

against enjoying the holiday resorts and against terminating or assigning membership at any time before payment in full of the membership fee. The plaintiff wanted to rescind the contract on the grounds of unconscionability and misrepresentation.

Held: The court held that among other things, the “timeshare” contract was a *consumer contract for the sale of goods* or the provision of services.

## 2. DEFINITION OF A CONTRACT OF SALE

**5.005** A contract of sale has to have certain essential features to become legally binding. As you will have previously studied, a legally binding contract comprises three main features: *consensus ad idem* for reaching an agreement, a consideration that is the price of the goods so bought or sold and an intention to be legally bound to the contract of sale. Now, we need to understand what is a *sale*, what are *goods* and what is the *legal significance* of goods and money exchanging hands.

**5.006** Section 3(1) of the Sale of Goods Ordinance provides that a contract becomes a “contract of sale of goods” whereby the *seller transfers or agrees to transfer the property in goods* to the buyer for a money consideration called the *price*.

**5.007** Simply speaking, a contract for the sale of goods is a contract where there is a transfer of *ownership* (property) in *goods* (as opposed to other items) by the seller in *exchange for money* (as opposed to other types of consideration) to the buyer. An illustration of the above principle can be seen in a simple sale of goods.

Shengming buys a tennis racket from a *Nike Sports* retail shop for the price of HK\$800. Shengming is now the owner of those goods (the racket), he has physical possession of the racket and also gets a legal title when Nike Sports sells him the racket by transferring its *ownership* over it by accepting the amount of HK\$800.

**5.008** Thus, a valid *sale* gets completed when a seller transfers property to the buyer, entitling the buyer to have a *legal title* to the goods.

**5.009** There are two types of transactions envisaged by the Sale of Goods Ordinance. These are an agreement to transfer the property in the goods and an agreement to buy the property at a future time. It may happen that a seller agrees to transfer ownership to the buyer immediately; such a transaction is a *sale*.<sup>3</sup>

<sup>3</sup> Section 3(3) and 3(4) provide that “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. 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”.

**5.010** However, a contract is called an *agreement to sell* and is not a contract for the sale of goods where a seller agrees with the buyer that the transfer of ownership in the goods *will take place at a future time*; for example, when goods are not ready as yet or not manufactured; or *where some condition needs to be fulfilled*, for instance, the seller needs to measure or count or put the goods in a deliverable state.

**5.011** The contract becomes a contract for the sale of goods only when the future time elapses or the conditions that need to be fulfilled are complied with. Both sale and agreement to sell are legally binding. Consider the following example:

Shifeng agrees to sell to Ming An five dozen stems of tiger lilies every month for one year from 1 September 2007 to 30 August 2008. Shifeng delivers the tiger lilies for six months until February 2008. However, in March, Ming An refuses to take further deliveries. Can Shifeng enforce the contract between him and Ming An? If so, what kind of damages, if any, can Shifeng claim under the contract from Ming An?

The above illustration is an example where there is a legally binding agreement to sell between Shifeng and Ming An for future goods—something that needs to grow or mature or be manufactured. The legal title to the tiger lilies passes to Ming An only when the tiger lilies are ready to be picked from Shifeng’s nursery and when he delivers them to Ming An. Here, Ming An refuses to take delivery after six months and has thereby breached the contract. The remaining tiger lilies that would have become Ming An’s property have not become his, as these were future unascertained goods. Cancellation by Ming An means that Shifeng cannot identify and collect the tiger lilies that would eventually become Ming An’s property. He can sue Ming An and claim damages for non-acceptance of the tiger lilies only. However, he cannot demand or claim for the price of the tiger lilies, because the legal title of these tiger lilies has not validly passed on to Ming An.

### (a) Goods

**5.012** The definition of goods is important. *Goods* are defined in s.2 as including “all personal chattels other than things in action and money. The term includes emblements, industrial growing crops and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale”. It has been observed that this definition is virtually all embracing.<sup>4</sup> Nevertheless, there are certain things that do not fall within this definition. Immovable property (ie land and leases) is (are) excluded. 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*. In more recent times, a question has arisen as to whether computer software constitutes goods for the purpose of the United Nations Convention on International

<sup>4</sup> Atiyah, *The Sale of Goods* (Longman, 2001) 65.

Sales of Goods, or the UK Sale of Goods Act 1979<sup>5</sup> or the Uniform Commercial Code, USA or even indeed under the Sale of Goods Ordinance. This has been settled by judicial interpretations of or legislative amendments to the existing sale of goods laws in various countries, although Hong Kong has not followed suit.<sup>6</sup> Despite the fact that Hong Kong has not had any legislative amendments other than in a commercial sense and following the example from other common law jurisdictions, computer software has been impliedly accepted as falling under the definition of *goods*.<sup>7</sup> Not only software programs but also virtual goods are classified as goods internationally.<sup>8</sup>

**5.013** In Hong Kong, “emblemments” and “industrial growing crops” are crops grown by human labour. These are treated as goods, no matter who is responsible for their severance. Domestic animals such as a pet dog, cat, turtle, and chinchilla are treated as goods under the Sale of Goods Ordinance.<sup>9</sup> A timeshare contract has also been held to be a consumer contract for the *sale of goods or the provision of services*.<sup>10</sup>

**(i) Contract of sale of goods distinguished from contract for work, labour and materials**

**5.014** A contract of sale of goods, however, needs to be distinguished from a contract for work and labour and materials. The former is a contract where there is a transfer of the property in, and the delivery of the possession of, goods, as such, to the buyer.<sup>11</sup> In a contract for work and labour, the object is not the transfer of goods as such; the contract is one for work and labour.<sup>12</sup> The test is that skill and labour have to be exercised for the production of the article, and it is only ancillary to the fact that they will pass from the artist to his client or customer some materials in addition to the skill involved in the production of the portrait; this does not make any difference to the result, because the substance of the contract is the

<sup>5</sup> *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd* 1996 SLT 604; *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481; *Eurodynamics Systems plc v General Automation Ltd* (unrep., 6 September 1988); *Computer Supermarkets (S) Pte Ltd v Goh Chin Soon Ricky* [1997] 2 SLR 283. 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*, D 48. For an explanation on what constitutes goods under tort law for the purposes of wrongful interference with goods or conversion, see *Tort Law and Practice in Hong Kong* (Sweet & Maxwell, 2nd ed., 2011) 344–348, para.6.031. See also *Chitty on Contracts—Hong Kong Specific Contracts* p.740, para.11-006.

<sup>6</sup> Frank Diedrich, “The CISG and Computer Software Revisited”, (2002) 6 *VJ Supplement* at <http://www.vindobonajournal.com> (visited 16 Feb 2007) (article on file with author). See also *Advent Systems Ltd v Unisys Corp* 925 F 2d 670 (3rd Cir. 1991); sale of standard software goods held to be governed by CISG in Germany, see the decision of LG Munchen, 8 Feb 1995, No. 8 HKO 24667/93, Case 131 CLOUT.

<sup>7</sup> *Liu Peggy v Alfa Com Technology Ltd* [2007] 1 HKLRD 528 (a contract for installation of computer programs was held to have mixed characteristics—it could be a contract for services as well as a contract for sale of goods). See also *Tort Law and Practice in Hong Kong*, pp.344–348, para.6.031.

<sup>8</sup> Diedrich, n 7, above. Cf *Liu Peggy v Alfa Com Technology Ltd*.

<sup>9</sup> *Wong Ng Kai Fung v Yau Lai Chu* [2005] 4 HKLRD 134 (pet dog purchase from a pet shop treated as “goods”). See also *Benjamin’s Sale of Goods* (6th ed., 2002) [1-088].

<sup>10</sup> *Cheung Kam Sing v International Resort Developments Ltd* (a “timeshare” contract was held to be a consumer contract for the sale of goods or the provision of services. However, the court held that in this case the defendants had misrepresented the facts to the plaintiffs and in the circumstances, it was impossible for the plaintiffs to understand the legal content and consequences of the contractual documents. In deciding whether such a contract was unconscionable, the court could have regard to a number of factors, including, but not limited to, the tests laid down in s.6(1) of the Unconscionable Contracts Ordinance (Cap.458)).

<sup>11</sup> *Halsbury’s Laws of England* (4th ed) Vol.41, [603].

<sup>12</sup> *Ibid.*

skill and experience of the artist in producing the article.<sup>13</sup> 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 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.<sup>14</sup> Sometimes, a sale of goods contract may be coupled with a contract for services, especially where the nature of the contract reflects mixed characteristics.

**5.015** See the following illustration:

**Liu Peggy v Alfa Com Technology Ltd**  
[2007] 1 HKLRD 528

The subject matter of the contract in this case was a computer software. The plaintiff engaged the defendant to provide, install and implement a computer software called Nexus Professional Management System (the Program), which was customised to the needs of the plaintiff and the configuration of the plaintiff’s computer system, at a price of HK\$80,000. The plaintiff paid a deposit of HK\$40,000 to the defendants when they signed the contract. The representatives of the defendant went to the plaintiff’s office to install the Program but discovered that the plaintiff’s computer system was infected with a virus. As a result, the Program could not be installed. The plaintiff demanded the refund of the deposit of HK\$40,000 on the ground that the defendant had failed to deliver the Program as per the contract, which was refused by the defendant. The plaintiff claimed for the return of the deposit of HK\$40,000. The defendant counterclaimed for the balance of the price of HK\$40,000.

The question, among others, was whether the assessment of loss and damage to the defendant was dependent on whether the Contract was a sale of goods contract or a contract for services.

The plaintiff argued that the Contract was a sale of goods contract. The defendant had failed to provide even the initial package, let alone the Program. He could not maintain an action for price. However, the defendant contended that the contract was a contract for services. When the defendant was prevented from rendering the services because of the plaintiff’s breach, he was entitled to the balance under the Invoice.

Held: On the evidence before the Court of First Instance, it was held that it was not clear whether the contract was purely a sale of goods contract or a contract for services or a contract with mixed characteristics.

<sup>13</sup> *Mak Ping Kui v Millionice Ltd* (unrep., HCA 940/1998, [2001] HKEC 460); *Tin Tsun Lithographers v United Battery Service and Oversea Battery Factory* (1937) 29 HKLR 16; *Robinson v Graves* [1935] 1 KB 579. See also *Halsbury’s Laws of England* (4th ed) Vol.41, [603].

<sup>14</sup> *Mak Ping Kui v Millionice Ltd*.

## 1. INTRODUCTION

**9.001** A company is a form of business organisation formed by incorporation under the Companies Ordinance (Cap.32). There are basically four types of company under the Companies Ordinance, namely:

- (1) a private company limited by shares;
- (2) a public company limited by shares;
- (3) a company limited by guarantee; and
- (4) an unlimited company.

**9.002** By the end of 2011, a total of 956,392 companies were incorporated in Hong Kong and registered at the Companies Registry.<sup>1</sup> Most of them are private companies limited by shares. Private companies are also the most popular form of business entity registered at the Business Registration Section of the Inland Revenue Department. For this reason, this chapter will focus on issues related to private companies only. The following aspects will be covered:

- (1) incorporation process;
- (2) shelf companies;
- (3) advantages and disadvantages of incorporation;
- (4) concept of separate legal entity and limited liability;
- (5) definition of private companies;
- (6) memorandum and articles of association;
- (7) management and control;
- (8) directors and secretaries;
- (9) director's duties;
- (10) protection of minority;
- (11) financing; and
- (12) liquidation

## 2. INCORPORATION PROCESS

**9.003** A private company is incorporated by registration under the Companies Ordinance. Section 4 of the Companies Ordinance provides that any one or more persons (whether a natural person or a body corporate)<sup>2</sup> may, for any lawful purpose, by subscribing their name(s) to a memorandum of association (which must be printed in the English or Chinese language) and complying with the requirements of the Companies Ordinance in respect of registration, form a limited liability company.

**9.004** The Companies Ordinance does not impose any restrictions on the nationality of a shareholder. It follows that in the case of a natural person, any person (whether acting alone or in association with others) who has attained the age of majority can incorporate a

<sup>1</sup> Information available from the website of the Companies Registry: [www.cr.gov.hk](http://www.cr.gov.hk).

<sup>2</sup> Before 13 February 2004, a company was required to have at least two members. Today, a one-man company is allowed under the Companies Ordinance.

company in Hong Kong. In the case of a body corporate, a PRC company can incorporate a company in Hong Kong. The person(s) who incorporate a company are generally known as *founder member(s)*. The process of incorporating a company is called *promotion*. In most cases, founder member(s) will also become the first shareholder(s) and/or the first director(s) of the company. Incorporation of a private company will usually involve the following steps.

### (a) Choose a name for the company

**9.005** To incorporate a new company, the founder member(s) must submit two documents (namely the memorandum and articles of association and the Incorporation Form of the new company) to the Companies Registry. Before both these documents are submitted, the founder member(s) must first choose a name for the company, because the name of the company will have to be stated in these documents. The name of the company can be in English or Chinese, or in both languages with a reference to its limited liability.<sup>3</sup> However, a company name with a combination of English letters and Chinese characters will not be accepted for registration.<sup>4</sup> There are some other restrictions on the choice of company names. A company shall not be registered by a name: (1) that is the same as one already registered; (2) which is offensive or otherwise contrary to the public interest or (3) which constitutes a criminal offence.<sup>5</sup> For instance, under the Banking Ordinance (Cap.155), it is a criminal offence to include the word *bank* in the name of a company without first obtaining approval from the government.

**9.006** A company name will not be registered if it has already appeared on the index of company names maintained by the Registrar of Companies. One can find out whether the intended company name has already been taken by someone else by conducting a name search on companies at the Public Search Centre of the Companies Registry or through on-line service provided by the Companies Registry at [www.icris.cr.gov.hk](http://www.icris.cr.gov.hk).

**9.007** In addition, the Companies Registrar may direct a company to change its name if he considers the name a misleading indication of the nature of the company's activities such that it is likely to cause harm to the public.

Peter was an employee of a furniture manufacturing company, Artlane Furniture Co Ltd. Two months ago, Peter resigned from the company and set up his own company to compete with his employer (ie Artlane Furniture Co Ltd). Peter's new company has been registered as "Artland Furniture Co Ltd". Peter also successfully solicits business for his company from the clients of Artlane Furniture Co Ltd. Many of these clients have been misled to believe that Artland Furniture Co Ltd is a branch of Artlane Furniture Co Ltd.

Artlane Furniture Co Ltd can lodge a complaint to the Registrar of Companies and request him to direct Artland Furniture Co Ltd to change its name on the grounds that "Artland" is similar to "Artlane".<sup>6</sup>

<sup>3</sup> Companies Ordinance s.5.

<sup>4</sup> Company Names Guideline 2011 issued by the Companies Registry.

<sup>5</sup> Companies Ordinance s.20.

<sup>6</sup> *Ibid.*, s.22.

**(b) Memorandum and articles of association**

**9.008** The next step is to prepare and print a memorandum and articles of association. These are the constitutional documents of a company. A memorandum of association regulates the relationship between the company and outsiders, whereas articles of association prescribe the regulations for the internal management of a company. The founder member(s) must submit a copy of their memorandum and articles of association of the intended company to the Companies Registry.

**(c) Incorporation form**

**9.009** The next step is to complete the Incorporation Form, which contains among other things information on the following aspects of the proposed company: (1) name of the company; (2) address of the registered office; (3) particulars of the first secretary and (4) particulars of the first directors. The Incorporation Form must be signed by any two founder members or, in the case of a one-person company, by the founder member. This form should be submitted to the Companies Registry along with the memorandum and articles of association of the company. In submitting the Incorporation Form, the founder member(s) also confirms that the company has complied with all the requirements of the Companies Ordinance in respect of registration.

**(d) Registration fee**

**9.010** The registration fee is payable at the time when the memorandum and articles of association and the Incorporation Form are submitted to the Companies Registry. The amount of the registration fee is prescribed by Sch.8 to the Companies Ordinance. The current rate is HK\$1,720 (HK\$1,425 as a registration fee and HK\$295 as a lodgment fee for the delivery of the memorandum and articles). Before 1 June 2012, capital duty was levied in accordance with the amount of the authorised share capital of the company at the rate of HK\$1 per every HK\$1,000 of the authorised share capital, subject to the maximum rate of HK\$30,000. To encourage investors to set up companies in Hong Kong and to enhance Hong Kong's attractiveness and competitiveness as an international financial centre, the Hong Kong Government amended the Companies Ordinance in early 2012 to abolish capital duty. Any company incorporated in Hong Kong after 1 June 2012 is no longer subject to the levy of capital duty.

**9.011** Any person who wishes to form a company under the Companies Ordinance can now submit the application documents (ie the duly completed Incorporation Form and a copy of the company's memorandum and articles of association) either in paper form to the Companies Registry in person or by post or in the form of electronic records through the e-Registry ([www.eregistry.gov.hk](http://www.eregistry.gov.hk)). Through e-Registry, a company can be incorporated in less than one day if the intended company name does not require further consideration and approval by the Companies Registry.

**(e) Certificate of incorporation**

**9.012** If the Registrar of the Companies Registry is satisfied that all the formalities and procedures of incorporation have been complied with, he will issue a certificate of

incorporation to the founder member(s). The company is formally incorporated on the date stated in the certificate of incorporation.<sup>7</sup>

**(f) Business registration certificate**

**9.013** Within a month after the issuance of the certificate of incorporation, the company must apply to the Inland Revenue Department for a business registration certificate. This is a requirement imposed under the Business Registration Ordinance (Cap.310).<sup>8</sup> Basically, a business registration certificate is required for every person (including a limited liability company) carrying on business in Hong Kong. A business registration certificate must be renewed every year at an annual fee payable to the Inland Revenue Department. If a company carries on a business using one or more business or trade names, then a separate business registration certificate will be required for each of such names. A company must renew its business registration certificate even though it is a dormant company (ie even if it is not carrying on any business).

**9.014** Before February 2011, the founder member(s) needed to go through separate procedures to incorporate a new company. First, he needed to submit the application documents (ie the duly completed Incorporation Form and a copy of the company's memorandum and articles of association) to the Companies Registry. Then, he had to file another set of documents to the Inland Revenue Department to apply for the business registration certificate. This is no longer necessary, because the Companies Registry and the Inland Revenue Department jointly launched a one-stop company and business registration service in February 2011. Today, any person who submits an application for company registration will have to pay the prescribed business registration fee as well and will be deemed to have applied for business registration at the same time.

**(g) First board meeting**

**9.015** After the company has been duly incorporated, the founder member(s) should convene the first board meeting as soon as possible to record the following points:

- (1) The date of incorporation of the company (this is stated in the certificate of incorporation);
- (2) Appointment of first director(s). Each private company must have at least one director.<sup>9</sup> The first director(s) are appointed by the founder member(s) in the Incorporation Form submitted to the Companies Registry.<sup>10</sup>
- (3) Appointment of company secretary. Each private company must have a company secretary, who must be either a Hong Kong resident or a Hong Kong company secretary.<sup>11</sup> The first secretary is also appointed by the founder member(s) in the Incorporation Form submitted to the Companies Registry.

<sup>7</sup> ss.16, 18.

<sup>8</sup> Business Registration Ordinance s.5.

<sup>9</sup> Companies Ordinance s.153A. Section 158 provides that every company shall keep a register of its directors and secretaries.

<sup>10</sup> *Ibid.*, s.153A.

<sup>11</sup> s.154.

- (4) Issuing the share certificate to the shareholder(s). Each private company must have at least one shareholder. The founder member(s) named in the Incorporation Form is the first shareholder. The shareholders of a company are also known as the *members* of a company.
- (5) Appointment of auditor. Each company must prepare its annual accounts and have the accounts audited by the company's auditor. The auditor is an independent third party (in most cases, the company will appoint a firm of accountants to act as its auditor).
- (6) Adoption of the common seal of the company.
- (7) Opening of the bank account of the company.
- (8) Address of the registered office of the company (this is also stated in the Incorporation Form).

### 3. SHELF COMPANIES

**9.016** So far, we have examined briefly the steps for incorporating a company. In the alternative, a person can buy a shelf company. This is usually speedier and often more straightforward than incorporating a new company from scratch. A shelf company is basically a ready-made company duly incorporated, but that has not started any business activity. A person can purchase a shelf company from a firm of solicitors, an accounting firm or a firm offering secretarial services. Once a person has bought a shelf company, he can "activate" the company by appointing new directors and secretaries and start business activities. Activation of a shelf company does not take long and is less complicated than incorporating a new company. In short, the purchase of shelf companies is a convenient alternative to many business people.

**9.017** In practice, there is no distinction between a shelf company and a company incorporated from scratch, because the name and the constitutional documents of the shelf company can easily be changed to satisfy individual requirements.

### 4. ADVANTAGES AND DISADVANTAGES OF INCORPORATION

#### (a) Advantages

##### (i) Limited liability

**9.018** Shareholders or directors of a company will not be liable for the debts incurred by the company in the course of its business. The limited liability concept of a company is certainly more attractive to potential investors, because their personal assets can be protected.

##### (ii) Ability to raise finance

**9.019** Unlike a sole proprietorship or a partnership, it is much easier for a company to raise finance for business. A company can issue additional shares to existing shareholders or to new shareholders. There is no limit on how many shares a company can issue. Moreover, a company can issue debentures or execute floating charges to borrow money.

##### (iii) Perpetual succession

**9.020** The death or bankruptcy of a shareholder or director of a company will not affect the life or continuity of the company, because the shares can be transmitted from the deceased shareholder to his estate. Likewise, a deceased director can be replaced by another one.

##### (iv) Transfer of ownership

**9.021** Although there are restrictions on the transfer of shares in a private company, ownership can still be changed relatively easily without disrupting the operation of the company as a going concern. In contrast, in a sole proprietorship, the transfer of ownership in the business without disrupting the business is almost impossible.

##### (v) Expansion and size

**9.022** It is easier for a private company to expand its business, as it can have up to 50 shareholders.<sup>12</sup> Moreover, it is easier for a private company to attract potential investors to become shareholders because of the protection of limited liability. A potential investor may not be willing to invest in a partnership business, because he may be treated as a partner and incur unlimited liability.

#### (b) Disadvantages

##### (i) Incorporation costs and formalities expenses

**9.023** A company is formed by registration under the Companies Ordinance and must comply with a number of formalities such as preparation of the constitutional documents of the company; payment of the registration fee; convening of the annual general meeting every year; and costs related to annual returns and audited accounts. All these formalities usually require professional assistance from either accountants or solicitors. In addition, most of the information related to a company is open to public; for example, the identity of directors or shareholders who are registered in the Companies Registry can be searched by the public.

##### (ii) Tax

**9.024** Compared with a sole proprietorship or a partnership, companies are subject to a higher tax rate of 16.5%. A sole proprietorship or a partnership is currently subject to a lower tax rate of 15%.

##### (iii) Restriction on business

**9.025** Some companies, especially those established before 10 February 1997, may still be subject to object clauses in their memorandum of association. These object clauses have the effect of restricting a company's scope of business activities, because any activities beyond the stated object clause may be invalid in some circumstances.

**9.026** There is no such restriction in the case of a sole proprietorship or a partnership. Companies set up after 10 February 1997, however, are not required to state the object clause and can have the capacity as a natural person. In other words, a company (in terms of scope of business) can now be as flexible as a sole proprietorship or a partnership.

<sup>12</sup> If there are more than 50 shareholders in a company, it would be regarded as a public company, as opposed to a private company (see s.29 of the Companies Ordinance).

is based “on the simple principle that in a civilized society, people must be able to live on the assumption that others will respect their person and possessions and if they fail to do so, they will pay for their unwarranted interference, aggression, or for failure to observe norms of expected behaviour”.<sup>2</sup> In imposing liability for certain acts, the law of tort also sets standards of behaviour.

## 2. TYPES OF TORTIOUS LIABILITY

**11.003** There are three main types of tortious liability, namely, liability for intentional torts, liability for negligence (unintentional torts) and strict liability. The liability in the first two categories is based on fault. It is concerned with a person’s failure to live up to a certain standard. Where a person deliberately beats you, locks you up in a place, sexually harasses you, enters your land or throws something onto your land, or takes away your property or damages it, such conduct amounts to intentional torts. On the other hand, where a person carelessly drives his car and injures a pedestrian; gives careless investment advice to his clients, causing the client financial loss; or a manufacturer carelessly produces contaminated articles of food which causes food poisoning to the consumer, such person or manufacturer is liable in the tort of negligence.<sup>3</sup>

**11.004** Strict liability arises independently of any fault. A person is liable for strict liability whether or not the harm is caused intentionally or negligently. For instance, where a person stores a large quantity of chemicals on his premises without any statutory authority and an explosion is caused destroying the plaintiff’s flat, that person may be liable under the tort of strict liability.<sup>4</sup>

**11.005** It is beyond the scope of this chapter to examine each and every tort. Most parts of this chapter deal with the tort of negligence and defamation as these are the most important topics for business law students.

### (a) Remedies

**11.006** In a tort claim, the successful plaintiff is awarded damages. The objective of awarding damages is, as far as practicable, to return the victim to the same position in which he was before the tort was committed. For instance, where a person is injured in an accident because of the defendant’s negligent driving, he is entitled to an award of damages for all medical expenses incurred and loss of income as a result of the accident, as well as damages for pain and suffering.

**11.007** Where the court is satisfied that payment of damages will not adequately compensate the victim, it may order the wrongdoer to do something else to compensate the victim. For instance, if a person has taken away your vintage sports car, the court may order him to return the car to you. It may also grant an injunction to restrain a wrongdoer from interfering with another’s enjoyment of his property (eg an injunction may be granted to prevent a person from playing mahjong after midnight, causing nuisance to neighbours).

<sup>2</sup> Srivastava and Tennekone, *The Law of Tort in Hong Kong*, 5.

<sup>3</sup> *Ibid.*

<sup>4</sup> However, where a thing is brought onto the land under the authority of a statute, it is generally necessary to prove negligence in order to establish liability. See *Halsbury’s Laws of Hong Kong* (Butterworths, 2000) Vol. 25, 247.

### (b) Tort and crime

**11.008** A tort is different from a crime. When a person commits a crime, he is punished and sent to prison. A victim of crime does not usually get damages from the criminal. Tort, on the other hand, is a civil wrong. It gives the victim the right to sue the wrongdoer for damages. Tort law is more concerned with compensating the victim rather than punishing the wrongdoer.

**11.009** There are situations where an act could be both a crime and a tort. For example, when a person beats you, the wrongdoer can be prosecuted and punished for the crime of assault. The victim can also sue the wrongdoer in the tort of battery to claim damages.<sup>5</sup> Likewise where the defendant splashes paint on the plaintiff, he commits the tort of assault as well as a crime.<sup>6</sup>

### (c) Tort and contract

**11.010** Both a breach of contract and a tort are civil wrongs. However, contractual obligations are fixed by the parties to a contract and are generally owed by one party to the other. Only a party to the contract can sue or be sued. By contrast, liability in tort is not based on any pre-existing relationship. Tortious duties are imposed by law and are generally owed to all persons. Whosoever commits a breach of duty in tort is liable. Sometimes, a wrong act could give rise to both liability in tort as well as liability for breach of contract. For example, where you employ a surgeon to operate upon you and that surgeon has done his work carelessly, leaving a pair of scissors in your stomach, you can sue him either for breach of contract or in the tort of negligence.

## 3. NEGLIGENCE: DUTY OF CARE

**11.011** A person who suffers injury or damage caused by a careless act or omission of the defendant may have a claim against the defendant in negligence.<sup>7</sup> However, not all careless acts or omissions causing injury or damage give rise to liability. “A man is entitled to be as negligent as he pleases towards the whole world if he owes no duty”.<sup>8</sup> And, as Judge Cardozo said, “there is no liability in an indeterminate amount for an indeterminate time to an indeterminate class”. The courts use control devices to limit the range of potential claimants.<sup>9</sup> To succeed, the plaintiff must establish the following:

- (1) the defendant owes a duty of care to him;
- (2) the defendant has breached that duty;
- (3) the breach of duty has, in fact, caused injury or damage; and
- (4) the injury or damage is not too remote (ie it is a foreseeable result of the defendant’s breach of duty).

<sup>5</sup> See I Steele, *Negligence Liability for Failing to Prevent Crime: the Human Rights Dimension*, C.L.J. 2008, 67(2), 239–241.

<sup>6</sup> *Chang Ming Fang Jacqueline v Zhang Zi Qiang* (unrep., HCA 2714/2006, [2009] HKEC 1411).

<sup>7</sup> *Chiu Chit v Bank of China (Hong Kong) Ltd* (unrep., DCCJ 4041/2007, [2009] HKEC 1357).

<sup>8</sup> *Le Lievre v Gould* [1893] 1 QB 491.

<sup>9</sup> *Ultramares Corp v Touche* 174 NE 441 (1931).

**(a) The existence of a duty of care**

- (1) A lorry driver is drunk. While he is driving in an inebriated state along Tai Po Road, he kills a man and injures a woman. Can the deceased's estate and the injured woman claim against the lorry driver in negligence?

Their claims are likely to succeed. A driver owes a duty to take reasonable care of other road users. Apparently, the lorry driver has failed to discharge this duty.

- (2) Because of financial instability, the stock market is closed. Investors lose money due to the closure of the market. Jack, one of the investors, sues the Hong Kong Securities and Futures Commission in negligence for financial losses arising from such closure. Advise Jack.

Jack is unlikely to succeed. Although Jack's losses may be foreseeable by the Hong Kong Securities and Futures Commission, the court may not impose a duty on the Commission due to policy reasons. A decision to close down the stock market may have been taken in the best long term interest of Hong Kong. It will be wrong to inhibit the Commission by the threats of legal proceedings (see *Richardson Greenshields of Canada (Pacific) Ltd v Keung Chak Kiu* [1989] 2 HKLR 103).

**11.012** *Donoghue v Stevenson* is the seminal case which laid down the present law of negligence in 1932. Before *Donoghue v Stevenson*, the law recognised only a few "duty situations" (eg innkeepers owed a duty of care to their guests, surgeons to their patients and attorneys to their clients). *Donoghue v Stevenson* itself creates a new duty category (ie manufacturer and consumer). But, more importantly, *Donoghue v Stevenson* also lays down a general principle for the creation of new categories of duty. The position that has been reached now is this: the plaintiff must prove that his case falls within one of the recognised duty categories. If the plaintiff cannot do so, his case will fail unless the court recognises a new duty.

**Donoghue v Stevenson**  
[1932] AC 562

The plaintiff drank a bottle of ginger beer manufactured by the defendant. The ginger beer was bought by her friend from a retail shop. The bottle was sealed with a metal cap and was made of opaque glass. Some of the ginger beer was poured over the ice-cream in a tumbler and the plaintiff drank it. As some of the ginger beer was still left in the bottle, her friend emptied it into her tumbler. A foreign body flowed out of the bottle. It looked like the remains of a dead snail. The plaintiff became ill. She either suffered food poisoning or became sick by the sight of what she saw, or both.

The plaintiff claimed damages from the manufacturer of the ginger beer who had sold it to the retailer. The plaintiff could not sue the retailer because she did not have a contract with the retailer as the ginger beer had been bought by her friend.

Held:

- (1) The manufacturer of the ginger beer was liable. It owed a duty of care to the ultimate consumer to see that there was no noxious matter in the articles which would cause injury to the consumer.
- (2) "The rule that you are to love your neighbour becomes in law, you must not injure your neighbour; and the lawyer's question, Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be—persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question". (Lord Atkin)

**11.013** Lord Atkin's speech in *Donoghue v Stevenson* laid down what is called the neighbour principle for imposing liability in negligence. The neighbour principle is seen as implying that a duty of care can be established if the following three elements are satisfied:

- (1) foreseeability of harm;
- (2) proximity; and
- (3) fairness, justice and reasonableness.<sup>10</sup>

**11.014** These requirements are in most cases merely facets of the same thing. The criterion of proximity does not lay down a precise, scientific ultimate test; the presence of the necessary degree of proximity determines what is fair, just and reasonable.<sup>11</sup>

**11.015** The leading Hong Kong authority on the question of the existence of a duty of care is the erudite decision by Bokhary PJ of the Court of Final Appeal. A summary of the case appears below.

**Luen Hing Fat Coating & Finishing Factory Ltd v Waan Chuen Ming**  
(2011) 14 HKCFAR 14

A factory owner engaged a competent independent contractor to repair the calendaring unit of a machine. The factory owner lent the independent contractor equipment, namely two pallet jackets and bearing trolley which were used to transport cloth. The factory owner's supervisor knew what the equipment would be used for and the dangers involved in using it but did not warn the independent contractor. In order to

<sup>10</sup> *Caparo Industries Plc v Dickman* [1990] 2 AC 605, 628-629 (Lord Bridge). A summary of *Caparo* is given below.  
<sup>11</sup> *So Kai Hau v YSK2 Engineering Co Ltd* [2010] 5 HKLRD 278.