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Editorial

We feature three articles in this edition. The first article outlines the procedure for voluntary winding up and winding up by the Court under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32).

The second article is an overview of the Financial Institutions (Resolution) Bill which establishes a regime for the orderly resolution of failing financial institutions with a view to avoiding or mitigating the risks posed to the stability and effective working of the financial system of Hong Kong.

The third article talks about the common law principle of restraint of trade which states that a contract in restraint of trade is prima facie unenforceable unless it is shown to be reasonable with reference to the interests of the parties concerned and of the public.

We also feature three case reports in this edition. The first case report talks about the principles to be applied by the Court when it orders inspection of records or documents of a company by the company's members under s.152FA of the former Companies Ordinance (Cap. 32).

The second case is a re-visit of the Yung Kee case we reported in the Summer 2013 edition. In this edition, we report the CFA decision which allowed the petition to wind up the BVI holding company on just and equitable grounds under s.327(3)(c) of the former Companies Ordinance (Cap. 32).

The third case is about the common law principle of remoteness of damage as formulated in the landmark case of Hadley v Baxendale.

YUNG Lap-yan

Commencement of Winding up of Companies

Introduction

This article outlines the types of winding up, the grounds for winding up and the procedure for commencement of winding up of Hong Kong companies[1] under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO"). The article also highlights some related changes introduced by the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 (the "Bill") which is currently under scrutiny by the Legislative Council.

There are two general categories of winding up: voluntary winding up and winding up by the court[2]. The latter involves a greater degree of court supervision compared with the former.

Voluntary winding up

S.228(1) of CWUMPO sets out the circumstances in which a company may be wound up voluntarily:

(a) the company's members pass an ordinary resolution requiring the company to be wound up voluntarily pursuant to a clause in the company's articles that provides for the company to be dissolved after a specified period or on the occurrence of a specified event;

(b) the members pass a special resolution for winding up the company voluntarily;

(c) the members pass a special resolution to the effect that the company cannot by reason of its liabilities continue its business, and that it is advisable to wind up; or

(d) the company's directors deliver a winding-up statement under s.228A(1) of CWUMPO.

As the circumstances in which a company may be wound up under s.228(1)(c) are covered by s.228(1)(b), the Bill[3] amends s.228 by deleting s.228(1)(c).

A voluntary winding up can be a members' voluntary winding up or a creditors' voluntary winding up. In the latter, the company would be insolvent and the creditors have greater control in the winding up process.

Where a company is solvent and the members resolve that the company be wound up voluntarily in the case where a certificate of solvency has been issued and delivered by the directors under s.233 of CWUMPO, a winding up is a members' voluntary winding up[4]. Otherwise, the winding up proceeds as a creditors' voluntary winding up. A certificate of solvency would state that the directors have made a full inquiry into the affairs of the company, and that they have formed the opinion that the company will be able to pay its debts in full within 12 months from the commencement of the winding up[5].

A voluntary winding up is deemed to commence at the time of the passing of the members' resolution for voluntary winding up[6].

The special procedure under s.228A of CWUMPO allows the directors to commence a voluntary winding up without first obtaining a resolution of the members of the company. The directors (or a majority of them) may resolve and deliver a winding-up statement to the Registrar, signed by one of the directors, certifying that a resolution has been passed to the effect that:

(a) the company cannot by reason of its liabilities continue its business;

(b) they consider it necessary that the company be wound up and that the winding up should be commenced under s.228A because it is not reasonably practicable for it to be commenced under another section of CWUMPO (with reasons given[7]); and

1 For the winding up of non-Hong Kong companies, see Part X of CWUMPO. As for the winding up of companies carrying on banking or insurance business, see also Cap. 155 and Cap. 41 respectively.
2 s.169(1) of CWUMPO
3 Clause 58 of the Bill
4 s.233(4) of CWUMPO
5 s.233(1) of CWUMPO
6 s.230 (with exceptions under s.228A(5)(a) and s.209B(a)(i)) of CWUMPO
7 s.228A(2) of CWUMPO

(c) meetings of the company and of its creditors will be summoned[8].

To take effect, the winding-up statement must be delivered to the Registrar within 7 days after it is made[9]. On delivery of the statement, the winding up of the company commences; and the directors must forthwith appoint a provisional liquidator and cause meetings of the company and of its creditors to be summoned[10].

The s.228A procedure should only be used in exceptional circumstances. To safeguard the interests of creditors and members, the Bill introduces new provisions requiring the directors to send the notices for the meeting of the company and to appoint a provisional liquidator before delivering the winding-up statement[11]. This aims to give earlier notice to members of the proposed winding up and to allow a provisional liquidator to take control of the company from the directors immediately on the winding up commencing.

Winding up by the court

A court winding up (also referred to as compulsory winding up) is commenced by a court order for the company to be wound up.

S.177(1) of CWUMPO provides for the main grounds[12] on which a company may be wound up by the court:

(a) the company's members have passed a special resolution that the company be wound up by the court;

(b) the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;

(c) the company has no members;

(d) the company is unable to pay its debts (i.e., the company is insolvent);

(e) an event occurs on the occurrence of which the company's articles provide that the company is to be dissolved; or

(f) the court is of opinion that it is just and equitable that the company should be wound up.

An application for winding up is made by the presentation of a petition (by the company, a member or a creditor) to the court[13]. Where a creditor seeks to wind up a company on the ground of insolvency, the creditor typically serves a written demand (commonly referred to as a statutory demand) on the company requiring the company to pay the debt that is owed. If the company fails to do so within 3 weeks, the company is deemed to be unable to pay its debts[14] and the creditor may rely on this in a winding up petition to show that the company is insolvent. As with all petitions for winding up, the court retains a discretion whether to order winding up. However, the court will usually order winding up if the company is insolvent.

Currently, there is no prescribed form for a statutory demand. The Bill provides for a prescribed form for the demand so as to avoid disputes over the validity or effect of a demand made by a creditor[15].

Where the court makes a winding up order, the earlier time of the presentation of the petition is deemed to be the time of commencement of the winding up[16]. In the case where the company was already in a voluntary winding up before conversion to compulsory winding up, the earlier time of the passing of the members' resolution for voluntary winding up is regarded as the time of commencement of the compulsory winding up[17].

Stefan Lo and Ida Chan

8 s.228A(1) of CWUMPO
9 s.228A(3) of CWUMPO
10 s.228A(5) of CWUMPO
11 Clause 59 of the Bill
12 See also s.177(2) and s.179(2) of CWUMPO, s.879(1) and (2) of Cap. 622 and s.212(1) of Cap. 571.
13 s.179(1) of CWUMPO
14 s.178(1)(a) of CWUMPO
15 Clauses 24(1), 122 and 173(1) of the Bill
16 s.184(2) of CWUMPO
17 s.184(1) of CWUMPO

Financial Institutions (Resolution) Bill ("FIRB")

Background

The collapse of Lehman Brothers in the United States triggered the global financial crisis in 2008. During the crisis, governments were required to inject a huge amount of public funds into failing financial institutions ("FIs") which were "too big to fail" in order to preserve the financial stability of their own economic systems. In response, the Group of Twenty established the Financial Stability Board ("FSB") in 2009 with a mandate to promote financial stability around the world. To address the problem of FIs that are "too big to fail", FSB has proposed the "resolution" regimes and promulgated international standards for the regimes.

Under the resolution regimes, national resolution authorities are given powers and tools to take swift actions to resolve failing FIs in an orderly manner to avoid severe systemic disruption to the economy or exposing taxpayers to the risk of loss. The regimes aim to protect the failing FI's functions that are critical to the financial market and to ensure that losses are borne by shareholders and creditors of the failing FIs, as they would be in insolvency.

The resolution regime in Hong Kong

Resolution Authority

In Hong Kong, the financial sectors are regulated by different authorities: the banking sector by the Hong Kong Monetary Authority ("HKMA"), the securities sector by the Securities and Futures Commission ("SFC") and the insurance sector by the Insurance Authority ("IA")[18]. Under the FIRB (which was introduced into the Legislative Council on 2 December 2015), HKMA, SFC and IA are designated as the resolution authority ("RA") for their respective sectors. The Financial Secretary ("FS") may designate a lead resolution authority in case a failing FI has cross-sectoral businesses.

Scope of the resolution regime

Under the FIRB, the resolution regime in Hong Kong applies to all banks, certain financial market infrastructures (such as designated clearing and settlement systems and recognized clearing houses), designated exchange companies, licensed corporations, authorized insurers, branches and holding companies of certain foreign FIs, and affiliated operational entities which provide essential services to a failing FI (which are called "within scope FIs"). Only within scope FIs are subject to the resolution regime. The FS may by gazette designate an FI to be a within scope FI.

Initiation of resolution

An RA can initiate the resolution of a within scope FI if (1) the FI has ceased or is likely to cease to be viable; (2) there is no reasonable prospect that private sector action would result in the FI again becoming viable within a reasonable period; and (3) the non viability of the FI poses risks to the stability and effective working of the financial system of Hong Kong and resolution will avoid or mitigate those risks.

Powers of RA prior to resolution

Prior to the resolution, an RA can give directions to a within scope FI to remove any impediments (e.g. the complex structure of the FI) which may affect the resolution process. The within scope FI can apply to the Resolvability Review Tribunal to review the RA's directions. Failure to comply with any directions given by the RA is a criminal offence for both the within scope FI and its officers.

The FIRB restricts the commencement of any winding up proceedings against a within scope FI except with the RA's consent.

[18] At present, the IA is a public officer and is supported by the Office of the Commissioner of Insurance ("OCI") which is a government department. Under the Insurance Companies (Amendment) Ordinance 2015, an independent Insurance Authority ("IIA") will be established to regulate the insurance sector. The new Ordinance will commence in stages to allow for a transition from the OCI and the existing self-regulatory regime for insurance intermediaries to the IIA.

Powers of RA during resolution

An RA is given extensive powers for resolution under the FIRB. These powers aim to stabilize those parts of the failing FI's business which need to be continued in order to secure continuity of critical financial functions and protect financial stability (known as "stabilization options"). The stabilization options include transferring the failing FI's businesses, assets, rights or liabilities to a third party purchaser, a bridge institution, an asset management vehicle and a temporary public ownership company, bailing-in of liabilities (e.g. cancellation or modification of the failing FI's liabilities), and mandating the failing FI to convert some of its capital instruments into ordinary shares. These powers are exercised by the RA through issuing statutory instruments.

An RA is also empowered to direct the continued performance of certain essential services by the failing FI or its affiliated operational entities and to suspend obligations to make a payment or delivery under a contract for a specific period to which the failing FI or its subsidiary is a party.

Powers of RA against directors

An RA may remove any directors of a within scope FI if it is of the opinion that such removal will assist in meeting the resolution objectives.

An RA may also apply for a court order to clawback an amount equivalent to a maximum of 3 years' remuneration of certain officers (including director and chief executive officer) of a failing FI if the court finds that the officers intentionally, recklessly or negligently contributed to the failure of the FI. If the officers' contribution to the failure of the FI involves dishonesty, the court may clawback up to a further 3 years' remuneration of the officers.

Compensation to shareholders and creditors of failing FIs

During resolution, as quality assets of the failing FI would be sold to third parties while liabilities would be written off, the position of the failing FI's shareholders and creditors (including the FI's employees) would likely be affected. The FIRB provides these shareholders and creditors with a right to seek compensation from the RA if as a result of resolution, they receive a less favourable treatment than would have been the case had the entity been liquidated immediately before its resolution (known as the no creditor worse off than liquidation "NCWOL" principle). Whether NCWOL compensation is payable in an individual resolution case will be determined by an independent valuer. If the creditors and shareholders are not satisfied with the independent valuer's valuation, they can appeal to the Resolution Compensation Tribunal.

Sources of resolution funding

Notwithstanding the fundamental resolution principle of reducing reliance on public funds, it is recognized that orderly resolution may not be achievable in all cases without some provision of temporary public funding support. The resolution regime, therefore, allows for temporary public funding support to be deployed. Under the FIRB, any public funding deployed to resolution will be recouped in resolution actions such as receiving sales proceeds of the failing FI's assets and charging the FI a reasonable cost for resolution. If there are still any losses of public funding, the losses will be recovered from the wider financial industry through an ex post levy.

Boyce Yung and Patrick Yung

Contracts in Restraint of Trade

A contract may not be enforceable if it is contrary to public policy. One example is a contract in restraint of trade. A contract in restraint of trade restricts a party's future liberty to carry on that party's trade, business or profession in such manner and with such persons as that party chooses. This article will provide a highlight of the primary common law rules on this class of contracts. The same rules apply to a covenant in a contract that constitutes restraint of trade.

Basic Principle

The basic common law principle is that a contract in restraint of trade is prima facie unenforceable unless it is shown to be reasonable with reference to the interests of the parties concerned and of the public[19] (the "Principle"). Hence, in applying the Principle, the court would consider two questions independently – firstly, whether the contract is in restraint of trade, and secondly, if the contract is in restraint of trade, whether it is reasonable in the interest of the parties concerned and also in the interest of the public[20]. The Principle has to be applied to factual situations with a broad and flexible rule of reason[21].

Whether a Contract is in Restraint of Trade

No exhaustive test can be stated for defining or identifying contracts which are in restraint of trade[22]. The court will construe the contract in question in the light of the circumstances existing at the time when it was made in order to determine the nature and extent of the restriction contained in the contract as contemplated by the parties. The object that the parties had in view, rather than the wording used in the contract, is the decisive factor[23].

Despite the absence of a definitive test for determining whether or not a contract is a contract in restraint of trade, a long line of case authorities has shown that two categories of contracts are prima facie void as being in restraint of trade – contracts which restrict competition by a former employee against his former employer and contracts which restrict competition by a vendor of a business against the purchaser of his business. Nevertheless, it should be noted that the categories of contracts which may be classified as contracts in restraint of trade must remain fluid and the categories can never be closed[24].

Whether a Contract in Restraint of Trade is Reasonable

If a contract is found by the court as a contract in restraint of trade, the next question to be considered is whether the contract can be justified as being reasonable. In considering this question, the court must scrutinize the restriction contained in a contract as at the date when the contract was made in the light of the circumstances then existing and also in the light of what at that date might possibly happen in the future. What has actually happened by the time of the trial is not relevant to the consideration because a contract containing a restriction alleged to be excessive must be either invalid from the very beginning or valid from the very beginning[25].

Three matters should be considered in determining whether a contract in restraint of trade can be justified as being reasonable. Firstly, it must be established that there is a proprietary or other legitimate interest meriting protection, e.g. an employer is entitled to protect his trade secrets and business connection. Secondly, the court must be satisfied that the restriction is reasonable and not excessive by looking at the relationship between the interest to be protected and the restriction. Factors that will often be taken into account by the court include the geographical limit and duration of the restriction and the scope of activities restricted. For instance, an employee canvasser's covenant of not entering into similar

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19 *Chitty on Contracts* (32nd ed., 2015), p.1269-1270

20 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1967] 1 All ER 699 at 729

21 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1967] 1 All ER 699 at 729

22 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1967] 1 All ER 699 at 729

23 *Cheshire, Fifoot & Furmston's Law of Contract* (15th ed., 2007), p.526

24 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1967] 1 All ER 699 at 732

25 *Cheshire, Fifoot & Furmston's Law of Contract* (15th ed., 2007), p.527

business as his employer's business in an area which was about 1,000 times as large as that in which the employee had been employed was held to be unreasonable and therefore void[26]. Finally, the contract in restraint of trade must not be contrary to the public interest. It is arguable that a restriction on persons whose services are in short supply may be contrary to the public interest, even though it is reasonable in relation to the interest which the covenantee is entitled to protect[27].

Legal Consequences

If a covenant in restraint of trade which is excessively wide and therefore void is only part of a contract, the invalidity of the covenant will not necessarily nullify the entire contract. The valid covenants, if severable, will remain fully enforceable. Severance may take two forms - an objectionable covenant in restraint of trade may be eliminated altogether from a contract, leaving the rest of the contract valid and enforceable ("Elimination of Restriction"), or an objectionable covenant in restraint of trade may be cut down in extent ("Reduction of Restriction").

Whether Elimination of Restriction is appropriate depends in turn on whether the objectionable covenant forms the whole or only part of the consideration. If it is substantially the only consideration given for the covenant of the other contractual party, it may not be severed from the contract and hence the entire contract will be unenforceable. On the other hand, if the objectionable covenant forms only part of the consideration, it may be severed from the contract and the rest of the contract will remain enforceable[28].

In addition, the court will be prepared to apply a Reduction of Restriction if the scope of the objectionable covenant may be reduced without eliminating it entirely. The predominant principle is that the court will not rewrite the covenant as expressed by the parties. It will not invent a valid covenant and thus enforce a covenant that the covenantor might well have made but did not actually make[29]. Hence, the covenant in question must be drafted by the parties as divisible into a number of separate and independent parts so that one or more of the parts may be struck out and yet leave a covenant that is substantially the same in character as that framed by the parties, with its scope of operation diminished in extent though[30].

Sandy Hung

Veron International Ltd v RCG Holdings Ltd [2013] 6 HKC 469

Facts

The plaintiff ("P"), Veron International Ltd, was the single largest shareholder of the defendant ("D"), RCG Holdings Ltd, a public company listed in both London and Hong Kong. P did not have a seat on D's board of directors. Between 2007 and 2010, D acquired substantial shareholdings in two BVI technology companies, Vase Base Technology Ltd ("C1") and Strong Aim Ltd ("C2"). In 2011, D disposed of its shares in C1 and C2 for nominal consideration. P applied under s.152FA of the former Companies Ordinance (Cap. 32) (see now Companies Ordinance (Cap. 622) s.740) for an order to enable it to inspect D's records relating to its acquisition of C1 and C2.

P's case was that inspection should be ordered not only because substantial losses had been made in respect of D's investments in C1 and C2 and the disposal of those investments (which came after the s.152FA application was made), but also because of certain matters which led to a reasonable suspicion that D's directors had failed to assess the risks and verify matters when deciding whether to acquire C1 and C2.

In two press releases issued in 2008 in compliance with the rules of the London Stock Exchange, D stated that C1 had secured supply contracts with 19 major hospitals in mainland China. It was however stated in D's listing documents in Hong Kong in February 2009 that C1 did not provide technology to end users (such as hospitals) directly, but contracted with four distributors. P also alleged that only one of the three hospitals named in the press release existed and used C1's technology.

As for C2, D acquired 70% of the shares in 2010 for $185 million but one year later, D disposed of the

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[26] Mason v Provident Clothing & Supply Co Ltd [1913] A.C. 724
[27] *Treitel on the Law of Contract* (13th ed., 2011), p.513
[28] Goodinson v Goodinson [1954] 2 QB 118
[29] Putsman v Taylor [1927] 1 KB 637 at 639-640
[30] Attwood v Lamont [1920] 3 KB 571

shares for $3,000. There was some evidence that during the year ended 31 December 2010, a profit of $149 million was made. However, D disclosed that 6 months later, C2 was loss-making.

Barma J at first instance accepted that P's application was made in good faith, but then went on to dismiss the application on the basis that the inspection sought was not for a proper purpose (as required by s.152FA(3)(b)). The judge further held that if P had satisfied the proper purpose requirement, inspection would have been ordered but restricted to certain records only. P appealed, contending that the judge had misapplied the proper purpose requirement to the facts of the case. P also applied to adduce fresh evidence in the appeal, relating to D's disposal of its interests in C1 and C2.

Decision

The Court of Appeal ("CA") allowed both the application to adduce fresh evidence and the appeal for the reasons set out below.

To make an application under s.152FA, a shareholder must satisfy the court that the application was made in good faith and the inspection was for a proper purpose. Even if those conditions were satisfied, the court still had a discretion whether or not to grant an order for inspection.

The relevant principles to be applied were as follows:

(a) the court would determine whether each of the conditions had been demonstrated by applying an objective test. The burden was on the applicant to so prove;

(b) if the applicant's primary or dominant purpose was a proper purpose, it was not to the point that an inspection might be of benefit to the applicant for some other purpose;

(c) the right provided by s.152FA should not be regarded as affecting the basic rule of company law that a shareholder should not ordinarily have recourse to the courts to challenge a managerial decision made by or with the approval of directors;

(d) the procedure under s.152FA was not intended to be a process as wide-ranging as that of discovery of documents so that inspection would generally be confined to the results of decisions of directors rather than all the documents such as board papers leading to decisions.

CA also stated that there is no reason to apply the legislation differently in the case of a listed company as compared with a private company.

CA held that P made a reasonable case that there was a need to investigate what had or had not been done by D's directors to safeguard the interests of D prior to its acquisition of C1. As for C2, the inspection of D's records on the acquisition of C2 was also for a proper purpose. C2 was in a similar line of business with a similar business model. There was a similar lack of information regarding its customers and nothing was known of the scope of "due diligence" by D's lawyers. A substantial loss was made by D on its disposal. In the circumstances, P's application for inspection of D's records on the C1 and C2 acquisitions were for proper purposes, thereby satisfying the requirement under s.152FA(3)(b).

In considering how the court should exercise its discretion, it was relevant that:

(a) the judge would have made an order in favour of inspection had he found that the requirement under s.152FA(3)(b) was satisfied, and there was no respondent's notice challenging that;

(b) the records sought should be useful to P in its consideration whether to write off its investment in D or to seek to recover damages in derivative proceedings against one or some of D's directors or others for breach of duty;

(c) even if it was assumed that P could obtain a seat on D's board, the court could not insist that P had to seek to become a director to obtain the records it sought, rather than to exercise its statutory rights as a shareholder. It was noted that D was being investigated by the Commercial Crimes Bureau and so the duties of the directors would be more onerous than usual;

(d) D would not suffer any substantial prejudice in complying with an order.

CA made an order allowing inspection but restricted to the records listed in Barma J's judgment. If D had possession of such documents of its subsidiaries, inspection should be given of those documents as well but not otherwise.

Danny Yuen

Kam Leung Sui Kwan v Kam Kwan Lai and Ors
(FACV No 4 of 2015)

In my last case commentary[31] on Re Yung Kee Holdings Ltd [2012] 6 HKC 246 ("Yung Kee No.1") we saw how, in the face of unequivocal finding of "unfairly prejudicial conduct" on the part of the controlling shareholder of Yung Kee Holdings Ltd ("Company"), the Court of First Instance ("CFI") found the Company lacked sufficient nexus with Hong Kong and refused to intervene in a petition brought by the aggrieved minority shareholder under s.327(3)(c) of the former Companies Ordinance, Cap. 32 ("Ordinance").

Facts of Yung Kee No.1

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 trustee of a unit trust.

The Petitioner, Kam Kwan Sing, (holding 45% shares of the Company) alleged that the affairs of the Company had been conducted by the Respondent, Kam Kwan Lai, (effectively holding 55% shares) in a manner unfairly prejudicial to him as a member and sought relief firstly under s.168A, and alternatively under s.327(3)(c) of the Ordinance to wind up the Company on just and equitable grounds.

Decision of the CFI & CA

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

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 CFI found that the Company had not established a place of business in Hong Kong and dismissed the petition.

The petition under s.327(3)(c) was also denied because the Company had insufficient connection with Hong Kong.

Appeal by the widow, Kam Leung Sui Kwan, and Personal Representative ("PR") of the estate of the Petitioner who had since deceased to the Court of Appeal was dismissed.

Appeal to the CFA

The PR appealed to the CFA whose judgment was delivered on 11 November 2015.

S.168

On the application of s.168, the CFA opined that:-

(i) "place of business" connotes a place where or from which the company either carries on or possibly intends to carry on business;

(ii) while "business is not confined to commercial transactions or transactions which create legal obligations, purely internal organizational changes in the governance of the company itself are not sufficient"; and

(iii) "establish" indicates that some degree of regularity and permanence of location is required.

The CFA found the Company not having established a place of business in Hong Kong and dismissed the PR's petition under s.168.

S.327(3)(c)

Overturning the lower courts' decisions, the CFA ruled that the Company has a sufficient connection to Hong Kong to justify the making of a Hong Kong winding-up order.

[31] CU Review Summer 2013 Issue.

The CFA held that the **same test** for winding up a foreign company applied in respect of both a shareholder's petition and a creditor's petition, namely –

(i) there is a sufficient connection with Hong Kong (usually, but not necessarily, the presence of assets within the jurisdiction);

(ii) there is a reasonable possibility that the winding-up order would benefit those applying for it; and

(iii) the Court is able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

When determining whether sufficient connection exists between a foreign company and Hong Kong however, the court looks to different factors in the context of a shareholder's petition than in a creditor's petition.

The CFA found the following "connecting factors with Hong Kong" to be "compelling":–

(i) The Company itself is merely a holding company of a group of directly and indirectly held subsidiary companies and carries on no business of any kind whether in the BVI or Hong Kong.

(ii) All the underlying assets of the Company, i.e. the assets of its wholly owned subsidiary Long Yau, are situated in Hong Kong.

(iii) The business of the group is wholly carried on by subsidiaries of Long Yau, all of which are incorporated and carry on business exclusively in Hong Kong.

(iv) The whole of the Company's income is derived from businesses carried on in Hong Kong.

(v) All the Company's shareholders and directors have always been resident in Hong Kong.

(vi) All the directors of its directly and indirectly held subsidiaries have always been resident in Hong Kong.

(vii) All administrative matters relating to the Company are discussed and decided in Hong Kong.

(viii) Crucially the dispute is a family dispute between parties all of whom have always been resident in Hong Kong and the events giving rise to it and the conduct of which complaint is made all took place in Hong Kong.

(ix) The only connection which the Company has with the BVI is that both it and Long Yau are incorporated there. The fact that the Company's only asset, being its shareholding in Long Yau, is situated in the BVI is a consequence of this.

The CFA confirmed the CFI's findings and conclusions on unfair prejudice and allowed the appeal.

Implications

The CFA observes that the dearth of authorities on shareholders' petitions in England may be explained by there being usually no occasion for English shareholders of small, private, family or quasi-partnership companies to cause them to be incorporated overseas. Hong Kong is however different and there are numerous family companies owned by a foreign holding company.

The CFA's decision is significant in that group structures similar to the Yung Kee business will not be an obstruction to the Hong Kong court exercising its jurisdiction to wind-up an offshore holding company, at least insofar as a shareholder's petition is concerned. Once a foreign company is wound-up, shareholders can realize their investments through the Hong Kong insolvency regime. A liquidator appointed by the Hong Kong court will also be able to use the tools under Hong Kong insolvency law to realize assets and conduct investigations thereby bypassing the difficulties often faced by foreign liquidators in Hong Kong.

Vivian NW Cheung

Richly Bright International Ltd v De Monsa Investments Ltd
(2015) 18 HKCFAR 232

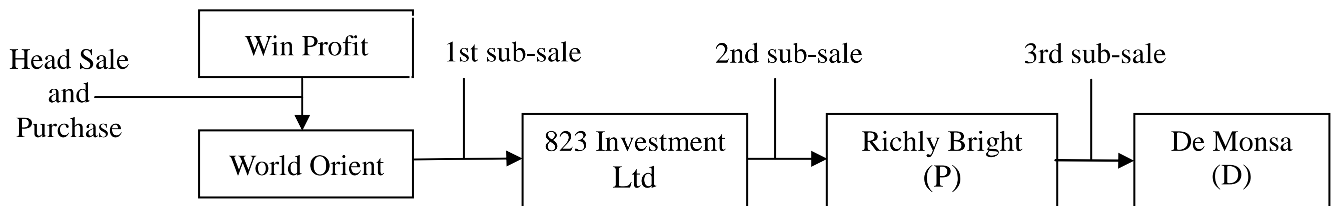
The object of an award of damages for breach of contract is compensatory. It aims to place the innocent party, so far as monetary award can do so, in the same position as if the contract had been performed in accordance with its terms. This basic principle could, however, if applied without any constraint, result in a defendant being made liable for all losses caused by a particular breach regardless of the improbability or remoteness of any item of loss.

Accordingly, a rule for remoteness of damage was formulated in the landmark case of *Hadley v Baxendale*[32]. The rule was that a defendant is responsible for damage (a) that may fairly and reasonably be considered as arising naturally, i.e. according to the usual course of things, from such breach of contract (the 1st limb), or (b) that may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it (the 2nd limb) ("HB Rule").

In *Richly Bright*[33], the Court of Final Appeal ("CFA") revisited the HB Rule.

Facts

This case concerns a chain of confirmor sale in respect of a commercial property in New Mandarin Plaza ("Property") as illustrated below.



De Monsa Investments Ltd ("D") was the ultimate purchaser on the chain. It had contracted to purchase the Property from Richly Bright International Ltd ("P") for $135,586,400 and 10% deposit ("Deposit") was paid. D failed to complete the sub-sale with P. Each of the purchasers up the chain also failed to complete.

In P's case against D, D was ordered to pay damages totaling HK$40,783,238 plus interest and costs. Apart from forfeiture of the Deposit, D was held liable for damages representing consequences of the chain defaults. D was adjudged liable to pay such damages because the Court of First Instance and the Court of Appeal ("CA") were satisfied that given D's knowledge that it was involved in a confirmor sale, it was within its reasonable contemplation that its default was likely to lead to chain defaults and consequential losses. D appealed to CFA.

[32] (1854) 9 Ex 341.
[33] (2015) 18 HKCFAR 232.

Decision

CFA unanimously allowed the appeal. CFA held, amongst others, that:

(a) Both limbs of the HB Rule were the practical expression of a single principle that the parties should only be liable for damages which were within their contemplation at the time they contracted. The crucial question was whether, on the information available to the defendant when the contract was made, he should, or a reasonable man in his position would, have realized that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation.

(b) Since all contractual liability was voluntarily undertaken, it was logical to found liability for damages upon the intention of the parties. HB Rule was a *prima facie* assumption about what the parties might be taken to have intended, and was capable of rebuttal in cases where a party would not reasonably have been regarded as assuming responsibility for such losses. Whether a contract breaker had assumed responsibility for a particular type of loss was to be decided by viewing the nature and object of the contract against its commercial background, and the common expectation, objectively assessed, on the basis of which the parties were entering into their contract.

(c) Each purchaser under the relevant sub-sale reached its own decision whether to complete its transaction, and the failure by each upstream purchaser to complete might not "fairly and reasonably be considered as arising naturally, i.e. according to the usual course of things" from D's failure to complete. The fact that this was a multi-million transaction in respect of which a substantial deposit had been paid reinforces the view that objectively, the reasonable contemplation was that the parties would make timely preparation to complete the purchase. It was not a reasonable and natural consequence of D's default that P would also default.

(d) Further, it cannot be said that D had undertaken responsibility for the chain default. There was no basis for concluding that at the time of entering into the 3rd sub-sale, it would have been in the parties' reasonable contemplation that non-completion by D should result in losses voluntarily incurred by P under its settlement with 823 Investment Ltd ("823") in 823's action for damages against P for P's default in the 2nd sub-sale. Liability so incurred would have been wholly unquantifiable and make the ultimate purchaser arbitrarily liable for fortuitous matters over which it had no control.

(e) A deposit is, by its legal nature, a percentage of the purchase price provided by a purchaser as an earnest to guarantee his performance of the contract. Hence, in the case of a sub-sale of property, provided the amount paid as a deposit is reasonable, a confirmor would be able to forfeit the deposit paid by his non-completing sub-purchaser. However, he would not have a claim for additional damages unless the deposit failed to cover the whole of the profit he would have made on the sub-sale.

(f) The loss of anticipated profit on P's resale as confirmor to D of $2,597,400 was plainly recoverable. As P suffered no recoverable loss exceeding the Deposit of $13,558,640 and had no claim for additional damages, D's liability was limited to the forfeiture of its Deposit.

(g) CA erred in holding D liable for all the upstream losses simply on the basis that such losses arose out of foreseeable prior sub-sales. The assessment of remoteness of damage must focus on the consequences of breach of the contract to which D was a party, not what flowed from a breach of someone else's contract.

Blondie Poon

Editors : **Yung Lap Yan**
Beverly Yan
Ada Chen
Stefan Lo

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