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Editorial

We feature three articles in this edition.

The first article talks about the key features of the current Scheme of Control Agreements ("SCAs") between the Government and the two power companies in Hong Kong. Such features include many green initiatives such as the promotion of energy efficiency and conservation and renewable energy which make the current SCAs the greenest SCAs ever.

The second article discusses whether the holding of hybrid or virtual meetings and the passing of written resolutions by shareholders or directors are allowed under the Companies Ordinance. This topic is of particular importance during the pandemic when the holding of physical meetings may be a challenge.

The third article briefly sets out the regulatory regime on trustees in Hong Kong.

We also feature three case reports.

The first case concerns a simple employment contract between a school and one of its teachers which provides that either party may terminate the employment by three months' notice or payment in lieu of notice. The teacher terminated the employment and the school demanded him to make payment in lieu of notice. The Court of Appeal considered whether the teacher's obligation to make payment in lieu of notice was a primary obligation to which the doctrine of penalty would not apply.

The second case is about the validity of a guarantee executed by the defendant as security for the indebtedness of another defendant. The two defendants were cohabitees. The Court had to decide whether the first defendant could avoid the contract under the doctrine of undue influence.

In the third case, the plaintiff, a customer of the defendant bank, was deceived by the bank's securities manager into making a series of investments which the securities manager claimed were "internal" investments offered to the bank's staff only. In fact, the investments were bogus and the plaintiff suffered significant loss. The Court had to decide whether the bank was vicariously liable for the plaintiff's loss.

YUNG Lap-yan

Introduction

In Hong Kong, electricity is supplied by two privately owned power companies, i.e., the CLP Power Hong Kong Limited and Castle Peak Power Company Limited ("CLP"), and The Hongkong Electric Company Limited and HK Electric Investments Limited ("HKE"). The electricity market is regulated through the Scheme of Control Agreements ("SCAs") signed between the Government and each of the power companies.

The SCAs do not give the power companies any franchises or exclusive rights to supply electricity. Rather, they set out the rights and obligations of the power companies, and provide a framework for the Government to monitor the financial affairs of the companies so far as they are electricity-related. The first SCA was signed in 1964 between the Government and CLP. Over the years, features have been added to the SCAs to improve its operation and to better achieve the Government's energy policy objectives[1], which include safety, reliability, affordability and environmental protection[2].

The current SCAs with CLP and HKE took effect on 1 October 2018 and 1 January 2019 respectively, and will expire at the end of 2033. By signing the SCAs, the power companies undertake to provide sufficient facilities to meet present and future electricity demand of their respective supply areas. In return, they are entitled to receive returns at a permitted rate based on their average net fixed assets[3].

Tariff and development plan

Electricity tariffs payable by consumers are determined by the mechanism and methods stipulated in the SCAs.

In order to establish agreement on the levels of projected basic tariffs[4], a development plan ("DP") review will be conducted jointly by the Government and each power company when the current DP of the power company is about to expire, or whenever there are major additions to the company's electricity generation, transmission and distribution system. The DPs (which outline the proposed capital projects, the estimated operating and capital expenditures, as well as the projected sales and basic tariff rates for each of the years covered by the DPs) are proposed by respective power companies, submitted to the Government in accordance with the requirements of the SCAs, and approved by the Executive Council. The current DPs of CLP and HKE as approved by the Executive Council cover the period until 31 December 2023.

The actual tariffs to be charged to consumers will be determined in the annual tariff review conducted jointly by the Government and each of the power companies in October of each year in accordance with the SCAs. Any proposal by a power company to increase the basic tariff by more than 5% of the projected basic tariff in the DP will be subject to further approval by the Executive Council.

Under the SCAs, the power companies are required to maintain a tariff stabilisation fund. The main purpose of the tariff stabilisation fund is to accumulate and provide funds to ameliorate tariff increases or facilitate tariff reduction where appropriate.

Financial incentives and penalties

The current SCAs provide for various performance-linked financial incentives and penalties. For instance, financial incentives are provided to the power companies for improvement in supply reliability, operational efficiency, customer services and supply restoration, while financial penalties are imposed for under-performance. These incentives and penalties aim to encourage the power companies to further improve their performance in order to ensure the electricity supply in Hong Kong will continue to be reliable and stable, while the services provided to consumers, including the restoration time required in case of power outages, will remain satisfactory[5].

1 See https://www.gov.hk/en/residents/environment/energy/schemeofca.htm

2 See the Administration's paper on "New Scheme of Control Agreements with the Two Power Companies" LC Paper No. CB(4)925/16-17(01)) (available at https://www.legco.gov.hk/yr16-17/english/panels/edev/papers/edevcb4-925-1-e.pdf), para. 3

3 Average net fixed assets for a year means the average for that year of the opening and closing balances of Net Fixed Assets as defined in the SCAs

4 Put simply, basic tariff is set at a level which enables the power companies to recover their operating costs and earn the permitted return under the SCAs

5 See the Administration's paper on "New Scheme of Control Agreements with the Two Power Companies" (LC Paper No. CB(4)925/16-17(01)) (available at https://www.legco.gov.hk/yr16-17/english/panels/edev/papers/edevcb4-925-1-e.pdf), para. 26

Green initiatives

Under the current SCAs, promotion of energy efficiency and conservation ("EE&C") is a key focus. It will contribute not only to the Government's efforts to meet the carbon intensity reduction target for 2030 but also to the energy intensity reduction target for 2025[6]. Incentive schemes in relation to the promotion of EE&C are put in place under the SCAs to encourage the power companies to further promote EE&C. For instance, the power companies may earn financial incentives based on the number of energy audits[7] conducted and energy saving achieved under the energy audit programmes[8].

In addition, both power companies continue to maintain an energy saving loan fund to provide loans to non-Government customers to implement initiatives to promote EE&C. The power companies will also double the education fund established for promoting energy efficiency under the current SCAs[9].

Promotion of renewable energy ("RE") is another key focus of the current SCAs. The Feed-in Tariff ("FiT") Scheme and RE certificates are two important initiatives in this area[10].

6 *Ibid*, para. 19

7 Energy audits are conducted by the power companies for their customers in order to identify opportunities for energy saving in non-domestic premises

8 See the Administration's paper on "Implementation Details concerning Renewable Energy, Energy Efficiency & Conservation and Fuel Clause Charge Adjustment Mechanism under the Post-2018 Scheme of Control Agreements" (LC Paper No. CB(1)809/17-18(03)) (available at https://www.legco.gov.hk/yr17-18/english/panels/ea/papers/ea20180423cb1-809-3-e.pdf), paras. 6 and 10

9 See the Administration's paper on "New Scheme of Control Agreements with the Two Power Companies" (LC Paper No. CB(4)925/16-17(01)) (available at https://www.legco.gov.hk/yr16-17/english/panels/edev/papers/edevcb4-925-1-e.pdf), para. 21

10 *Ibid*, paras. 22 and 23

Under the FiT Scheme, any persons who install solar photovoltaic or wind systems at their premises can sell the RE they generate to the power companies at a rate as high as about five times more than the normal electricity tariff rate. FiT encourages the community at large to invest in RE and develop distributed RE generation in order to exploit the RE potential as fully as possible[11]. Individuals (not in the course of a business) who install small-scale RE systems at their residential premises and participate in the FiT Scheme are exempt from business registration in respect of the FiT business and exempt from the profits tax in respect of the FiT payments received from the power companies[12].

RE certificates are sold by the power companies for units of electricity from RE sources (whether such electricity is generated or purchased by the power companies) such that buyers can claim their operation or activities are carbon-free. The revenue from the RE certificates is used to help alleviate the overall tariff impact on all consumers brought about by the introduction of the FiT Scheme[13].

With the new features for the promotion of EE&C and RE, the current SCAs are described as "the greenest SCAs ever"[14].

Blondie Poon

11 See https://www.gov.hk/en/residents/environment/renewable/feedintariff.htm

12 See https://www.ird.gov.hk/eng/tax/fit.htm

13 See the Administration's paper on "New Scheme of Control Agreements with the Two Power Companies" LC Paper No. CB(4)925/16-17(01)) (available at https://www.legco.gov.hk/yr16-17/english/panels/edev/papers/edevcb4-925-1-e.pdf), para. 23

14 See https://www.info.gov.hk/gia/general/201704/25/P2017042500763.htm

The Regulatory Regime on Trustees in Hong Kong

Introduction

Broadly speaking, where a person holds a property for or on behalf of another and provided that there has been a transfer of such property to that person, he is said to hold the property on trust for that other person. The person holding the property is known as the trustee, and the person for whom the property is held is known as the beneficiary. This article serves to summarise the applicable laws in Hong Kong in relation to the regulation of trustees.

Licensing and regulatory regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance

A licensing regime[15] has been in place since 1 March 2018 under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Chapter 615 of the laws of Hong Kong) ("AML Ordinance") such that it is an offence to carry on the business of

15 See s.53G of the AML Ordinance

providing a trust service without a licence to be issued under Part 5A of the AML Ordinance[16]. The person performing the business of providing a trust service being granted such licence is known as a "TCSP licensee"[17]. One of the criteria to be fulfilled in order to be granted a TCSP licence is to satisfy a "fit-and-proper" test[18]. The factors relevant to the "fit-and-proper" test are set out in s.53I. In short, the test concerns a consideration of the criminal record of the applicant, each of the partners or directors of the applicant which is a partnership or corporate applicant, and the ultimate owner of the applicant, and whether the applicant has failed to comply with the requirements under the AML Ordinance and relevant regulations issued by the Registrar [19]. Any bankruptcy or liquidation or receivership proceedings concerning the applicant will also be taken into account[20]. The Registrar may revoke or suspend the licence if the TCSP licensee or any of the aforementioned persons no longer satisfies the "fit-and-proper" test[21].

The AML Ordinance also provides for certain anti-money laundering and counter-terrorist financing ("AML/CTF") requirements relating to customer due diligence and records keeping for specified financial institutions and DNFBP[22] (which includes a TCSP licensee). Such AML/CTF requirements shall apply to a TCSP licensee if it prepares or carries out for a client a transaction concerning a trust service or company service[23]. The Registrar of Companies is the regulator of TCSP licensees. The Registrar is empowered to investigate any non-compliance in relation to a TCSP licensee and impose disciplinary sanctions (including a pecuniary penalty not exceeding HK$500,000) where a TCSP licensee contravenes any applicable AML/CTF requirement or any specified statutory requirement or any condition of the licence[24].

Trustees' conduct

Duties at law and in equity

Under the common law and rules of equity, a trustee owes fiduciary duties, a duty of care and duties to comply with the terms of a trust. As for fiduciary duties, a trustee must not place himself in a situation of conflict between his personal interests and the interest of the trust[25] or make any secret profit from the trust property.[26]

As for the duty of care, the common law rule is that a trustee must execute the trust with reasonable diligence and conduct its affairs in the same manner as an ordinary prudent man of business would conduct his own affairs[27]. Professional trustees with greater knowledge and experience (e.g., a trust corporation carrying on the specialised business of trust management) have a higher standard of duty of care imposed on them than lay trustees[28].

Statutory duty

The Trustee Ordinance (Chapter 29 of the laws of Hong Kong) ("Trustee Ordinance"), as amended by the Trust Law (Amendment) Ordinance 2013, imposes a default statutory duty of care on trustees in a number of specified situations, such as investment of trust properties and engagement of agents and custodians. According to s.3A(1) of the Trustee Ordinance, where the statutory duty of care applies under each specified situation as mentioned in Schedule 3 to the Trustee Ordinance, the trustee is required to exercise the care and skill that is reasonable in the circumstances, having regard to any special knowledge or experience that the trustee has or holds out as having, and, if the trustee is acting in the course of a business or profession, any special knowledge or experience that is reasonably expected of a person acting in the course of that kind of business or profession. Subject to the terms of the trust instruments, the statutory duty of care will apply to trustees when they exercise their powers and duties[29].

Under the Trustee Ordinance, it is possible to remove a trustee by the consent of all the beneficiaries without the need to terminate the trust and re-settle the trust fund with a new trustee[30].

In the case of a trustee acting in a professional capacity and receiving remuneration for his trust services, the terms of the trust must not (a) relieve the trustee from liability for a breach of trust arising from

[16] See s.53F of the AML Ordinance
[17] See the definition in s.1 of Part 2 of Schedule 1 to the AML Ordinance
[18] See s.53H of the AML Ordinance
[19] See the definition in s.1 of Part 2 of Schedule 1 to the AML Ordinance
[20] See s.53I (d) and (e) of the AML Ordinance
[21] See s.53Q of the AML Ordinance
[22] "DNFBP" is an acronym for persons in the category described as "*designated non-financial businesses and professions*"
[23] See s.5A(5) of the AML Ordinance
[24] See s.53Z of the AML Ordinance
[25] *Boardman v Phipps* [1967] 2 AC 46
[26] See footnote 11 above
[27] *Speight v Gaunt* (1883-84) L.R. 9 App. Cas. 1
[28] *Bartlett v Barclays Bank Trust Co. Ltd.* [1980] 2 W.L.R. 430
[29] See s.3A(3) of the Trustee Ordinance
[30] See s.40A of the Trustee Ordinance

the trustee's own fraud, wilful misconduct or gross negligence; or (b) grant the trustee an indemnity against the trust property for the liability[31].

[31] See s.41W of the Trustee Ordinance and provided that the trust was created after the commencement date of the Trust Law (Amendment) Ordinance 2013

Conclusion

Hong Kong is a major asset management centre in Asia. It is believed that the competitiveness of Hong Kong's trust services industry will be further bolstered with an effective regulatory regime.

Silvia Tang and Oswald Law

Alternatives to Shareholders' and Directors' Physical Meeting Under the Companies Ordinance

Introduction

With a view to combatting the COVID-19 pandemic, the Government has introduced social distancing measures and imposed travel restrictions. This article explores the meeting requirements under the Companies Ordinance (Cap. 622) ("CO") and Schedule 2 to the Companies (Model Articles) Notice (Cap. 622H) ("Model Articles") for shareholders and directors of private companies limited by shares incorporated in Hong Kong; and ways for those companies to tackle the challenge to hold physical meetings in these times.

All sections and articles mentioned herein refer to those respectively under CO and the Model Articles.

What is a meeting?

The essence of a meeting is the meeting of the minds. It is unnecessary for all attendees of a meeting to be physically present in the same place.[32] In the context of company law, the purpose of a meeting is to have members gathered, discussed and if achievable concurred in certain decisions affecting the affairs of a company.[33]

Hybrid or virtual meetings allowed?

Shareholders' meetings

CO facilitates a hybrid general meeting, i.e. a physical meeting coupled with electronic participation simultaneously such as video-conferencing, tele-conferencing or other electronic means.

S.584 allows a company to hold a general meeting at 2 or more places using any technology that enables the shareholders who are not together at the same place to listen, speak and vote at the meeting. The company may also set out the procedures in its Articles for holding such meeting.

Pursuant to s.576(1)(b) and (2), subject to a company's Articles, if a general meeting is to be held in 2 or more places, the notice of the meeting must specify the principal place and the other place(s) of the meeting.

Directors' meetings

CO is silent as to whether directors' meetings may be held on hybrid or entirely virtual basis. CO has neither mandated that directors could only meet at physical meetings. Such flexibility means that one may resort to a company's Articles for the format and procedures of its directors' meetings.

Article 10 allows directors to participate in directors' meetings in different places. It further provides that where the directors are, and how they communicate with each other, are irrelevant in determining whether they are participating in a directors' meeting. In other words, for companies adopting the Model Articles, directors' meetings held physically, or on hybrid or entirely virtual basis are all allowed. For companies which do not adopt the Model Articles, whether all those formats are allowed would be subject to any provision of their Articles.

Written resolutions as an alternative to meetings?

Shareholders' written resolutions

Subdivision 2 of Division 1 of Part 12 of CO sets out the procedures for proposing and passing written resolutions by shareholders in lieu of resolutions passed at general meetings of a company. Such procedures facilitate efficient transaction of business especially for small and medium-sized enterprises, saving time and cost which may otherwise arise from holding meetings.

[32] *Company Law in Hong Kong – Practice and Procedures (2021)*, para. 5.005
[33] *Ibid*, para. 5.003

Under s.548(1), anything that may be done by a resolution passed at a general meeting may be done, without a meeting and without any previous notice being required, by a written resolution of the shareholders. Under s.548(5), such written resolution has effect as if passed by the company at a general meeting. However, pursuant to s.548(6), the written resolution procedure does not apply to a resolution removing an auditor or a director before the end of the term of office.

Under s.549, both directors and shareholders may propose a resolution as a written resolution, the former must be circulated by the company pursuant to s.550. For the latter, if requested by shareholders representing not less than 5%[34] of the total voting rights of all shareholders entitled to vote on the resolution, the company must also circulate the same under s.552(1).

The company must arrange the above circulation to its shareholders within 21 days under s.553(3). Circulation may be in hard copy, in electronic form or via website pursuant to s.553(2). Under s.553(6), the circulation must be accompanied by guidance as to how to signify agreement to the resolution, and the date by which the resolution must be passed if it is not to lapse. Pursuant to s.555(1), the company must also send to its auditor the proposed resolution and other related documents required to be sent to its shareholders under s.553 on or before the circulation date.

Under s.556(1), a written resolution is passed when all eligible members[35] have signified their agreement to it. Such agreement may be sent to the company in hard copy or in electronic form pursuant to s.556(3).

Pursuant to s.558(1), a proposed written resolution lapses if it is not passed before the end of 28 days beginning on the circulation date, or such other period as may be specified in the company's Articles.

Under s.559(1), after a written resolution is passed, the company must notify its shareholders and auditor accordingly within 15 days.

A company's Articles cannot contract out the statutory right or obligation to propose and pass written resolutions pursuant to s.561(1). Subject to members' unanimous approval under s.561(3), a company may, pursuant to s.561(2), set out in its Articles authorizing the passing of resolutions without a meeting otherwise than in accordance with Subdivision 2 of Division 1 of Part 12 of CO.

Directors' written resolutions

S.481(1)(b) requires a company to record all resolutions passed by its directors without a meeting, implying that directors' written resolutions are allowed. However, CO does not provide for the procedures of passing directors' written resolutions. A company that has adopted the Model Articles as its Articles may rely on Article 8(2) to pass written resolutions signed by all eligible directors[36]. For companies which have not adopted Article 8(2), they may set out in the Articles their own procedures for passing directors' written resolutions.

Summary

(a) CO allows shareholders' meetings to be held on a hybrid basis.

(b) A company's Articles may authorize the passing of shareholders' written resolutions, in the absence of which the procedures for passing written resolutions in Subdivision 2 of Division 1 of Part 12 of CO apply.

(c) A company's Articles may set out the format of directors' meetings and the procedures for passing directors' written resolutions.

Ida Chan

Law Ting Pong Secondary School v Chen Wai Wah [2021] CA 873

Facts

The appellant school ("S") put up an advertisement for the recruitment of a teacher. The defendant ("D"), who was then working for another school, applied for the job. S offered to hire D for the term commencing on 1 September 2017. On 17 July 2017, S issued to D three documents, i.e.: (1) the Letter of Offer of Appointment ("Offer Letter"); (2) the Letter of Acceptance ("Letter of Acceptance"); and (3) the Conditions of Service ("Conditions of Service").

The Offer Letter stated that the employment terms were set out in the Conditions of Service, which provided that the employment period shall commence from 1 September 2017 and that either party may

[34] Or a percentage lower than 5% if so specified in the company's Articles: s.552(2)

[35] I.e. the members who would have been entitled to vote on the resolution on the circulation date of the resolution: s.547(2)(a)

[36] I.e. directors who would have been entitled to vote on the matter if it had been proposed as a resolution at a directors' meeting: Article 8(3)

terminate the employment by three months' notice or payment in lieu of notice ("Termination Provision").

The Letter of Acceptance stipulated that "*the conditions of the new contract will come to [sic] immediate effect e.g. I need to give three months' notice to terminate my employment with [S]*".

D signed and returned the Conditions of Service and the Letter of Acceptance. However, in late August 2017, he informed S that he would not report to duty as he had decided to stay on with his current school. S demanded D to make payment in lieu of three months' notice. D only offered to pay the re-advertising expenses for recruitment.

S sued D in the Labour Tribunal, which found in favour of S. The Court of First Instance allowed D's appeal, holding that the terms of the employment offer made by S consisted only of the provisions in the Conditions of Service. The Letter of Acceptance was simply the mode of acceptance prescribed by S and the additional terms therein did not form part of the offer.

Issues

S appealed to the Court of Appeal ("CA") and the issues were:

(1) whether the Letter of Acceptance with the sentence that the contract came into immediate effect was part of the contract ("Interpretation Issue"); and

(2) whether the Termination Provision, in particular the provision on payment in lieu of notice, was unenforceable as a penalty clause ("Penalty Clause Issue").

Decision of the CA

The Interpretation Issue

The CA referred to the oft-cited passage of Hoffmann NPJ in *Jumbo King Ltd v Faithful Properties Ltd & Ors*[37] which pointed out "*the overriding objective in construction is to give effect to what a reasonable person ... would have understood the parties to mean*", and this "*involves having regard, not merely to the individual words they have used, but to the agreement as a whole, the factual and legal background against which it was concluded and the practical objects which it was intended to achieve*".

The CA considered that all three documents given to D together when S made its offer of employment were accepted by D as a "package deal". Viewing the circumstances as a whole, it must be plain and reasonably understood by D that S was offering (and only ready to offer) employment on the basis set out in all three documents. A reasonable person would have no difficulty understanding the sentence in the Letter of Acceptance to mean that the terms of the contract (including the Termination Provision) would come into immediate effect. The CA held that the Letter of Acceptance (and its content) forms part of the contract. Either party was bound by the terms of the contract (including the Termination Provision) immediately upon the creation of the contract on 17 July 2017, even before the commencement of the employment period on 1 September 2017.

The Penalty Clause Issue

The CA followed the law in relation to the doctrine of penalty reviewed in *Cavendish Square Holdings v Makdessi*[38] by the UK Supreme Court. In *Cavendish*, it was considered that while the traditional test was a useful tool in a simple case, it was not easily applied to more complex cases. The true test for whether a sum stipulated was a penalty was whether the clause was out of all proportion to the innocent party's legitimate interest in enforcing the contract.

In applying the test, the court should first identify the legitimate interest of the innocent party that is being protected by the clause, and then assess whether the clause is out of all proportion to the legitimate interest by considering the circumstances in which the contract was made. Notions of whether the clause has a deterrent purpose or whether it is a genuine pre-estimate of loss would be subsumed by the broader enquiry into the legitimacy of the interest that supports the provision.

In *Cavendish*, it was also decided that the doctrine of penalty is not applicable to contractual provision which stipulates an obligation to pay certain amount of money by way of a primary obligation.

In the present case, the payment of a sum in lieu of notice was a contractually agreed method of lawful termination of the employment contract. It was a primary obligation to pay rather than a secondary obligation arising upon the breach of a primary obligation. The CA therefore held that the doctrine of penalty was not engaged in the present case.

[37] [1999] 3 HKLRD 757

[38] [2016] AC 1172

The CA further considered that, even if the doctrine of penalty applied in the present case, the Termination Provision would not be an unenforceable penalty clause. As a school with substantial number of students, it must be important to S to have suitable, steady and sufficient number of teaching staff at all times so as to ensure proper operation of the school curriculum. The potential adverse impact caused by a teacher's termination of contract at short notice must be a relevant consideration for S when formulating the employment terms with its teachers. The CA considered that the three months' notice and the payment-in-lieu specified in the Termination Provision could not be said to be out of all proportion to S's interest in enforcing the contract, having regard to the difficulties S would face in appointing a replacement teacher.

The CA allowed S's appeal.

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

Shun Hing Electronic Trading Co Ltd v Sunrise Air-Conditioning Co Ltd and others [2021] HKCFI 1190

Facts

The Plaintiff ("P") sub-contracted the installation works under eight projects (the "Projects") to the 1st Defendant ("D1"). The 2nd Defendant ("D2") was D1's sole director and shareholder. The 3rd Defendant ("D3") and D2 were cohabitees.

The work progress of the Projects was delayed as D1 encountered financial difficulties. P advanced certain retention money and progress payments to D1 under several pledge agreements (the "PAs").

D2 executed a personal guarantee in favour of P as security for D1's indebtedness. D3 executed a similar guarantee with a charge over her property (the "D3 Guarantee").

D1 was unable to keep up the work progress. P had to engage alternative sub-contractors to complete the works and incurred extra costs. Two loan agreements were entered into between P and D1 under which the extra costs incurred by P was treated as loans granted to D1 (the "Loan Agreements").

P commenced action against all defendants. Default judgment was entered against D1 and D2. Since further works were executed by P on D1's behalf, P claimed against D3 for the extra costs. D3 disputed her liability under the D3 Guarantee.

D3's main defence was undue influence.

Undue influence

There are two categories of undue influence, namely, actual undue influence and presumed undue influence.

To establish actual undue influence, the party seeking to set aside the contract has to prove that, in procuring the contract, coercion has been used or one party has exercised a dominating influence over the mind of the other so that his independence in decision making is substantially undermined. For this category, it is not necessary to prove there was a special relationship between the parties. In the present case, the Court did not find that there was actual undue influence.

Presumed undue influence has two sub-categories: Class A and Class B[39].

Class A refers to cases in which undue influence is presumed where a special relationship exists, such as doctor and patient, and solicitor and client.

To establish presumed undue influence under Class B, the party who seeks to avoid the transaction has to prove that:-

(1) he placed trust and confidence in the influencer or that the influencer had acquired a domination over him ("Limb (1)"); and

(2) the transaction cannot be readily explicable by the relationship of the parties[40], e.g. a transaction which is manifestly disadvantageous to the party who seeks to avoid the transaction, such as a gift which is so large as not to be reasonably accounted for on the ground of friendship, charity or other ordinary motives on which ordinary men act[41] ("Limb (2)").

If Class A or Class B can be established, the burden shifts to the other party to the transaction to prove that the transaction was entered into with an independent free will free from any undue influence[42], i.e. to rebut the presumption. Also, where Class A or Class B can be established, it would be necessary to ascertain

39 Class A and Class B are equivalent to the classified legal cases (i.e. class 2A and class 2B respectively) set out in *Barclays Bank Plc v O'Brien* [1994] 1 AC 180 36 and *Royal Bank of Scotland v Etridge (No. 2)* [2002] 2 AC 773
40 *Bank of China (Hong Kong) Ltd v Wong King Sing & Others* [2002] 1 HKLRD 358, 370
41 *Etridge (No. 2)*
42 *Bank of China (Hong Kong) Ltd v Wong King Sing & Others,* [2002] 1 HKLRD 358, 369

whether the other party to the transaction was put on inquiry; and if so, whether the other party to the transaction took reasonable steps to satisfy that there was no undue influence[43].

In the present case, the Court held that the cohabited relationship between D2 and D3 did not fall within the special relationship under Class A[44].

Regarding Limb (1) of Class B, it is assumed in law that a reciprocal trust and confidence exists between D2 and D3 as cohabitees. However, the evidence showed that D3 was capable of making a proper assessment of her risk. The Court considered that D3 actually signed the D3 Guarantee as an exercise of her independent free will and judgment rather than her reposing trust and confidence in D2.

As for Limb (2) of Class B, the evidence showed that the charged property was family asset bought by D2 but held in D3's name. D1 and D2 were in financial difficulties. They and D3 were in the same boat. Hence, the Court considered that it would not have been unreasonable for D3 to offer the property as security to keep D1 afloat.

Accordingly, the Court found that D3 failed to prove that the D3 Guarantee was signed as result of presumed undue influence[45] and hence was bound by the D3 Guarantee.

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

Luk Wing Yan v CMB Wing Lung Bank Limited [2021] HKCFI 279

Facts

The Plaintiff ("P") was a customer of the Defendant (the "Bank"). For over 3 years from September 2010, she engaged in a series of investments (the "Investments") which she thought were offered by the Bank and introduced to her by the Bank's securities manager (the "Employee"). P claimed that she had transferred a net sum of about HK$24 million from P's account with the Bank to the Employee's personal account also held with the Bank to make those Investments, under the impression that they were "internal" investments offered to the Bank's staff only, but which the Employee also made available to her.

The Investments promised extremely high returns and had no apparent downside. In fact, the Investments were not real. The Employee forged receipts and records purportedly issued by the Bank, which led P to believe that the Investments were genuine.

The Employee was convicted of 3 counts of fraud and sentenced to imprisonment of about 10 years. However, P was unable to get back the money that she had lost. Therefore, P brought proceedings against the Bank for the losses sustained by her as a result of the fraud perpetrated by the Employee.

Issues

The main issues before the Court of First Instance (the "Court") were:

(a) whether the Bank was vicariously liable for the losses sustained by P because of the Employee's fraud; and

(b) whether the Bank was negligent in handling transfers of funds from P's account to the Employee's account (i.e. *Quincecare* duty).

Vicarious liability

P sought to rely on the doctrine of vicarious liability, by which employers are in certain circumstances held liable for torts committed by their employees. P submitted that the relevant test for determining vicarious liability in the context of an employment relationship was the "close connection" test as laid down by the Court of Final Appeal in *Ming An Insurance Co (HK) Ltd v Ritz-Carlton Ltd*[46]. The test posed the question as to whether the employee's tort was so closely connected with his employment that it would be fair and just to hold the employer vicariously liable.

However, the Bank argued that in a case like this case, where the issue was whether a principal was bound by the fraudulent representations of an agent, the test for vicarious liability should be the test for authority.

While the Court recognized that the "close connection" test was firmly established, it considered that it was the apparent authority test which was applicable to the present type of cases involving fraudulent misrepresentations. Although the

[43] Ibid
[44] *Barclays Bank Plc v O'Brien* [1994] AC 180
[45] In the absence of any findings of presumed undue influence in the present case, the burden would not be shifted to the influencer (i.e. D2) to rebut the presumption; and it would be unnecessary for the Court to ascertain whether P was put on inquiry and if so, whether it took reasonable steps to satisfy itself that there was no undue influence
[46] (2002) 5 HKCFAR 569

underlying relationship might be one of master and servant, the test of liability was authority (actual or apparent), rather than the course of employment.

In reconciling the "close connection" test and the test of apparent authority, the Court was of the view that it is the apparent authority of the employee who makes a fraudulent representation that would identify the necessary close connection as might render it just to hold the employer vicariously liable.

Applying the apparent authority test, the Court found that:

(a) there was no representation or holding out by the Bank that the Employee had authority to offer the alleged "internal" investments to P, and the Employee could not clothe herself with apparent authority;

(b) there was in any event no actual reliance on any such apparent authority; and

(c) P's understanding that the investments were "internal", offered exclusively to the Bank's staff and in which outsiders could not participate, was in reality antithetical to authority, meaning that any reliance by P on any apparent authority would not have been reasonable reliance.

The Court concluded that P's claim against the Bank on the basis of vicarious liability must fail.

***Quincecare* duty**

P's claim in negligence was based on the *Quincecare* duty[47], which is the duty imposed on a bank to refrain from executing a customer's order when the bank is put on inquiry that the order is an attempt to defraud the customer. The *Quincecare* approach has been followed in Hong Kong, e.g. *PT Tugu Pratama Indonesia v Citibank NA*[48].

The Court held that the *Quincecare* duty came into play where the bank had received an instruction *on behalf of* its customer (i.e. from an authorized agent), rather than directly *from* its customer. The *Quincecare* duty has been held to arise only in circumstances of attempted misappropriation of the customer's funds by an agent of the customer, rather than by a third party perpetrating a fraud on the customer which induces the payment. The Court also held that where the bank's customer was an individual, the individual customer's authority to make the payment must be taken by the bank to be real and genuine.

P relied on *Federal Republic of Nigeria v JP Morgan Chase Bank NA*[49] and argued that the *Quincecare* duty arose when a bank had (or ought to have) reasonable grounds for believing (i.e. was put on inquiry) that an instructed payment was part of a scheme to defraud its customer *in any way and by any person*. The Court held that P's argument was something fundamentally different and it would require the bank to be potentially alert to factual circumstances of a very different nature than, and often if not usually wholly unconnected with, the relationship between the bank and its customer. The Court took the view that what P suggested would be more onerous and actually require a significant extension to the previously described delineation of the *Quincecare* duty. The Court refused to expand the scope of the *Quincecare* duty to include detection of the underlying purpose of the transfers or series of transfers.

The Court held that the *Quincecare* duty was not triggered on the pleaded facts of this case.

As noted by the Court: "*if something seems too good to be true, it probably is.*"

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

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47 Derived from the English case of *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363

48 [2018] 5 HKLRD 277, [49]-[55]

49 [2019] EWHC 347 (Comm), [28]