CHAPTER 4

BILLS OF EXCHANGE, CHEQUES AND PROMISSORY NOTES

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1. BILLS OF EXCHANGE

4–001 **The nature of a negotiable instrument.** Negotiable instruments were developed in the fourteenth century as a mechanism by which commercial transactions could be settled without the need for physical meetings of the parties and exchange of physical money. The law was codified in the English Bills of Exchange Act 1882, which was then adopted almost wholesale in Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19) (the Ordinance). The Ordinance still mirrors to a large extent its English equivalent, and is still the principal legislation for negotiable instruments in Hong Kong. Modern electronic transfers and banking services have diminished the use of negotiable instruments, in particular bills of exchange, but in a number of respects these are still in everyday use. The most common example is a bank cheque, a special form of negotiable instrument to which particular rules apply. Bills of exchange used to be favoured for international commercial transactions, but are now largely surpassed by electronic transfers or letters of credit. Promissory notes are still used as a form of additional security for, in particular, instalments or repayments under a loan agreement. All these forms of negotiable instruments are described in the following sections of this chapter.

4–002 **Bills of Exchange Ordinance.** The Bills of Exchange Ordinance, as with its English counterpart, was intended to codify and replace the common law. Earlier decisions on bills of exchange are still occasionally relevant where the Ordinance does not cover the point, or there is some ambiguity or inconsistency in the Ordinance.[1] Indeed s.102(3) expressly preserves the common law rules insofar as these are not inconsistent with the Ordinance. The Courts of Hong Kong have stated that they are bound by the English authorities on negotiable instruments, without reference to local banking practice.[2] The English Cheques Act 1957 made important changes to the law on cheques as a form of bill of exchange. This was in corporated in the Ordinance within ss.73 to 88.

4–003 **Negotiable instruments and simple contracts.** Although at heart a contract, negotiable instruments differ from simple contracts in a number of respects. Simple contracts may normally only be enforced by the original parties to them, or, on certain conditions being met, by subsequent assignees. An assignee may only sue on the contract if certain formalities are complied with, usually notice to the other party to the contract, or by joining the assignor into any action to enforce the contract. In contrast, negotiable instruments may be transferred by endorsement (signature) and physical transfer to a new holder, or in the case of bearer instruments, by simple physical transfer. The new holder takes full title to the instrument and may enforce it without further formality. As is described below, it is possible for a subsequent holder to rely on value or consideration given by a previous holder. It is also possible for a subsequent holder to gain a better title than a previous holder or the original party to the bill, provided certain conditions are fulfilled, and so take title free from equities or defences which

[1] *Barclays Bank Ltd v Ashley Industrial Trust Ltd* [1972] QBD 527.
[2] *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1987] HKLR 1041.

would bind prior holders. To this extent, a transferee may gain a better title than a transferor, again a key difference from simple contracts. In a simple contract, it is the meeting of the minds of the parties which forms the enforceable agreement between the parties. In many cases this is reduced to writing in a written contract, but that is to a large extent merely evidence of the parties' agreement, and although good commercial practice, in most situations not necessary. By contrast, the written document which forms a negotiable instrument is important in itself, and for many types of bill, possession of it gives title. The instrument is accordingly a chose in action. There is a statutory presumption that consideration has been given by the holder of the instrument, which may be rebutted, but consequent upon this there is no need to state the consideration given for an instrument on the face of the instrument.

4–004 **Insolvency.** A number of other characteristics of negotiable instruments should be mentioned: A bill of exchange or promissory note has a particular position for the purposes of security on insolvency. This arises from the fact that a holder in due course of a bill of exchange may have a right of action not only against the original drawer of the bill, but against the drawee if the drawee has accepted the bill, and against intervening payees or holders. Accordingly, for the purposes of voting in a bankruptcy or liquidation, the creditor who is a holder of a bill or promissory note must treat the liability to him of persons who come in the chain of liability after the bankrupt, as if that liability was secured (provided they have not also been made bankrupt). Only the net amount after deduction of this notional security may be voted in the insolvency. The effect is that every party liable on the bill after the bankrupt must be discounted, but not parties liable on the bill prior to the bankrupt (since the insolvency estate may claim reimbursement from these parties).[3] Similarly, since the written instrument of a bill of exchange or promissory note is of itself important, this must be produced in connection with any claim based upon a bill or promissory note.[4] Otherwise, ordinary bankruptcy rules apply to bills notwithstanding anything in the Ordinance.[5]

4–005 **MPF, insurance.** Under the Mandatory Provident Fund Schemes (General) Regulations, negotiable instruments, including bills of exchange, which are kept in Hong Kong, are counted as assets in Hong Kong for the purpose of the MPF Scheme.[6] Similarly, qualified assets in Hong Kong for the purpose of the Insurance Companies Ordinance (Cap. 41) include negotiable instruments kept in Hong Kong.[7]

(a) *Formalities, Definition and Parties to Bills of Exchange*

4–006 **Formalities.** The key formalities for a bill of exchange are set out in s.3 of the Ordinance. By s.3(1) a bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the

[3] See Bankruptcy Rules, rr.99J, 122R and Companies (Winding-up Rules), r.125.
[4] Bankruptcy Rules, r.111.
[5] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s. 102(1).
[6] Mandatory Provident Fund Schemes (General) Regulations s.10.
[7] Insurance Companies Ordinance (Cap. 41), Sch.8.

person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person, or to bearer. Each aspect of this definition will be considered in turn. If the purported bill goes on to prescribe acts to be done other than payment of money, it is not a valid bill of exchange, nor is it a valid bill if these formalities are otherwise not complied with (s.3(2)). However, by s.3(4), a bill is not invalid merely by reason that it is not dated, that it does not specify the consideration given, or indeed does not specify whether any consideration has been given. Nor is it invalid if it does not specify the place where it is drawn, or the place where it is to be payable. To come into effect, a bill must be "issued". This is defined in s.2 to mean the first delivery of a bill or note, complete in form, to a person who takes it as a holder, "Delivery" is also defined[8] to mean a transfer of possession, actual or constructive, from one person to another. Accordingly, the mere preparation of a bill, cheque or note does not make it valid. It has to be issued.

4–007 **Parties.** The essential parties to a bill of exchange are the "drawer", the "drawee" and the "payee". In the context of a bank cheque, the drawer will be the account holder wishing to make a payment, the drawee will be his bank, out of which the payment is made, and the payee will be the recipient of the proceeds of the cheque. A bill will normally direct payment to a payee, but may be drawn payable to the drawer himself, or to his order, or otherwise to the drawee, or to his order. The drawee may simply be "the bearer". The drawer is the party who draws up the bill and gives the unconditional order for payment. The bill must specify the sum of money which is to be paid, and give an unconditional order to the drawee to make that payment. The bill must identify who is to receive the payment, *i.e.* the payee, although since the drawer and the payee can be the same person, a drawer may order the payment to himself. However, "cash" is not a proper drawee, and so an instrument made out to "cash" is not a bill of exchange.[9] Cheques made out to cash may still be honoured as a matter of banking practice and the bank-customer contract. The drawer must sign the bill to make it a valid instrument. The drawee is the party being unconditionally ordered to make the payment of the sum of money. A bill may be addressed to more than one drawee jointly, but it may not be addressed to drawees in the alternative.[10]

4–008 **Accommodation bills and parties.** It is permissible, by s.28, for a person to be a party to a bill merely as an "accommodation party" on behalf of some other person. An accommodation party may sign a bill as drawer, acceptor or endorser, without receiving any value, and merely for the purposes of lending his name to the bill on behalf of some other person.[11] This is different from mere agency, where the agent is not rendered liable, and is more akin to a guarantee. Accommodation parties are liable on the bill to holders for value, regardless of whether or not such holder knew that the party was an accommodation

[8] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.2.

[9] *Madnani v Datwani* (unrep., CACV 65/1980, [1986] HKEC 195).

[10] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.16.

[11] *Chow Hak Sing v Chau Sau Suen* [1986] 1 HKC 133; *Wellship Co Ltd v Ngan Chung Leung* (unrep., CACV 174/2002, [2002] HKEC 1242).

party or not.[12] An "accommodation bill", is one where an accommodation party signs as acceptor. Nevertheless, the party who is accommodated by an accommodation bill has a duty to provide sums to meet payment under the bill on maturity by the accommodation party. This extends to a duty to indemnify any party who has in fact paid out on the bill, including intermediate endorsers. The obligation to provide funds or indemnify arises from the relationship of the parties, and so need not be expressed, or even in writing.[13] In order for the accommodation party to call on the indemnity, it is necessary to show that the payment under the bill was indeed an accommodation for the accommodated party, and a discharge of that accommodated party's liability.[14] Where an accommodation bill is paid "in due course"[15] by the party accommodated, the bill is discharged,[16] but the person accommodated is not discharged by the absence of due presentation for payment, or of notice of dishonour, or of protest, to the accommodated party.[17]

4–009 **Acceptance.** Although the order to the drawee is unconditional, the drawee only becomes liable to make the payment if he "accepts" the bill. If a drawee accepts a bill, he becomes an "acceptor", and becomes primarily liable to make the payment. If the drawee rejects the bill, *e.g.* because he has not been put in funds by the drawer, then the drawer retains primary responsibility to make the payment. The drawee may also be the payee at the same time.

4–010 **To bearer or to order.** Bills of exchange may either be drawn "to order", in which case the payee must be an identified person, and the payment is made to that payee or as directed or "ordered" by that payee. Alternatively, the bill may be drawn "to bearer" in which the case the payee is not a named person, but the party who at the time of presentment for payment physically holds the bill. A bill is normally negotiable, and so it may be "negotiated" or transferred to subsequent parties. The process of negotiation is known as endorsement. A bill payable to a named payee or to order may be transferred by that payee to a new holder by endorsement of his signature on the back of the bill together with physical delivery. Thus the payee is an "endorser", and by "endorsement" transfers the bill to an "endorsee", or holder. In the case of bearer bills, no endorsement is necessary, and transfer is by mere physical delivery. Subsequent parties to a bill are holders, and may fall into three categories: holder, holder for value, or holder in due course. A holder in due course has the best title to a bill, and his title may overcome equities or defects in title of previous holders, provided certain conditions are met.[18] The next best title is a holder for value,[19] followed by a mere holder.

[12] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.27(2). See also *Yue Tai Plywood and Timber Co Ltd v Far East Wagner Construction Ltd* [2001] 2 HKLRD 446; *The Wing On Bank Ltd v Tech-Craft Industries Ltd* [1975] HKLR 533.

[13] *Yeoman Credit Ltd v Latter* [1961] WLR 828.

[14] *Sleigh v Sleigh* (1850) 5 Exch 514. See also *Leung Sun Hoy v The Cheong Wing Firm* (1908) 3 HKLR 69.

[15] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.59(1).

[16] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.59(3).

[17] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), ss.46(2)(d), 50(2)(d) and 51(9).

[18] See para.4–061.

[19] See para.4–060.

4–011 **Restricting liability and waiving requirements.** The drawer of a bill and any endorser may insert words which limit or negative his own liability to a subsequent holder,[20] provided the essential elements of a bill remain. The bill must remain an unconditional order to pay, but in particular, it is common for the drawer to restrict the right of the payee to endorse the bill, or to prescribe that payment should only be made at a particular place. Endorsers may also restrict the scope of subsequent endorsements. Similarly, the drawer or endorser may waive some of the holder's duties in relation to a bill, such as the holder's duty to give notice of dishonour or to protest the bill. An endorser may avoid the liabilities which endorsement would normally give to subsequent holders by an endorsement marked "without recourse".[21]

4–012 **Capacity.** By s.22 of the Ordinance, capacity to incur liability as a party to a bill is co-extensive with capacity to enter into a simple contract. A corporation may make itself liable on a bill provided it is competent to do so under the law of its incorporation. A minor, being a person under 18 years of age, may not enter into a bill of exchange. A contract made with a minor is avoidable at the option of the minor during minority, or within a reasonable time after reaching majority.[22] Nevertheless, even if a bill is drawn or endorsed by a minor, or a corporation having no power to incur liability on the bill, the bill is not void, but may still be enforced by other parties to the bill amongst themselves, who have capacity, and the holder is entitled to payment.[23] Accordingly, if a bill is drawn by a minor, but accepted by the drawee, payment may still be enforced by the payee. Bank notes are in fact bearer bills of exchange, but their issue is limited to certain banks by s.2 of the Bank Notes Issue Ordinance (Cap.65). In England, the issue and negotiation of bills of exchange is to an extent restricted by consumer credit legislation, which does not apply in Hong Kong. Bills of exchange may not be entered into by person suffering a mental disability. Nevertheless, a bill to which a person under a mental disability is a party is not void but voidable by or on behalf of that person, if the other party enforcing the bill knew of the mental incapacity. A person under a mental disability who signs a bill is therefore not liable to anyone aware of the disability, but is liable to a holder of value or holder in due course without notice.

4–013 A manager of an insurer is given the power under the Insurance Companies Ordinance (Cap.41) Sch.7 to draw, accept, make and endorse any bill of exchange on behalf of the insurer.

4–014 **Unconditional order to pay.** It is a fundamental requirement of a bill of exchange that it be in writing and give an unconditional order for payment. A bill of exchange may be in any language, and in any form. There is no prescribed form of wording or layout, although certain forms have become usual by practice. As a matter of bills of exchange law, a cheque need not be written on a cheque printed and produced by the drawee bank, but as a matter of banking practice,

[20] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.16.
[21] See below, paras.4–058 and 4–084.
[22] *Fung Kee v Tang Pun Sang* [1910] 1 HKLR 87.
[23] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s. 22(2).

and customer-bank contract, banks will not normally honour cheques for security reasons unless on their own prescribed and printed form. The bill may be handwritten or printed. A mere request for a payment is not an unconditional order, and so does not form a bill of exchange.[24] However, an unconditional order does not lose its status merely because the language used is couched in polite terms. Many of the authorities on Bills still date from the English nineteenth century, and in this respect their view of what is "polite terms", and what is banking practice, should now be treated in twenty-first century Hong Kong with some caution.

4–015 **Conditional orders to pay.** Difficulties may arise where conditions or qualifications are imposed upon the order to pay. An order to pay out of a particular fund is not an unconditional order to pay within the meaning of the Ordinance,[25] but an unqualified order to pay which is coupled with an indication of a particular fund out of which the drawee is to reimburse himself, or a particular account to be debited by the drawee is still an unconditional order and a valid bill of exchange. Similarly, a statement in the bill of the underlying transaction which gives rise to the bill does not render the order to pay conditional.[26] If the instrument makes the signing of a receipt a condition of payment, it cannot be a bill of exchange.[27] However, if the drawer's instruction that a receipt is needed is given to the payee rather than the drawee, the order to the drawee to pay remains unconditional for the purposes of the Ordinance and a bill of exchange is created.[28] A bill containing a pledge of additional security for the payment does not render the order to pay conditional.[29]

4–016 **The drawee.** The drawee must be named or otherwise indicated in the bill with sufficient certainty.[30] A bill may be addressed to two or more drawees jointly, whether they are partners or not, but an order addressed to two drawees in the alternative, or to two or more drawees in succession, is not a bill of exchange.[31] A drawer may be a payee, but if a drawer purports to draw a bill on himself as drawee, the document is not a bill of exchange. However, by s.5(2) of the Ordinance where the drawer and drawee are the same person, or where the drawee is a fictitious person or a person not having capacity to contract, the holder of the bill may nevertheless treat the instrument, at his option, as an enforceable bill of exchange or an enforceable promissory note. For practical purposes, therefore, a holder of such a bill is not disadvantaged.

4–017 **Time for payment.** By s.3(1) a bill may be payable on demand, or at a fixed or future determinable time. A bill payable at a fixed time must be presented for payment on the date it falls due. An on demand bill must be presented for

[24] *Little v Slackford* (1828) M & M 171.
[25] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19).
[26] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.3(3b).
[27] *Wirth v Weigel Leygonie & Co Ltd* [1939] 3 All ER 712.
[28] *Lathan v Ogdens Ltd* (1905) 93 LT 553.
[29] *The Elmville* [1904] p.319.
[30] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.6(1).
[31] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.6(2).

payment within a reasonable time of its issue. What amounts to reasonable time depends on the nature of the bill, the usage of trade with respect to similar bills and the facts of the particular case.[32] If the bill is transferred by endorsement (or, in the case of a bearer bill, by mere delivery) to another person, it must be presented for payment within a reasonable time of endorsement or delivery. By s.10 of the Ordinance, a bill is payable on demand where it is expressed to be payable on demand, or at sight, or on presentation, or where no time for payment is expressed. Even though the reasonable time for presentation may have passed, and so a bill is overdue, if a drawee accepts the bill, or an endorser endorses the bill, they accept liability for it despite it being overdue, and it becomes a bill payable on demand by them.[33] See also generally s.45 of the Ordinance.[34]

4–018 **Determinable time.** By s.11, a bill is deemed to be payable at a determinable future time if it is expressed to be payable at a fixed period after a specified date or after sight of the bill, or otherwise if it is expressed to be payable on or at a fixed period after the occurrence of a specified event, which is certain to happen, although the timing of it may be uncertain. An instrument which is expressed to be payable on a mere contingency is not a bill of exchange, and the actual happening of the contingent event does not cure that defect.[35] What constitutes a determinable future time and what is a mere contingency has been the cause of much debate. In *Ex p Tootell*[36], a bill payable two months after marriage was held not to be a valid bill of exchange. Marriage is not a certain future event, since the marriage may not take place, because the parties change their minds or one of them dies or otherwise is unable to marry.[37] Also, 30 days after the arrival of a ship has been held to be a contingency.[38] By contrast, 10 days after the death of a specified person is a definite event, although the timing of it is uncertain, it is certain to occur at some future time.[39]

4–019 More difficulty is created with the frequently occurring incidence of bills made payable "on or before" a specified date. The better view in Hong Kong is that this is not a contingency and the obligation to pay only arises on the final specified date.[40] Nevertheless, English cases have generally held this to be a contingency so that a valid bill of exchange is not created. Where the date of payment is ambiguous or unclear, a bill will be invalid,[41] but the courts will construe ambiguous words so as to give certainty and render the bill valid where

[32] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.45(b).
[33] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.10(2).
[34] See para.4–076.
[35] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.11(2).
[36] [1798] 4 Ves Jun 372.
[37] *Williamson v Rider* [1963] 1 QB 89.
[38] *Palmer v Pratt* (1824) 2 Bing 185.
[39] *Colehan v Cooke* (1742) Willis 393.
[40] *Chevalier (E&M Contracting) Ltd v Rotegear Development Ltd* [1994] 3 HKC 457. See also *Golden Garden Mangement Ltd v Grand TG Gold Holdings Ltd* [2012] 1 HKLRD 934 (s.89(1) on promissory notes). English cases to the contrary have not been followed.
[41] *Korea Exchange Bank v Debenhams Ltd* [1979] 1 Lloyd's Rep 100.

this is reasonably possible, and where the uncertainty is merely one of ambiguity rather than because there is a contingency.[42]

Computation of time. The computation of time for payment of a bill is governed by s.14 of the Ordinance. A bill is due and payable on the last day of the time for payment, assuming it is not payable on demand, but if that day is a general holiday, it falls to be payable on the next business day. Where a bill is payable at a fixed date after sight or the happening of a specified event, the time of payment is determined by excluding the day from which time is set to begin to run, but including the date of payment. Accordingly, for a bill payable 30 days after a certain event, the day following that event is the first day. Where a bill is payable at a fixed period "after sight" the time begins to run from the date of the acceptance of the bill if it is accepted, or from the date of noting or protest of the bill for non-acceptance or non-delivery, if the bill is not accepted.[43] Noting, protest and non-acceptance are dealt with later.[44] The term "month" means a calendar month.[45] 4–020

Reasonable time. A bill payable on demand must be paid within a reasonable time of its issue. What constitutes a reasonable time is uncertain and must depend on all the facts and circumstances, including the nature of the bill, the particular circumstances of the case and any usual commercial practice in the particular place or industry. The practice in banking is for cheques not to be honoured more than six months after their date of issue, but this is a matter of banking practice rather than the Bills of Exchange Ordinance.[46] A cheque more than six months old is not automatically invalid under the Ordinance, if "all the facts and circumstances" point to its validity. 4–021

Date of bill. By s.3(4)(a) of the Ordinance, a bill need not be dated. However, as a matter of banking practice, a cheque as a bill of exchange will not be honoured if it is undated. Where on a bill the date of the bill is inserted, or an acceptance or endorsement on a bill is dated, then there is a rebuttable presumption that the date inserted is the true date of the drawing, acceptance or endorsement of the bill as the case may be.[47] A bill may be dated on a public holiday, and may be both ante-dated or post-dated.[48] If a bill is post-dated and the payee endorses it to a new holder, the holder can recover on the bill, even if the original payee has died before the post-dated date has passed.[49] A difficulty may arise where a bill is expressed to be payable at a fixed period after the date of its issue, but it is issued undated. The same may apply where the acceptance of a bill payable at a fixed period after sight is undated. However, any holder may insert on the bill 4–022

[42] *HSBC Corp Ltd v GD Trade Co Ltd* [1998] CLC 238.
[43] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.14(c).
[44] See below, paras.4–085 *et seq.*
[45] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.14(d).
[46] *Lee Man Ching Mandy v Chiu Hing* [2001] 4 HKC 280.
[47] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.13(1).
[48] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.13(2).
[49] *Pasmore v North* (1811) 13 East 517.

the true date of its issue or acceptance, and the bill will be payable accordingly.[50] If a wrong date is inserted, or a holder in good faith by mistake inserts a wrong date, a subsequent holder in due course (as defined in s.29 of the Ordinance) may still enforce the bill and it is payable as if the date inserted had been the true date rather than a mistaken date.[51]

4–023 **Payment of money.** An instrument to be a bill of exchange must contain an unconditional order for the payment of money. If it contains an instruction for anything other than the payment of money, it is not a bill. A promissory note, as a form of negotiable instrument, will still be valid even if it contains a pledge of security.[52] The amount payable must be certain. It may be expressed in any currency, and indeed in a currency foreign to the parties. A rate of exchange need not be stated.[53] By s.9 of the Ordinance, a sum payable is still a sum certain within the meaning of the Ordinance even it is expressed to be paid with interest, by instalments with a provision for acceleration of instalments on default, or payable according to an indicated exchange rate or according to a rate of exchange to be determined as directed by the bill. If a bill is expressed to be payable with interest, but no rate is stated, then the court itself will fix an appropriate commercial rate.[54] If a sum is stated to be payable by instalments, then those instalments must be certain as to amount and time. Where a bill is expressed to be payable with interest, then unless the bill otherwise states, interest runs from the date of the bill. If the bill is undated, interest runs from the "issue of the bill".[55] "Issue" means the first delivery of a bill to a person who takes it as a holder, and delivery means transfer of possession, actual or constructive from one holder to another.[56]

4–024 **Discrepancies in the amount.** The sum payable under a bill is typically expressed both in numbers and words. This is practice, in particular, for cheques. Where the sum payable in words and numbers differs, the words prevail.[57] In relation to cheques, it is normal banking practice to honour a cheque for the smaller sum payable, whether this is the words or the numbers, provided the difference between the two is not so significant as to cast doubt upon the genuineness of the whole cheque. To these extents, accordingly, uncertainty or ambiguity in the sum payable is permitted and does not invalidate the bill. Even though by statute the words are to prevail, obvious mistakes in the words themselves will not invalidate a bill.[58] Numbers will be accepted in Hong Kong written in Arabic numerals, or the simplified or the complex Chinese characters which represent numerals.

[50] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.12.
[51] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.12.
[52] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.89(3).
[53] *Lindsay, Gracie & Co v Russian Bank for Foreign Trade* (1918) 34 TLR 443; *Cohn v Boulken* (1920) 36 TLR 767.
[54] Practice Direction (Claims for Interest) [1983] 1 All ER 934.
[55] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.9(3).
[56] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.2.
[57] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.9(2).
[58] *Banco di Romaspa v Orru* [1973] 2 Lloyd's Rep 505.

4–025 **Consideration and value for a bill.** An instrument is not invalid by reason that it does not specify the consideration given.[59] Every party whose signature appears on a bill is *prima facie* deemed to have become a party to the bill for value.[60] There is also a presumption that valuable consideration has been given.[61] As with simple contracts, the parol evidence rule applies, such that extraneous parol evidence is, *prima facie*, not admissible in an attempt to vary clear terms of a bill. Nevertheless, parol evidence is admissible to rebut the presumption that consideration has been given, or to show otherwise the actual absence or failure of consideration.[62] "Value" in terms of the Ordinance is defined in s.2 to mean valuable consideration. Valuable consideration is further defined in s.27. A gross inadequacy of consideration may be taken as evidence of fraud.[63] By s.27(1) valuable consideration may be constituted by any consideration sufficient to support a simple contract, but also any antecedent debt or liability[64] is deemed to be valuable consideration whether the bill is payable on demand or at a certain future time.[65] It seems that even a time-barred debt may therefore be sufficient consideration.[66] This represents a further departure of negotiable instruments from the principles which apply to simple contracts, where past consideration is generally insufficient.

4–026 Accordingly, a customer may endorse a cheque, payable to himself as payee, to his bank (as holder) to be used to reduce a pre-existing overdraft of the customer. The bank becomes a holder for value of the cheque, the pre-existing debt of the overdraft being sufficient consideration.[67] However, the principle of simple contracts that consideration must move from the promisee,[68] although it need not reach the promisor.[69] A payee's action on a bill may be resisted by the drawer on the ground of absence of consideration.[70] Accordingly, if a drawee receives cheque from a drawer in repayment of a debt owed by a third party, there is no valuable consideration for the bill, and the drawee has not given value.[71] However, if, in exchange for receipt of the cheque, the same drawee defers enforcement

[59] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.3(4)(b).
[60] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.30(1).
[61] *The Wing On Bank Ltd v Tech Craft Industries Ltd* [1975] HKLR 533.
[62] *Leo-Concept Industrial Co Ltd v Sportex Industrial Ltd* [1992] 2 HKC 452; *Prosperity Limes and Components Ltd v Rotegear Corp Ltd* [2000] 2 HKC 638; *Suen Ho Sun v Kamenar International Ltd* [1989] 1 HKC 135; *Hong Kong Chinese Bank Ltd v Delon Photo and Hifi Centre Ltd* [2000] 3 HKC 71.
[63] *Cole v Milsome* [1951] 1 All ER 311.
[64] *Kao Lee and Yip v Euro Treasure Ltd* [1985] 1 HKC 46.
[65] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.21(1)(b).
[66] *La Touche v La Touche* (1865) 3 H & C 576.
[67] *Barclays Bank Ltd v Ashley Industrial Trust Ltd* [1972] QBD 527; *Sharp v Ellis* [1972] VR 137.
[68] *Kao Lee Yip v Euro Treasure Ltd* [1985] 1 HKC 46.
[69] *Media Asia Distribution Ltd v China Culture Program Investment Ltd* (unrep., HCA 1244/2008, [2009] HKEC 1118).
[70] *Yeung Sai Hung v Chan Tse Ying* (unrep., DCCJ 1313/2006, [2007] HKEC 94); *Oliver v Davis* [1949] 2 KB 727; *Hasan v Willson* [1977] 1 Lloyd's Rep 431.
[71] *Fortune Focus International Ltd v The Holdings Co Ltd* [1998] 1 HKC 578, applying *Oliver v Davis* [1949] 2 KB 727. See also *Mok Chi Yuen v Lee Sau Ling* (unrep., DCCJ 1631/2006, [2007] HKEC 725); *Lomax Leisure Ltd (In Liq) v Nicholas Miller, Timothy James Bramston* [2007] EWHC 2508 (Ch).

of repayment of the third party debt, then the consideration is arguably the forbearance to enforce[72] rather than the repayment of the debt, and valuable consideration has been given.[73] Where a payee asserts that his forbearance to sue a third party constituted good consideration for a cheque, the payee's forbearance must have been at the drawer's (implicit or express) request.[74]

4–027 **Incomplete bills.** Section 20 of the Ordinance provides for what is to happen in circumstances where a simple signature is put on a blank piece of paper, in order that it may be completed and converted into an enforceable bill. Such blank signature operates as *prima facie* authority to the holder to fill the paper up as a complete bill for any amount. The holder must comply with the scope of his authority, if any is prescribed. Thus a merchant may have *prima facie* authority to complete a blank cheque with the amount owed for goods sold to the drawer, where the cheque is payment for those goods. Even where a bill is incomplete in a material respect, the holder has *prima facie* authority to fill up the omission. If no payee is named in a bill, then it is incomplete and unenforceable. However, the holder or person in possession of it has a *prima facie* authority by s.20(1) of the Ordinance to complete the bill in any way he thinks fit. This includes putting his own name as the payee, so long as this cannot be shown to be outside his authority. A bill completed in this way is valid and enforceable provided it was completed within a reasonable time.[75] What amounts to reasonable time is a question of fact, but *prima facie* a person completing a bill in this way has six years to do so (*i.e.* the limitation period) in the absence of the authority he holds limiting that right, or some other trade custom which will prevail. Time runs from the due date according to the completed bill.

4–028 If a bill completed in this way is endorsed to a holder in due course, it is valid for all purposes and that holder may enforce it as if it had been completed within the scope of authority and a reasonable time.[76] The holder who completes the bill in this way need not be a "holder in due course" as defined. Since a holder in due course must, by s.29, take a bill complete and regular on its face, a holder who takes a blank or incomplete document cannot be a holder in due course, and so cannot have a better title than the transferor. He can however complete the bill, and endorse it to a holder who can become a "holder in due course". See also discussion in relation to blank cheques.[77]

4–029 **Requirement for signature: agents.** To be valid a bill must be signed by the drawer.[78] By s.23, similarly, a person may be liable as acceptor or endorser

[72] *Hoven International Ltd v Mass Resources Development Ltd* [1997] 1 HKC 38; see also *Wong Yin Mui v Newport May* (unrep., DCCJ 2477/2004, [2006] HKEC 1606), [65] – [69].

[73] *Pollway Ltd v Abdullah* [1974] 1 WLR 493; *Hasen v Wilson* [1977] 1 Lloyd's Rep 431; *Oliver v Davis* [1949] 2 KB 727.

[74] *Media Asia Distribution Ltd v China Culture Program Investment Ltd* (unrep., HCA 1244/2008, [2009] HKEC 1118).

[75] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.20(2).

[76] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.20(2).

[77] See below, para.4–116.

[78] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.3(1).

of the bill only if he has signed in such a capacity. Where a person signs a bill in a trade name or assumed name, he becomes liable on it if he signs his own name.[79] The signature need not be in a particular form and may be a printed or written signature or a simple mark.[80] A Chinese chop will usually be adequate.[81] A signature in the name of a firm is deemed equivalent to the signature of the names of all persons liable as partners in the firm.[82] Sections 24 to 26A provide further provisions in relation to signature by agents and corporate directors. Where a person signs a bill, as drawer, endorser or acceptor, but uses words with his signature indicating that he signs for and on behalf of a principal, or in some representative capacity, he is not personally liable on the bill, but binds his principal, so long as he acts within the scope of his authority.[83] Therefore, a signature as agent puts parties on notice that the principal is only bound to the extent of the agents' actual authority,[84] and it seems even a holder in due course cannot enforce against a principal to the extent the agent exceeded his actual authority.[85] This is in contrast to the usual rules of agency, which can encompass an ostensible authority binding on the principal, which an agent is deemed to have by virtue of his position or the circumstances, even where the agent has no actual authority. The agent may nevertheless be liable in such circumstances for breach of warranty of authority or deceit or misrepresentation.

4–030 The principal will be made liable on the bill rather than the agent,[86] provided there is sufficient indication on the bill that the signature was that of an agent. However, this is a matter of fact and degree in each situation, and the mere addition of words describing someone as an agent does not automatically exempt him from personal liability on the bill.[87] In determining whether a signature on a bill is that of an agent, or someone who, whilst an agent, is acting as principal, the construction of the words and signatures most favourable to the validity of the instrument will be adopted.[88]

4–031 By s.56, where a person signs a bill otherwise than as drawer or acceptor, he is held to incur the liability of an endorser to a holder in due course,[89] unless the circumstances show he was only acting as agent. The practice exists in some countries, particularly in Europe and the United States, of a signature on a bill *per aval*. This is intended to be a signature by way of guarantee of the liability of some other party to the bill only, and not to render the signatory liable primarily as an endorser. English law does not recognise such a concept, and so on the

[79] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.23(2).

[80] *Bird & Co v Thomas Cook & Son Ltd* [1937] 2 All ER 227.

[81] *Tsze Hing Cheong v Fung Choi* [1962] HKDCLR 34.

[82] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.23(2).

[83] *East Asia Co Ltd v Chan Chun Yuen* [1964] HKDCLR 280; *Mo Yiu Kwan v Four Union Trading Co* [1963] HKDCLR 71.

[84] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.25.

[85] *Morison v London County and Westminster Bank Ltd* [1914] 3 KB 356.

[86] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), ss.25 & 26.

[87] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.26(1).

[88] Hong Kong by the Bills of Exchange Ordinance 1885 (Cap.19), s.26(2).

[89] *Chow Hak Sing v Chau Sau Suen* [1986] 1 HKC 133.

CHAPTER 9

CREDIT AND SECURITY

Brian Gilchrist, Benjamin Lam & Swati Jhaveri

1. INTRODUCTION

9–001 **Introductory note.** The regulation of the provision of credit in Hong Kong, whether by way of loan credit or sales credit and whether to consumers or otherwise, is achieved through a multitude of ordinances, case law and non-statutory codes issued by industry associations. Hong Kong, unlike England and Wales and other Commonwealth jurisdictions, has no consumer credit legislation akin to the consumer credit legislation in these other jurisdictions;[1] the basic premise of which is that where consumer protection is considered desirable, that protection will be available in principle whatever the nature of the relevant credit transaction be.[2]

2. REGULATION OF LOAN AGREEMENTS

(a) *Money Lenders Ordinance (Cap.163)*

(i) *General*

9–002 **Scope of legislation.** The Money Lenders Ordinance (MLO) (Cap.163) is the principal legislation in Hong Kong regulating loan transactions entered into by any person other than an authorised institution.[3] Its stated purpose is to "provide for the control and regulation of moneylenders and money-lending transactions … [and] to provide protection and relief against excessive interest rates and extortionate stipulations in respect of loans".[4] Its provisions are derived mainly from the English Money Lenders Acts of 1900 and 1927 which also previously formed the basis for moneylender's legislation in the Australian states and New Zealand. With the exception of Hong Kong, the moneylender's legislation in all the aforementioned jurisdictions has since been the subject of significant reform and has now been repealed.[5] This was in part in response to such legislation having been criticised for its excessive intervention in commercial transactions and in particular for "excessive technicality, its harsh penalties for contravention, and its inhibiting effect on commercial lending".[6] Another reason for the demise of such legislation was its limited scope of application, which was confined only to "loans" and not other types of credit transactions.

[1] For example Consumer Credit Act of 1974 (England and Wales), Credit Act (Queensland) and Credit Contracts Act of 1981 (New Zealand).

[2] See *Chitty on Contracts*, edited by H.G. Beale, 32nd (London: Sweet & Maxwell, 2015), Vol.2, para.38.001.

[3] MLO s.3. An authorised institution is a licensed bank, a restricted licence bank or a depositing company: Banking Ordinance (Cap.155) s.2.

[4] Money Lenders Ordinance, preamble.

[5] For example Sch.5 Pt 1 of the Consumer Credit Act of 1974 (England and Wales) prospectively repealed the Money Lenders Act 1900.

[6] Bob Allcock, "The Money Lenders Ordinance" (1981) 11 *Hong Kong Law Journal* 293.

9–003 In England, for instance, in response to the Report of the Committee on Consumer Credit (the Crowther Report),[7] the Consumer Credit Act of 1974 was enacted. It purported to be:

> "[A]n Act to establish for the protection of consumers a new system… concerned with the provision of credit, or the supply of goods on hire or hire-purchase, and their transactions, in place of the present enactments regulating moneylenders, pawnbrokers and hire-purchase traders and their transactions, and for related matters".[8]

9–004 In a similar vein, Australia promulgated the Consumer Credit Code on 1 November 1996, which was subsequently adopted by legislation in each of the States.[9] This was in addition to the previous enactment of the Credit Act of 1987 (Queensland), Credit Act of 1984 (Victoria) and Credit Act of 1984 (New South Wales), which are simply related to the provision of credit, regardless of whether the same is a loan or sales credit. Similarly, New Zealand has enacted a Credit Contracts Act 1981, which is described as "an Act to reform the law relating to the provision of credit under contracts of *various kinds*".[10] However, Hong Kong has yet to enact similar consumer credit legislation. The MLO has not received similar attention in terms of reform. Instead, it appears that the HKSAR Government takes a piecemeal approach to reform certain aspects of the MLO and, in particular, reviewing the ceiling rates of interest set out in ss.24 and 25 of the MLO.[11]

9–005 It should be noted that the MLO does not apply to an authorised institution or, in respect of a loan made to an authorised institution, any person who makes such a loan. Loan agreements entered into by an authorised institution are therefore not subject to the requirements of the MLO.

9–006 **Retrospective effect of the MLO.** Section 36 provides for the application of the MLO to agreements made prior to the enactment of the legislation on 12 December 1980. Section 36(2), however, goes on to provide that the enactment of the MLO will nevertheless not render void or unenforceable any pre-existing agreements. This protection offered to pre-existing agreements is subject to the

[7] Cmmd. 4596; 1971.

[8] Preamble to the Consumer Credit Act of 1974 (United Kingdom).

[9] For example the Consumer Credit (Queensland) Act 1994 (Act No. 51 of 1994) and the Consumer Credit (New South Wales) Act 1995.

[10] Preamble to the Credit Contracts Act of 1981 (New Zealand) (Emphasis added).

[11] See, for example, the Government's written response to a question posed by a member of the Legislative Council on the prohibitive rates of interest set out in the MLO and "whether [the Government] has regularly reviewed if the [interest rate] caps are in keeping with Hong Kong's economic, cultural and social situations, their effectiveness and their impact on combating illegal loan-sharing activities and their impact on the legal lending market". In response, Mr Frederick Ma the then Secretary for Financial Services and the Treasury stated that: "We will continue to keep sections 24 and 25 under review in the light of Hong Kong's situation…[s]hould the situation warrant, we will also consider the need to suitably amend these provisions as necessary to ensure that they continue to meet the needs of our community". This reflects an intention to review certain aspects of the MLO and there is no indication of a wider reform agenda at this stage beyond ss.24 and 25.

application of ss.36(2)(a) and 36(2)(b), which provide that such agreements will remain enforceable if any benefit to the moneylender is not more favourable and any obligation or liability of the borrower or surety is not more onerous than it would have been if such an agreement had been made in compliance with the requirements of the MLO. It is apparent from this that, in large part, the MLO takes a substantive approach to pre-existing agreements that will not be rendered void or unenforceable by the non-compliance with the more technical requirements of the MLO. The only technical requirements with retrospective effect relate to the obligations of moneylenders during the continuance of the relevant agreements[12] and do not impact on the initial validity of the agreement.

9–007 It has been unsuccessfully argued in *Harvester Stock Investment Co v Kwan Siu May*[13] that s.36(2) was intended to refer to agreements that, although not in compliance with the MLO, were in compliance with the provisions of the Moneylender's Ordinance of 1911. This argument was rejected by the court on the basis that this could not have been the intention of the legislature and any such intention would have been expressly included as an additional qualification in s.36(2).

9–008 In any event, the question of the extent of the retroactive application of the MLO is to a large extent academic in relation to civil claims that may be made in respect of those provisions that were enacted and have remained unchanged from the initial enactment of the MLO. The MLO was enacted in early 1980 and any loan or security documents executed prior to then will have by now run their limitation period[14] and should accordingly no longer be actionable.

9–009 The position on retroactivity needs to be considered separately for each section enacted after s.36 and therefore after the initial enactment of the MLO. One such section is s.23, which states the general position that loans made by an unlicensed moneylender will not be recoverable. The proviso to s.23 gives the court a discretionary power to permit the enforcement of loan transactions by an unlicensed moneylender if it is equitable to do so. In the case of *Wong Kwai Fun v Li Fung*,[15] the court held that this proviso had no application to the subject transactions in the case, which took place in 1986, being two years prior to the enactment of the proviso in 1988. The court held that if the proviso was to be applied retroactively, it would displace the vested rights of the borrower in question and accordingly, express language would be required in the legislation to so affect these rights.

[12] MLO s.19(1): "in respect of every agreement, whether made before or after the commencement of this Ordinance … the moneylender shall, on demand in writing being made by the borrower at any time during the continuance of the agreement…supply to the borrower … a statement [setting out the particulars listed in subsection (1)]".

[13] [1987] 1 HKC 271, 282.

[14] In the case of simple contractual claims, a limitation period of six years (Limitation Ordinance (Cap.347) s.4(1)(a)) and in the case of a deed, a limitation period of 12 years (Limitation Ordinance (Cap.347) s.4(3)).

[15] [1994] 1 HKC 549.

Balance of interests between borrower and moneylender. As stated above, the moneylender's legislation has been criticised for its inhibiting effect on commercial lending. Accordingly, for such legislation to work, it is important to incorporate measures to strike a balance between the legitimate commercial interests of the moneylenders and the perceived vulnerable position of the borrowers. One example of this in the MLO is s.18(3) which provides that: **9–010**

> "notwithstanding [the formal requirements of] subsection (1), if the court … is satisfied that in all the circumstances it would be inequitable that any such agreement or security which does not comply with [s.18] should be held not to be enforceable, the court may order that such agreement or security is enforceable to such extent, and subject to such modifications or exceptions, as the court considers equitable".

The case law demonstrates that, in considering whether to exercise their discretion under s.18(3), the court will genuinely balance the interests of the borrower and the money lender in determining disputes. This judicial approach was apparent in the Court of Final Appeal's decision in the case of *Strong Offer Investment Ltd v Nyeu Ting Chuang*.[16] The case was concerned with two loans made by the plaintiff to the defendant under two margin finance accounts. The defendant sought to argue that the loans were unenforceable for failing to comply with certain technical requirements of s.18(1). In deciding in favour of the money lender, the court took into account the fact that the defendant was a sophisticated borrower who suffered no obvious prejudice. The court observed that the MLO strives to balance the need for sufficient protection to a borrower with the effective functioning of genuine money-lending transactions and accordingly, "[i]n resolving any dispute between the money lender and the borrower…there should be no pre-conceptions either in favour of or against the money lender or the borrower".[17] **9–011**

The various factors to be taken into account by the court in exercising its discretion under this subsection include "the relative status of the parties, the nature and extent of the default, the way in which it arose, the implications for the borrower, and the attitude of the lender and the general appearance of the contract throughout".[18] The court will also consider the "breach or breaches [of s.18(1)] in question, their consequences for the parties to the **9–012**

[16] (2007) 10 HKCFAR 529, (amount of damages to be awarded to be determined see (unrep., FACV 21/2006, [2008] HKEC 732) and (unrep., FACV 21/2006, [2009] HKEC 8)). See also *Bank of China (HK) Ltd v Secretary for Justice*, (unrep., HCMP 1820/2014, 10 June 2015) (CFI).

[17] This discretion was used by the court in *South China Securities Ltd v Lam Kwen Yuen* [2012] 5 HKLRD 524. The Court held that they would exercise their discretion under s.18(3) where it would otherwise be inequitable to hold certain documents unenforceable. In the case at hand, there was no evidence to show that the parties had systematically or deliberately disregarded the requirements of s.18. In holding thus, the court applied *Emperor Finance Ltd v La Belle Fashions Ltd* (2003) 6 HKCFAR 402 and *Strong Offer Investment Ltd v Nyeu Ting Chuang* (2007) 10 HKCFAR 529.

[18] *Adams v Paul's Properties* [1965] NZLR 161 which was cited with approval in *Brother's Co v Ah Puk Transportation* [1988] HKLR 821.

transactions and any other circumstances which may make it inequitable to hold the agreements unenforceable".[19] It is clear therefore that the list of factors the court will consider is not closed and can be potentially fairly broad. For example, in *Emperor Finance Ltd v La Belle Fashions Ltd*,[20] the court took into account a wide range of factors relating to the borrower, including the fact that the borrower in question had not been misled or uncertain about the terms of the loan transaction notwithstanding the fact that she did not receive the memoranda required under s.18. In addition, the borrower had received daily statements from the money lender showing her the precise status of her financial situation with the lender. Interestingly, the court also took into account the context of the case (namely, the margin financing situation) and held that since "the statutory policy is now to permit corporations licensed to carry on a business in securities margin financing under Part V of the Securities and Futures Ordinance to be exempt from the requirements of the Money Lenders Ordinance, [this] may be interpreted as recognition that there is room for easing some of the constraints posed by the legislation on the provision of finance for properly regulated margin trading activities".[21] Accordingly, the court exercised its discretion to enforce the loan transactions in favour of the money lender. This sensitivity to commercial realities is a positive aspect of the judicial approach relating to the MLO, especially in view of the rapidly changing regulatory environment for financing transactions in the securities market.[22]

9–013 Section 18(3) has been successfully relied on by moneylenders[23] however, it is clear that the courts will be careful in their assessment of the facts of a case and, in particular, the behaviour of the moneylender in deciding whether to exercise their discretion in favour of moneylenders.[24] It has even been stated by judges that this discretion should be available to courts in the context of other provisions of the MLO.[25] Currently only specific provisions of the MLO give the courts such discretion.[26]

[19] *Emperor Finance Ltd v La Belle Fashions Ltd* (2003) 6 HKCFAR 402.

[20] (2003) 6 HKCFAR 402.

[21] (2003) 6 HKCFAR 402, *per* Mr Justice Ribeiro PJ.

[22] See also *China Everbright Finance Ltd v Chan Yung* (unrep., HCA 18300/1999, [2006] HKEC 1960) in relation to this approach to margin financing activities.

[23] For example *Silverlink (Hong Kong) Finance Ltd v Zhang Sabine Soi Fan* (unrep., HCA 2783/1998, [2005] HKEC 1937). *Emperor Finance Ltd v La Belle Fashions Ltd* (2003) 6 HKCFAR 402; see also *Treasure Spot Finance Co Ltd v Li Chik Ming* (unrep., HCA 5387/2001, [2007] HKEC 1649 and [2007] HKEC 2166) for a discussion of *Emperor Finance*.

[24] See, for example, *Brother's Co v Ah Puk Transportation* [1988] HKLR 821 where the court looked closely at a wide range of factors relating to the conduct of the money lender before deciding not to exercise their discretion in favour of the moneylender. This included a consideration of the high interest rate, the "blatant" disregard of the provisions of the MLO by the moneylender and the objectionable manner in which the lender held cheques as security.

[25] *New Japan Securities Int'l (HK) Ltd v Lim Yiong Lin* [1986] 1 HKC 435, 440 in relation to a previous version of s.22 of the MLO which did not have such a discretion.

[26] For example ss.22(2) (since 1988, when it was amended following the *New Japan Securities* case, above [1986] 1 HKC 435) and MLO s.23.

Another measure provided in the MLO for balancing the interests between the borrower and the moneylender is through rebuttable presumptions. Section 25(3) states that: **9–014**

> "any agreement for the repayment of a loan or for the payment of interest on a loan in respect of which the effective rate of interest exceeds 48 per cent per annum shall, having regard to that fact alone, be presumed for the purposes of this section to be a transaction which is extortionate".

This accords a degree of protection to the borrower by transferring the burden of proof in relation to certain deemed extortionate credit transactions to the lender. However, the section stops short of providing an irrefutable conclusion that transactions with an effective rate of interest exceeding 48 per cent per annum are extortionate. Instead, it sets out certain factors to be considered by the court in the exercise of its discretion before it concludes whether or not the transaction is extortionate. **9–015**

Anti-avoidance provisions. The MLO contains various provisions that permit a court to look behind the label or characterisation of a particular agreement by the parties and into the surrounding facts in order to re-characterise a particular agreement or provision to give it its true legal effect. This is reinforced by s.1(2) of the MLO which states that "[t]his Ordinance shall have effect notwithstanding any agreement to the contrary". This would restrict the ability of parties to contract out of or contract to avoid the application of the MLO. **9–016**

One of the anti-avoidance measures in the MLO is the applicability of certain provisions to persons and loans regardless of whether they are exempt from the licensing and other requirements of the MLO pursuant to Sch.1 of the MLO.[27] This assists in avoiding any abuse of the categories of exempted persons and exempted loans under the MLO. The Court of Appeal recently addressed this issue in *Secretary for Justice v Global Merchant Funding Ltd*[28] where Kwan JA held: **9–017**

> "...It is trite law that "in determining the legal categorisation of an agreement and its legal consequences the court looks at the substance of the transaction and not at the labels which the parties have chosen to put on it" (*Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 at 160b, per Dillon LJ). However, it is also pertinent to bear in mind that the task of looking for the substance of the parties' agreement may arise in a case where the written agreement is a sham intended to mask the true agreement, and also in a case without any question of sham. It is not in dispute that we are in the latter situation... Here, the court looks for "some objective criterion in law" by which it can test

[27] Sections in this category include ss.24 and 25 of the MLO that deal with excessive interest rates, which will be discussed in more detail below.

[28] [2015] 2 HKLRD 843 (CA) (Leave to appeal granted (unrep., HCMA 716B/2013, [2015] HKEC 1036). See also, *Nga Investment Ltd v Lau Jennifer P.T.*, (unrep., DCCJ 4140/2014, [2015] HKEC 517) (DC).

whether the agreement the parties have made does or does not fall into the legal category in which the parties have sought to place their agreement (*Welsh Development Agency*, supra at 160f). In this kind of situation, one should look "only at the written agreement" in order to ascertain from its terms whether it amounts to a transaction of the legal nature which the parties ascribe to it, instead of seeking to discover from extrinsic evidence the true agreement where there is a sham. In other words, it is an "internal consideration" of the agreement itself, on the basis that the parties intended to be bound by its terms, and by nothing else (Welsh Development Agency, supra at 186d and e, and 187e per Staughton LJ)... Where there is no one clear touchstone by which it can necessarily and inevitably be said that a document which is not a sham and which is expressed as an agreement for sale and puchase must necessarily, as a matter of law, amount to a loan, it is neessary to look at the provisions in the agreement as a whole to decide whether in substance it amounts to an agreement for sale and purchase of future receivables or an agreement for a loan. The terms of the contract expressly provided for an agreement of sale and purchase of future receivables, not a loan. The agreement of a discount at the outset, with no interest to be charged regardless of how long it takes for the Purchased Amount to be collected in full by [the Defendant], is entirely consistent with a sale and purchase transaction, but inconsistent with a loan transaction with interest accruing from day to day on the outstanding amount...There is no question of the written agreement being a sham to mask the true agreement. In determining the substance of the agreement, it is permissible to have regard to the words the parties had used in the agreement to describe the transaction. The burden lying on the prosecution to establish that the transactions expressed in terms of sale were in substance loans is a heavy one...The courts' approach has been to uphold freedom of contract. In the absence of a sham, parties were permitted to structure transactions in whatever way they choose, and features which could be said to be indicative of a secured loan were explained away as not inconsistent with a sale...it is not a requirement that there should be a definite time for payment, or that the rate of interest should be ascertainable by reference to a definite time for payment."

9–018 The definition of "loan" in s.2(1) reflects the importance of substance over form by having the following qualification to the definition "...whatever its terms or form may be...which is in substance or effect a loan of money". Similarly, s.2(3) specifically states that for the purpose of determining the amount of the principal of a loan, any amount which is not shown to have been lent, except for the purpose of treating it as an instalment paid by the borrower in repayment of the loan and which is so treated by the lender, shall be disregarded. These provisions are indicative of the legislature's intent to provide protection to parties who may not have the bargaining power to avoid contractual provisions purporting to delimit or avoid the protection provided under the MLO.

9–019 In line with such provisions, the courts have also indicated that the real nature of any arrangement must be looked at and not the motive or object

which the parties hoped to achieve by their arrangement; the real test was to be found in what, in fact, the parties had done and the legal effect of the documents they had entered into.[29]

Extra-territorial effect of the MLO. It is apparent from various provisions **9–020**
of the MLO that their wording is wide enough to raise the possibility that the MLO has some extra-territorial effect. For example, the definition of "company" (which is relevant to the meaning of "person" in the definition of "money-lender") in s.2(1) includes entities incorporated overseas. Further, s.7(1)(a) refers generally to entities "carry[ing] on business" without limiting the section to the carrying on of business *in Hong Kong*. Similarly, the preamble to the MLO or s.1 does not expressly contain or imply any geographical restriction to the application of the MLO.

Part of the answer to the question of whether the MLO has extra-territorial **9–021**
effect lies in the purported legislative intent behind the MLO. Some indication of the intention of the legislature can be found in case law on this point. In *Hong Kong Shanghai (Shipping) Ltd v The Owners of the ships or vessels "Cavalry" Panaman(an flag)*,[30] the court stated in relation to the predecessor of the MLO that:

> "[The 1911] Ordinance is plainly directed primarily to domestic transactions. Its apparent social purpose is to prevent the exploitation of Hong Kong citizens by Hong Kong loan sharks ... It enables the court, clearly meaning I think the Hong Kong court, to reopen transactions in certain circumstances".[31]

This viewpoint was endorsed in the case of *China Merchants Bank v Minvest Int'l* **9–022**
Ltd[32] where the court expressly stated, "...the new Money Lenders Ordinance retains the same objective. There is nothing in its provisions which suggests that the [MLO] intends to supervise and regulate money-lending activities outside Hong Kong".[33] The case concerned agreements having the PRC law as the relevant governing law. However, it was accepted that in order to succeed on any argument raised on the MLO, the parties would have to show that, notwithstanding that the chosen law is the PRC law, the MLO still applies in the sense that it is an overriding statute, by satisfying the following two conditions: (1) that at the time of making the agreement, the lender was carrying on business as a moneylender in Hong Kong or advertising, announcing or holding itself out as so conducting itself; and (2) that, objectively assessed, the proper law of the contract was Hong Kong law. In reaching its decision that PRC law was the proper governing law in this case, the court took into consideration the express choice of governing law of the loan agreement and guarantee in question, the

[29] *Harvester Stock Investment Co v Kwan Siu May* [1987] 1 HKC 271, which followed the approach in *Talcott Factors v G Seifert Pty* [1964] NSWR 1205.
[30] [1987] HKLR 287.
[31] [1987] HKLR 287, 294C–H.
[32] (unrep., CACV 2960/2001, [2002] HKLRD (Yrbk) 217).
[33] (unrep., CACV 2960/2001, [2002] HKLRD (Yrbk) 217), p 11.

fact that the relevant lending entity was incorporated and carried on business in the PRC and that the money was actually advanced in the PRC.

9–023 A more difficult question arises in situations where there is no nexus to Hong Kong through the borrower or the lender or the place where the loan is advanced, but the relevant agreement is governed by Hong Kong law. Although, as indicated by the case law above, it is apparent that the legislature intended to offer protection to Hong Kong persons and entities only, there is a risk that the MLO may apply by agreement of the parties. In view of the stringent technical and substantive requirements of the MLO, the parties would be well advised to avoid choosing Hong Kong law as the governing law of the loan agreement.

9–024 However, the converse is not necessarily true in the sense that the express choice of a foreign law as the governing law of the loan agreement will not in itself avoid the application of the MLO if the two conditions stated in the *China Merchants* case are otherwise satisfied.

9–025 **Supervision and enforcement.** The various powers linked to the enforcement of the provisions of the MLO are vested separately in the Registrar of Money Lenders, the Commissioner of Police and the judiciary. This is reflective of the criminal and civil consequences of non-compliance with different provisions of the MLO. The supervision and control of the licensing procedure is also vested separately in the Registrar of Money Lenders and the judiciary.

9–026 **Code of Money-lending practice.** This Code was issued by The Hong Kong SAR Licensed Money Lenders Association (HKMLA) with support from The Hong Kong Monetary Authority and the Companies Registry to take effect from 18 March 2002. The objectives of the Code are to promote good money-lending practices by setting out minimum standards to be followed, to promote a fair relationship between moneylenders and borrowers and to foster consumer confidence in the money-lending industry. The Code achieves these objectives by requiring members to ensure proper and detailed disclosure and explanation of the terms and conditions of the loan to the prospective borrower at each stage of the loan approval process.[34]

9–027 The Code is non-statutory in nature and issued on a voluntary basis. Accordingly, it has no force of law in that there are no civil, criminal or regulatory implications of non-compliance with the Code. This is reinforced by the fact that the regulation of compliance with the Code is carried out by the HKMLA. As stated above, the supervision and control of the licensing procedure for moneylenders is vested in the Registrar of Money Lenders and the judiciary and not the HKMLA. Accordingly, any findings of non-compliance with the Code by the HKMLA is unlikely to have any direct impact on the

[34] Paragraph 13.2 of the Code requires information to be provided on, *inter alia*, (a) the rate of interest for the loan and whether it may be varied over the period of the loan; (b) the basis on which interest will be determined and when it will be payable, including where relevant the average percentage rates and the number of days in the year that will be used for the calculation; and (c) details of terms of repayment, including where relevant the instalments payable by the customer.

licensing of moneylenders. However, it is probable that compliance with the provisions of the Code by a moneylender will be viewed favourably by the court or the supervisory authorities if the relevant loan agreement or the renewal of its licence is subsequently called into question.[35]

(ii) *Consequences of Breach*

General. Apart from criminal sanctions, a breach of a provision of the MLO may have civil consequences. Depending upon the type of provision in question, the civil consequences of a breach may differ. 9–028

Breach of licensing provisions. Part 1 of the MLO provides for the licensing of persons carrying on business as moneylenders. Section 7(1)(a) specifically provides that no person shall carry on business as a moneylender without a moneylender's licence. In the absence of the production of a licence or evidence that at the date of the loan or the making of the agreement or the taking of the security (as the case may be) the relevant entity was so licensed, "no moneylender shall be entitled to recover in any court any money lent by him or any interest in respect thereof or to enforce any agreement made or security taken in respect of any loan made by him".[36] 9–029

The fact that a person is not a licensed moneylender in circumstances where he should have a moneylender licence does not strictly have an impact on his legal capacity to enter into a loan agreement as the underlying agreement is not rendered void or voidable by the fact that he is not properly licensed. The wording of s.23 indicates that the relevant agreement is simply rendered unenforceable in any court. 9–030

The fact that the agreement is unenforceable rather than illegal and void means that the borrower or surety can get equitable relief to recover any security given without being required to repay the loan. However, where the loan has been repaid by the borrower, there is authority to suggest that it cannot be recovered.[37] However, the borrower could seek a restitutionary remedy against the lender if the borrower can make out grounds for a claim based on unjust enrichment.[38] 9–031

[35] Conversely and, in line with the court's approach in *Brother's Co v Ah Puk Transportation* [1988] HKLR 821, the blatant disregard of the Code by the money lender may have some repercussions in the way the court exercises their discretion to enforce defective loan transactions.

[36] MLO s.23.

[37] *Thomas v Brown* (1876) 1 QBD 714.

[38] For example, the borrower could claim restitution of any repayments on the ground that the repayments were made on the basis of a mistake of law as to the legal validity of the loan transaction; *Kleinwort Benson v Lincoln CC* [1999] 2 AC 349 and *Deutsche Morgan Grenfell Group Plc v Inland Revenue Commrs* [2007] 1 AC 558. However, this is a highly complex area of law where there is significant controversy on the exact nature of such a claim and also on the principles and grounds applicable to such a claim. For a more detailed analysis of such claims, please see P. Birks, *Unjust Enrichment*, 2nd edn (Oxford: Oxford University Press, 2005); R. Goff and G. H. Jones, *The Law of Restitution*, 7th edn (London: Sweet & Maxwell, 2007); A Burrows, *The Law of Restitution*, 2nd

9–032 **Breach of formal technical requirements.** The MLO imposes on a moneylender certain requirements as to the form and contents of the loan agreement and the provision of information to the borrower or a surety.[39] Non-compliance with these requirements under the MLO renders the loan agreement or security unenforceable. In the case of non-compliance with the requirements as to the form and contents of the loan agreement under s.18 of the MLO, the court has a wide discretion to enforce the relevant agreement regardless of the non-compliance.[40] However, in relation to the requirements as to the provision of information to the borrower or a surety under s.19 or s.20 of the MLO, there is no such relief available. In *Emperor Finance Ltd v La Belle Fashions Ltd*,[41] Mr Justice Ribeiro PJ, in *obiter*, remarked that the absence of a discretion being given to the court under s.20 of the MLO was due to the fact that a breach under s.20(1) was, in view of the words "while the default continues" in s.20(4), curable by eventual compliance, whereupon the enforceability of the security revived.[42] Although the court in that case did not have to deal with the position under s.19, the same logic should apply to that section in view of the words "so long as the default continues" in s.19(4).

9–033 An interesting point to note in this regard relates to a line of authority in the United Kingdom, whereby the equivalent provisions in the Consumer Credit Act 1974 have been successfully challenged on the basis that they constitute a breach of the moneylender's right to a fair trial enshrined in the Human Rights Act (1998). One such case is *Wilson v First County Trust*.[43] Section 127(3) of the Consumer Credit Act 1974 requires that for a regulated agreement to be enforceable it must set out clearly certain terms, including e.g. the amount of the loan advanced. This is akin to the requirements contained in s.18(2) of the MLO. The court held that there was an argument that s.127(3) infringed Art.6(1) of the European Convention on Human Rights, which expressly states that everyone is entitled to a fair and public hearing. By imposing an absolute bar to enforcement where an agreement does not set out certain prescribed terms, s.127(3) constitutes a disproportionate restriction on the right of the lender to have the loan's enforceability fully considered by the courts.[44]

edn (London: Butterworths, 2002); G. Virgo, *Principles of the Law of Restitution*, 2nd edn (Oxford: Oxford University Press, 2006).

[39] MLO ss.18–20.

[40] See MLO s.18(3) and the related discussion on this section in para.9-010 above.

[41] (2003) 6 HKCFAR 402.

[42] There have since been several cases following *Emperor Finance Ltd v La Belle Fashions Ltd* (2003) 6 HKCFAR 402 on the issue of the curability of s.20 defects and the revival of the underlying security. See, for example, the decision of the Court of Final Appeal in *Celestial Finance Ltd v Yu Man Hon* [2005] 1 HKLRD 747 and the decision of the Court of Appeal in *Huaxin (Hong Kong) Co Ltd v Cheerful Corp.* (unrep., HCA 621/2003, [2005] HKEC 1139).

[43] [2001] All ER 28.

[44] The Court of Appeal was subsequently overturned by the House of Lords, [2003] All ER 187, on technical grounds relating to the limited retrospective application of the Human Rights Act to pre-existing legislation, such as the Consumer Credit Act 1974.

9–034 As provisions equivalent to those of the Human Rights Act can be found in the Bill of Rights Ordinance,[45] it is possible that a moneylender may raise an analogous argument in the Hong Kong courts, at least in relation to those provisions of the MLO under which the court is not given a residual discretion to grant equitable relief.

9–035 **Breach of the substantive requirements of the MLO.** Various provisions of the MLO impose restrictions on the substantive terms of a loan.[46] While a breach of those provisions will generally render the loan agreement unenforceable[47] (often with no residual discretion being given to the court to grant equitable relief), one such provision (s.22(1)) provides that any agreement which breaches that provision is "illegal".[48] However, in that case, where the court is satisfied that it would be inequitable not to enforce such an agreement, it may enforce it to such an extent as it considers equitable.[49] In view of the court's residual discretion to reopen and enforce the "illegal" agreement, s.22(1) really only renders a non-compliant agreement "unenforceable" pending the exercise of the court's discretion.[50]

(iii) *Key Definitions Used in the Money Lenders Ordinance*

9–036 **"Loans".** The MLO contains a very wide definition of what constitutes a "loan". It includes any advance, discount, money paid for or on account of or on behalf of or at the request of any person, or the forbearance to require payment of money owing on any account whatsoever, and every agreement (whatever its terms or form may be) which is in substance or effect a loan of money, and also an agreement to secure the repayment of any such loan, and "lender" or "lend" will be construed accordingly.[51]

9–037 Although the definition is more specific in its terms than the general common law definition which is based generally on the obligation to repay, it is in fact wider. For example, the definition includes ancillary security documents regardless of whether they include a separate covenant to repay, although there is authority to indicate that this extended application does not apply to every

[45] Chapter 383.

[46] For example s.21 (no restrictions on early repayment by borrower), s.22 (restrictions on compound interest, prohibition of repayment by instalments and charging of increased default interest) and s.24 (prohibition of excessive interest rates) discussed below. See also s.27 (prohibition of any charges or expenses).

[47] MLO s.24(2).

[48] MLO s.22(1).

[49] MLO s.22(2).

[50] Contrast s.22(1) with s.27(1) which simply renders an agreement contravening the latter provision illegal without the court being given any residual discretion to grant relief on equitable grounds.

[51] MLO s.2(1). It is interesting to note that the Money Lenders Act of 1927 in the United Kingdom does not define loan; such a definition is, however, found in s.3(1) of the Moneylending Act of 1941 in New South Wales and s.3(1) of the Money Lenders Act of 1958 in Victoria.

part of the MLO.[52] Moreover, it has previously been held that the purchase at a discount of bills of exchange, trade debts and other contractual rights does not usually constitute a loan of money at common law.[53] However, the definition in the MLO includes the word "discount". The interpretation of "discount" in the case of *Wide Bay & Burnett Finance Co Ltd v Andersens Ltd*[54] led the court to conclude that the discounting of hire purchase agreements fell within the statutory definition of "loan". As identified by Bob Allcock in his article,[55] "if this approach is followed the scope of the ordinance would be greatly increased and many types of financing which do not amount to money-lending at common law would be affected". Although there is authority in the Australian states that goes the other way in its decision,[56] it is uncertain what approach Hong Kong courts will take on this issue.

9–038 A restrictive interpretation of the term "loan" would seem desirable when one considers the breadth of the definition which includes a "forbearance to require payment of money owing on any account whatsoever". This would appear to apply to a normal sale of goods on credit. The Moneylending Act of 1941 in New South Wales responded to this problem by subsequently adding the following wording to the definition of "loan": "but shall not include any bona fide transaction entered into by a vendor (not being a money-lender licensed under this Act) of goods for the sale of goods by him where time for payment of such goods has been postponed". As with discounting transactions, it would be desirable to ensure that normal credit sales transactions do not fall within the ambit of the MLO.

9–039 In this regard, it may be instructive to look at the approach of interpretation adopted by the courts in relation to provisions in the MLO. In one case, the court has stated that:

> "the Ordinance must be construed, *however widely it appears at first glance* to be drawn, to accord with general principles. To use modern parlance, 'a loan is a loan is a loan'. The very nature of a loan is that it should be repaid and the very nature of a money lending loan is that it should be repaid with interest".[57]

9–040 Accordingly, although the definition sets out a wide range of transactions that can constitute "loans", it is arguable that they should all be considered in the context of general principles. The court will consider all the surrounding circumstances,

[52] *Rees v Regent Insurance Ltd* [1963] VR 570; *Mobil Oil Australia Ltd v Marshall* (1968) 88 WN (Pt 1) NSW 391.

[53] *Chow Yoong Hong v Choong Fah Rubber Manufactory* [1962] AC 209.

[54] [1932] QSR 119.

[55] Allcock, "The Money Lenders Ordinance" *(1981) 11 Hong Kong Law Journal 293*.

[56] *Talcott Factors Ltd v G Seifert Pty Ltd* [1964] NSWR 1205 and *Dieta Investments Pty Ltd v Sharp* [1968] WAR 86.

[57] *Harvester Stock Investment Co v Kwan Siu May* [1987] 1 HKC 271.

and the incidence of interest[58] or the manner in which interest is calculated and charged[59] is not a conclusive factor in determining that the true nature of a transaction is that of a loan.

9–041 In deciding whether or not a particular transaction constitutes a "loan" for the purposes of the MLO, the court will look behind the parties' designation of a particular document and at the substance of the particular transaction.[60] Accordingly, in the case of *Oriental Patron China Investment Ltd v Wong Chun Hung*,[61] the court looked behind the title of certain Subscription Agreement and Exchangeable Note and recategorised the transaction as a loan to the issuer of the note from the purchaser of the note. Similarly, in the case of *Roseford Resources Ltd v Dato Lim Hui Boon*,[62] the true nature of a transaction involving the provision of funds by the plaintiff to the defendant for investment purposes with a guaranteed profit return from the defendant to the plaintiff was considered a triable issue by the court in the context of a summary judgment hearing.[63]

9–042 This approach was reiterated in the case of *Supreme Design Fashion Ltd, Hung Lai Chu v Michael Hope Int. Ltd.*[64] In this case, the parties purported to enter into an agency agreement under which the defendant was appointed to handle the purchase of goods in exchange for an agency commission of 35 per cent. However, pursuant to the terms of the agency agreement, the defendant was not to place orders for equipment and materials; instead it was to open letters of credit and/or other documentary credits up to a total amount not exceeding US$3,000,000 on the instructions of the first plaintiff in favour of certain payees. In holding that the agency agreement was in fact a loan agreement, the court relied on, *inter alia*, the fact that the defendant did not in fact (regardless of the terms of the agency agreement) act as a purchasing agent; it did not order anything or arrange for the shipping and delivery of any items. It simply used its own credit facilities to pay for goods ordered by another in return for which it expected to get 35 per cent on the money so used. However, the court also appeared to have placed some reliance on the subjective opinion of the defendant

[58] *Harvester Stock Investment Co v Kwan Siu May* [1987] 1 HKC 271. Deputy Judge G.P. Muttrie: "[t]here is a matter of interest income, but in the absence of explanation it is difficult to see what conclusion can be drawn from it. Interest may be from other sources than money lending".

[59] *Harvester Stock Investment Co v Kwan Siu May* [1987] 1 HKC 271, pp 281–282.

[60] *Harvester Stock Investment Co v Kwan Siu May* [1987] 1 HKC 271. See also *Wu Yiping v Mak Yuk Yee* (unrep., HCA 1520/2004, [2008] HKEC 738) and *Pearldelta Group Ltd v Huge Winners Int'l Ltd* (unrep., HCA 595 & 818/2008, [2010] HKEC 601), where the Court of Appeal concluded that, in principle, a convertible bond could consititute a "loan" (damages assessed in *Pearldelta Group Ltd v Huge Winners Int'l Ltd* (unrep., CACV 105 & 106/2010, [2010] HKEC 1367) and leave to appeal refused by Court of Appeal and Court of Final Appeal (unrep., CACV 105/2010, [2010] HKEC 2033) and (unrep., FAMV 1/2011, [2011] HKEC 621).

[61] (unrep., HCA 9947/2000, 8 October 2001).

[62] (unrep., HCA 21850/1998, 8 October 1999).

[63] At the full hearing, the plaintiff eventually won as the defendant was not able to produce evidence to support his argument that the transaction was really in the nature of a loan rather than an investment (unrep., HCA 21850/1998, [2001] HKEC 1038).

[64] (unrep., HCA 1198/1996, 20 July 1999).

CHAPTER 20

SALE OF GOODS

Dr Charu Sharma

1. IN GENERAL

(a) *Introduction*

Sale of Goods Ordinance (Cap.26). The Sale of Goods Ordinance (SOGO) (Cap.26) was first enacted in 1896, and was based on the English Sale of Goods Act 1893. Its intention was to codify the common law relating to the sale of goods. The Hong Kong ordinance was amended in 1977 and 1994. The latest version of the law is as of June 1997 with a few amendments that were incorporated in 1998 and 2000.[1] **20–001**

As this is a codifying statute, enquiry may be made into the previous state of the law for the purpose of construing any doubtful or technical provisions, but only after examining the language for its natural meaning.[2] **20–002**

The Ordinance only deals with the law of sale and does not deal with issues common to the whole of contract law, such as questions of what amounts to a formation of contract[3] or a valid offer and acceptance. Nor does it deal with ordinary rules of interpretation, aside from a few sections dealing with specific aspects of a contract of sale.[4] It should also be noted that the Ordinance does not exclude rights and liabilities outside of the law of contract, so eg a seller, **20–003**

[1] See s 2 Interpretation, para three for "business" that includes a profession and the activities of a public body, a public authority, or a board, commission, committee or other body appointed by the Chief Executive or Government; The Sale of Goods (Amendment) Ordinance 1994 amended the Sale of Goods Ordinance (Cap 26). The major amendments included a new definition of "merchantable quality", and clarification of a buyer's right to reject defective goods where he has not had a reasonable opportunity to examine the goods, even after a sub-sale of the goods. See The Hong Kong Law Reform Commission Report: *Consultation paper on Contracts for Supply of goods*, chaps 1 and 2, 2001. Contracts of barter, contracts for work and materials, contracts of hire and contracts of hire purchase also fall outside the definition of contracts of sale. Sale of Goods Ordinance does not govern such contracts as the latter are are governed by the common law so far as the implied obligations of the suppliers under these contracts are concerned. The Supply of Services (Implied Terms) Ordinance (Cap 457) deals with the service element under a contract for work and materials. See also *Pang Yau Shing Glendy v Sano Engineering Ltd* (unrep., DCCJ 61/2013, [2016] HKEC 234) contract for renovation of residential premises; whether contractor in breach by (a) failing to complete work on or before completion date; (b) failing to render service with reasonable skill and care; and (c) producing defective works.

[2] *Bank of England v Vagliano Bros* [1891] AC 107, 144–145. However modern day judges do apply the purposive approach to interpreting a provision of the statute, see the Irish Law Reform Commission Rep 1999, *"Consultation Paper on Statutory Drafting and Interpretation: Plain Language and Law* (CP14-1999, 1999): Irish Interpretation Act; s.15AA of the Australian Interpretation Act 1901., New Zealand Law Commission, *A New Interpretation Act- To Avoid "Proxility and Tautology"* (Report No 17, 1990), 34. See also *Pepper v Hart* [1993] 1 All ER 42, at p. 50 per Lords Griffith.

[3] See *iRiver (HK) Ltd v Thakral Corporation (HK) Ltd* [2008] 4 HKLRD 1000.

[4] Sale of Goods Ordinance sections 2, 12, 14, 17(2) and 20.

in addition to being liable in contract, might be liable in tort,[5] or in a situation when goods are sold in a condition likely to cause danger to the user (buyer or end consumer).

20–004 The Sale of Goods Ordinance is not exhaustive and in s.62, it is provided that:

(1) The rules in bankruptcy relating to contracts of sale shall continue to apply thereto, notwithstanding anything in this Ordinance.[6]
(2) The rules of the common law, including the law merchant,[7] save in so far as they are inconsistent with the express provisions of this Ordinance, and in particular the rules relating to the law of principal and agent,[8] and the effect of fraud, misrepresentation,[9] duress or coercion,[10] mistake,[11] or other invalidating cause,[12] shall continue to apply to contracts for the sale of goods.
(3) Nothing in this Ordinance or in any repeal effected thereby shall affect the enactments relating to bills of sale,[13] or any enactment relating to the sale of goods which is not expressly repealed by this Ordinance.[14]
(4) The provisions of this Ordinance relating to contracts of sale do not apply to any transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, charge or other security.[15]

[5] *Glory Gold Ltd v Star Play Development Ltd* [2008] 2 HKLRD 416.

[6] See of the Bankruptcy Ordinance ss.3, 43(iii), 49, 49A, 59(1), 59(5), 60(a), 61(d) and 108.

[7] Numerous cases have assumed that these include rules of equity eg rescission for misrepresentation, see para.19–046 and *Benjamin's Sale of Goods*, edited by Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014), paras.1-007, 10-009. See also s.16(2) of the High Court Ordinance (Cap.4) and *Lau Suk Ching v Ma Hing Lam* [2006] 4 HKLRD 432 (equity goes to the root of the relief for specific performance of a contract) and ss 29-39 on performance of contract part III, SOGO.

[8] See Chapter 1. Also see *LAL Imp Exp SA v Utaniko (HK) Ltd* (unrep., DCCJ 1907/2010, [2014] HKEC 307).

[9] See *Chitty on Contracts*, edited by H. G. Beale, 32nd edn (London: Sweet & Maxwell, 2015), Vol. 1; *LAL Imp Exp SA v Utaniko (Hong Kong) Ltd* (unrep., DCCJ 1907/2010, [2014] HKEC 307) See also *Lee Tit Fan v Strong Base International Industrial Ltd* (unrep., DCCJ 3680/2008, [2012] HKEC 512) vitiating factors – *non est factum* – fraudulent misrepresentation – alleged oral agreement followed by written agreement between same parties but in materially different terms – whether written agreement null and void on ground one party misled into believing that terms of two agreements identical – whether oral agreement existed. For misrepresentation (negligent) see also *Formosa Taffeta Co Ltd v Banque Indosuez* [2009] 1 HKLRD 568; *Lam Ching Sheung v Official Receiver* [2009] 5 HKLRD 263; *Winplus Australasia Pty Ltd v Beauty Captial Industrial Development Ltd* (unrep., DCCJ 3718/2012, [2014] HKEC 1213).

[10] See *Chitty on Contracts*, edited by H. G. Beale, 32nd edn (London: Sweet & Maxwell, 2015), Vol. 1, Ch. 7.

[11] See *Chitty on Contracts*, edited by H. G. Beale, 32nd edn, Vol.1 Ch. 5.

[12] See *Chitty on Contracts*, edited by H. G. Beale, 32nd edn, Vol.1 Ch. 16.

[13] Bills of Sale Ordinance (Cap.20) and *Chitty on Contracts*, Vol. 2, para.38-481.

[14] See the Factors Ordinance (Cap. 48).

[15] See below, paras.20–025–20–026.

Conflict of laws.[16] Contracts of sale made abroad are generally governed by the law of the place where the goods are located at the time of sale. The principle is that if the sale is binding under the law of the country where the goods are, then the sale is binding elsewhere. 20–005

The buyer and seller can determine their choice of law by an express term in the contract.[17] If there is none, and no implied choice can be found in the circumstances, the appropriate system of law is the one with which the contract has the closest and most real connection. 20–006

Definitions 20–007

The definitions are contained in ss.2 and 2A.

"action" includes suit, counterclaim and set-off;

"business" includes a profession and the activities of a public body, a public authority or a board, commission, committee or other body appointed by the Chief Executive or Government;[18]

[16] *Chitty on Contracts*, edited by H. G. Beale, 32nd edn (London: Sweet & Maxwell, 2015), Vol. 1, Ch. 30.

[17] See *Sinom (Hong Kong) Ltd v Swati International* (unrep., HCA 2493/2004, [2005] HKEC 1708). Where there is no evidence of any difference between the applicable Hong Kong law and the law of the foreign jurisdiction it is assumed that "the laws of all foreign jurisdictions are the same as Hong Law, in the absence of proof by evidence of what the true position is under the foreign law concerned" see *Kolinker Industrial Equipment Ltd v Longhil Industries Ltd & Solid State Equipment Corporation* (unrep., DCCJ 5052/2002, [2004] HKEC 653).

[18] The Business Registration Ordinance (Cap.310) defines a "business" as "any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain and also means a club". The Inland Revenue Ordinance (Cap.112) defines "business" in s.2(1) as follows:

> "business" includes agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government".

The definition provided by the Inland Revenue Ordinance is an inclusive one. In *Lee Yee Shing v Commissioner of Inland Revenue,* (2008) 11 HKCFAR 6, [2008] 3 HKLRD 51 it was held that:

> "While engaging in activities with a view of profit making is an important indicator, and in some cases an essential characteristic, of a business, a profit making purpose does not conclude the question whether the activities constitute a business. Whether or not they do depends on a careful analysis of all the circumstances surrounding the activities".

In *Commissioner Of Inland Revenue v Bartica Investment Ltd* [1996] 4 HKC 599, the court through Cheung J held that the fact that the taxpayer has applied for a Business Registration Certificate and "the systematic placing of the company's funds on deposit and their use as security for loans advanced by banks to the taxpayer's hotel company was a 'gainful use of the assets of the taxpayer which, in the words of Lord Diplock, constituted, a *prima facie* a carrying on of a business' ". See *Rolls v Miller* (1884) 27 Ch. D. 71 (the word business was described as anything which is an occupation or duty that requires attention (Lindley J) [88]); *Rael-Brook Ltd v Minister of Housing*

"buyer" means a person who buys or agrees to buy goods;
"contract of sale" includes an agreement to sell as well as a sale;
"delivery" means voluntary transfer of possession from one person to another;
"document of title to goods" includes any bill of lading, dock warrant, warehouse keeper's certificate and warrant or order for the delivery of goods, and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by indorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented;[19]
"fault" means wrongful act or default;
"future goods" means goods to be manufactured or acquired by the seller after the making of the contract of sale;
"goods" includes all chattels personal other than things in action and money.[20] The term includes emblements, industrial growing crops, and

& Local Government [1967] 2 QB 65, [1967] 1 All ER 262 (where it was stated that for "business" neither the making of a profit nor any commercial activity is essential). However largely business is understood to mean a regularly conducted commercial enterprise: see *IRC v Marine Steam Turbine Co Ltd* [1920] 1 KB 193, at [202]–[204]; *Customs and Excise Comrs v Lord Fisher* [1981] 2 All ER 147, [1981] STC 238. The UK's Partnership Act 1890 s.45 recognizes even a single transaction as business (see *Re Abenheim, ex p. Abenheim* (1913) 109 LT 219); *Re Griffin, ex p. Board of Trade* (1890) 60 LJQB 235, [237]; *Linstead v Simpson* 1927 JC 101, [104], [105]; and cf. *Cornelius v Phillips* [1918] AC 199; [1916–1917] All ER Rep 685 (HL). Business may include a loss making enterprise or a profession: *Re Ogilby, Ogilby v Wentworth-Stanley* [1942] Ch. 288, [1942] 1 All ER 524; *South Western Suburban Water Co v Guardians of the Poor of St Marylebone* [1904] 2 KB 174, [180]; *Re Williams Will Trusts, Chartered Bank of India, Australia and China v Williams* [1953] Ch. 138, [1953] 1 All ER 536 and *R v Breeze* [1973] 2 All ER 1141, [1973] 1 WLR 994 (CA); and contrast *Stuchbery v General Accident Fire and Life Assurance Corporation Ltd* [1949] 2 KB 256, [1949] 1 All ER 1026: See also *Halsbury's Laws of England*, 5th edn (2010) Vol. 47, Trade and Industry, para.6, *Words and Phrases legally defined,* 3rd edn (London: Butterworths, 1988) Vol. 1 p.204 and Supp.2005 pp. 104–106.

[19] *Cf.* the definition under s.2(1) of the Factors Ordinance (Cap.48). *Fanlin Investments Ltd v Hang Seng Finance Ltd* [1994] 3 HKC 433, applying *Joblin v Watkins and Roseveare (Motors) Ltd* (1949) 64 TLR 464. See *Benjamin's Sale of Goods*, edited by Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014), paras.18-006. A car registration document is not a document of title in England under the Sale of Goods Act: *Joblin v Watkins and Roseveare (Motors) Ltd* (1949) 64 TLR 464 and *Beverley Acceptances Ltd v Oakley* [1982] RTR 417.

[20] *Chan Juen v Yu Fook Shung* [1987] 3 HKC 539. Usually tangible property but in Canadian case, steam and gas have been held to be tangible personal property: *Re Social Services Tax Act, Re Central Heat Distribution Ltd* (1970) 74 WWR 246 and *Bradshaw v Boothe's Marine Ltd* [1973] 2 OR 646. It does not include things in action, such as shares, insurance policies, negotiable instruments, but it does include a part interest in goods (see *Nicol v Hennessy* (1896) 1 Com Cas 410). The Sale of Goods Ordinance (SOGO) has not been amended to include computer software as goods however it [goods] is taken to include software programs, software licences and CD-Roms containing software programs, see eg *Tech-Trans System Ltd v ELM Computer Technologies Ltd* (unrep., DCCJ 1299/2005, [2007] HKEC 1539); even though Hong Kong as not followed suit with an amendment – sale and purchase of computer programs is considered to be falling under a contract for services and contract for sale of goods or having "mixed characteristics": *Liu Peggy v Alfa Com Technology Ltd* [2007] 1 HKLRD 528. Internationally and in other countries, the

things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale;[21] It does not include land or realty property.[22]
"plaintiff" includes a defendant counterclaiming;
"property" means the general property in goods, and not merely a special property;[23] "quality of goods" includes their state or condition;

debate whether computer software constitutes goods has been laid to rest whether by an amendment or under judicial interpretation, especially, for the purposes of United Nations Convention on International Sale of Goods, 1980, the UK Sale of Goods Act, 1979 (see *Beta Computers (Europe) Ltd v Adobe* [1996] SLT 604; *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481; Uniform Commercial Code, USA (Art.2b) (*Advent Systems Ltd v Unisys Corporation* 925 F2d 670 (3rd Cir. 1991)); *Softman Products Co, LLC v Adobe Systems Inc* 171 F Supp 1075 (CD Cal 2001), in Singapore *(Computer Supermarkets (S) Pte Ltd v Goh Chin Soon Ricky* [1997] 2 SLR 283); sale of standard software "goods" has been held to be governed by CSIG in Germany, see the decision of L. G. Munchen (8 Feb. 1995, No.8 HKO 24667/93, Case 131 CLOUT). See also M. Edenborough, "Computer Contract/Sale of Goods: Software Goods within the Meaning of Sale of Goods Act 1879" (1995) 17(2) *European Intellectual Property Law Review* D48; Frank Diedrich, "The CISG and Computer Software Revisited" (2002) 6 *VJ Supplement* at http://www.vindobonajournal.com; C. Sharma, "Sale of Goods" in D. K. Srivastava (ed.), *Business Law in Hong Kong*, 2nd edn (Hong Kong: Sweet & Maxwell Asia, 2007), p.321; J. Lookofsky, "In Dubio Pro Conventione? Some thoughts about Opt-Outs, Computer Programs and Preemption under the 1980 Vienna Sales Convention" (2003) 13 *Duke Journal of Comparative and International Law* 263. See also Jacob Ziegel, "The Future of the International Sales Convention from a Common Law Perspective" (2000) 6 *New Zealand Business Law Quarterly* 336, 345.

[21] Slag, cinder tips or other artificially formed mounds of debris may, in the process of time, so accede to the soil as to become incapable of forming the subject matter of a contract of sale within the Sale of Goods Ordinance: *Morgan v Russell* [1909] 1 KB 357; *Mills v Stokman* (1867) 116 CLR 61 (abandoned slate); *cf. Kursell v Timber Operators and Contractors Ltd* [1927] 1 KB 298 (growing timber). Mineral oil extracted and removed from the soil is in the category of movables: *Anglo Iranian Oil Co Ltd v Jaffrate* [1953] 1 WLR 246. It has been held in Australia that the sale of a house to be moved on a trailer was a sale of goods: *Symes v Laurie* [1985] 2 Qd R 547. See also *Elitestore Ltd v Morris* [1997] 1 WLR 687 (degree of annexation).

[22] For personal chattels, *cf.* the definition in s.2 of the Bills of Sale Ordinance. Things in action (eg company shares, actionable claims (right to sue another for a debt) and items of intellectual property, for example, copyrights, patents and trademarks, would fall outside the definition of goods. For emblements (acquired under the right to cut and carry away crops after determination of a tenancy), see *Halsbury's Laws of England,* 4th edn (2007 Reissue) Vol. 1 Agriculture, para.382. A ship comes within the definition of "goods" in this section: see *Behnke v Bede Shipping Co* [1927] 1 KB 649, [1927] All ER Rep 689.I However a coin sold as a collector's piece may be "goods": see *Moss v Hancock* [1899] 2 QB 111; Coins are goods or chattles as held in *Chow Shun Yung v Weh Pih Stella* [2007] HKCLRT 72. A one thousand dollar note that was wrongly printed by the Hong Kong mint, was held to be a chattel: *Hongkong and Shanghai Banking Corporation v Chan Yiu Wah* [1988] 1 HKLR 457 (CA). The note in question was a special kind of bank note having a special value by virtue of being "one of a kind" or unique. In *Cheung Kam Sing v International Resort Developments Ltd* [2003] 2 HKLRD 113 a "timeshare" contract was held to be a consumer contract for the sale of goods or the provision of services. "Flowers" are "fructus industrials" and are therefore "goods" within this section: *Chan Juen v Yu Fook Shung* [1987] 3 HKC 539. Pet dogs and domestic animals are also goods for the purposes of this definition: see *Wong Ng Kai Fung v Yau Lai Chu* [2005] 4 HKLRD 134 (CFI).

[23] An example of a special property could arise by way of pledge. See *Sewell v Burdick* (1884) 10 App Cas 74; *The Odessa* [1916] 1 AC 145.

"sale"[24] includes a bargain and sale as well as a sale and delivery;
"seller" means a person who sells or agrees to sell goods;
"specific goods" means goods identified and agreed upon at the time a contract of sale is made;[25]
"warranty" means an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.[26]

20–008 By s.2(2), a thing is deemed to be done "in good faith" when it is in fact done honestly, whether it is done negligently or not.[27]

20–009 By s.2(3), a person is deemed to be insolvent within the meaning of the Ordinance if he has either ceased to pay his debts in the ordinary course of business or he cannot pay his debts as they become due.[28]

20–010 By s.2(4), goods are in a "deliverable state" within the meaning of the Ordinance when they are in such a state that the buyer would under the contract be bound to take delivery of them.[29]

[24] In *Yu Man Fung Alice v Chiau Sing Chi Stephen* (unrep., CACV 50 & 69/2013, [2014] HKEC 574), it was held that as "a matter of ordinary language and daily experience, a 'sale' involves a transfer of ownership (or at least some proprietary interest) in property to a purchaser (or purchasers) in exchange for something else (usually money)".

[25] Whether goods are specific or general is a question of fact and law. It is not always an easy question: *Hopeful Meat Ltd v Tai Po Frozen Meat Co Ltd* (unrep., DCCJ 15918/2000, 26 July 2006) (in that case, the court was concerned with whether goods were specific or general to ascertain at what point property passed).

[26] See below, para.20–044; see also *Chitty on Contracts*, edited by H. G. Beale, 32nd edn. (London: Sweet & Maxwell, 2015) Vol. 1, paras.12-019 *et seq.* See also *New Optics Manufacturing Co Ltd v Lap Shing (Hong Kong) Freight Forwarding Ltd* (unrep., HCAL 49/2007, [2008] HKEC 270) (for nature of fob contract); *Croydex Ltd v Tung Shing Plastic Factory Ltd* (unrep., DCCJ 1548/2005, [2007] HKLRD (Yrbk) 550) (defective toilet seats in this case the contract was f.o.b. the court held that measure of damages for rejection of goods was *prima facie* price difference between rejected and substitute goods. Further in an fob contract the wasted shipping costs of the rejected goods are deducted from the airfreight charges for the substitute goods *GKN Centrax Gears Ltd v Matbro Ltd* [1976] 2 Lloyd's Rep 555; *Microsport GMBH & Co KG v Pactland Ltd* (unrep., DCCJ 2854/2004, [2006] HKEC 44).

[27] The definition of "in good faith" is similar to that in s.96 of the Bills of Exchange Ordinance (Cap.19); *Jones v Gordon* (1877) 2 App Cas 616; *Janesich v Attenborough & Son* (1910) 102 LT 605; *Moody v Pall Mall Deposit and Forwarding Co Ltd* (1917) 33 TLR 306; *Heap v Motorist Advisory Agency Ltd* [1923] 1 KB 577, 590–591; *Davey v Paine Bros (Motors) Ltd* [1954] NZLR 1122, 1130; *cf. Bishopsgate Motor Finance Corporation Ltd v Transport Brakes Ltd* [1949] 1 KB 322, 338; *Pearson v Rose and Young Ltd* [1951] 1 KB 275, 289; *Stadium Finance Ltd v Robbins* [1962] 2 QB 664, 672, 675; *Astley Industrial Trust Ltd v Miller* [1968] 2 All ER 36 (whether sale of vehicle without registration document is evidence of bad faith).

[28] See below, para.20–314.

[29] See below, para.20–155.

By s.2A:[30] **20–011**

"(1) a party to a contract of sale 'deals as a consumer' in relation to another party if:
(a) he neither makes the contract in the course of a business nor holds himself out as doing so;
(b) the other party does make the contract in the course of a business; and
(c) the goods passing under or in pursuance of the contract are of a type ordinarily supplied for private use or consumption.
(2) Notwithstanding subs.(1), on a sale by auction or by competitive tender the buyer is not in any circumstances to be regarded as dealing as consumer.
(3) It is for the person claiming that a party does not deal as consumer to prove that he does not".

Section 2A(1)(a) - In the course of a business. In *R & B Customs Brokers Co v United Dominions Trust*[31] the court held that to hold an incidental transaction as "business" it would have to a have a degree of regularity and an activity would be so classified that can be said to be an integral part of the business carried on and so entered into in the course of that business.[32] **20–012**

Overseas sales. Many of the provisions in the Ordinance are rendered inapplicable to a variety of common international sale contracts by s.57(1) which provides that any right, duty or liability under a contract of sale may be negatived or varied by usage. One of these common forms of international sale contracts is the 'cost, insurance and freight' (CIF), contract, where the seller sells the goods at a price which includes their cost and freight to destination and the premium on an insurance policy to cover the risk during transit, and the buyer pays the price on delivery of the documents showing the delivery of the goods, usually these are the bill of lading,[33] **20–013**

[30] This definition is extended in s.4(1)(c) of the Control of Exemption Clauses Ordinance to cover other agreements under which possession or ownership of goods passes. See *Chitty on Contracts*, edited by H. G. Beale, 32nd edn (London: Sweet & Maxwell, 2015), Vol. 1, para.14-066.

[31] [1988] 1 All ER 847, [1988] 1 WLR 321 (CA).

[32] "It is difficult to imagine that the court would treat a person who trades in very large sums of foreign currency, through an attorney and other agents or assistants as one who did not make the various foreign exchange contracts in the course of a business": *Natamon Protpakorn v Citibank NA* (unrep., HCA 190/2005, [2005] HKEC 1920). Similarly a printing press so used by the party must be used in the course of business and is not something which is ordinarily supplied for private use and certainly not for private consumption: *Artech Printing Ltd v Yee Fat Printing Equipment Ltd* (unrep., CACV 92/2000, [2000] HKEC 1027).

[33] A bill of lading may be of two kinds: a "straight-consigned bill of lading" and an "order bill of lading". A straight bill of lading is a document if title which is not negotiable and does not have on its face the words "to order" to indicate that the property in the goods is transferable by indorsement and delivery of the bill of lading: see *The Rafaela S* [2004] QB 702; applied by the Court of Final Appeal in *Carewins Development (China) Ltd v Bright Fortune Shipping Ltd* [2009] 3 HKLRD 409 (CFA). A bill of lading is a document of title and a carrier may be liable to the shipper seller) when the carrier breaches its contract when goods are delivered to the consignee without providing the bill of lading: see *The Rafaela S* [2004] QB 702, and *Carewins Development (China) Ltd v Bright Fortune Shipping Ltd* [2009] 3 HKLRD 409 (CFA), *cf. Sze Haoi Tong Bank Ltd v Rambler Cycle Co Ltd*

the insurance policy[34] and invoice. Another is the FOB (free on board) contract, where the seller is required at his own cost to deliver the goods to and place them on board a ship at the designated port of shipment, whereupon payment becomes due, and the property passes to the buyer.[35] Other types of contract include:[36]

(1) C&F or CFR, cost and freight;
(2) FAS, free alongside ship or FOR, free on rail;
(3) FCA or FRC, free carrier at a named place;
(4) CIP, carriage and insurance paid to a named place of destination;
(5) Ex Works, Ex Ship or Ex Quay.

2. FORMATION OF THE CONTRACT[37]

(a) *Contract of sale*

20–014 **Sale and agreement to sell.** The terms "sale" and "agreement to sell" are defined as follows by s.3 of the Sale of Goods Ordinance (Cap.26):

> "(1) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price. There may be a contract of sale between one part owner and another.[38]

[1959] AC 576; *J I MacWwilliam Co Inc v Mediterranean Shipping Co SA* [2005] 2 AC 423; see also *Benjamin's Sale of Goods*, Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014); G. Treitel, *Carver on Bills of Lading*, 1st edn (London: Sweet and Maxwell).

[34] See *Anbest Electronic Ltd v CGU International Insurance Plc* [2008] 4 HKLRD 202, a situation where a liability of the insurer to indemnify the assured had accrued and a duty of the assured arose to minimise the amount of that liability or even eliminate it in a cost, insurance and freight contract.

[35] Where goods are sold free on board, the duty of the seller is to deliver the goods on board ship at the contractually appointed port at his own expense for carriage to the buyer. The contract of carriage may be made by the buyer himself or by the seller on the buyer's behalf, and the buyer is liable for the freight and *prima facie* all charges subsequent to delivery on board. If the free on board contract does require the seller to make the contract of carriage or is silent as to who should make it, the seller's duty is then to give up possession of the goods to the ship upon the terms of a reasonable and ordinary bill of lading or other contract of carriage", see *Halsbury's Laws of Hong Kong* (2004 edn, Vol. 23), paras.355.311, 355.411. See also *New Optics Manufacturing Co Ltd v Lap Shing Freight Forwarding Ltd* (unrep., DCCJ 5193/2005, [2008] HKEC 726).

[36] In general, see Part 7 of *Benjamin's Sale of Goods*, edited by Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014).

[37] Parties could form a contract by reaching an agreement even though there were ongoing negotiations as to further terms to be agreed on: see *iRiver Hong Kong Ltd v Thakral Corp (HK) Ltd* [2008] 4 HKLRD 1000.

[38] The terms "contract of sale" and "agreement to sell" are used widely. However contract of sale does not include contracts by way of mortgage, pledge, charge or other security: see SOGO s.62(4) below. It is a contract where there is a transfer of ownership (property) in goods by the seller in exchange for money to the buyer; See also s.2, Stamp Duty Ordinance (Cap.117); s.2, Conveyancing and Property Ordinance (Cap. 219) and *Yu Man Fung Alice v Chiau Sing Chi Stephen* (unrep.,

> (2) A contract of sale may be absolute or conditional.
> (3) Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.
> (4) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred".[39]

Note that the consideration mentioned in s.1 above is in all cases "money consideration" or what the law recognises as valuable. An oral agreement is not enforceable on the ground that the pleaded consideration of "plain loyalty and chastity of the defendant towards the plaintiff during the courtship" does not amount to valid and sufficient consideration. It has been held that a binding a gratuitous promise will not be enforceable as it lacks consideration and "something of value that the law refuses to recognise as such" will also not be considered valid consideration. Furthermore the requirement under s.3(1) is clearly stipulated as "money consideration", although partial payment and exchange of goods to set off price contracts have been held to constitute a valid sale of goods contract.[40] 20–015

Sales distinguished from agreements to sell. It is important to make this distinction because a sale of goods involves both a contract and a conveyance, while an agreement to sell is purely a contract.[41] So, a party to an agreement to sell can only sue for a personal remedy. In contrast, where there has been a sale, a seller can sue for the price of the goods, and the buyer may have proprietary remedies in the goods themselves. Further, if there has been a sale, the buyer who 20–016

CACV 50 & 69/2013, [2014] HKEC 574). A contract of sale will thus include a contract where a buyer contracts to buy artificial teeth: *Lee v Griffin* (1861) 1 B & S 272, [1861–1873] All ER Rep 191; a contract to supply and fit blackout curtains: *Love v Norman Wright (Builders) Ltd* [1944] KB 484, [1944] 1 All ER 618; to make a fur coat: *J Marcel (Furriers) Ltd v Tapper* [1953] 1 All ER 15, [1953] 1 WLR 49; to provide a carpet and lay it: *Philip Head & Sons Ltd v Showfronts Ltd* [1970] 1 Lloyd's Rep 140, (1969) 113 SJ 978. In contrast where the materials supplied is of relatively little value as compared to the work and labour then it will not be a contract of sale of goods rather a contract for work and labour: see *Robinson v Graves* [1935] 1 KB 579, [1935] All ER Rep 935 (CA) (commission to paint a portrait). See further *Clay v Yates* (1856) 1 H & N 73 (contract to print work, materials to be supplied to printer: held to be work and labour). However a contract for installation of computer program was held to have mixed characteristics – it could be a contract for services as well as a contract for sale of goods see *Liu Peggy v Alfa Com Technology Ltd.* [2007] 1 HKLRD 528.

[39] In *Money Consultants Inc v Meridian Apparal Ltd* (unrep., DCCJ 94/2012, [2013] HKEC 2047), the defendant failed to deliver the pants to the plaintiff in breach of an agreement to resell a pair of pants. As the defendant failed to provide consideration, the defendant was required to repay the deposit to the plaintiff.

[40] See for commentary *Chitty on Contracts*, 32nd edn (London: Sweet and Maxwell, 2015) Vol. 1, paras.3-002 and 3-003 and *Chan Man Tin v Cheng Leeky* [2008] 3 HKLRD 593.

[41] An agreement to sell does not amount to publication within the Control of Obscene and Indecent Articles Ordinance (Cap.390) s.2(4) that covers "sale", see: *R v Chan Chiu Cheung* [1989] 2 HKLR 446.

is the *prima facie* the owner of the goods, usually takes the risk of damage to the goods. Conversely, under an agreement to sell, the risk stays with the seller.

20–017 **Contracts of sale distinguished from other contracts.** If a contract on its true construction is some contract other than one for the sale of goods, the provisions of the SOGO (Cap.26) will not apply. This distinction is also important in the context of implied terms. The Control of Exemption Clauses Ordinance (Cap.71) regulates the exclusion of these terms in different ways, depending on whether the contract in question is one for the sale of goods or some other contract under which the possession or ownership of goods passes.[42]

20–018 **Transactions outside the Ordinance.** The following transactions are outside the scope of the Ordinance:

(1) *Gift*. At first glance, this appears to be a superfluous distinction as the provisions of the Ordinance applies only to sale of goods. However, this can be important in the case of advertising and promotional offers of goods:[43] if there is a sale, the Ordinance will apply, but if there is merely a gift, it will not. A usual practical consequence is that the implied terms as to quality may not apply.

(2) *Exchange or barter*. Section 3(1) defines a contract of sale to be one under which property in goods is transferred for a money consideration. If the contract is one under which property in goods is transferred in exchange for other goods, then it is a contract of exchange or barter and is not covered by the provisions of the Ordinance, for s.2 defines goods so as to exclude money.[44] However, if part of the consideration consists of money then the contract may still constitute one of sale. This is because it may be treated as involving reciprocal sales with a set-off of prices,[45] or as a sale where the buyer has the option of satisfying the price in part delivery of goods.[46]

(3) *Contract for work and materials*. Such a contract may fall within the application of the Ordinance depending on whether on its true construction,[47] it is a contract of sale. Two tests have been advanced.

[42] Recently the Hong Kong courts have clarified that there is no division or a conceptual wedge between exclusion clauses and limitation of liability clauses. Where there is a "catch all" provision that would be an unreasonable one given its potential breadth and attempt to limit liability for a deliberate breach of the carrier's fundamental obligation to release goods only on presentation of an original bill of lading such a provision will not be able to protect a party who has included such a provision, see *Mau Wing Industrial Ltd v Ensign Freight Pte Ltd* [2009] 5 HKLRD 240; *Forsa Multimedia Ltd v C & C Logistics (HK) Ltd* (unrep., DCCJ 3467/2009, [2011] HKEC 185).

[43] *Esso Petroleum Co Ltd v Customs and Excuse Commissioners* [1976] 1 WLR 1; *Beecham Foods Ltd v North Supplies (Edmonton) Ltd* [1959] 1 WLR 643; *Chappell Co Ltd v Nestlé Co Ltd* [1960] AC 87.

[44] Note the definitions of sale in other ordinances includes exchange and barter eg Interpretation and General Clauses Ordinance (Cap.1); Public Health and Municipal Services Ordinance.

[45] *Aldridge v Johnson* (1857) 7 El & Bl 885; *Commission Car Sales (Hastings) Ltd v Saul* [1957] NZLR 144 (SC); *Davey v Paine Bros (Motors) Ltd* [1954] NZLR 1122 (SC); but see *Flynn v Mackin* [1974] IR 101 (SC).

[46] *GJ Dawson (Clapham) Ltd v H & G Dutfield* [1936] 2 All ER 232.

[47] *Tin Tsun Lithographers and United Battery Service v Overseas Battery Factory* [1937] HKLR 16.

In *Lee v Griffin*,[48] Blackburn J stated that the test was whether the contract was intended to pass the property. If so, the contract must be one of sale. But in *Robinson v Graves*,[49] the Court of Appeal held that a contract to paint a portrait was one for work and materials and not for the sale of goods, and Greer LJ stated the law as follows:

> "If the substance of the contract … is that skill and labour have to be exercised for the production of the article and … it is only ancillary to that that there will pass from the artist to his client or customer some materials in addition to the skill involved in the production of the portrait that does not make any difference to the result, because the substance of the contract is the skill and experience of the artist in producing the picture".

The test in this latter case seems to be favoured by subsequent cases. For example, it has been held that the ordering of tailored clothing is a sale of goods,[50] but not the drafting of a legal document or the supply of plans by an architect.[51] However, this test is by no means universally approved. In a case, the Supreme Court of Victoria criticised this test as being inconsistent with the earlier test, and was illogical and unsatisfactory.[52]

Where the contract is one to supply and install goods on the basis that property passes on installation, it is established that the contract is one for work done and materials supplied.[53] If, however, the transaction is one where property in the goods passes at an earlier stage, the contract is one of goods agreed to be delivered as a chattel and afterwards fixed. The test is whether what was intended by the contract was the supply of goods with a subordinate agreement for their installation, or a single agreement to supply, deliver and install the article in question.[54] "Neither the ownership of the materials, nor the value of the skill and labour as compared with the value of the materials, is conclusive, although such matters may be taken into consideration in determining in the circumstances of a particular case whether the contract is in substance one for work and labour and materials or one for the sale of a chattel".[55] If the

[48] (1861) 1 B & S 272.

[49] [1935] 1 KB 579. See also *Mak Ping Kui v Millionice Ltd* (unrep., HCA 0940/1998, [2001] HKEC 460).

[50] *J Marcel (Furriers) Ltd v Tapper* [1953] 1 WLR 49 (QB).

[51] *Vautier v Fear* [1916] GLR 524 (SC); but see *Gibbon v Pease* [1905] 1 KB 810 (CA).

[52] Fullagar J in *Deta Nominees Pty Ltd v Viscount Plastic Products Pty Ltd* [1979] VR 167, a case involving an oral contract to design and manufacture a set of dies.

[53] *Brooks Robinson Pty Ltd v Rothfield* [1951] VLR 405 (FC); *Deta Nominees Pty Ltd v Viscount Plastic Products Pty Ltd* [1979] VR 167, 185 (Fullagar J).

[54] *Aristoc Industries Pty Ltd v RA Wenham (Builders) Pty Ltd* [1965] NSWR 581 586–587 (Jacobs J); *Collins Trading Co Pty Ltd v Maher* [1969] VR 20, 24 (Lush J); *Hewett v Court* (1983) 149 CLR 639, 662 (Deane J); *Symes v Laurie* [1985] 2 Qd R 547 (FC).

[55] See *Mak Ping Kui v Millionice Ltd* (unrep., HCA 940/1998, [2001] HKEC 460).

distinction concerns implied terms, the current status of the common law suggests that terms similar to the ones implied into a sale of goods contract by the Ordinance would be implied even though the contract is one for work and materials.[56]

(4) *Hire purchase agreements.* If under the hire purchase agreement, the hirer does not agree to buy the goods hired, but only has an option to buy, the hire-purchase agreement is not a contract for the sale. If, however, the hirer agrees to buy the goods, even though property in the goods does not pass until all the instalments under the agreement has been paid, the hire-purchase agreement is subject to the sale of goods legislation. One of the purposes behind the distinction was to avoid the provisions which in certain circumstances allowed a buyer in possession of the goods with the consent of the seller to pass a good title to an innocent purchaser.[57]

(5) *Mortgages of Goods.* A transaction in the form of a contract of sale which is intended to operate by way of mortgage or charge is not subject to the provisions of the Ordinance.[58] Whether a contract is in essence a mortgage or a contract of sale is a question of substance and not a form.[59] In a legal mortgage of goods, the property in goods is transferred from the mortgagor to the mortgagee in order to secure a debt, with a proviso for retransfer on redemption of the debt.[60] Since there is a transfer of property, the mortgage of goods resembles a contract of sale. However, possession of the goods remains with the mortgagor subject to the power of the mortgagor to gain possession on default of payment. Often difficulty in drawing the distinction between a mortgage and a contract of sale arises where there has been a sale and lease back of goods, the combined effect

[56] *Aristoc Industries Pty Ltd v RA Wenham (Builders) Pty Ltd* [1965] NSWR 581, 586–587 (Jacobs J); *Collins Trading Co Pty Ltd v Maher* [1969] VR 20, 24 (Lush J); *Hewett v Court* (1983) 149 CLR 639, 662 (Deane J); *Symes v Laurie* [1985] 2 Qd R 547 (FC); *Harmer v Cornelius* (1858) 5 CB (NS) 236; *GH Myers & Co v Brent Cross Service Co* [1934] 1 KB 46.

[57] See Control of Exemption Clauses Ordinance s.27(1) and *Helby v Matthews* [1895] AC 471. In *Forthright Finance Ltd v Carlyle Finance Ltd* [1997] 4 All ER 90 (CA), the buyer was obliged to pay all instalments of price, with property passing on final payment unless the buyer declined to take title. The transaction was held to be a conditional agreement to sell goods. See also *Hang Seng Finance Ltd v Lin Kwok Man* [1991] 2 HKC 613; *Sun Hung Kai Credit Ltd v Szeto Yuk Mei* [1986] HKDCLR 1; *WOC Finance Co Ltd v Fullrate Enterprises Ltd* [1982] HKLR 474; *Wayfoong Credit Ltd v Cheung Wai Wah Samuel* [1990] 1 HKC 367.

[58] See Control of Exemption Clauses Ordinance s.62(4). It may be covered by the Bills of Sale Ordinance if in writing, or a registrable charge under Pt III of the Companies Ordinance.

[59] See *Benjamin's Sale of Goods*, edited by Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014), paras.1-064–1-066.

[60] Four kinds of consensual security of assets under contract exist these include mortgage, pledge, lien and charge: see R. Goode, *Legal Problems of Credit and Security*, 5th edn (London: Sweet & Maxwell, 2013), para.1-42; see also *In Re Far East Structural Steelwork Engineering Ltd* (unrep., HCCW 354/2001, [2005] HKEC 763). *China Minsheng Banking Corporation Ltd (Shenzhen Branch) v DiChain Holdings Ltd* [2008] 5 HKLRD 373 and *Jumbo Key Holdings Ltd v Hong Kong Equestrian Centre Ltd* [2009] 3 HKLRD 260.

of which may be that of a loan on security of the goods, similar to that of a mortgage.[61]

(6) *Pledges.* When goods are pledged, the owner of goods, the pledgor, promises to repay a debt owed to the pledgee and secures the promise by the bailment of goods.[62] The pledgor retains general property in the goods, while the pledgee acquires a special property in them as security. A transaction in the form of a contract of sale which is intended to operate by way of a pledge is not governed by the Ordinance.[63]

(7) *Agency.*[64] An agent's duties are normally no more than to use his best endeavours and are quite different from those of a seller. The extent to which the person concerned is remunerated by commission is relevant to this distinction: even more relevant is the extent to which he has to account to the other.

(b) *Capacity of the parties*

Capacity of parties. By s.4: 20–019

"(1) Capacity to buy and sell is regulated by the general law concerning capacity to contract, and to transfer and acquire property:

Provided that where necessaries are sold and delivered to an infant or minor, or to a person who, by reason of mental incapacity or drunkenness, is incompetent to contract, he must pay a reasonable price therefor.

(2) In this section, 'necessaries' means goods suitable to the condition in life of such infant or minor or other person, and to his actual requirements at the time of the sale and delivery".

[61] *Yorkshire Ry Wagon Co v Maclure* (1882) 21 Ch. D. 309; *Victoria Dairy Co of Worthing v West* (1895) 11 TLR 233; *British Ry Traffic and Electric Co v Kahn* [1921] WN 52; *Staffs Motor Guarantee Ltd v British Wagon Co Ltd* [1934] 2 KB 305; *Olds Discount Co Ltd v Krett* [1940] 2 KB 117; *Diamond* (1960) 23 MLR 518; *Re Watson* (1890) 25 QBD 27; *Wheatley's Trustee v Wheatley Ltd* (1901) 85 LT 491; *Maas v Pepper* [1905] AC 102; *Polsky v S&A Services* [1951] 1 All ER 1062 (Note), CA affirming [1951] 1 All ER 185, KBD (Eng); *North Central Wagon Finance Co Ltd v Brailsford* [1962] 1 WLR 1288. *Cf. Kingsley v Sterling Industrial Securities Ltd* [1967] 2 QB 747. See also *Stoneleigh Finance Ltd v Phillips* [1965] 2 QB 537; *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786; *Re Curtain Dream Plc* [1990] BCLC 925; *Benjamin's Sale of Goods*, Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014), para.1-066.

[62] See *Chitty on Contracts*, Vol. 2, para.33-118. See also Roy Goode, *Legal Problems of Credit and Security*, 5th edn (London: Sweet & Maxwell, 2013), para.1-42.

[63] See Control of Exemption Clauses Ordinance s.62(4). For pledge and sale contrasted, see *Burdick v Sewell* (1884) 13 QBD 159, 175 and 10 App Cas 74, 93. See also *In Re Far East Structural Steelwork Engineering Ltd* (unrep., HCCW 354/2001, [2005] HKEC 763) CFI (trust receipts not pledge -security created was an equitable charge in this case). For a case where a storage arrangement having some appearance of a bailment was held to be a sale, see *Chapman Bros v Verco Bros & Co Ltd* (1933) 49 CLR 306.

[64] For a full discussion, see *Benjamin's Sale of Goods*, edited by Michael G Bridge, 9th edn (London: Sweet & Maxwell, 2014), paras.1-048–1-049; *Bowstead and Reynolds on Agency*, 20th edn (2016), para.1-030. See also *Chitty on Contracts*, Vol. 2, para.31-125.