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What's inside

Directors' Duties Regarding Creditors' Interests on Company's Insolvency 2

100% Personal Loan Guarantee Scheme 3

Scope of Implied Duties of Good Faith in Contracts 5

Convoy Global Holdings Ltd v Kwok Hiu Kwan [2020] 4 HKLRD 222 6

Re L & A International Holdings Ltd [2020] 4 HKLRD 544 8

Re Hsin Chong Construction Co Ltd [2020] 1 HKLRD 316 9

Editorial

We feature three articles in this edition.

The first article is about the common law duty of directors to take into account the interest of the company's creditors in the context of insolvency or likely insolvency of companies.

The second article talks about the Government's 100% Personal Loan Guarantee Scheme which aims at providing a supplementary financing option to unemployed individuals who suffer from cessation of main recurrent incomes from employment during the COVID-19 pandemic.

The third article discusses the case law developments in England in the past decade which indicate that courts may be more prepared today to imply a duty of good faith into contracts.

We also feature three case reports.

In the first case, the plaintiffs sought a declaration from the civil court that the defendants had contravened s.131 of the Securities and Futures Ordinance. S.131 creates an offence in that any person who becomes a substantial shareholder of a corporation licensed under s.161 without first being approved by the Securities and Futures Commission commits an offence. The question was whether a civil court should refuse declaratory relief if the declaration in effect amounts to a declaration of criminality.

The second case is about the interpretation of s.729 of the Companies Ordinance, Cap. 622. Cap. 622 is the product of a rewrite of the previous Companies Ordinance, Cap. 32. S.729 of Cap. 622 was modelled on s.350B of Cap. 32. The Court considered whether it was the intention of LegCo that s.729 of Cap. 622 should have similar effect as s.350B of Cap. 32.

The third case is about whether certain dispositions by a company under an agreement infringe s.182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance or the anti-deprivation principle or the pari passu principle.

YUNG Lap-yan

Introduction

In general, directors owe no fiduciary duty to the company's creditors. However, a common law duty to take into account creditors' interests arises in the context of insolvency or likely insolvency of companies.

Nature of common law duty

The duty of directors to take into account the interests of the company's creditors is regarded as being part of the fiduciary duty of directors to act in good faith in the interests of the company. When a company is solvent, the interests of the company are constituted by the interests of the shareholders. When a company is insolvent, the interests of the company are determined on the basis of the creditors' interests since it is the creditors' money now at stake if the company's assets are further depleted[1]. Since the duty is not owed to the company's creditors directly, they do not have standing under the general law to bring an action against the company's directors for a breach of duty[2]. As the duty is owed to the company, the liquidator in a winding-up would have power to take action on behalf of the company against its wrongdoing directors.

When does duty arise?

The directors' duty to have regard to the interests of the company's creditors only arises when the company is insolvent or is likely to become insolvent. "Likely" means probable[3].

Content of the duty

Pursuant to the duty, directors should avoid prejudicing the interests of the company's creditors and should seek to preserve the assets of the company so that those assets may be dealt with in accordance with ordinary principles of insolvency law, including the fundamental principle of *pari passu* distribution of the company's assets amongst the general creditors[4].

Examples of breach of duty

The making of payments by the company could amount to a breach of duty where the transaction does not provide any real benefit to the company and where the payments have effectively reduced the funds available for distribution to its creditors[5]. Where a company in a group of companies transfers assets to another company in the group that benefits the group as a whole, there may still be prejudice to the creditors of the first-mentioned company unless some benefit for that company can be identified[6]. Where a sum is paid by a company to one of its creditors in discharge of a debt, there may be a breach of duty if the payment amounts to a preference to the recipient and the payment does not advance the interests of the creditors as a whole[7]. Transactions at an undervalue to the disadvantage of the company, e.g. a transfer of assets at an undervalue, may also constitute a breach of duty[8]. The giving up of a claim by a company against another party could also amount to a breach of duty[9]. The directors' failure to take reasonable action to protect the company's funds from being lost or dissipated could amount to a breach of duty. Where directors allow a company in financial difficulties to continue trading, there may be a breach of duty if the risks are unjustified, having regard to the need to preserve the assets of the company available for distribution to its creditors[10].

Objective or subjective test?

On the question of whether the duty to take into account interests of creditors is triggered, it appears to be accepted that an objective test is applied. Even if the directors did not know that the company was insolvent or likely to become insolvent, the duty is triggered if they ought to have known[11].

However, on the question of whether there has been a breach of the duty (namely whether the directors have duly taken into account the interests of creditors), it has been held in England and in Hong Kong that a subjective test is to be applied. This is on the basis that the duty to take into account creditors' interests is seen as part of the duty to act in good faith in the interests of the company, and a subjective test is

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[1] *Tradepower (Holdings) Ltd v Tradepower (Hong Kong) Ltd* (2009) 12 HKCFAR 417

[2] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187

[3] *BTI 2014 LLC v Sequana SA* [2019] BCC 631; *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI 398

[4] *Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei* (2014) 17 HKCFAR 466, [57]

[5] *Company Law in Hong Kong: Insolvency* (2021), para. 1.023

[6] *Walker v Wimborne* (1976) 137 CLR 1

[7] *Company Law in Hong Kong: Insolvency* (2021), para. 1.026

[8] *Ibid*, para. 1.027

[9] *Ibid*, para. 1.028

[10] *Ibid*, para. 1.029

[11] *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242

prima facie applied in determining whether the directors have acted in the company's interests. On this approach, directors would not be in breach of duty if they have in good faith considered that the transaction or decision in question would not be prejudicial to the creditors[12].

The courts have held that the application of the subjective test is subject to the following qualifications though. Firstly, the subjective test only applies where the directors have actually considered the interests of the company. If the directors have not put their minds at all to the creditors' interests, the test to be applied in determining whether there is a breach of duty is whether an honest and intelligent person in the position of the directors of the company concerned could, in the circumstances, have reasonably believed that the transaction was for the benefit of the creditors. Also, where a very material interest, for example, that of a large creditor, is unreasonably (i.e. without objective justification) overlooked and not taken into account, the objective test must equally be applied. Failing to take into account a material factor is something which goes to the validity of the directors' decision-making process[13].

[12] *Re HLC Environmental Projects Ltd* [2014] BCC 337; *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* (above)

[13] *Ibid*

Even if the test for breach of the duty to take into account the interests of creditors is *prima facie* a subjective one, there will be a breach of the separate directors' duty to exercise reasonable care, skill and diligence[14] if the directors have acted negligently. This duty incorporates objective elements in the standard of care. Hence, directors can be in breach of duty if they failed to take reasonable care to protect a company as to expose it to a risk of insolvency[15].

Remedies

Remedies for breach of fiduciary duty include misfeasance proceedings[16], an order to repay to the company amounts wrongfully transferred or to compensate the company for its losses, and a declaration of the transaction to be void. Also, third parties can be held liable for their involvement in the director's breach of duty under the principles relating to "knowing receipt" or "knowing assistance".[17]

Ida Chan

[14] See s.465 of the Companies Ordinance (Cap. 622)

[15] *Company Law in Hong Kong: Insolvency* (2021), para. 1.030

[16] See s.276 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)

[17] *Company Law in Hong Kong: Insolvency* (2021), para. 1.031

100% Personal Loan Guarantee Scheme

Background

Hong Kong's economy has been facing significant downward pressure since the outbreak of Coronavirus Disease 2019 (COVID-19) in early 2020. As the labour market deteriorates following the fourth wave of local outbreak, individuals suffering from cessation of main recurrent incomes face financial pressure.

Against this backdrop, the Financial Secretary announced in the 2021-2022 Budget the time-limited 100% Personal Loan Guarantee Scheme ("PLGS"). The application period lasts for six months counting from the launch of the PLGS on 28 April 2021. The Government provides a total commitment of $15 billion for the PLGS, which has already been approved by the Finance Committee of the Legislative Council.

PLGS

The LPGS aims at providing a supplementary financing option to unemployed individuals who suffer from cessation of main recurrent incomes from employment during the COVID-19 pandemic. The Government provides 100% guarantee for concessionary low-interest loans taken out by eligible borrowers.

The key features are summarized below.

Eligible Borrower	Borrowers must:- (i) be Hong Kong permanent residents holding a valid Hong Kong identity card aged 18 or above; (ii) have been unemployed for at least 2 months at the time of loan application; (iii) be able to produce proof of cessation of main recurrent incomes from employment in Hong Kong. Borrowers are required to provide documentary proofs of previous employment and having main recurrent

	incomes for at least 3 months during the period from January 2020 to the announcement of PLGS in February 2021, and a written declaration and proof of unemployment and loss of main recurrent incomes for at least 2 months.
Credit History	No requirement for assessing repayment ability of borrowers, including no requirement for satisfying any minimum credit rating or for having no outstanding default. Borrowers must not be undischarged bankrupts, or be subject to any bankruptcy petition or proceedings at the time of loan application and shall maintain valid bank accounts in Hong Kong.
Maximum Repayment Period	6 years counting from the loan drawdown.
Principal Moratorium	Borrowers may apply for principal moratorium for the first 12 months from the loan drawdown.
Maximum Loan Amount Per Individual	The maximum amount of loan per eligible borrower is the lower of:- (i) 6 times the average monthly income for any 3 months from January 2020 to the announcement of LPGS in February 2021; (ii) 6 times the average monthly assessable income as calculated with reference to tax demand note for financial year 2019/2020; or (iii) HK$80,000.
Loan Type	Term loans only.
Use of Loan Proceeds by Borrower	No restriction.
Interest Rate and Interest Rebate	The annualised percentage rate is 1%. Borrowers will receive full rebate of the interest payments made after the loan and interests are fully repaid by the end of the scheduled repayment period, which is 6 years at maximum, notwithstanding any interim delinquencies.
Collateral Requirement	Nil. If a borrower does not fulfil the repayment obligations, it may adversely affect the borrower's credit records maintained at the credit reference agencies. The Participating Lending Institution ("PLI") concerned will also follow up in accordance with its usual processes.
Guarantee Fee	Nil.

Scheme Arrangements, Loan Recovery and Safeguards

Under the PLGS, loans are originated by the PLIs (which are essentially commercial banks in Hong Kong). A borrower applies to a PLI for a loan. As the scheme administrator, the HKMC Insurance Limited ("HKMCI") will rely on the professional expertise, judgement and care of PLIs in conducting customer due diligence and verification of borrowers' eligibility.

After drawdowns, the loans will be sold by PLIs to Hong Kong Mortgage Corporation Limited ("HKMC"), acting as agent of the Government, without recourse to the PLIs. The Government will provide funding to HKMC for the purchase of the loans.[18] After the purchase, the loans will actually be owed by borrowers to the Government; and the Government will appoint the PLIs to service the loans for the Government. For each loan purchased by HKMC for and on behalf of the Government, the Government bears an originating fee and a loan servicing fee provided to the PLI concerned, and an administration fee provided to the HKMCI.

Although no credit assessment will be carried out[19], certain control and safeguard measures will be adopted to minimize the risks of abuse of the PLGS. For example, HKMCI will conduct upfront quality assurance sample check at the application stage; and PLIs (as servicers of the loans) will report the repayment history of borrowers under the PLGS to relevant credit reference agencies.[20]

If a borrower defaults on repayment for a loan, a PLI concerned will initiate appropriate recovery actions against the borrower. The Government will reimburse PLIs for the necessary enforcement and debt recovery expenses incurred by them in relation to a defaulted loan.[21] In essence, if borrowers default, the outstanding loans and the associated debt recovery expenses will be borne by the Government. The expected default loss (i.e. revenue forgone by the Government) is estimated to be around $3.75 billion.[22] Loan repayments will be credited to the general revenue.

Ada Ng

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18 Para. 11 of the Finance Committee Paper FCR(2020-21)105 on 26 March 2021 at: https://www.legco.gov.hk/yr20-21/english/fc/fc/papers/f20-105e.pdf ("Relevant FC Paper")

19 Footnote 3 of the Relevant FC Paper

20 Para. 14 of the Relevant FC Paper

21 Para. 12 of the Relevant FC Paper

22 Para. 18 of the Relevant FC Paper

Scope of Implied Duties of Good Faith in Contracts

Introduction

There is no general duty of good faith applicable for all contracts as a matter of law in England or Hong Kong. Absent express inclusion of a good faith duty, such a duty will only be implied into contracts in limited circumstances. Case law developments in England in the past decade indicate, however, that courts may be more prepared today to imply such a duty into contracts.

Meaning of "good faith"

A duty to act in good faith reflects the expectation that a contracting party will act honestly towards the other party and will not conduct itself in a way which is calculated to frustrate the purpose of the contract or which would be regarded as commercially unacceptable by reasonable and honest people[23]. "Good faith" requires parties to adhere to the spirit of the contract, to observe reasonable commercial standards of fair dealing, to be faithful to the agreed common purpose and to act consistently with the justified expectations of the parties[24].

When is a duty of good faith implied into a contract?

For certain categories of contracts, a duty of good faith is implied as a matter of law, such as in employment, partnership or insurance contracts.

Apart from such established categories, a duty of good faith can be implied into a contract on the basis of the general principles of implication of terms in fact, based on the objective intention of the parties. The judge in *Yam Seng Pte Ltd v International Trade Corp Ltd*[25] suggests that a good faith duty to act honestly can often be implied into a contract, including commercial contracts, since a general norm which underlies almost all contractual relationships is an expectation of honesty and a requirement that parties will behave honestly is so obvious that it goes without saying. Such a requirement is also necessary to give business efficacy to commercial transactions.

In *UTB LLC v Sheffield United Ltd*[26], the judge suggested that the test is "whether a reasonable reader of the contract would consider that an obligation of good faith was obviously meant or whether the obligation is necessary to the proper working of the contract". The courts have emphasized that whether good faith duties are to be implied is heavily dependent on the context, including the overall character of the contract as well as the particular terms[27].

The courts may be more willing to imply duties of good faith in "relational contracts", namely contracts that require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence, such as certain joint venture agreements, franchise agreements and long term distributorship agreements. Such contracts may involve expectations of loyalty which are not set out in the express terms but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements.

In *Yam Seng*, which involved a distribution agreement between the plaintiff and defendant distributor for exclusive distribution rights for sale of Manchester United branded products in duty-free outlets in Singapore, the judge held that a duty of good faith was to be implied into the contract. This gave rise to two specific duties, namely a duty to not knowingly provide false information on which the other party would likely rely and a duty on the defendant not to undercut prices (by selling to other retailers at lower prices enabling them to sell below the duty-free prices of the plaintiff). The first duty was implied as such conduct would clearly be contrary to standards of commercial dealing which the parties would have taken for granted. The second duty was implied in the special circumstances where the duty free retail price of the plaintiff was specified in the contract and where the industry assumption was that general retail prices will be higher than the corresponding duty free retail prices at airports.

In *Yam Seng*, the judge also took into account the fact that the written contract between the parties was not professionally drafted and was only a very simple document. In other cases, courts have observed that it will be difficult to imply a duty of good faith where the contract is a complex one between two sophisticated parties who negotiated at arm's length.

[23] *Astor Management v Atalaya Mining* [2017] EWHC 425 (Comm), [98]
[24] *CPC Group Ltd v Qatari Diar Real Estate Investment Co* [2010] EWHC 1535 (Ch), [246]
[25] [2013] EWHC 111 (QB), [135]-[137]
[26] [2019] EWHC 2322 (Ch), [203]

[27] *Ibid*; *Globe Motors v TRW Lucas Varity* [2016] EWCA Civ 396, [68]

Further, a term of good faith would not be implied where it conflicts with an express term[28].

Discretionary contractual powers

The element of good faith may also arise if a "Braganza duty" is implied into a contract. Following the UK Supreme Court decision of *Braganza v BP Shipping Ltd*[29], a duty may be implied to control the exercise of a contractual power which allows a party to exercise discretion (including a discretion that is expressed to be "sole" or "absolute") or which requires a party to make an evaluative judgment or to form an opinion as to relevant facts. Where appropriate, a Braganza duty will be implied so that the decision-making process must be rational in the public law sense[30]. Pursuant to such a duty, the contractual power must not be exercised arbitrarily, capriciously or unreasonably. Wholly extraneous considerations must be excluded, and obviously relevant ones must be taken into account, in the decision-making process. In *Braganza*, the court held that such a duty should be implied in respect of an employer's decision under the employment contract on whether the employee committed suicide (so as to deny liability to the claimant for a death-in-service benefit under the contract). The court held that the employer's decision was invalid where there was little evidence to justify a conclusion of suicide.

Whether a Braganza duty is to be implied also depends on the test of necessity, namely whether, in the context of the contract, a restriction on the contractual power is essential to give effect to the reasonable expectations of the parties and their presumed intentions[31]. In *Cathay Pacific Airways Limited v Lufthansa Technik AG*[32], it was held that a Braganza duty is more likely to be implied if the contractual discretion has to be exercised considering a range of options taking into account the interests of both parties, rather than making a simple decision as to exercising an absolute contractual right. For example, it has been held that a contractual right of termination is not a discretion and may be exercised irrespective of the party's reasons for doing so[33].

[28] *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313
[29] [2015] 4 All ER 639
[30] *Ibid*, [30]
[31] *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd* [2020] QB 418, [148], [151], [158]
[32] [2020] EWHC 1789
[33] *Mode Petroleum SA v Western Zagros Ltd* [2016] EWHC 1472 (Comm)

Conclusion

After *Yam Seng* and *Braganza*, there is a greater possibility of courts deciding that a duty of good faith can be implied in fact. However, the traditional position that duties of good faith are not implied automatically in all contracts still stands. It remains to be seen how the higher courts in the UK and the courts in Hong Kong will further develop the law in this area.

Kennis Lam

Convoy Global Holdings Ltd v Kwok Hiu Kwan [2020] 4 HKLRD 222

Facts

The plaintiffs in these proceedings ("SFO Action") were Convoy Global Holdings Ltd ("Convoy") and its wholly-owned subsidiary CSL Securities Ltd ("CSL") (collectively, "Ps"). Convoy is listed on the Main Board of the Hong Kong Stock Exchange. CSL is a corporation licensed by the Securities and Futures Commission ("SFC") under s.116 of the Securities and Futures Ordinance (Cap. 571) ("SFO") to carry out Type 1 and Type 4 regulated activities.

The 1st Defendant ("D1") was Mr. Kwok and the 2nd Defendant ("D2") was Mr. Chen. They held together a 37.38% shareholding stake in Convoy ("37% Stake").

There were a number of related proceedings, including HCA 2922/2017 ("Main Action"). In the Main Action, Convoy, CSL and Convoy Collateral Ltd alleged that certain shares allotted by Convoy in 2015 were void or voidable and that the 37% Stake owned by D1 and D2 could be traced from the disputed allotment and ought to be rescinded as being invalid. Various declarations and injunctions were sought to restrain D1 and D2 from exercising the voting rights of, or transferring or otherwise dealing with their interest in, the 37% Stake.

In the SFO Action, Ps sought a declaration that D1 and D2 had contravened s.131 of the SFO and an injunction restraining D1 and D2 from exercising their voting rights in Convoy.

D1 and D2 sought to strike out the SFO Action on the grounds of failure to disclose a reasonable cause of action and abuse of process.

Issues

The issues were:

(a) whether there was a sustainable claim for Ps to seek declaratory relief, which in this case depended on:

    (i) whether there was any private right of action for breach of statutory duty under s.131 of the SFO; and

    (ii) whether the declaration sought by Ps constituted a declaration of criminality; and

(b) whether there was any abuse of process by Ps in view of both the Main Action and the SFO Action.

Decision

Court's jurisdiction to grant declaratory relief

The Court stated that an applicant seeking to invoke the Court's jurisdiction to grant declaratory relief must show that[34]:

(a) he has a real interest in the subject matter of the declaration ("real issue requirement");

(b) he has a real interest in obtaining a declaration against the adverse party ("real interest requirement"); and

(c) the adverse party is a proper contradictor.

A practical utility approach should be adopted by asking whether the Court's jurisdiction to grant declaratory relief is properly exercisable.

No private right of action

The Court reviewed the relevant statutory regime under the SFO. S.116 provides for corporations to be licensed for carrying on regulated activities and requires, *inter alia*, an applicant to be a fit and proper person. S.129 sets out factors for the SFC to consider when determining whether a person is fit and proper. S.131 imposes restrictions on a substantial shareholder of a licensed corporation by creating two offences — a person who (a) becomes and continues to be a substantial shareholder of a corporation licensed under s.116 without first being approved by the SFC under s.132, or (b) purportedly exercises any voting right which is not exercisable by virtue of s.131(4), commits an offence. These regulatory offences are for the protection of members of the public dealing with or using the services of the licensed corporation. The SFC is the enforcement authority. There is nothing on the face of the statute to suggest that the offences are intended to regulate any private rights as between the licensed corporation and its shareholders, or as between shareholders amongst themselves. Moreover, s.133 provides the SFC with a power to direct the licensed corporation to deem void and of no effect any votes cast by the person who has not sought the SFC's prior approval to becoming or continuing to be a substantial shareholder.

In light of the relevant statutory regime summarized above, the Court took the view that there were no legal rights really in issue. What Ps really sought through the declaratory relief was to confirm their stance that the facts do bring ss.131 and 132 into effect and do permit certain further steps by operation of those sections. But the Court did not need to declare what those sections state, or what those sections bring into effect or permit by operation of their terms. As such, the declaration sought by Ps served no practical purpose or utility. The Court also took the view that the policing powers of those sections were granted to the SFC and it was not for the court to usurp the SFC's role. For these reasons, the Court held that there is no private right of action for breach of statutory duty under s.131 of the SFO.

Declaration of criminality

The Court referred to the established principle that a civil court would normally refuse declaratory relief that certain conduct amounts to criminal conduct[35], and held that the declarations sought by Ps would in effect amount to a declaration as to criminality. It explained that once it is understood that the purpose of s.131 is simply to create the offences, any declaration that it has been contravened is a declaration of criminality.

No sustainable claim to seek declaratory relief

In view of the above, the Court held that Ps could not satisfy the "real issue requirement" and "real interest requirement".

Abuse of process

The Court found that the orders sought by Ps in the Main Action were similar to those sought in the SFO Action. As such, the only reason to commence the SFO Action pleading the same facts is presumably to seek an earlier result or there would be no practical purpose at all. If it was the former, the Court did not think any case management orders could remove any abuse of process concerns. A more proper approach,

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[34] Applying _Koo Ming Kwon v Rev Mr Mok Kong Ting_ [2018] HKCFI 967

[35] _R v DPP ex p Camelot Group_ (1997) 10 Admin L Rep 93

in order to obtain an earlier result to prevent D1 and D2 from voting, would be to make an application for an interim injunction in the Main Action. The Court stated that a second action, relying on the same facts as in the Main Action, seemed to be an abuse of process.

Conclusion

The SFO Action was dismissed.

Sandy Hung
(Commentary prepared with the assistance of Mr Carter Chim of Denis Chang's Chambers)

Re L & A International Holdings Ltd [2020] 4 HKLRD 544

Facts

The Plaintiff ("P") initially held 10.21% of the shares of L & A ("D1"), a listed company. Subsequent to a general offer to acquire all shares in D1, P requisitioned an extraordinary general meeting ("EGM") to remove D1's directors. D1 then granted share options ("Disputed Options") and, upon their exercise, allotted shares ("Disputed Shares") to the defendants ("D", some of which were D1's directors), with the intention of defeating the general offer and diluting P's shareholding in D1 to below 10% so as to frustrate its requisition for an EGM. In light of D's refusal to convene the EGM, P purchased more shares to increase its shareholding in D1 to above 11% ("Further Purchase"). On 26.8.2016 ("Action Date"), P issued the originating summons pursuant to ss.728-730 of the Companies Ordinance (Cap. 622) ("CO"), seeking orders for:

(a) a declaration that the granting of the Disputed Options, and allotment of the Disputed Shares, is void;

(b) D to restore D1's shareholding structure by acquiring such number of shares equivalent to the Disputed Shares from the market and returning them to D1 for cancellation;

(c) damages to P for losses suffered as a result of the granting of the Disputed Options and the wrongful allotment of the Disputed Shares.

The lower court held that injunctive relief was not available but ordered D to pay damages to P. D appealed to the Court of Appeal ("CA") on the question of jurisdiction to award damages if an injunction cannot be granted and on quantum.

Jurisdiction Ground

Construction of s.729

S.729(1) of the CO provides that the court may, on application by a member whose interests have been affected, do any or all of the following: grant an injunction; order damages; declare a contract to be void or voidable. An order may be made under s.729 if, *inter alia*, directors have breached their duties.

The wording used in s.350B of the previous CO (Cap. 32) (i.e. predecessor of ss.728-730 of the CO) was different. In particular, s.350B(7) provided that the court may, *in addition to or in substitution for the grant of an injunction*, order the payment of damages.

The modern approach to statutory interpretation is to adopt a purposive interpretation. Words in statutes are given their natural and ordinary meaning unless the context or purpose points to a different meaning. Context and purpose are considered when interpreting the words used and not only when there is ambiguity. CA considered it necessary to construe s.729 in its proper context, including the predecessor provision s.350B and the remedies in the CO for a derivative action to obtain damages. CA also considered it relevant to take into account the Legislative Council Brief introducing the CO.

CA considered it clear that s.350B(7) only conferred a discretion on the court to award damages in addition to or in substitution for an injunction, without creating a free-standing right on the part of members for damages arising out of breaches of duties to the company. CA further noted that the CO was not drafted from scratch but the product of a rewrite. Subject to certain identified changes which did not concern s.729, the rewrite served to restate existing law in modern language without changing its substance. Based on the legal principle that "Parliament should not change either common law or statute law by a sidewind, but only by measured and considered provisions"[36], CA doubted if it was the legislative intent to confer on the court a general power to award damages under s.729(1), a position fundamentally different from s.350B(7), in circumstances where the Legislative Council papers introducing the CO indicated that no major changes were being made to the previous law on s.350B.

CA thus concluded that notwithstanding the use of "any or all" in s.729(1), having regard to the entire admissible context, it should be interpreted in a manner similar to s.350B, i.e. an order for damages

[36] *Bennion on Statutory Interpretation* (7th ed.), at 703

thereunder should only be granted in addition to or in substitution for an injunction.

Injunction possible?

CA then considered whether the lower court could have granted an injunction on the Action Date, failing which its order for payment of damages should be set aside.

D asserted that an injunction could not have been granted as the Disputed Shares had been sold in open market as at the Action Date. CA disagreed. On that day, ownership of the Disputed Shares had yet to change as settlement of trades through the Stock Exchange occurred two trading days after the trade date. The court could have still granted an injunction to restrain disposition of the Disputed Shares and to restrain D from recognising or giving effect to the Disputed Shares.

Damages to whom?

In the circumstances of wrongful allotment of shares causing dilution of shareholdings for a member (i.e. P), CA was satisfied that damages may be ordered to be paid under s.729(1) to P as substitutive compensation in lieu of an injunction.

Quantum Ground

D asserted that P's Further Purchase was more than necessary to restore its initial shareholding in D1 and that the lower court failed to apply the compensatory principle when it allowed damages for the entire cost of the Further Purchase. At common law, damages are assessed on a compensatory basis by reference to the position the plaintiff would have been in if the obligation had not been breached.

The wrongful allotment of shares did not cause loss of property to P as such, given that while its stake in D1 was diluted, its shares remained intact. Even if P behaved prudently in the Further Purchase, this was for improving its position only and did not transform the expenses involved into a loss. Hence, CA held that P could not claim the whole cost of the Further Purchase but only the cost for restoring its property to what it was before, i.e. a 10.21% stake in D1. The lower court's order for damages was set aside and was substituted with one in a lesser amount.

Quinnci Wong
(Commentary prepared with the assistance of Mr Carter Chim of Denis Chang's Chambers)

Re Hsin Chong Construction Co Ltd [2020] 1 HKLRD 316

Facts

The Appellant (the "Company") and the Respondent entered into a joint venture agreement (the "JVA") to establish a joint venture (the "JV"). Clause 17.1 of the JVA provided that the occurrence of any of the five events on the part of the defaulting party would give the other party an option to (i) exclude the defaulting party from further participation in the JV and take over its benefits; or (ii) wind up the affairs of the JV. One of the five events of default that could trigger the rights of exclusion in Clause 17 was a party's insolvency. In case Clause 17.1 is triggered, an accounting exercise would be undertaken under Clause 17.5 to determine the defaulting party's proportionate share of profits up to the date of its exclusion less (i) its share of losses arising whether before or after the date of exclusion, and (ii) costs, expenses, losses and damages incurred by the other party as a result of the default.

Following the award of a government contract (the "Contract") to the JV, the Company encountered financial difficulties and a winding-up petition was presented against it. The Respondent then purported to exercise its rights under Clause 17 to exclude the Company from the JV by acquiring all the Company's residual rights in the JV, i.e. the Company's interest in whatever profit generated by the JV and its right to participate in the JV and the Contract ("Acquisition") such that the Company would have no further involvement in the JV.

The Company sought to argue, *inter alia*, that:

(i) the exclusion of the Company from the JV pursuant to Clause 17 was void under s.182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32); and

(ii) Clause 17 should be pronounced as ineffective for infringing the anti-deprivation principle (the "ADP") or the *pari passu* principle (the "PPP").

At first instance, Deputy Judge Le Pichon (the "Judge") held, *inter alia*, that:

(i) the Respondent's exercise of its exclusion rights under Clause 17 did not involve a disposition of the Company's property within s.182; and

(ii) Clause 17 did not infringe the ADP or the PPP.

The Company appealed against the Judge's decision.

Decision

Whether Clause 17 involved disposition of the Company's property within s.182

S.182 provides that any disposition of the property of a company after the commencement of winding up is void, unless the Court orders otherwise.

The Company argued that the subject matter of the Acquisition should be treated as "property" of the Company under s.182.

The Court of Appeal (the "CA") rejected the Company's argument by referring to *Re Campbell (A Bankrupt)*[37] that a mere expectation to be paid money is not "property" within s.182, as such indeterminate right is not a contingent interest in property, but a mere possibility of achieving an interest in something which presently does not exist but may exist in the future. Also, according to *Revenue and Customs Commissioners v Football League Ltd*[38], there was no legal entitlement to future profits unless the Company was in a position to perform and had performed its contractual obligations.

The CA held that as the Company was unable to perform its contractual obligations, there was no basis to assert that the Company had been deprived of a right to share the JV's future profits or participate in the Contract. Hence, the Acquisition did not involve disposition of the Company's property within s.182.

Whether Clause 17 infringed the ADP

The ADP is a common law principle that prevents parties from contractually agreeing to remove assets from a company which would otherwise form part of the insolvent estate for distribution to the company's creditors upon its liquidation.

The Company argued that the Judge erred in taking into account the commercial justification and intention of the parties in determining whether an agreement infringed the ADP. The CA disagreed. According to *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd*[39], it was necessary to look at the substance of the agreement and consider whether the provision amounted to an illegitimate attempt to evade insolvency law or had some legitimate commercial basis.

In this case, only one of the five events specified in the exclusion clause (i.e. Clause 17) concerned insolvency. This suggested an absence of intention of the parties to evade insolvency law and it was clearly sensible and in the interests of the parties to provide for the contingency that has occurred, namely, the insolvency of one of the parties. The CA upheld the ruling that there was no infringement of the ADP as the exclusion clause did not amount to an illegitimate attempt to evade insolvency law and had some legitimate commercial basis.

Whether Clause 17 infringed the PPP

The PPP is a common law principle that prohibits parties from contracting out of the legislation for *pari passu* distribution to creditors in a winding-up.

The CA held that the contractual arrangement under Clause 17.5 negotiated at the outset of the JV merely qualified the nature of an asset on the exercise of the exclusion rights on insolvency (i.e. the Company's interest in the JV). Clause 17.5 did not remove from the creditors an asset otherwise available for distribution. Hence, the PPP was not engaged or infringed.

In the light of the above, the Company's appeal was dismissed.

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(Commentary prepared with the assistance of Mr Carter Chim of Denis Chang's Chambers)

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37 [1997] Ch 14
38 [2012] Bus LR 1539
39 [2012] 1 AC 383