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## The Commercial Unit, Civil Division
## The Department of Justice

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## Editorial

We feature three articles in this edition. The first article discusses the law on bona vacantia under the Companies Ordinance, Cap. 622, and its predecessor Cap. 32.

The second article discusses the different stages involved in a Government tender exercise, the difference between a Process Contract and a Main Contract and the common pitfalls in drafting tender documents and tips to avoid them.

Electronic transactions have become more and more common nowadays. In order to provide the infrastructure to facilitate a digital economy and the use of e-transactions, the Electronic Transactions Ordinance, Cap. 553 (the "ETO") came into force in 2000. The third article talks about the rules in the ETO which equate e-transactions with their traditional counterparts. Such rules concern for example how information is to be given and stored and how a document is to be signed and served.

We also feature three case reports in this edition. The first case is about the circumstances in which a person will be regarded a de factor director of a company and thus owes fiduciary duties to the company as if he were an actual director.

The second case is about construction of contract. The Court of Final Appeal held that the court should give effect to the language of the contract when the words are unambiguous and that commercial common sense does not give a licence to the court to rewrite the contract merely because the terms seems unreasonable or not commercially wise.

The third case concerns the use of liquidated damages clause in a renovation works contract and the application of the test in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* ([1915] AC 79).

**YUNG Lap-yan**

# *Bona Vacantia*: Vesting of Dissolved Companies' Property in the Government

## Introduction

When companies are dissolved, they no longer exist. On occasion, a dissolved company may still own property immediately before dissolution. If that happens, the property is referred to as "*bona vacantia*" (ownerless property) and vests in the Government. This legal principle was developed to avoid a situation where there is no owner of property, in order "*to prevent the strife and contention to which title by occupancy might otherwise give rise*"[1].

## *Bona Vacantia* under the Companies Ordinance

Under s.752(1) of the Companies Ordinance (Cap. 622) ("CO"), if a company is dissolved pursuant to the CO (where there is no winding up of the company preceding the dissolution) or pursuant to the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO") (where dissolution follows the completion of winding up), every property or right vested in or held on trust for the company immediately before the dissolution is vested in the Government as *bona vacantia*. S.752 applies to companies dissolved on or after 3 March 2014 (commencement date of the CO).

Property within s.752(1) covers all forms of property, whether personal property (e.g. chattels) or real property (e.g. freehold land). Intangible property, e.g. shares in another company, is also covered. Apart from "property", s.752(1) also refers to "rights" which vest in the Government as *bona vacantia*. Rights within s.752(1) must also be of a proprietary nature. E.g. a right reserved to a company to affix notices to walls under a deed of mutual covenant was held to be a right in the nature of a licence personal to the company and ceased to exist once the company ceased to exist[2]. Accordingly such a right did not vest in the Government as *bona vacantia*.

If any property or right is vested in the Government under s.752(1), the property or right remains subject to the liabilities imposed on the property or right by law and does not have the benefit of any exemption that it might otherwise have as a property or right vested in the Government: s.752(3). A reference to a liability imposed on a property or right by law includes a liability that is a charge or claim on the property or right which arises under an Ordinance that imposes rates, taxes or other charges: s.752(5).

S.752(3) ensures that all liabilities attached to the property remain despite the company being dissolved and the property vesting in the Government as *bona vacantia*. This includes liabilities to third parties secured by some security interest over the property. It also includes statutory rates or other charges recoverable against the property itself, e.g. pursuant to a security interest in the form of a statutory charge imposed over the property. If the rates or charges are payable to the Government, effectively the Government would be required to make notional payments to itself to discharge the liability. Any exemption from the liability which the Government would otherwise have enjoyed as owner of the property or right does not apply.

The Government, however, is only required to satisfy the liabilities referred to in s.752(3) out of the property or right to the extent that it is properly available to satisfy those liabilities: s.752(4). The Government is not subject to any personal obligation to discharge the liabilities. The Government is only required to discharge the liabilities out of any income from use of the property or proceeds received from sale of the property.

S.752(4) only applies in relation to the liabilities referred to in s.752(3). These are liabilities that were imposed on the property or right *before* the property or right vested in the Government as *bona vacantia*. If there is some liability that is imposed on or in connection with the property or right *after* the vesting, the Government would be subject to such liability as owner in the same way as any owner of the property. The restriction on discharging the liability out of the property or right in s.752(4) does not apply. However, in respect of such "post-vesting" liabilities, the Government is not prevented from taking the benefit of any exemption to such liability that it might have.

S.752(3) is only concerned with liabilities imposed on

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1 *Halsbury's Laws of England – Crown and Crown Proceedings*, para. 149

2 *Incorporated Owners of Cheong Wang & Cheong Wai Mansion v Government of HKSAR* [2001] 1 HKLRD 483

any remaining property or right of the company. If the company was subject to liabilities of a personal nature which are not actually imposed on or attached to any property or right of the company, then such personal liabilities would not devolve onto the Government. E.g. if the company still owed a debt to an unsecured creditor, such a liability to the creditor is only a personal liability of the company and would not devolve onto the Government.

The Companies Registry has authority to act on behalf of the Government in *bona vacantia* cases[3].

**Restoration of a Dissolved Company and the Effect on *Bona Vacantia* Property**

A dissolved company may be restored to the Companies Register pursuant to the CO or CWUMPO (e.g. by court order). Once restored, the company is regarded as having continued in existence as if it had not been dissolved. If any property or right is still vested in the Government at the time of restoration, it revests in the company subject to any liability, interest or claim that was attached to the property or right immediately before the revest: s.773(5).

If, during the time when the company was still dissolved, the Government had disposed of or otherwise dealt with the property or right, the restoration does not affect the disposition or dealing: s.773(3). However, under s.773(6), if the Government received any consideration from the disposition or dealing, the Government must pay the amount of the consideration to the restored company. If no consideration was received, the Government must pay to the company the value of the property or right disposed of or otherwise dealt with. There may be deducted from the above sum the Government's reasonable costs in connection with the disposition or dealing: s.773(7).

**Companies Dissolved before 3 March 2014**

For companies which were dissolved under the predecessor Companies Ordinance (Cap. 32) ("predecessor CO") prior to the current CO coming into effect, s.292 of the predecessor CO would have applied at the time of dissolution to vest the property or right in the Government as *bona vacantia*. S.292 did not have the equivalent of CO s.752(3)-(5) dealing with liabilities imposed on the property or right, but previously the Government would also take the property subject to any liability secured on the property pursuant to the common law principles on *bona vacantia*[4].

**Stefan Lo and Ida Chan**

## Government Procurement

The *Guide to Procurement* by the Treasury Branch of the Financial Services and the Treasury Bureau (the "FSTB")[5] provides a useful overview of the procurement regime of the Government. It highlights the principles underlying the Government's procurement practices and summarises the Government procurement process and the Government bodies involved in procurement. As mentioned in the section titled "Laws and Regulations Related to Government Procurement", the government procurement process is governed by the Stores and Procurement Regulations (the "SPRs") issued by the Financial Secretary under the Public Finance Ordinance (Cap. 2). The SPRs are supplemented by Financial Circulars and FSTB Circular Memoranda. The SPRs are applicable to[6]:

(a) Government stores i.e. all articles purchased or acquired on behalf of the Government, excluding land and buildings;

(b) services performed for and on behalf of the Government which include services for construction and engineering works, consultancy services and other general services; and

(c) revenue contracts i.e. contracts that generate revenue for and on behalf of the Government.

When preparing an invitation to tender document (a "Tender Document") pursuant to which the procuring department seeks to invite the submission of tenders for the supply of goods or services, the tender procedures contemplated in Chapter III (Tender Procedures) of the SPRs will be relevant. This article discusses the contracts that arise from a tender exercise and how they relate to a Tender Document, and gives some examples of common pitfalls in drafting Tender Documents and tips to avoid them.

3 Law Society Circular 01-355(PA), 10 December 2001

4 Noel Ing, *Bona Vacantia* (1971) 128

5 Available at http://www.fstb.gov.hk/tb/en/guide-to-procurement.htm

6 Reference SPR 200

**Formation of Contract in a Government Tender Exercise**

We set out the different stages involved in a Government tender exercise. For simplicity, we will assume that the Government is seeking the supply of services for the remainder of this article.

(a) The Government issues a Tender Document to service providers inviting them to submit tenders to provide services to the Government;

(b) some service providers submit tenders offering to provide the services;

(c) the Government evaluates the tenders received and selects a successful tenderer;

(d) the Government accepts the successful tenderer's tender.

On the occurrence of (d), a contract ("Main Contract") is formed between the Government and the successful tenderer for the latter to supply the services to the Government.

*Process Contract*

However, the Main Contract is not the only contract which is formed in the tender exercise.

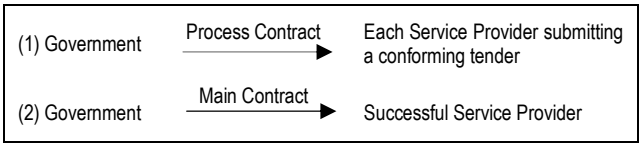
In the English case *Blackpool and Flyde Aero Club Ltd. v Blackpool Borough Council*[7], the Council, a local authority which owned and managed the local airport, had since 1975 granted to the plaintiffs, a flying club, a concession to operate pleasure flights from there. In 1983 the grant of the concession came up for renewal and the Council prepared an invitation to tender which they sent to the plaintiffs and six other parties. The invitation to tender specified, amongst other things, the deadline for receipt of tenders and also that no late tenders would be accepted. The plaintiff submitted a tender before the deadline but as a result of a careless failure by Council staff to empty the letter box at the town hall when they should have, it was treated as late and excluded from consideration. The Court of Appeal held that a contract should be implied between the parties. Such contract included a term that if a conforming tender was submitted before the deadline, it would be "opened and considered in conjunction with all other conforming tenders or at least…will be considered if others are"[8].

Such contract arising from the process of competitive tendering is often referred to as a "process contract" (the "Process Contract"). It is a contract separate and distinct from the Main Contract. The Main Contract will only come into existence if and when the Government has accepted one of the tenders received.

In a 2012 Hong Kong case[9], the Court of First Instance applied the principles of the Process Contract to Hong Kong.

**Relevance to Government Tender Documents**

Accordingly, a tender exercise gives rise to the following contracts:




A common pitfall is for procuring departments to mix up the terms of the Process Contract with the terms of the Main Contract when drafting Tender Documents. Further comment on this, and other common pitfalls are set out below together with tips to avoid them.

*Common pitfalls in drafting Tender Documents and tips to avoid them*

(a) Wrong placement of the terms of the Process Contract / Main Contract - The terms of the Process Contract should only be set out in the Terms of Tender of the Tender Documents. The terms of the Main Contract should not be included in the Terms of Tender. The terms of the Main Contract are usually set out in the Conditions of Contract, Specifications and Contract Schedules.

(b) Confusion between essential requirements and requirements under the Main Contract - By essential requirements we mean requirements failure of which would render the tender invalid and the tender not to be considered further. Tenderers' compliance with essential requirements is only relevant for the Process Contract and not the Main Contract. Note, however, that the subject of an essential requirement (set out in the Process Contract), e.g. the holding of a particular licence, may

7 [1990] 1 W.L.R. 1195

8 *Chitty on Contracts* (32nd edition, 2015), at 11-042

9 *Cheung Shing Scrap Metals Recycling Limited v Secretary for Justice*, HCA2190/2011 at para. 73

also be a requirement under the Main Contract (set out in the Main Contract).

(c) Setting completion of a document as an essential requirement – Requiring submission of a completed Schedule is a common essential requirement proposed by procuring departments. Unless it is the intent of the procuring department that each and every space in the Schedule be completed, a narrower and more precise essential requirement should be formulated instead e.g. completion of a particular column in the Schedule.

(d) Not appreciating the repercussions of requiring use of prescribed forms as essential requirements – We have come across procurements where tenderers have been disqualified because they did not use the prescribed form as required, but rather, reproduced the form with different degrees of accuracy. If a procuring department would be satisfied with the substance of the information requested and prepared to overlook variations in form, then they should not require submission of a prescribed form as an essential requirement. Instead, they may consider requiring submission of information requested in the form.

(e) Unnecessary complication of the Tender Document – If procuring departments are not using standard contract forms which envisage incorporation of both General Conditions and Special Conditions, and are designing their own Tender Documents, they need not have both General Conditions and Special Conditions, and may simply have Conditions instead.

**Josephine Ho**

## Electronic Transactions Ordinance (Cap. 553) ("ETO")

Electronic transactions ("e-transactions") have become a vital part of our daily lives. With the growth of electronic commerce in 1990s, the HKSAR Government provided the infrastructure to facilitate a digital economy and established a clear legal framework to support secure e-transactions by introducing the Electronic Transactions Bill ("Bill") in 1999. Minimalist regulatory and technology-neutral approaches were adopted for the legal framework, to avoid unnecessarily constraining e-commerce development in the private sector and to ensure the legal framework can cope with rapid technological changes[10]. The ETO became law on 5 January 2000 and was updated in 2004.

The Government has put in place the e-Procurement Programme to enable e-transactions between suppliers and participating bureaux and departments in respect of departmental purchases of low-value goods and services. The Government Logistics Department has implemented the e-Tender Box for tenderers to submit tenders electronically.

### Aims of the ETO

In general, the ETO is to:

(a) accord electronic records ("e-records") and electronic signatures ("e-signatures") the same legal status as their paper-based counterparts;

(b) establish a framework to promote and facilitate the operation of certification authorities ("CA") (i.e. the Postmaster General and other recognized CA(s)) to provide confidence and security in e-transactions.

### Functional Equivalence Rules

The ETO defines e-record as a record generated in digital form by an information system ("IS"), which can be transmitted within or between IS(s) and stored in an IS or other medium[11].

Rules which equate e-transactions with their traditional counterparts under ETO Part III ("Functional Equivalence Rules") are summarized in the table below.

[10] Legislative Council ("**LC**") Panel Paper on *Legal Framework for Electronic Transactions* dated January 1999, para. 3

[11] ETO s.2

| | |
|---|---|
| s.5 | If a rule of law ("Rule") requires/permits information to be/given in writing, an e-record satisfies the Rule if the information therein is accessible for subsequent reference. |
| s.5A | If a Rule under a provision set out in ETO Schedule 3[12] requires/permits a document to be served by personal service/post, service in the form of an e-record satisfies the Rule if the information therein is accessible for subsequent reference. |
| s.6(1) | For transactions *not involving a government entity*[13], a signature requirement under a Rule can be met by any form of *electronic signature* if:<br>(a) the signatory uses a method to attach the electronic signature to, or logically associate the electronic signature with, an e-record for identifying himself and indicating his authentication/approval of the information therein;<br>(b) it is reliable and appropriate; and<br>(c) it is agreed by the recipient of the signature. |
| s.6(1A) | For transactions *involving a government entity*, a signature requirement under a Rule can be met by a *digital signature* supported by a recognized digital certificate issued by a recognized CA. |
| s.7 | If a Rule requires presentation/retention of information in the original form, an e-record satisfies the Rule if:<br>(a) there exists a reliable assurance as to the integrity of the information since it was first generated in its final form; and<br>(b) the information can be displayed in a legible form. |
| s.8 | If a Rule requires retention of information, the Rule may be satisfied by retaining information in the form of e-records. |

**Technology Neutrality**

Under the ETO, the Government has to accept submission of e-records under law unless a specific exclusion has been made thereunder[14]. Owing to resource, operational and technical constraints, it would not be practicable or in the public interest for the Government to put in place all necessary systems and software to accept all types of electronic signatures that the public may wish to use when transacting with the Government electronically. The ETO has therefore specified that for transactions with a government entity, only a digital signature (i.e. a particular secure form of electronic signature) can meet a signature requirement under law[15]. "Digital signature" in ETO s.2(1) is defined with reference to technology currently available for supporting a digital signature, i.e. digital signature must be generated using an asymmetric cryptosystem and a hash function.

For other cases where there is a requirement for signature under law and in the case of contracts, any form of e-signature may be used, i.e. a technology-neutral approach[16].

**Electronic Contracts**

In the context of contract formation, an offer and acceptance may be expressed by e-records, unless the parties agree otherwise. A contract shall not be denied its legal effect solely because an e-record was used in its formation. An e-signature attached to or logically associated with the e-record shall not be denied legal effect on the sole ground that it is an e-signature[17].

**Exemptions**

The ETO has limited the application of the Functional Equivalence Rules:

(i) matters such as wills, trusts, powers of attorney, documents concerning land and property transactions, affidavits, statutory declarations, court judgments and orders and negotiable instruments, etc. are exempted from those Rules[18]. There is a practical need to conduct these matters through conventional means

[12] e.g. Landlord and Tenant (Consolidated) Ordinance (Cap. 7); Inland Revenue Ordinance (Cap. 112)

[13] The term "government entity" is defined in ETO s.2(1) as "a public officer or a public body"

[14] ETO s. 5

[15] LC Paper on *Review of the ETO* dated October 2002 ("LC Paper Oct 2002"), para. 13

[16] LC Brief on *Electronic Transactions (Amendment) Bill 2003* dated 11 June 2003, paras. 4-7

[17] ETO s.17

[18] ETO s.3 and Schedule 1

because of the solemnity and complexity involved[19];

(ii) the Permanent Secretary for Commerce and Economic Development may by Gazette specify the ordinances that are excluded from those Rules[20]. In this regard, the Electronic Transactions (Exclusion) Order (Cap. 553B) provides for exclusions regarding election matters; matters concerning public property and infrastructure; registration matters; and public health and safety matters; and

(iii) proceedings before various court and tribunals[21] are exempted from those Rules unless the relevant authority provides for their application[22].

**Other Forms of e-Signatures**

In the 2002 review, the Administration considered it not appropriate to make a general amendment to the ETO on the use of personal identification number for satisfying a signature requirement under law. It was also mentioned that other means of authentication including biometrics could be examined at a later stage[23].

**Ada Ng**

## Karla Otto Ltd v Bulent Eren Bayram [2017] 2 HKLRD 124

**Facts**

Ms Otto was the founder of a group of companies (the "Group") including the Plaintiff ("P"), an English company. She met the 1st Defendant ("D1") in July 2007 and they began to have a personal relationship. Since then D1 played an increasingly important role in the affairs of the Group with Ms Otto's agreement, although he was not formally a director, shareholder or employee of P or the Group. In February 2009, D1 became the sole administrator of P's bank account in the U.K. He incorporated the 2nd Defendant ("D2"), a Hong Kong company, using P's funds and made himself its sole shareholder and director.

The personal relationship between Ms Otto and D1 came to an end in July 2010. It was P's case that D1 had misappropriated substantial sums of money from the Group's bank accounts, including a sum of EUR200,000 from P's account in the U.K. to D2's account in Hong Kong. Ms Otto contended that she had not authorized D1 to establish any company in Hong Kong.

P asserted that D1 had breached his duties as a *de facto* director, a shadow director and a fiduciary. Apart from the sum of EUR200,000, P also claimed the shares in D2 and an order that D1 should resign as a director of D2.

***De facto* Director**

The Court examined the circumstances in which a person should be regarded as a *de facto* director and quoted the judgment of the Supreme Court of the U.K. in *HMRC v Holland*[24].

*"…those who assume to act as directors and who thereby exercise the powers and discharge the functions of a director, whether validly appointed or not, must accept the responsibilities of the office. So one must look at what the person actually did to see whether he assumed those responsibilities in relation to the subject company."*

The Court then cited the following passage in the same case to illustrate the various tests which the courts had considered in deciding whether a person was a *de facto* director:

*"A number of tests have been suggested of which the following are the most relevant. First, whether the person was the sole person directing the affairs of the company (or acting with others equally lacking in a valid appointment), or if there were others who were true directors, whether he was acting on an equal footing with the others in directing its affairs... Second, whether there was a holding out by the company of the individual as a director, and whether the individual used the title... Third, taking all the circumstances into account, whether the individual was part of 'the corporate governing structure'…"*

**Shadow director**

A shadow director is defined in s.2 of the Companies Ordinance (Cap. 622) to be:

19 LC Brief on the Bill dated 8 July 1999, para. 6; and LC Paper Oct 2002, para. 21
20 ETO s.11
21 e.g. the Court of Final Appeal; the Court of Appeal; the Court of First Instance; the Lands Tribunal
22 ETO s.13 and Schedule 2
23 LC Paper Oct 2002, paras. 10-11 and Consultation Paper attached thereto, para. 9
24 [2010] 1 WLR 2793

*"… a person in accordance with whose directions or instructions (excluding advice given in a professional capacity) the directors, or a majority of the directors, of the body corporate are accustomed to act."*

The English Companies Act 2006 contains a similar statutory definition. The Court reviewed the English case of *Smithton v Naggar*[25] where it was noted that, to establish that a person is a shadow director, it is necessary to show that there was a pattern of behavior in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the instructions of the person. The Court concluded that the essential element of being a shadow director is that of pulling the strings from behind the stage in such a way that the actual directors are essentially puppets who move only in accordance with the way the strings are pulled.

**Application to the present case**

The Court found that D1 was not a shadow director of P. Ms Otto ran the business and her companies through all the years of her relationship with D1. She was clearly not a puppet.

D1 was however held to be a *de facto* director of P and thus owed to P the same fiduciary duties as if he were an actual director. One of the duties was not to make a personal profit for himself at the expense of P. In addition, by assuming control of P's bank account, D1 entered into a fiduciary relationship with P, namely that the money should be used for the benefit of P or for purposes authorized by P.

Ms Otto made no decision to incorporate a company in Hong Kong, and even if she did, there could be no credible reason why D1 should be the sole shareholder and director of such company. D1 used P's money to establish D2 and in so doing was in breach of his fiduciary duty to P. To that extent, D1 had made a profit and must disgorge that profit to P.

D2 was impressed with knowledge of D1's breach of fiduciary duty and breach of trust, and was therefore liable to account to P for any assets in its hands which it knew to be traceable to the breach of trust. As D1 was the sole director of D2, it must follow that D2 through the mind of D1, had knowledge of D1's breaches of fiduciary duty and trust.

[25] [2014] 1 BCLC 602

**Relief**

The Court made a declaration that the defendants held the sum of EUR200,000 on trust for P. The Court also found that the money used to incorporate and establish D2 was derived from D1's breach of trust, and thus declared that D1 held the shares in D2 on trust for P.

The Court examined whether it had jurisdiction to order D1 to resign as a director of D2 under ss.728 and 729 of the Companies Ordinance. S.728(1)(a) and s.728(4)(b) provide that s.729 applies if in relation to a company, a person has engaged in conduct that constituted a breach of the person's fiduciary or other duties as a director of the company. S.729(1)(a) empowers the Court to grant an injunction requiring the person in breach of s.728(1)(a) to do "any act or thing". The Court concluded that it was vested with a wide power to make orders against a defaulting director who has been found to be in breach of fiduciary duty to do any positive act, including an order against D1 to resign as director of D2. The Court made the order accordingly.

**Daniel Yan**

## Sinoearn International Ltd v Hyundai-CCECC Joint Venture (2013) 16 HKCFAR 632

In this case, the Court of Final Appeal (the "CFA") was asked to revisit the extent to which the courts can consider the commercial purpose of the parties when interpreting a commercial contract.

**Facts**

D had to acquire two permits for dumping contaminated mud dredged in Hong Kong to Mainland waters, one from the Mainland authorities and the other from the Environmental Protection Department ("EPD") in Hong Kong. On 14 and 21 July 2000, two agreements were made between P and D (herein collectively defined as the "Contract") wherein P agreed to act as the agent of D to obtain dumping permits from the Mainland authorities to enable D to dump contaminated mud to South Erzhou China (the "SEZ Site"). D would secure the Hong Kong export permit himself. D agreed to pay P a dumping fee at a rate of HK$17 per $m^3$. A dumping permit was secured for the dumping of the first 1,000,000 $m^3$ of contaminated mud ("First Dumping

Permit"). D paid P approximately one-third of the dumping fee in respect of the First Dumping Permit and a batch of mud (approximately 338,128 $m^3$) was dumped by D pursuant to the First Dumping Permit. However, from then on, no Hong Kong export permit could be granted due to a change in EPD's practice. Consequently, D made a commercial decision to abort the idea of dumping at the SEZ Site.

A dispute arose as to whether D was under an obligation to dump a minimum quantity of contaminated mud at the SEZ Site and to make payment to P for such minimum quantity. P contended that the Contract was a fixed-sum contract and therefore he was entitled to be paid on the entire amount of contaminated mud dredged. D viewed the Contract in a completely different light and argued that it was a measurement contract i.e. P was only entitled to be paid for the contaminated mud actually disposed of by D.

**The Courts Below**

The Court of First Instance (the "CFI") held that D was not under an obligation to dump and to pay for a minimum quantity of contaminated mud. This decision was reversed by the Court of Appeal (the "CA") where it was ruled that D had agreed to pay P to secure the right to dump the entire amount of contaminated mud dredged. The courts had different interpretations on certain provisions in the Contract. In particular, one provision provided that "the measurement of the final volume shall be … less any other … contaminated mud ***dumped in other disposal areas***" (***emphasis added***). The CFI was of the view that the phrase "dumped in other disposal areas" was inconsistent with a construction which required all contaminated mud to be dumped at the SEZ Site. It also did not agree with P's submission that the phrase only referred to dumping elsewhere in the event of bad weather because the Contract did not refer to a bad weather exception. However, the CA regarded the phrase to be opened to two interpretations – one supported D's case that it was not bound to dump all contaminated mud in the SEZ Site; the other was that these words only referred to the limited circumstances under which the mud might be dumped elsewhere e.g. pre-contract dumping and bad weather condition. The CA rejected the former interpretation because they regarded it as contrary to business common sense and there was evidence on the parties' discussion on bad weather condition after the Contract was made which supported the latter interpretation.

D appealed to the CFA on the grounds that the CA had placed too much emphasis on what it perceived to be the commercial purpose of the parties i.e. the contaminated mud could be dumped at the SEZ Site.

**The CFA's Decision**

The CFA disagreed with the CA's interpretation of the abovementioned provision. Nothing suggested that the discussion on bad weather led to the inclusion of that provision in the Contract. In fact, the CFA thought that the CA chose to construe the provision in that way (and also read too much into other provisions in the Contract) because the CA based their decision on what they thought was commercial common sense rather than a literal construction of that provision. In this regard, Tang PJ cited the relevant principles on the role to be played by consideration of commercial common sense when interpreting a contract:

(i) the law generally favours a commercially sensible construction but the words of a contract must be interpreted in a way in which a reasonable commercial person would construe them;

(ii) having a commercial common sense does not represent a licence to the court to rewrite the contract merely because the terms seem unexpected or unreasonable or not commercially wise; and

(iii) although the court should know the commercial purpose of the contract, it must always give effect to the language of the contract when the words are unambiguous and commercially sensible having regard to the rest of the document and the factual background, even though the consequence may appear hard for one of the parties.

Upon examination of the language used in the Contract, the CFA held that there was no statement of contractual obligations on D to dump any amount of mud in the Contract. Some provisions in the Contract referred to how the volume of contaminated mud should be measured. The phrase "dumped in other disposal areas" when read literally meant that D was not bound to dump all contaminated mud to the SEZ Site. On the face of it, this seemed to be a measurement contract.

Turning to the role of commercial common sense, the CFA took the view that the commercial purpose did not materialize into the assumption that D would be fully liable under the Contract if the dumping did not

take place. If there was such assumption, the parties would have contracted on that basis. Tang PJ commented that commercial common sense, like commercial purpose, must not be seen through the eyes of only one party. Although the Contract turned out to be disadvantageous to P due to the unforeseeable circumstances, it would also make very little commercial common sense from D's perspective if D was fully liable for dumping not carried out in Mainland waters because on top of paying in full for the dumping not carried out, D would have to bear higher costs of dumping in Hong Kong waters. Having regarded to the above, the CFA ruled that there was no relevant commercial common sense in this case which would enable the court to override the language used. Thus, it was held that the Contract was, as reflected from the language used, a measurement contract.

**Fiona Lai**

## Evergreen (FIC) Ltd v Golden Cup Industries Ltd [2016] 5 HKLRD 636

**Facts**

This is a construction dispute concerning renovation works carried out by the Plaintiff ("P") at the restaurant of the Defendant ("D"). P claimed for the outstanding amount for work done on site.

According to the contract between P and D, P undertook to complete the renovation works by certain deadline; in case of delay, P had to compensate 1% of the contract sum ($5,032,600) as a daily penalty; if P could not complete the works properly notwithstanding the delay, D was entitled to engage another contractor and P would be responsible for all losses ("Undertaking").

D conceded P's claimed sum but counterclaimed on the basis that:

(a) P had breached the Undertaking by failing to complete the works on time and was liable for the liquidated damages; and

(b) D was required to incur extra costs to rectify defective or incomplete works left by P.

It was P's case that the material delay was not caused by P but by the other contractors directly engaged by D ("Other Contractors"). P had suffered delay in its works as a result of the default of the Other Contractors and was entitled to claim compensation against D. In the circumstances, the parties agreed by an oral agreement that D would arrange and carry out remedial work at D's own cost, and P in turn would not claim any compensation for the delay ("Oral Agreement").

**Decision**

***Whether P was in breach of the Undertaking***

The Court accepted that contemporaneous documents provided the best guide as to what had actually happened, particularly in building and construction cases. Based on the contemporaneous email and WhatsApp communications adduced, the Court concluded that the delay was indeed caused by the Other Contractors. The Court bore in mind that under the Undertaking, P was no different from the Other Contractors. P was not the main contractor and had no contractual duty to coordinate or supervise the Other Contractors' works. P was not in breach of the Undertaking.

***Whether the liquidated damages clause was enforceable***

Notwithstanding the above ruling, the Court went on to hold (in *obiter*) that the liquidated damages clause in the Undertaking was not a penalty and should be enforced, applying the four-point test in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*[26]

(1) A liquidated sum payable on a breach will not be held to be a penalty unless it exceeds the greatest loss which would be predicted at the time that the contract was entered into;

(2) Where the breach consists only in not paying a sum of money the sum stipulated will be penal if it exceeds the sum which ought to have been paid;

[26] [1915] AC 79

(3) Where a single lump sum is payable on the occurrence of one or more events some of which may give rise to a more significant loss than others there is a presumption (but no more than a presumption) that the clause providing for liquidated damages is penal;

(4) The fact that precise pre-estimation of the loss is difficult or impossible to determine does not render the assessment of liquidated damages penal, "on the contrary, that is just the situation when it is probable that the pre-estimated damages was a true bargain between the parties".

The Court found that the liquidated damages clause at 1% of the contract sum per day (i.e. $50,326) was a genuine pre-estimate of loss as D would have suffered loss of profit and rent each day the opening of the restaurant was delayed (the evidence showed that the estimated turnover of the restaurant would be around $200,000 per day), and such loss could exceed the liquidated sum.

***Whether there was Oral Agreement between P and D***

On the evidence, the Court found that P had established the Oral Agreement. First, this was supported by the fact that D had never compiled a defects list to P when P was asked to vacate the site or anytime thereafter before commencement of the action. While D instructed various contractors to carry out the remedial work after D had commenced its operation of the restaurant, P was never informed of the alleged defects or the rectification of such. Second, P had incurred substantial additional overhead and overtime payments to its workers due to the delay by the Other Contractors. It would be against commercial common sense for P not to bill D for such additional expenses, had there been no Oral Agreement. Third, P had set out the Oral Agreement in an email to D, but D failed to rebut that email without any satisfactory explanation. The obvious inference must be that the content of the email was true.

Judgment was given in favour of P, and D's counterclaim was dismissed.

**Comments**

On the question what makes a contractual provision penal, in *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis*,[27] the UK Supreme Court commented that the concept of "genuine pre-estimate of loss" was unhelpful and queried if the four-point test in *Dunlop* should be treated as an immutable rule of general application. The Supreme Court said that "*[t]he true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation*".

This "true test" was recently applied in *Force Way Engineering Ltd v Incorporated Owners of Grand Court*, DCCJ 3216/2016, 19 December 2017 (also a renovation works dispute), where it was said that *Cavendish* had now made it clear the mere fact that the clause was not a pre-estimate of loss did not by itself mean that it was penal in nature[28].

On the facts of this case, it appears that the Court would have come to the same conclusion even applying *Cavendish* – D had a legitimate interest in ensuring timely completion of the renovation works, and the liquidated damages clause at 1% of the contract sum did not seem to be out of proportion to the loss that would be occasioned by the delay.

**Angel Li**

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[27] [2015] UKSC 67

[28] At paras. 241 and 243.