# Commercial Law in Hong Kong

Third Edition

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# CHAPTER 1

# BACKGROUND AND INTRODUCTION

## 1. INTRODUCTION AND BACKGROUND TO SECURITY TRANSACTIONS

### 1.1 Law Merchant

**[1-1]** The principles regulating the law of security are derived from several sources including the law merchant, contract, property concepts, equitable concepts, and remedies at common law and in equity.

**[1-2]** The Law Merchant, or mercantile law, refers to customs of merchants and traders which were common in England and continental Europe, notably from the fourteenth century onwards. In earlier centuries, in trade fairs, merchants from throughout Europe and the Mediterranean countries travelled to and fro fairs. English merchants also travelled overseas to various fairs. In that way, mercantile law became the law that was common to merchants in England, and from which they expected the customs to be applied in matters commercial.

Various sources were said to be the foundation of Law Merchant, such as the early 'banking' activities of the Knights Templar.[1]

**[1-3]** Law Merchant law applied to local English merchants and traders, as well as to those from Continental Europe with whom English traders dealt with in English markets and those on the continent. In England and elsewhere, special courts were established to hear complaints about transactions. In England, these courts were independent from the King's Courts. Therefore, the courts atfairs, the commercial courts of large towns, and the Court of Staple (dealing with staple products, such as wool) were established from the fourteenth century onwards, and they continued to deal with mercantile complaints until at least the sixteenth century (for local merchants) and mid-seventeenth century for foreign merchants. The core of jurisdiction in these courts was the customary law of merchants, their usage as developed through their various activities. Remnants of these customs remain today in the common law courts: for example, the effect

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1 See Ferris E, *The Financial Relations of the Knights Templar to the English Crown* (1902) 1 American Historical Review 1.

of a bill of exchange, the role of the bill of lading (as maritime and mercantile law were closely allied in early centuries), and questions of title to personal property.[2]

These merchants' Courts regulated security for the property of those attending fairs. The principles applied in these courts were the customs and special procedure for the privileges of merchants, Equity, contract law, and other commonly accepted notions of 'fair and just business practices'. Justice was speedy enabling merchants with complaints to be heard expeditiously enabling them to leave the fair for home at the end of the fairs; most fairs lasted less than a week.

## 1.2 A rule of law

**[1-4]** When a custom was recognised as binding on the parties before the court, and as being universally accepted and applied by merchants and traders, it became established as a rule of law. A rule of law indicates that a combination of facts results in legal consequences accepted by the court without the need for proof. Thus, historical knowledge of the law, plus precedents relying on judicial interpretation of that law, and finally acceptance by the courts as the law to be applied in a particular fact situation, meant that mercantile law merged into common law as an essential part. *Stare decisis* is a basic principle of common law by which precedents, within a given hierarchy, are authoritative and binding, and so must be followed.[3]

**[1-5]** Mercantile customs[4] were gradually drawn into, and became part of, the law of England for commercial matters; much of this adaptation activity took place in the court of Lord Mansfield from 1756 to 1788. This process was achieved largely by the courts taking judicial notice of the relevant principles from mercantile law; and then applying those principles to the common law claim before the court. Acceptance of these principles then led to the nineteenth century codification of commercial law such as the Bills of Exchange Act 1882 and the Sale of Goods Act 1893.[5]

2 See generally *Goodwin v Robarts* (1875) LR 10 Ex 337; *Brandao v Barnett* (1846) 12 Cl & Fin 787 (HL); and *Hargreaves v Spink* [1892] 1 QB 25.

3 See *China Field Ltd v Appeal Tribunal (Buildings)* [2009] 5 HKC 231, [2009] 5 HKLRD 662 (CFA).

4 *Carter v Boehm* (1766) 3 Burr 1905. See also the earlier decision of Holt JC in *Lethulier's Case* (1692) 2 Salk 443 where it was said that 'We take notice of the laws of merchants that are general, not of those that are of particular usage'.

5 See *Brandao v Barnett* (1843–60) All ER Rep 719 (HL); *Newcastle Fire Insurance Co v Macmorran & Co* (1814–23) All ER Rep 467 (HL). Many of the codifications were followed in Hong Kong. See for example: Bills of Exchange Ordinance (Cap 19); Bills of Sale Ordinance (Cap 20); Law Amendment and Reform (Consolidation) Ordinance (Cap 23); Partnership Ordinance (Cap 38); and Sale of Goods Ordinance (Cap 26).





## 1.3 Law Merchant as part of common law

**[1-6]** As the principles of Law Merchant progressively became part of the common law, in relation to commercial or mercantile affairs, by the nineteenth century the courts observed these principles, rather than pure common law principles.[6] Once universal customs of mercantile law had become part of the common law, it was no longer necessary to prove the incidents of custom in each case. Instead, the court could take judicial notice of the relevant practice thereby adopting it as part of English common law. The result was that a particular mercantile custom either had no independent force outside the express terms of the contract, or it was considered to be part of common law.[7] In the latter situation, it was unnecessary to plead or prove it specifically.[8] In *Vanheath v Turner*,[9] it was said that 'the Law Merchant was part of the Common Law of the Kingdom, of which the judges ought to take notice'. However, as the usages of a particular trade were not considered part of Law Merchant because they were not universal in application, they would not apply unless they could be proven specifically in any given case.[10]

## 1.4 Significant commercial developments in the nineteenth century

### 1.4.1 Legislation and Law Merchant

**[1-7]** There were significant developments in the nineteenth century in a variety of matters which have had a large impact on what we now call 'secured transactions', and the development of the modern 'quasi-security transactions'. This may well have been because it was in that century that many principles of Law Merchant, or mercantile law, were codified into legislation. This process had been gradual over the centuries especially in relation to the principles of contract law as it evolved. The courts moved on from the adoption of many of the principles of mercantile law where apt, as 'rules of law' and in the nineteenth century, Parliament adopted many of those principles as the common law of England, thereby making the underlying principles available for all persons dealing with the common law by means of codifying enactments.

**[1-8]** Certain mercantile principles were codified during the nineteenth century, including those relating to negotiable instruments and similar documents by the Bills of Exchange Act 1882 (see the Bills of Exchange Ordinance No 3 of 1885), and for the sale of goods by the Sale of Goods Act 1893 (see the Sale of Goods Ordinance No 4 of 1896). Of course, many of these principles were from

6 See *Goodwin v Robarts* (1875) LR 10 Ex Ch 337; cf *Crouch v Credit Foncier of England* (1873) LR 8 QB 374 which was reversed in part by Goodwin.

7 *Meyer v Dresser* (1864) 16 CBNS 646.

8 *Woodward v Rowe* (1666) 2 Keb 105.

9 *Vanheath v Turner* (1621) Win 24. See also *Produce Brokers Co Ltd v Olympia Oil and Coke Co Ltd* [1914–1915] All ER Rep 133 (HL).

10 *Lloyds Bank Ltd v Swiss Bankverein* (1913) 108 LT 143 (CA, Eng).

Law Merchant. Apart from codification, a large amount of specific legislation was enacted to deal with commercial transactions and principles. Much of the impetus for nineteenth century codification had come from merchants' associations such as the Association of Chambers of Commerce who paid for the preparation of the Partnership Act 1890 (see the Partnership Ordinance No 1 of 1897). Some nineteenth century legislation merely amended pre-existing statutes (for example, Bills of Sale Acts: see for Hong Kong the Bills of Sale Ordinance No 5 of 1856), whilst others were quite innovative (for example, the Bills of Exchange Act). Once enacted in England, many of these amendments or new laws were adopted in most colonies; sometimes in the same form but in other cases with variations to reflect a common proviso in most English colonies in Asia. This proviso was that the laws of England, including in some cases the legislation itself, were to be in full force in the Colony, 'except where the same shall be inapplicable to local circumstances of the colony or its inhabitants'.[11]

### 1.4.2 The development of commercial law

**[1-9]** In the nineteenth century, England required of its merchants' profits from around the world to stabilise the country and to make use of the products of the industrial revolution. To enable this, Parliament and the courts were prepared to allow a 'laissez faire' approach to legal regulation. So, whilst towards the end of the nineteenth century, codification of what had been law merchant principles took place to meet the requirements of commercial law, micro-regulation was absent. The commercial transactions, and in particular those relating to borrowing of money by merchants and thus the development of the banks over the nineteenth century, set out the basic pattern of commercial law up until today. Three features stand out in this regard.

**[1-10]** *First*, the conversion of mercantile law (previously applicable only to merchants and traders) as part of the general, common law was made available in commercial transactions generally. Legislation reflected the Law Merchant as well as other relevant commercial matters including developments in modern commerce, and sometimes with a large overlay from equity. Much of the nineteenth century legislation remains enforceable in its original form in Hong Kong.

**[1-11]** *Second*, the role of equity was essential in enabling the effective introduction of various transactions, as well as in the revival of traditional forms of assistance, and protection. Protection was devised primarily for the party who in modern terminology is called the 'consumer'; see for example principles relating to clogs on the equity of redemption; relief against forfeiture of interests such as that under a lease; and the examination and classification of agreed sum clauses. But for equity's intervention in recognising future or after-acquired property, the floating charge would not have been possible, with the result that companies would not have been able to continue to trade whilst 'securing' their trading stock to the lender.

11 Section 3 of the Supreme Court Ordinance (Cap 4), enacted as No 15 of 1844, on UK legislation adopted in Hong Kong.





**[1-12]** These developments were made necessary, and hastened, by the progressive alteration of the nature, effect and prominence of a company, from its beginnings particularly from the sixteenth century in the form of a chartered company (to carry out monopolistic rights, such as those granted to the East India Company) through the seventeenth and eighteen centuries with the joint stock company (which functioned as partnerships), and continuing through to the nineteenth century company, which is more akin to the form it has today.[12]

**[1-13]** The development of company law brought about the introduction of various trading companies that were entitled to issue 'shares' in the financial activities of the company, the so-called joint stock company, in which the Government (or the Crown itself) was a subscriber. These 'companies' functioned originally as partnerships with each 'corporate' activity being an individual profit-making venture; the capital of the company was not permanent as each owner could remove his capital after each venture. By the mid-seventeenth century, the demand for longer term capital, both equity capital as well as debt capital (from borrowings with re-payment of money on termination or default), became common. The result was the introduction of a secondary market for trading debt and equity instruments. Then the limited liability company developed as a discrete legal entity. This resulted in capital being owned by a fictional legal person who was required to undertake commercial actions on its own account. Whilst the merchant would have, or could have, mortgaged his assets, this meant that their use was lost to him until redemption as title passed to the mortgagee during the currency of the loan, and thereafter on default until sale. Assets sold or dealt with in the course of the borrower's business could not be mortgaged, and for this reason the floating charge enabled merchants who had mortgaged their lands, or who did not own land, to borrow on the security of the 'company's undertaking'.

**[1-14]** The *third* matter of interest is probably the attempt to protect the owner of goods from the activities of a rogue. Usually this requires the law to decide which of two innocent parties is to suffer in cases where the rogue has passed possession of the owner's goods to a bona fide purchaser for value without notice of the defect in title. Protection of the purchaser represents an exception to the principle of *nemo dat quod non habet*. This principle is that 'no one gives who possesses not' or that 'he who has not title cannot pass title'.[13]

**[1-15]** This principle and several exceptions were entrenched in the Sale of Goods Act, and the Factors Act. Their presence and the manner in which the courts usually weighed the balance against the true owner in any circumstances where the exceptions were present, spurred suppliers to develop various forms of personal or quasi-security, such as hire-purchase to better protect their property right.

12 On this, see the early legislation such as the Joint Stock Companies Act 1844, the Companies Clauses Act 1845, and Limited Liability Act 1855, and the Joint Stock Companies Act 1856, and the Companies Act 1862.

13 See *Helby v Matthews* [1895] AC 471 (HL) but cf *Bruton v Quadrant Housing Trust* [1999] 3 All ER 481 (HL) (where a licensee was held able to grant a lease of land for the duration of the licence, despite his absence of possessory rights derived from the holder of the legal title).

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**[1-16]** So, during the later years of the nineteenth century, the legislating zeal of Parliament in England re-examined and amended earlier 'commercial' principles in light of the new legal identity in the person of the company. The company became prominent in transactions of loan and security, and in addition traditional equitable rules were propounded and applied in new ways, and to 'new' forms of transactions. Of course, the basic structures remained in force; often, however, with a new title or form.

### 1.4.3 Other nineteenth century developments

**[1-17]** There were other subsidiary, or complementary, nineteenth century developments including:

(1) the abolition of the prohibition of 'usury', ie the charging of interest, in 1854 followed several decades later by the Money-Lenders Act 1900 made necessary by the excesses of unregulated, rapacious, money lenders after 1854.

It is to be noted that more recent, twentieth century developments of remedial relief in the form of 'restitution', as the prevention of general, unjust enrichment, have resulted in a practical reversal, or perhaps avoidance, of the common law rule that 'a debt does not carry interest unless the parties agreed expressly or by implication that it should'.[14] A case in which unjust enrichment morphed into 'common law damages' in relation to repayment of overpaid tax, was *Sempra Metals Ltd v Commissioners of Inland Revenue*,[15] where the House of Lords said that the court has jurisdiction at common law to award compound interest in respect of a restitutionary remedy for the time value of money paid under a mistake. It may well be that this view can be extended beyond restitutionary relief as a general factor in loan contracts. Indeed, the House of Lords said, of compound interest, in *Sempra Metals Ltd v Commissioners of Inland Revenue* (above), that it is now the accepted form of interest in commercial transactions.

(2) the use of the assignment of the benefit of a chose in action as a form of security for the book debts of the company, assisted by Equity in permitting by the company to grant security over future property, ie, the proceeds of the book debts, prior to those proceeds coming into the hands of the company.[16] This was made possible in the form of the equitable floating charge, in which the trust, equity's main machine of relief, played a role. Any jurisdictional differences between legal and equitable chose had been abolished in England by the Judicature Acts 1873–1875. It is to be noted that in Hong Kong, from the beginning of the Colony, there was no separation of the Court of Chancery from the common law courts.[17]

14 *President of India v La Pintada Compania Navigacion SA* [1984] AC 104 (HL).
15 *Sempra Metals Ltd v Commissioners of Inland Revenue* [2007] 4 All ER 657, [2007] UKHL 34 (HL).
16 *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 (CA, Eng).
17 See the Supreme Court Ordinance No 15 of 1844, sections 13 and 14.





(3) the establishment of principles of priority in relation to multiple assignments of the benefit of the chose in action, known as 'the rule in *Dearle v Hall*',[18] thereby enabling the assignment of the chose in action to function more perceptibly as an element of security; and

(4) the continued presence, of several Chinese customary loan transactions which have been somewhat changed by legislation, such as the chit fund (see the Chit-Fund Businesses (Prohibition) Ordinance (Cap 262) which restricts the operation of certain chit-funds), or the modern regulation of traditional pawnbroking (see the Pawnbrokers Ordinance (Cap 166) for which the customary rate of interest, namely 3.5% per lunar month continues to apply).

### 1.4.4 Nineteenth century developments in contract and property law

**[1-18]** Apart from codification, the nineteenth century was a busy period for legislation relating to commercial transactions, the developing regulation of the company, activity in relation to priorities found in a variety of contract, property or security decisions, and the extension of certain contractual concepts such as resulted in *Carlill v Carbolic Smoke Ball Co.*[19] The great commercial 'invention' of the nineteenth century was, of course, the floating charge enabling companies to borrow on stock in trade, both present and future. The nineteenth century also marked the final adaptation of the law merchant into the common law, especially by the codification of principles, for example the Bills of Exchange Act 1882. International trade ensured that the Bill of Lading retained its traditional attribute as the only common law document of title.

## 1.5 Usury and interest payments

**[1-19]** One factor that enabled the expansion in, and further development of, commercial law in the nineteenth century was that of the payment of interest on a loan. The proscription on the charging of interest, which had been first introduced in 1190 as usury, had been finally abolished in 1854 by the Usury Repeal Act to meet growing commercial demands for freedom of contract in lending and finance. Although there had been limited modification for specific circumstances over the centuries thereby allowing a money lender to charge a statutory rate of interest in certain cases, the repeal meant that there were no limits at all on the amount of interest chargeable, and interest was no longer to be considered contrary to the medieval view that it was sinful to make a profit on the loan of money.[20] Consequently, without barriers, the rate of interest flowed freely. Exorbitant and unconscionable rates being charged as a norm, and in conjunction with loan contracts containing other unconscionable and oppressive terms. Whilst the Court could reopen a harsh and unconscionable contract, the unregulated rate of interest was an indefinite and unreliable cause of complaint.

18 *Dearle v Hall* (1828) 3 Russ 1.
19 *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256 (CA, Eng).
20 *Chambers v Goldwin* (1804) 9 Ves 254.

**[1-20]** Eventually in 1900, the Money-lenders Act was passed to require moneylenders to be registered, and to impose some restraint on the rate of interest charged. Registration simply required an application to register and the payment of a fee; hence there was no supervision of moneylenders or any inquiry as to the bona fides of the moneylender. The Act provided for insertion of certain information about the lender and the details of the loan in the agreement. But there was no regulation of the conduct of the money lending business. It was not until the Money-Lenders Act 1911 that the business of the money lender was regulated by requiring the lender to be licensed by the Board of Trade; however, as the Act provided for certain money lenders and certain loans to be exempt from its terms, not all transactions were covered. Licensing required some form of scrutiny of the person applying for the license. Freedom of contract allowed the parties (or more correctly, the moneylender) to contract as they wished so long as the terms were not illegal.

**[1-21]** Realistically, until 1911 the Court would enforce the promise to pay interest without much scrutiny. So, where a contract expressly provided for the payment of interest, the court could not intervene.[21] A court of equity would allow the payment of interest, despite it not being referred to in the contract, where a mortgagor sought to redeem his land on repayment of the principal of a mortgage but had no contractual obligation to pay any interest. The court would only allow redemption on the payment of interest. Once interest rates were free to float, there was extensive development in the loan contract with corresponding enhancement of the forms of traditional security in support, in particular that of hypothecation for company charges, both fixed and floating. It was the special facility of equity that permitted the introduction of both forms of the charge, covering both present and future property. Other forms of security which flourished or were devised included the use of the pledge for individual loans through the use of pawnbrokers, and the invention of what became known as hire-purchase to protect the title of the unpaid seller of goods against a third party, thereby upholding the principle of *nemo dat quod non habet*, that one who does not have title cannot pass title.

## 1.6 Early money lenders in Hong Kong

**[1-22]** The position of money lenders in Hong Kong was quite different from that in England. The Ordinance No 7 of 1844 provided that the usury laws of England were not to apply in Hong Kong. Where there was no agreement on the rate of interest, then 12% per annum was the accepted rate. At that time, Chinese custom provided for a rate of interest of 3.5% per lunar month.[22] Then, Ordinance No 5 of 1856 extended the Usury Law Repeal Act to Hong Kong despite the terms of Ordinance No 7 of 1844 which made it clear that the English law of usury did not apply in Hong Kong. Finally, in 1886 an ordinance was enacted to state that the usury laws of England had never applied in Hong Kong.

21 *Hamlin v Great Northern Railway Co* (1856) 1 H & N 408.

22 *AG v Shimizu Corpn* [1996] 3 HKC 175 (CFI). See also Usury Ordinance No 5 of 1886.





## 1.7 Twentieth century transactions

**[1-23]** Just as the nineteenth century built on earlier principles to produce transactions such as hire-purchase, the floating charge and others, so too did the twentieth century, particularly in the later decades, to keep pace with the needs of commerce and to enforce sophisticated transactions built on the basics of contract and property; amongst these are derivatives (to some degree based on nineteenth century contracts for differences), and the *Romalpa* clause.

**[1-24]** The categories of security arrangements are not 'closed' because a transaction can rely on elements of different areas of the law to achieve the intended purpose of the parties. This resulted in appropriate reclassification of the principles. However, there are some barriers on too much 'experimentation' as was exemplified in the criticism of cases such as *Re New Bullas Trading Ltd*.[23] See also *Re Charge Card Services Ltd*,[24] where it was held that it was conceptually (and thus legally) impossible for a depositor in a bank to charge that deposit to the bank. However, this view was quickly set aside in Hong Kong by the introduction of section 15A of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23).

## 1.8 Terminology

**[1-25]** The elements of modern security transactions are often submerged in the jargon used. So, a general transaction, for example a contract, takes on further legal principles when given a specific title; often these additional principles come from the law of property.

**[1-26]** For the various forms of quasi-security, the terms 'covenantee', 'lender' and 'creditor' will not be common; instead, terms such as 'owner', 'seller', 'buyer', 'lessee' are used, depending on the nature of the transaction. So too, a charge is referred to as a mortgage when it involves land and complies with the terms of the Conveyancing and Property Ordinance (Cap 219), even though the transaction under consideration is in reality a hypothecation in form but a mortgage in substance: see section 44 of the CPO (sub-section (1) dealing with the form of the transaction, and sub-section (2) dealing with its substance). To seek to avoid confusion, the term 'creditor' will be used generally here to refer to the lender, obligee, covenantee, and person to whom a debt or other form of obligation is owed; the corresponding term for the party owing these duties is that of the 'debtor'. Only where necessary will the exact term be used.

**[1-27]** The phrase 'forms of security' ('securities' generally) will mean the various forms of the formal, or real, security being described in this book, namely the mortgage, charge, pledge and common law lien, as well as various written undertakings to secure repayment of a debt relevant to transactions in financial markets where there is no relationship to the assets of the debtor,[25] and a varied

23 *Re New Bullas Trading Ltd* [1994] 1 BCLC 485 (CA, Eng) finally overruled in *National Westminster Bank plc v Spectrum Plus* & Ors [2005] 4 All ER 209, [2005] 2 AC 680 (HL).

24 *Re Charge Card Services Ltd* [1986] 3 All ER 289, [1987] Ch 150 (Ch D).

25 At least, until action is taken to access them by way of remedial relief: see *Singer v Williams* [1921] 1 AC 41 (HL).

group of transactions, largely purely contractual in nature, which seek to resemble the benefits of real securities, namely the 'quasi-securities'.

**[1-28]** In general a 'security' transaction is one which results in a proprietary interest in an asset to support enforcement of a personal obligation; some forms of 'quasi-security' are contracts which seek to imitate the effect of a security transaction. However, some of these transactions attempt to disassociate themselves from the word 'security' due to problems with priorities and perfection of a real security.

## 1.9 Terminology: The term 'security'

**[1-29]** The word 'security' (or 'securities') can mean:

(1) the position where the owner of an asset owes a debt, or the performance of some contractual obligation, to the creditor and that debt or obligation is secured in some way giving the creditor a right to resort to a fund, or property, for payment;

(2) the position where a third party, *qua* indemnitor (or indemnifier) or guarantor, offers to pay the debt or to be financially responsible for the failure of the debtor to perform his obligations. The third party might also use his assets as a formal, third-party security on behalf of the debtor by way of charge or mortgage. This binding of a third party's assets is referred to as a collateral transaction which extends the manner in which the creditor can seek repayment or satisfaction; and

(3) where there is an instrument which creates, or acknowledges, an obligation to repay a sum of money, or to perform an obligation. Without more, the document (for example, a Debenture) might not create any security. To achieve a collateral security to the contractual obligations, the document must contain terms to achieve this purpose; if it fails to do so, the law will require the execution of the additional documentation and perhaps registration of that documentation to perfect any interest sought to be created in respect of the asset. Where the initial documentation refers only to the debt, then it merely creates, and evidences, a contract which gives no immediate or direct recourse to the assets of the 'borrower' as security for the repayment of the loan or performance of obligations.[26]

A 'secured' interest gives the creditor a proprietary interest in the secured asset, enabling some form of 'seizure and sale' on default. The interest acts as a back-up, for the performance of the personal obligation to repay a debt, by resort to a collateral interest in the form of a security. On the breach of the obligation to repay the debt, the security can be enforced against the collateral, proprietary right and thus on realisation of the asset, generally the debt is satisfied.

26 See *Independent Television Authority etc v IRC* [1961] AC 427 (HL); *Knightsbridge Estates Trust v Byrne* [1940] AC 613 (HL); and *Edmonds v Blaina Furnaces Co* (1887) 36 Ch D 215.





**[1-30]** In *Singer v Williams*,[27] it was said that:

> the normal meaning of the word "securities" is not open to doubt. The word denotes a debt or claim the payment of which is in some way secured. The security would generally consist of a right to resort to some fund or property for payment; but I am not prepared to say that other forms of security (such as personal guarantee) are excluded. In each case, however, where the word is used in its normal sense, some form of secured liability is postulated. No doubt the meaning of the word may be enlarged by an interpretation clause contained in a statute, as by the interpretation clauses in the *Conveyancing and Law of Property Act* 1881, the *Settled Land Act* 1882, the Trustee Act 1893, and the Finance Act 1916; or the context may show, as in certain cases relating to the construction of wills, [*Re Rayner* ([1904] 1 Ch 176; 89 LT 681) and *Re Gent and Eason's Contract* ([1905] 1 Ch 386; 92 LT 356)], that the word is used to denote, in addition to securities in the ordinary sense, other investments such as stocks or shares. But, in the absence of any such aid to interpretation, I think it clear that the word "securities" must be construed in the sense above defined, and accordingly does not include shares or stock in a company.

So, the word here will be used with this in mind, defining it where necessary.

## 1.10 Contractual relief

**[1-31]** Where there is no secured interest, the remedy of the creditor will rest usually only in contract. In contract, the case of a contract, the remedy can be:

(1) a judgment debt requiring thereby court proceedings;

(2) perhaps action for the 'contract price' again requiring court proceedings; or

(3) action for breach of contract; again requiring court proceedings.

**[1-32]** In the case of (1) and (2), the amount sought is a liquidated sum. For (3), the amount sought is unliquidated requiring the plaintiff to show loss from the breach assessed on the basis of *Hadley v Baxendale*.[28]

In all three cases, failure to honour the judgment will result in action for execution (see for example Orders 46 to 50 of the RHC) thereby expending time and money without a guarantee of full recovery. Often the remedy is that of a charging order registered against the land. In some of these cases, action is taken then under the Partition Ordinance by obtaining an order to sell the subject land.[29]

27 *Singer v Williams* [1921] 1 AC 41 (HL), at 49-50.

28 *Hadley v Baxendale* [1843 -60] All ER Rep 461, (1854) 23 LJ Ex 179, (1854) 9 Exch 341. *Jackson v Royal Bank of Scotland plc* [2005] 2 All ER 71, [2005] UKHL 3 (HL); and *De Monsa Investments Ltd v Richly Bright International Ltd* [2015] 3 HKC 583, (2015) 18 HKCFAR 232 ; and *Paul Chen & Anor v Lord Energy Ltd* [2002] 1 HKLRD 495, (2002) 5 HKCFAR 297, [2002] HKCU 236 (CFA).

29 See *Golden Connection Finance Ltd v Chan Tat Man Simon & Anor* [2019] 4 HKLRD 155, [2019] HKCU 3009, [2019] HKCFI 1932; and *Ng Muk Fun v Silver Hope Ltd & Anor* [2020] HKCU 2979, [2020] HKCFI 2117.

**[1-33]** There is another group of transactions referred to throughout. These are generally known as quasi-securities; some of which are also termed 'reverse securities' others as 'purchase money securities': still others as 'commercial securities', and a further group as 'taking credit risk on a third party'. By and large these transactions seek to simulate the effect (but not the form) of a 'real' secured transaction, for example, a charge, mortgage, pledge or common law lien, despite the absence of necessary formalities with the result that the substance of the particular transaction is purely contractual. In so doing, the creditor expects that the form of his contract will maintain, sustain, and actively protect his interest, and right of recovery, despite the competing rights of secured creditors, prior interests and such.

## 1.11 Novel interests

**[1-34]** For some time, until 2005, there was some confusion in dealing with documented intangibles where a chose in action was evidenced by a document. The confusion was settled in *Silver Stone Development Ltd & Anor v Lai Kwong Ching James & Ors*,[30] and see *OBG Ltd v Allan; Douglas v Hello! Ltd (No 3)*,[31] where it was made clear that the presence of a document, or writing does not alter the inherent nature of a chose in action.

Associated with the re-statement of the principle has been a series of newer forms of 'assets' such as data contained in an electronic database, as well as other forms of 'tradable' assets. It has been suggested that a 'new form of property' could assist in establishing certainty in the criteria for creating, recognising, dealing with and remedying these novel interests: on this see Chapter 18.

30 *Silver Stone Development Ltd & Anor v Lai Kwong Ching James & Ors* [2007] 4 HKC 77, [2007] 2 HKLRD 717 (CA).

31 *OBG Ltd v Allan; Douglas v Hello! Ltd (No 3).*



# CHAPTER 2

# PROPERTY

## PART A

## BACKGROUND

## 1. INTRODUCTION

### 1.1 Personal property

**[2-1]** In Hong Kong property is described as personal property, and it is divided into three types. These are (1) chose (or choses) in action, (2) chose (or choses) in possession, and (3) land as chattels real.[1] There is no 'real' property in Hong Kong, other than for St John's Cathedral; the term 'real' is used to denote freehold land in particular. A division is made in relation to choses in action and choses in possession between present and future property. The reference to future property relies on equitable principles for protection, and thus transactions with future property are equitable. Common law was unable to deal with future property thereby losing the opportunity for the vast field of equitable charges over company assets that developed in the nineteenth century.

**[2-2]** Some assets are referred to as 'fungibles' meaning that they have a commercial quality but one fungible can be replaced by another without loss in value.

**[2-3]** An important element when considering property is the principle of *nemo dat quod non habet.*

'Property' itself involves a bundle of rights: these include ownership; possession; use; enjoyment; and relief on abuse by a third party. In property terms, the concept covers corporeal rights (such as chattels) as well as incorporeal assets such as Intellectual Property [IP] rights and shares in a company.

**[2-4]** A *chose in action* is a right that can be enforced and enjoyed by taking action. It has no physical attributes, making it 'intangible and immovable'. There

1 Historically under English law, land held by way of leasehold was treated as personal property, hence the term 'chattels real'. Although for the purposes of relief on the dispossession of the lessee of leasehold land, this distinction between leasehold and freehold in this regard was removed, yet the classification of leasehold land remained. The general definition of 'chattels real' is that they are extracted out of real estate.

are two elements in a chose in action resulting in: (1) the benefit of the chose which reflects the right of the holder to take action to enforce the right, and (2) the burden, of the chose, that is the obligation to perform which on default makes the obligor/covenantor the defendant when sued by the obligee/covenantee.

**[2-5]** By contrast to the chose in action, the *chose in possession* does have physical characteristics. It is movable, tangible, and capable of physical possession: *Joseph v Phillips*.[2] As such, a variety of forms of security are available for choses in possession. Examples of choses in possession include goods, heavy machinery, vehicles, and stock-in-trade. A chose in possession can be attached to another chose in a manner similar to the concept of fixtures over land. For choses in possession, this attachment is referred to as either *accessio, confusio or specificatio*.

**[2-6]** The third division of property is that of land; this category of interests also included fixtures, that is chattels that have been attached to land in such a way as to become land. Due to historical reasons, as there is no freehold available to land-owners in Hong Kong,[3] land is classified as *chattels real*. Land is alienated in Hong Kong by way of leasehold, although in legislation and in common parlance the Government lessee is referred to as the 'owner'. Whilst much of the terminology and application of principles, found in traditional English property law, are not entirely irrelevant in Hong Kong, the development of land ownership and occupation has been relevant to the system developed since 1841 onwards.

## 1.2 The basic elements of personal property

**[2-7]** The elements of rights over an item of personal property can be classified as legal or equitable. This classification refers generally to the type of relief available to the owner, or where the asset has been used as security for a loan, by the lender. In some cases, as with an equitable charge over the benefit of a chose in action, the classification restricts the type of security available.

**[2-8]** The second form of classification of personal property relates to the manner in which it was created. Where a contractual obligation is created over the asset, the contract gives rise only to contractual rights on default, namely either to common law damages or if appropriate to an action for debt. However, if the obligation is proprietary, then the remedy available on default is resort to the asset itself; where the contract establishing the proprietary interest, or legislation, permits sale, there is no need to approach the court as the means of satisfaction of the obligation rests in the disposal of the asset by the obligee where appropriate provision has been made in the contract; the two common examples of this are (1) the power of attorney under which the borrower appoints the lender as his attorney, and (2) the signing of a 'blank assignment' by the borrower on entry into the contract, thereby enabling the lender to sell immediately on default.

2 *Joseph v Phillips* [1934] AC 348 (PC).

3 Only the land on which St John's Cathedral is situated is held on freehold title: see section 6 of the Church of England Trust Ordinance (Cap 1014).





**[2-9]** Examples of all three types of personal property may be classified as legal or equitable. There is also a group of property rights for which a court may be prepared to grant relief inconsistent with the personality of that property. For example, in *Latec Investments v Hotel Terrigal*,[4] in *De Mattos v Gibson*,[5] and in *Bank of Montreal v Dynex Petroleum Ltd*.[6] This relief results either from the contract made by the parties importing that change into their agreement or by court order by expanding the current principles granting relief in accordance with the wishes of the parties rather than under traditional legal principles.

## 1.3 The differences between the three types of property

**[2-10]** The main differences between the three types of property relate to their attributes, and in particular their relationship to whether or not the property is tangible or intangible, movable or immovable.

**[2-11]** A chose in action, as either the benefit or the burden, is an intangible and immovable item of property. It is merely a right to sue in court to exercise and obtain the right represented by the chose. Generally, this will be in an action for debt where the court will order the debtor to make good his promise to pay. This is not a proprietary claim but one based in contract. This makes the interest personal. A chose in action is sometimes described as either: (1) pure personalty or (2) documentary personalty. The presence of paper evidencing the pure personalty does not alter the classification as a chose in action.

**[2-12]** A chose in possession is a tangible and movable asset. It covers a wide variety of items of personal property. The owner has a proprietary right to recover the asset when it is dealt with adversely by a third party.

**[2-13]** Land is immovable but most transactions with land will give rise to a proprietary interest.

**[2-14]** The attributes of the items of property determine the manner in which the asset may be dealt with. For example, an intangible asset cannot be the subject of a possessory security; nor can land. All assets may be the subject of mortgages or charges, some of which can be legal (for land: section 44(1) Conveyancing and Property Ordinance (Cap 219)) whereas a chose in action may only be the subject of an equitable charge.

## 1.4 Traditional description of types of property

**[2-15]** An item of personal property classified as intangible is also referred to as an 'incorporeal interest'.[7] Thus a chose in action also can be referred to as such. Other examples are interests in land, such as easements. Other interests are referred to as 'corporeal interests'. Traditionally, the term 'hereditaments',

4 *Latec Investments v Hotel Terrigal* (1965) 113 CLR 265, (1965) BC6500350.

5 *De Mattos v Gibson* [1843 -1860] All ER Rep 803, (1858) 4 De G & J 276, (1858) 45 ER 108 (Ch D).

6 *Bank of Montreal v Dynex Petroleum Ltd* [2001] SCJ No 70, [2002] SCC 7 (SC, Can).

7 *Torkington v Magee* [1902] 2 KB 427; and see *Colonial Bank v Whinney* (1886) 11 App Cas 426, [1886–90] All ER Rep 466 (HL).