. Chung J found that the nature of the Policy is a marine cargo insurance contract. By giving effect to the named Vessel alone, but not to do so for the DWT Condition, would enable such an insurance contract to be carried into effect, namely, to provide insurance coverage for the Cargo. This interpretation is consistent with the purpose of the Policy, which had been similarly expressed as: *"In consideration of the payment to [the Insurer] named in the Policy by or on behalf of the Insured of the premium as arranged, [the Insurer] hereby agree to insure against loss damage liability or expenses as herein provided."*

If, however, the same point was put in another way, that is, to give effect to the DWT Condition, and not the named Vessel, it could not be the contractual intention for the Policy to mean that, despite the payment of premium by the insured, it could never take effect purely because the Vessel named therein never fulfilled the DWT Condition. In view of this absurd result, the Court remarked that had it been necessary to do so, it would have rectified the Policy by deleting the DWT Condition.

[1] Colinvaux's Law of Insurance in Hong Kong (2009 edn), para.3.001

[2] *Chitty on Contracts*, Vol.1, para.12-076

The Court further remarked that it is trite law that the task for ascertaining the parties' contractual intention must be approached objectively. The question to be asked is "the meaning which the contractual document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract": *Investors Compensation Scheme Ltd v West Bromwich Building Society*[3]. Subjective intent and declarations thereof is not admissible background. This passage shows that the principle of construction is one of objectivity, and relates to what a reasonable man in the position of the parties would have believed or intended.

The Court also looked at the previous history of insurance between the parties, which showed that there was no established usual practice to include the DWT Condition in the policies between them. On a true construction and given such history of insurance, the Court held that the insertion of the DWT Condition in the Policy was an error and did not represent the parties' common intention in relation to the Policy.

An afterword

It might be interesting to note from the judgment that, in interpreting a contractual document, the Court would give effect to the real intention of the parties as declared by the words of the policy; no regard was given to any subjective intention or any prior negotiation of the parties. The policy was considered as a whole and individual words which were added in error were ignored.

Lily Man

Zheng Chulin v Wo Wee Hong Kong Industrial Ltd [2012] 4 HKC 522

It is not uncommon for a contracting party to indicate his intention not to perform his obligations when they fall due in the future (i.e. intention to repudiate the contract). In such situation, what are the pitfalls that the other (innocent) party should watch out for in order to avoid prejudicing his attempts to claim different remedies? The Court of Appeal in *Zheng Chulin* case shed light on this issue in the context of a property transaction.

Facts

The plaintiff purchaser (P) and defendant vendor (V) entered into two formal sale and purchase agreements regarding two adjoining properties ("**Agreements**"). The terms of the Agreements were identical except for the particulars regarding the property and the price. V was to deliver up vacant possession of the properties to P on completion. The Agreements stated that time was of the essence. Also, they provided for forfeiture of deposits upon failure of completion and that the defaulting party would be liable for damages and expenses incurred in the sale and purchase. P paid to V the deposits and the agreed proportion of government rent, rates and management fees up to the set completion date.

Completion did not take place as agreed. P alleged that there was a tenant in the properties and V failed to give vacant possession to P. V denied the existence of any tenant in the properties or that it was unable to deliver vacant possession on the set completion date. On the set completion date, V's solicitors wrote to P's solicitors to accept P's repudiation of the Agreements in failing to complete the sale and purchase and to forfeit the deposits. By that letter, V further held P liable for any deficiency in price and expenses incidental to the resale of the properties.

P initially claimed damages only, but then sought to amend the Statement of Claim by introducing an additional claim of specific performance.

The crux was whether the matters pleaded in the Statement of Claim amounted to clear and unequivocal acceptance of V's repudiation of the Agreements so that P should not be permitted to amend his pleading to claim specific performance, as it is trite law that once a repudiation has been accepted, the acceptance cannot be withdrawn. The amendments were allowed by the District Court. V appealed.

Decision

In allowing the appeal, the Court of Appeal held that the amendments should be disallowed.

[3] [1998] 1 WLR 896, 912-913

The Court pointed out that as a general principle, an amendment should be allowed if it was for the purpose of determining a real question in controversy between the parties to the proceedings or of correcting any defect or error in the pleadings. However, if an amendment was not maintainable in law, it would not be allowed.

Citing the House of Lords decision in *Johnson v Agnew*[1], the Court affirmed that in a contract for sale of land, a purchaser could (i) accept a vendor's repudiation of contract and claim damages for breach of contract **or** (ii) seek specific performance with damages for any loss arising from the delay in performance. He was not required to make this election when he proceeded to sue. He might claim damages or specific performance in the alternative and elect at the trial which of the remedies he wished to pursue. However, if a purchaser was regarded to have already elected to treat the contract as repudiated, he could not thereafter seek specific performance, as this followed from the fact that both parties were discharged from further performance once repudiation had been accepted.

The Court stressed that whether there was acceptance of repudiation in a given case was a fact sensitive issue. The Court recognized that the House of Lords decision in *Vitol SA v Norelf Ltd*[2] had affirmed that the act of acceptance of repudiation required no particular form: a communication did not have to be couched in the language of acceptance. Clear and unequivocal communication or conduct conveying to the repudiating party that the aggrieved party was treating the contract as at an end would suffice. However, mere inactivity or acquiescence would generally not be regarded as acceptance for this purpose.

Here, the court decided that on an objective and proper reading of the Statement of Claim, P had clearly and unequivocally accepted V's repudiation of the Agreements. Paragraphs 24 and 25 of the Statement of Claim sought the return of all monies paid by P pursuant to the Agreements, alternatively, loss and damage suffered by P by reason of V's breach. The loss and damage, as particularized in those paragraphs, were the deposits paid by P, plus agency fee and legal costs incurred in the transaction. The claim for return of monies paid and costs and expenses wasted were plainly inconsistent with the subsistence of the Agreements.

Paragraph 26 of the Statement of Claim sought "*further or in the alternative to paras 24 and 25 above, damages to be assessed*". The Court considered that the purpose of such paragraph was to claim damages to be assessed by reason of V's breach rather than the sums particularized in paragraphs 24 and 25. Also, the Court considered that paragraph 26 could not be read to refer to a claim for damages for loss arising from delay in performance, absent any pleadings for such claim in paragraphs 24 to 26.

P argued that (a) repudiatory breach was pleaded as an alternative in the Statement of Claim, and (b) a decision not to pursue a remedy of specific performance did not commit the innocent party to accept repudiatory breach; he was entitled to claim other relief (including damages for the breach) and at the same time maintained the contract (*Bear Sterns Bank v Forum Global Equity*[3]). The Court rejected P's argument. It found that the Statement of Claim merely pleaded repudiation as an alternative to breach of the Agreements. Further, it decided that the dicta in *Bear Sterns* did not apply here, as P (the innocent party) had clearly and unequivocally accepted repudiation.

The Court of Appeal's decision means that if a purchaser elected to claim damages only in his pleadings, he would be taken as having accepted the vendor's repudiation of the contract. The purchaser could not thereafter amend his pleadings to claim an inconsistent remedy (i.e. specific performance), as both parties were discharged from further performance once repudiation had been accepted.

Ada Ng

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

[1] [1980] AC 367
[2] [1996] AC 800
[3] [2007] EWHC 1576 (Comm)