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Editorial

We feature three articles in this edition.

The first article talks about the establishment, governance and investments of the Hong Kong Growth Portfolio.

The second article discusses the irregularity principle in company law which provides that where a company's meeting involves procedural irregularity, the validity of the meeting and the lawfulness of the decisions passed at such meeting cannot be questioned, if the only fact alleged to make them unlawful is a "mere informality". A recent Hong Kong case shows that it may sometimes be difficult to predict whether a particular procedural irregularity would be regarded by the court as a "mere informality" and could not be questioned.

The third article discusses the modern test on liquidated damages and penalty following the UK Supreme Court decision in *Cavendish Square Holding BV v Makdessi*.

We also feature three case reports in this edition.

The first case concerns the construction of a "tail gunner clause" in a financial advisory agreement between a company and its financial advisor engaged to raise funds for the company. The clause provides that if the company completes fundraising transactions "introduced" by the financial advisor within two years after termination of the financial advisory agreement, the company shall pay the financial advisor a transaction fee. The Court of Final Appeal had to decide whether on a true construction of the clause, the financial advisor would be entitled to a transaction fee if it merely "introduced" an investor to the company but played no part in bringing about the fundraising transaction.

The second case is about an agreement for the sale and purchase of shares in a company. The agreement provides that the vendor will not be liable for any warranties under the agreement unless notice of a claim is received by the vendor within a stipulated period. The Court of Appeal had to decide whether on a true construction of the notice clause, it only required the giving of a notice without having to identify which of the warranties the claim was in respect of and without having to set out any details of the claim.

The third case is about the interpretation of s.182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32). The Court considered whether it had jurisdiction to issue an order to validate the issue of new shares and convertible bonds by a company which was being wound up by the court.

YUNG Lap-yan

Introduction

In his 2020-21 Budget Speech, the Financial Secretary (“FS”) announced that he would use part of the Future Fund (“FF”) to establish a new portfolio, named Hong Kong Growth Portfolio (“HKGP”), to make strategic investments in projects with a Hong Kong nexus. The objectives are to reinforce Hong Kong’s status as a financial, commercial and innovation centre, and raise the productivity and competitiveness of Hong Kong in the long run¹.

What is FF?

FF is an integral part of the Land Fund (“LF”), which was established on 1 July 1997 by Resolution of the Provisional Legislative Council (i.e. the LF Resolution, Cap. 20) to receive and hold all of the assets transferred from the Hong Kong Special Administrative Region Government Land Fund².

Pursuant to paragraph 7 of the LF Resolution, FS may authorize and direct the investment of any assets of LF which are not immediately required to meet expenses in respect of LF at any time in such manner as he may determine. As directed by FS, LF is managed by the Hong Kong Monetary Authority³.

On 1 January 2016, the balance of LF of \$219,730 million was set aside by FS to set up FF for long term investment with a view to securing higher investment returns. Initially, FF was placed with the Exchange Fund (“EF”) for an initial 10-year investment period. About 50 per cent of FF is set aside for incremental placement with the EF’s Long-Term Growth Portfolio, which includes private equities and investments in properties outside Hong Kong. The rest is placed with the EF’s Investment Portfolio or other investment assets⁴.

Establishment and Governance Structure of the HKGP

¹ See the Financial Services and the Treasury Bureau’s website, at: https://www.fstb.gov.hk/en/financial_ser/hong-kong-growth-portfolio.htm

² Land Fund, Memorandum Note, at: <https://www.budget.gov.hk/2022/eng/pdf/land.pdf>, para 1

³ Land Fund, Memorandum Note, at: <https://www.budget.gov.hk/2022/eng/pdf/land.pdf>, para 4

⁴ Land Fund, Memorandum Note, at: <https://www.budget.gov.hk/2022/eng/pdf/land.pdf>, para 7, and HKSAR Government Press Releases, at: <https://www.info.gov.hk/gia/general/201512/18/P201512180542.htm>

Upon the recommendations of the Group of Experienced Leaders on FF⁵, FS decided to deploy 10% of FF (around HK\$22 billion) from the EF’s Investment Portfolio to establish HKGP in 2020. For making investment for HKGP, instead of having the Government evaluating investment projects one by one, the Government will appoint private equity funds as general partners and the Government will be a limited partner⁶.

A two-tier committee framework, including a Governance Committee (“GC”) and an Investment Committee (“IC”), has been set up for HKGP. Chaired by FS, GC is a high-level advisory committee to provide strategic steering for the HKGP and give guidance on matters such as investment mandates and asset allocation. IC is chaired by the Secretary for Financial Services and the Treasury, and comprises representatives from relevant government agencies to, among others, decide on the appointment of general partners who will make investments for the HKGP⁷.

As of 30 December 2021, a total of eight general partners⁸, which are all private equity firms⁹, have been appointed by IC to make investments for HKGP. These appointed private equity firms have extensive experience in making Hong Kong nexus investments, including projects in Hong Kong and the

⁵ See <https://www.info.gov.hk/gia/general/202002/26/P2020022600468.htm> for a summary of the Group’s recommendations

⁶ SCMP, “Selection of fund managers to help run Hong Kong’s new US\$2.8 billion investment vehicle to begin in year’s second half, Paul Chan says”, 12.6.2020, at: <https://sg.news.yahoo.com/selection-fund-managers-help-run-113416334.html>

⁷ HKSAR Government Press Releases, at: <https://www.info.gov.hk/gia/general/202009/30/P2020093000707.htm> and FSTB website, at: https://www.fstb.gov.hk/en/financial_ser/hong-kong-growth-portfolio.htm

⁸ HKSAR Government Press Releases, at: <https://www.info.gov.hk/gia/general/202109/03/P2021090300263.htm> and <https://www.info.gov.hk/gia/general/202112/30/P2021123000158.htm?fontSize=1>

⁹ In general, a private equity firm refers to an investment management company which makes investments in private equity. Private equity is a finance instrument which is not publicly listed or traded and is created for the purpose of investing in companies with high growth potentials and/or acquiring company’s shares for a specific period of time. See: Gozde Akansel, Fatma; Dogan Ocak, Gul, “Private Equity Investment Funds” (2017), GSI Articletter, Vol. 16, pp. 199-212; and <https://www.investopedia.com/articles/financial-careers/09/private-equity.asp>

Guangdong-Hong Kong-Macao Greater Bay Area (“GBA”) and are used to invest in a wide spectrum of industries including technology, healthcare, logistics, supply chain management, business and financial services, and consumer products¹⁰.

Further Injection into HKGP

In the 2022-2023 Budget Speech, FS announced an injection of another HK\$10 billion into the HKGP. Half of the fund would be used to establish a Strategic Tech Fund to invest on technology enterprises which are of strategic value to Hong Kong as well as investments conducive to enriching Hong Kong’s innovation and technology ecosystem. The Hong

¹⁰ See: footnote 9 above

Kong Science and Technology Parks Corporation and the Cyberport will be invited to identify technology enterprises which are of strategic value to Hong Kong as well as investment opportunities conducive to enriching the innovation and technology ecosystem. As for the remaining \$5 billion, it will be used to set up a GBA Investment Fund, which will focus on investment opportunities, particularly in the development of various priority industries, in the GBA¹¹.

Sandy Hung

¹¹ See the 2022-2023 Budget Speech, https://www.budget.gov.hk/2022/eng/pdf/e_budget_speech_2022-23.pdf, paras 57 and 90

Irregularity Principle: Majority Rules?

Introduction

An aggrieved member of a company may challenge a decision made at a members’ meeting of the company. The majority shareholders of the company may invoke the irregularity principle against such challenge to argue that the court should not interfere. The following discusses what the irregularity principle is, its application in practice and its limits as clarified in a recent case.

Irregularity Principle

In gist, the irregularity principle provides that where a company’s meeting involves procedural irregularity, the validity of the meeting and/or the lawfulness of the decisions passed at such meeting cannot be questioned, if the only fact alleged to make them unlawful is a mere informality. The principle has been applied to enable meetings to be regarded as having been validly held despite there being procedural irregularity.

Le Pichon J summarized the principle in *Yip Peter v Asian Electronics Ltd*¹², “...the lawfulness of a decision taken by a meeting of members or board cannot be questioned if the only facts alleged to make it unlawful is a mere informality and irregularity and the intention of the meeting is clear. This is particularly so if there is no evidence that the decision of the meeting would have been different if the correct procedure had been observed. In this connection, it is appropriate to refer to what Cotton LJ observed in

¹² [1998] 2 HKC 96, 102-103

*Browne v La Trinidad*¹³, ‘A Court of Equity refuses to interfere where an irregularity has been permitted if it is within the power of the persons who have permitted it at once to correct it by calling a fresh meeting and dealing with the matter with all deal formalities.’”

Lack of Notice

One of the usual procedural irregularities is the failure to send notice to shareholders in accordance with the articles of association of the company (“articles”).

In *Re Green Valley Investment Ltd*¹⁴, the defendants were the directors and majority shareholders of the company while the plaintiffs were minority shareholders from China. The defendants held an extraordinary general meeting to pass resolutions authorizing lawyers to act for the company in legal proceedings and authorizing some of the defendants to handle those proceedings. The plaintiffs did not attend the meeting as they did not receive notice. The notice was sent to a Hong Kong address stated to be the plaintiffs’ address on the annual returns of the company, notwithstanding that the defendants knew that the plaintiffs would not receive the notice at such Hong Kong address. The plaintiffs sought declarations that the meeting was invalid and the resolutions passed void.

Despite the court found that the failure to send notice to the minority shareholders arose from a choice of service not made in good faith, it held that so long as the irregularities affecting internal management could

¹³ (1888) 27 Ch. D. 1

¹⁴ [2003] 2 HKLRD 915

be regularized by the majority shareholders in a properly convened meeting and the same did not constitute fraud on the minority, the court should not interfere in the internal management. The court did not find fraud on the minority as the resolutions passed at the meeting were for the benefit of the company. The majority shareholders successfully relied on the irregularity principle for the court not to interfere with the resolutions passed at the meeting.

Inquorate Meetings

Another usual procedural irregularities at members' meetings is the lack of quorum in accordance with the articles. In general, meetings cannot proceed without a quorum and inquorate meetings are invalid¹⁵. That notwithstanding, whether a member may successfully challenge the lawfulness of the decisions made at an inquorate meeting is subject to the irregularity principle. If the view of the majority members is clear and that the members would pass the resolutions in the same manner if the meeting was reconvened with a quorum, the court may not interfere by declaring that the resolutions passed at the inquorate meeting were invalid¹⁶.

In a recent case *Chen Pao Tzu v Chen Sheng Kuei & Ors*¹⁷, the court clarified the scope and limits of the irregularity principle in the context of inquorate meetings. The articles provided that the company business may only be transacted at a members' meeting where at least two members were present in person or by proxy. The company was held by Chen (as to 10%) and by Full Kang Company Limited (as to 90%).

A members' meeting was purportedly held to remove the plaintiff as a director and to appoint the principal defendants as directors. Despite the quorum requirement in the articles, the resolutions for the said change in directorship ("Resolutions") were passed by two representatives both representing Full Kang. Neither Chen nor his proxy was involved in passing the Resolutions.

The plaintiff applied to the court to impugn the Resolutions. The defendants resisted the application based on the irregularity principle, arguing that since Full Kang was a 90% majority shareholder and voted in favour of the Resolutions, the Resolutions would have been passed by a majority had there been a quorum. The court allowed the plaintiff's application on the grounds that:

- (a) the defendants failed to show that Full Kang could have held a quorate members' meeting in accordance with the articles (i.e. with the presence of Chen in person or by proxy) in view of Chen's poor health; and
- (b) while the court was empowered, under s.570 of the Companies Ordinance (Cap. 622), to give a direction that one member present at the meeting was to be regarded as constituting a quorum, the defendants did not make any application under s.570 of Cap. 622 for such direction and did not seek to convene a new meeting to ratify the Resolutions.

Linda Chan J expressed that, "... *The Court does not simply look to ascertain whether the result...was one which the majority shareholders would approve of...There is...an implicit requirement that the irregularity was one which could have been cured by the majority...the principle does not operate to validate a resolution which the majority shareholders could not have lawfully passed.*"

Conclusion

To invoke the irregularity principle in resisting the challenge of an aggrieved member as to the validity of a resolution passed with procedural irregularity, it is insufficient for the majority shareholders to show that they are in favor of such resolution. They must show that the irregularity was one which could have been cured by the majority and that the same result would inevitably be obtained.

Kristy Tse

¹⁵ *Re Alma Spinning Co (Bottomley's case)* (1880) 16 Ch. D. 681

¹⁶ *Lim Jonathan v She Wai Hung* [2011] 1 HKLRD 305

¹⁷ [2021] HKCFI 299

An Update on the Law in Relation to Liquidated Damages and Penalty

Introduction

Parties may agree in a contract that if a party breaches

the contract, that party pays a pre-agreed sum to the other party without the need for the other party to provide evidence to prove its loss. If the defaulting

party challenges the validity of such provision before the court, whether such provision is enforceable depends on whether the court considers that the amount payable thereunder is liquidated damages (therefore enforceable) or a penalty (therefore not enforceable). This article provides an update on the legal position in relation to liquidated damages and penalty.

The traditional *Dunlop* approach

Whether a provision requiring the payment of money in the contract is a penalty or liquidated damages is a question of law to be decided by courts¹⁸. For many years the “genuine pre-estimate test” summed up in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* (“*Dunlop*”)¹⁹ was regarded as the only applicable test²⁰. Based on this approach, courts concentrated on whether the provision in question provided for a genuine pre-estimate of the loss which was likely suffered by the payee²¹. A provision would be considered a penalty if it stipulated a greater or at least extravagantly greater sum than the loss likely suffered by the payee²².

The modern *Cavendish* approach

The law in relation to liquidated damages and penalties has been revamped by the UK Supreme Court in *Cavendish Square Holding BV v Makdessi* and *ParkingEye Ltd v Beavis* (“*Cavendish*”)²³. The court in these two cases held that the ruling in *Dunlop* had been interpreted too narrowly²⁴, and while the genuine pre-estimate test was a useful tool in a simple case, it was not easily applied to more complicated cases²⁵.

To summarise, the modern test after *Cavendish* is whether the liquidated damages provision is supported by a legitimate interest and is not extravagant or unconscionable in proportion to that interest²⁶.

The court in *Cavendish* also held that the law on penalties does not apply to a contractual term that specifies a primary obligation to pay a sum of money²⁷ as opposed to the second obligation to pay

an amount following from a breach of a primary obligation.

Hong Kong’s approach

In the recent case *Law Ting Pong Secondary School v Chen Wai Wah* (“*Law Ting Pong*”)²⁸, the Court of Appeal confirmed the application of the legitimate interest test in the Hong Kong context. Aside from *Law Ting Pong*, there have been a few other recent cases applying the test in the *Cavendish* decision.

One recent case is *Bank of China (Hong Kong) Limited v Eddy Technology Company Limited and Others*²⁹. In this case, the three appellants argued that the default interest was a penalty but the Court of Appeal dismissed such appeal and ruled that “[the] charging of default interest was ... a reflection that money is more expensive for a less good credit risk than for a good credit risk. The Defendants had no evidence to show that the default rates are **extravagant, exorbitant or unconscionable.**”³⁰ (emphasis added)

Another recent case concerning default interest is *Luvpa Limited v Honor City HK Pharmacy Limited*³¹, the Lands Tribunal affirmed a provision which charges a daily default interest at the monthly rate of 2.5% on any outstanding rent or other monies payable under a tenancy agreement and the provision described such amount as liquidated damages but not a penalty³².

The Lands Tribunal upheld the liquidated damages provision and the legitimate interest recognised by the Lands Tribunal in making such ruling is “a legitimate and obvious interest in receiving payment quickly and on time”³³. It further held that the interest rate was not extravagant or unconscionable whilst noting that the interest rate has not reached the excessive level or extortionate level under the Money Lenders Ordinance (Cap. 163)³⁴.

A third recent case is *Re Hsin Chong Construction Co Ltd*³⁵. The provision in contention is a provision in a joint venture agreement conferring a contractual right on the innocent party to exclude the defaulting party from the joint venture (“JV”) and carry on the JV on its own, in the absence of the defaulting party, to operate all the JV accounts and to complete the project. An accounting exercise is then carried out

¹⁸ *Sainter v Ferguson* (1849) 7 C.B. 716, 727; *Cargill International Trading Pte Ltd v Uttam Galva Steels Ltd* [2019] EWHC 476 (Comm) at para. 37

¹⁹ [1915] A.C. 79, 86 to 88

²⁰ See Chitty at para. 29-211

²¹ See Chitty at para. 29-212

²² *Ibid.* and *Lordsdale Finance Plc v Bank of Zambia* [1976] Q.B. 752, 762

²³ [2015] UKSC 67, [2016] A.C. 1172

²⁴ See Chitty at para. 29-226

Cavendish at para. 22

²⁶ *Ibid.*, at para. 32

²⁷ *Ibid.*

²⁸ [2021] HKCA 873

²⁹ [2019] 2 HKLRD 493

³⁰ *Ibid.*, at para. 38

³¹ [2021] 2 HKLRD 1326

³² *Ibid.*, at para. 4

³³ *Ibid.*, at para. 21

³⁴ *Ibid.*, at para. 20

³⁵ [2019] 3 HKLRD 367

on completion of the project to ascertain what, if any, money may be due to the defaulting party as a result of the profits made and losses incurred³⁶. The question which the Court of First Instance (“CFI”) had to deal with was whether this provision is penal in nature and not enforceable. The CFI accepted that the provision provides protection to the innocent party from the risk of contractors or suppliers refusing to supply or charging increased prices, and the negative impact on the innocent party’s own reputation as regards future tendering work for the government. It held that there is nothing inherently penal in the provision.

Conclusion

The *Cavendish* approach has become part of Hong Kong law. It is expected that the court will continue to take on a more lenient approach and will not likely hold that a provision is a penalty and not enforceable.

Oswald Law

Eminent Investments (Asia Pacific) Limited v DIO Corporation (2020) 23 HKCFAR 487

Facts

DIO Corporation (“DIO”) engaged Eminent Investments (Asia Pacific) Limited (“Eminent”) as its financial advisor for providing financial advice on fundraising pursuant to a Financial Advisory Agreement (“FAA”).

Clause 2(iv) of FAA states that upon completion of fundraising transactions, DIO agrees to pay Eminent a success fee (“Transaction Fee”).

Clause 3(i) of FAA (a “tail gunner clause”)³⁷ states that if DIO completes fundraising transactions introduced by Eminent within 2 years after termination of FAA, DIO shall pay Eminent according to Clause 2(iv).

Eminent introduced Dentsply International Inc (“Dentsply”) to DIO as a prospective investor, but Dentsply decided it was not interested to invest in DIO. FAA was subsequently terminated.

A year after introduction of Dentsply to DIO, a subsidiary of Dentsply approached DIO for business dealings on its own, eventually leading to its investment in DIO (“the Deal”).

Eminent commenced an action against DIO to recover the Transaction Fee. The trial judge (“Judge”) found that Eminent failed to show that any work done by it under FAA was the effective cause of the Deal. The Court of Appeal (“CA”) also dismissed Eminent’s appeal. Eminent appealed to the Court of Final Appeal (“CFA”).

The Judge’s decision

The Judge held that Clause 2(iv) connoted active participation by Eminent in the transaction and mere introduction was not enough. Clause 2(iv) is interpreted as requiring Eminent to be an “effective cause” in completing the transaction; or alternatively an implied term importing such a requirement.

The CA’s decision

The CA held that Clause 3(i) requires Eminent to introduce to DIO a transaction which DIO completed before it was entitled to the fee. To focus simply on the word “introduction” would ignore the rest of the phrase of the clause. Given the contextual background that DIO was seeking capital to expand its business, the entitlement of Eminent was not merely based on an introduction of a party but an introduction leading to a transaction.

The CFA’s decision

The arguments

Eminent argued for a “purposive” approach. It suggested that the CA was wrong to construe Clause 3(i) *in vacuo* detached from the relevant contextual considerations and that Clause 3(i) should be construed as requiring introduction of a party instead of introduction of a transaction.

DIO emphasized on a “textual” approach and argued that FAA should be construed as requiring introduction to the transaction which ultimately took place. This imputes a degree of causation and/or proximity between the introduction and the eventual transaction.

Interpretation

The CFA agreed that the starting point of interpretation is always the ordinary and natural meaning of the words of the contract, but recognized that the surer guide to interpretation is context.

³⁶ *Ibid.*, at para. 11

³⁷ *Kilometre Capital Management Cayman v Shanda Games Limited* (HCA 2009/2014, [2015] HKEC 1373) (13 July 2015) - The expression is used in financial circles in relation to fees for transactions which complete after the termination of an adviser’s engagement: see [9]

It summarized the principles by Lord Hodge JSC in *Wood v Capita Insurance Services Ltd*³⁸ and held that when there are conflicting interpretations, account should be taken of the natural and ordinary meaning of the provision, the purpose of the contract and of the provision, other relevant provisions, the facts and circumstances known or assumed by the parties when the contract was executed, the quality of the drafting of the instrument, and commercial common sense.

The CFA held that Clause 2(iv) makes a completed transaction pivotal for the entitlement to the Transaction Fee because (1) the clause is headed “TRANSACTION FEE”; (2) Transaction Fee is a “success fee” payable upon completion of relevant transaction; (3) the amount is 3% of the total transactional amount; and (4) the relevant transaction involves a form of fundraising.

To earn a Transaction Fee, Eminent is required not merely to introduce a third party, but to put in work towards achieving the successful completion of the fundraising transaction.

The CFA held that the words “introduced by the Financial Advisor” in Clause 3(i) qualify “a transaction related to fundraising”. Eminent has to introduce a successfully completed transaction. If it introduces a third party but plays no part or an insignificant part in bringing about the fundraising transaction completed, it is not entitled to a Transaction Fee.

The function of Clause 3(i) is to guard against Eminent being unfairly deprived of a Transaction Fee in relation to transactions it introduced that have completed during post-termination period. Without Clause 3(i), Eminent may be excluded from recompense by DIO deferring completion until after FAA is terminated.

The “effective cause” requirement and grey areas

The CFA considered that a requirement that the financial adviser’s contribution be an “effective cause” of the transaction may possibly arise in a different but related context. Where parties agree to a tail gunner clause, the parties inevitably run the risk of creating grey areas which may give rise to controversy. It may thus be arguable whether, on particular facts, the financial adviser has done enough to be entitled to the fee. Unless the agreement deals explicitly with that question, the issue would arise as to what the proper criterion is for determining the answer.

In any event, the CFA held that the issue of “effective cause” did not arise in the present case since Eminent did not introduce or contribute anything at all to the Deal.

Conclusion

The appeal was unanimously dismissed.

Angel Li
(Commentary prepared with the assistance of
Mr Vincent Kee of Ronny Wong SC Chambers)

Invest Gain Limited v Novel Good Limited [2021] HKCA 62

Facts

The Plaintiff (“P”) as the vendor and the Defendant (“D”) as the purchaser entered into an agreement for the sale and purchase of shares (“SPA”) in Shanghai Industrial Urban Development Group Limited (“Target Company”) on 19 January 2010. On the same day, D entered into a subscription agreement with the Target Company to subscribe for extra shares (“SA”).

Both transactions were completed on 24 June 2010 (“Completion”).

Clause 8.05 of the SPA (“Clause 8.05”) stated that P would not be liable for any warranties under the SPA (“Warranties”) unless notice of a claim (“Notice”) was received by P not later than the expiry of the period of 1 year following the date of the Completion (“Stipulated Period”).

In August 2010, a share charge (“Share Charge”) was granted by P to D as security under which if no claim was made by D against P under the SPA, D shall discharge the Share Charge at the request of P.

3 days before the end of the Stipulated Period, D issued a letter to P setting out six alleged instances of breaches of the SPA and/or the Warranties by P. D thus refused to release the Share Charge.

P commenced action before the Court of First Instance (“CFI”) to seek the release of the Share Charge. D counterclaimed in the same action for damages for breach of Warranties and other terms of the SPA. On the first key issue further specified

³⁸ [2017] AC 1173

below, the CFI held in favour of D. On the second key issue, the CFI held in favour of P.

Each of P and D appealed to the Court of Appeal (“CA”) against the ruling of the CFI on the key issue which was not held in its favour.

The Key Issues

The key issues were:

- (a) whether Clause 8.05 only required the giving of the Notice without having to identify which of the Warranties the claim was in respect of and without having to set out any information, particulars or details of the claim (“Bald Notice”); and
- (b) whether a Notice was only effective in relation to the matters that had come to D’s knowledge at the time when the Notice was given.

Bald Notice

The CFI ruled in favour of D that a Bald Notice under Clause 8.05 was sufficient.

In its decision, the CA reiterated the following principles on construction of notice clauses:

- (a) the starting point was to look at the matter linguistically, and to treat the natural meaning as the best guide to interpretation;
- (b) while commercial common sense and surrounding circumstances were factors to be taken into account, they should not be used to undervalue the importance of the language of the provision;
- (c) commercial common sense was not to be invoked retrospectively, or to be seen through the eyes of only one party; and
- (d) an ambiguity on the construction of exclusion clauses might be resolved by a narrower construction, if linguistic, contextual and purposive analysis did not answer this question with sufficient clarity.

The CA held that on the natural and ordinary meaning of Clause 8.05, it only required a Bald Notice. The CA also contrasted the SPA with the SA. Clause 7.09 of the SA imposed specific notification requirements for matters expected to give rise to a claim, whereas Clause 8.05 imposed no such similar requirement which would suggest that a Bald Notice was sufficient.

The commercial purpose of Clause 8.05 was to provide a temporal cut-off point so that P would know whether it was required to answer for the Warranties. If no Notice was given within the Stipulated Period, the Share Charge could be released. If the Notice was given within the Stipulated Period, D would be protected by the Share Charge and have the statutory limitation period to start legal proceedings for the claim (“Statutory Limitation Period”).

P argued that if Clause 8.05 was construed to only require a Bald Notice, D could raise any claim unbridled by the Stipulated Period. Instead of a cut-off point of the Stipulated Period, P would live with uncertainty during the Statutory Limitation Period.

The CA disagreed and held that it should give effect to the clear language of Clause 8.05, even if the consequences might appear hard for P.

Knowledge of Claim

The CFI ruled in favour of P that the Notice would only be effective if D had knowledge of the claim when the Notice was given.

D appealed on the grounds, inter alia, that there was no express provision in Clause 8.05 to that effect and such construction was inconsistent with the purpose of Clause 8.05.

The CA held that the absence of express wording in Clause 8.05 providing for D’s knowledge did not necessarily mean that this could not be the proper construction.

The threshold under Clause 8.05 was set very low. If it was construed as permitting any claim for breach of the Warranties to be made notwithstanding D’s knowledge, the threshold would be even lower. The purpose of setting the Stipulated Period would not be meaningful in such a case.

Following the approach for construing exclusion clauses and the principle that parties did not normally give up valuable rights without making it clear that they intended to do so, clear words were required if the Notice could be given for matters that D had no knowledge of. Clear words to that effect were not found here.

Looking at the matter linguistically and with common sense, the Notice could not be given for matters that D had no knowledge of. Without knowledge of the matters, there could be no genuine claim at all. The claim as notified could be non-existent at the time and which might or might not arise in future.

Conclusion

The CA upheld the CFI's ruling on both the above key issues.

Kennis Lam
(Commentary prepared with the assistance of
Mr Vincent Kee of Ronny Wong SC Chambers)

Re China Ocean Industry Group Limited [2021] 2 HKC 153

Facts

China Ocean Industry Group Limited (the "Company") was incorporated in Bermuda and listed on the Main Board of the Stock Exchange of Hong Kong Limited (the "SEHK"). The insolvent Company was subject to a winding-up petition. The Company was actively pursuing a debt restructuring and raising funds to pay its debts.

The Company proposed to raise funds by issuing: (1) up to 68,000,000 ordinary shares at HK\$0.105 per share (the "New Shares"); and (2) a convertible bond with the principal amount of HK\$30 million and the conversion price of HK\$0.1 per conversion share (the "CB").

At the request of the SEHK, the Company applied to the Court of First Instance (the "court") for a validation order under s.182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (the "Ordinance") in respect of the Company's fund-raising which involved the proposed issue of the New Shares and the CB. The winding-up petitioner (the "Petitioner") did not oppose the application.

Issue

The relevant part of s.182 of the Ordinance provides that in a winding up by the court, any disposition of the property of the company, any transfer of shares, or alteration in the status of the members of the company, made after the commencement of the winding up³⁹, shall, unless the court otherwise orders, be void.

The issue was whether the proposed issue of the New Shares and the CB would engage the court's jurisdiction to grant a validation order under s.182 of

the Ordinance.

Decision

Having reviewed cases from different jurisdictions, the court concluded that despite no opposition from the Petitioner on the application for the validation order; and despite that Hong Kong court has in a number of cases granted validation orders regarding the issue of new shares and convertible bonds, no validation order could be granted because the proposed issue of the New Shares and the CB did not engage s.182 of the Ordinance. The court's reasoning is summarized below.

- (a) The court's jurisdiction to grant a validation order under s.182 of the Ordinance was engaged only if the subject matter concerned a "disposition of the property of the company", "transfer of shares", or "alteration in the status of the members of the company". Issuing new shares did not engage s.182 of the Ordinance because it did not involve any alteration in the status of the members of the company. This proposition was supported by the High Court decision of *Bank of China (Hong Kong) Ltd v Oasis HKTL 04A Ltd*⁴⁰ and decisions in other Commonwealth jurisdictions, e.g. *Sellers; in the matter of Beckley Forge Pty Ltd*⁴¹ (a decision of the Federal Court of Australia) and *Lollback v Brakepower*⁴² (a decision of the Supreme Court of New South Wales in Australia). The above authorities demonstrated that the issue of new shares or convertible bonds would not engage the relevant legislation in their respective jurisdictions that is comparable to s.182 of the Ordinance.
- (b) The rationale behind the prohibition on share transfers and alteration in members' status under s.182 of the Ordinance was to prevent existing contributories from evading liability by transferring shares to an impecunious person after the commencement of winding-up. Since the issue of new shares and convertible bonds would not lead to existing contributories evading their liability, s.182 of the Ordinance is obviously not engaged. This rationale has been made clear in other Commonwealth authorities dealing with legislation in *pari materia* with the Ordinance, e.g. *Seah Teong Kang v Seah Yong Chwan*⁴³ (a decision of the Court of Appeal in Singapore) and *IRC v Laird Group plc*⁴⁴ (a

⁴⁰ Unreported, HCA 763/2008, 26 May 2008

⁴¹ [2003] FCA 523; (2003) 21 ACLC 1319

⁴² [2010] NSWSC 1457

⁴³ [2015] 5 SLR 792; [2015] SGCA 48

⁴⁴ [2003] UKHL 54; [2003] 1 WLR 2476

decision of the House of Lords of the United Kingdom).

- (c) While there were precedents in Hong Kong (e.g. *Singasia Holdings Ltd v 劉新生*⁴⁵ and *Re China Ocean Industry Group Ltd*⁴⁶) in which it seemed to have been assumed that the issue of new shares and convertible bonds fell within s.182 of the Ordinance for validation orders to be sought, the correct authorities were not brought to the judges' attention in those cases.
- (d) S.182 of the Ordinance is not engaged in the proposed issue of the New Shares and the CB. Therefore, the court has no jurisdiction to validate the proposed issue of the New Shares and the CB. It follows that the SEHK was mistaken in requiring the Company to obtain a validation order before proceeding with the proposed issue of the New Shares and the CB.

In light of the above, the court dismissed the Company's application for a validation order in respect of the proposed issue of the New Shares and the CB with no order as to costs and confirmed that the absence of a validation order did not inhibit the Company from proceeding with issuing the New Shares and the CB. The position is consistent with the decision in *Sellers; in the matter of Beckley Forge Pty Ltd*⁴⁷.

The court added that if s.182 of the Ordinance had been engaged, it would have granted a validation order in any event given that raising fresh capital would not prejudice the interests of creditors or contributories.

Ida Chan

**(Commentary prepared with the assistance of
Mr Vincent Kee of Ronny Wong SC Chambers)**

Editors : Yung Lap Yan Boyce Yung Denise Lam Quinnci Wong

⁴⁵ [2019] HKCLC 1023; [2019] HKCFI 2555

⁴⁶ [2019] HKCLC 975; [2019] HKCFI 2363

⁴⁷ [2003] FCA 523; (2003) 21 ACLC 1319