CHAPTER 1

Introduction: Property and Security

1.01 This chapter:

- contains details of background matters relevant to the use of assets for security and quasi-security purposes;
- contains the definition and description of a variety of matters relevant to subsequent chapters;
- identifies various forms if transactions as either securities or quasi-securities; and
- introduces contract principles relevant to most transactions dealt with in the book.

1.02 Some topics discussed in subsequent chapters are introduced here to show the panorama of the backgrounds, and the relevant, inter-locking principles of commercial law. Neither this chapter, nor the rest of the book, is designed to present every intricacy involved in the study of 'property and security'. It is designed to give enough background and information to enable the reader to draft effectively any form of security or quasi-security, to understand contractual principles (and those in tort) associated with the transaction and its breach, and to identify new forms of assets, and to consider and apply equitable principles as well as common law principles to the transaction, its breach, and the remedies therefor.

1.03 In this chapter, general principles, their application, and contradictions, relevant to following chapters, are set out as background. The classes of assets are 'not closed' and equitable innovation becomes increasingly more apparent in the operation and function of commercial law.

1.04 This chapter refers to many matters particularised in subsequent chapters dealing with 'securities'. The term is used here to enable the reader to reflect on the various types of transactions involving both real and quasi-securities.

1.05 It is hoped that the matters referred to in this chapter will be reflected upon as the reader proceeds through the book. Many are subliminal to specific topics.

MATTERS CONNECTED WITH PROPERTY AND SECURITY

1.06 The writer is not suggesting that Hong Kong's system of personal property, and real and quasi-securities require reform and updating to accord with twentieth-century attitudes and practice. Instead, several matters are simply brought to the forefront. The fact that, in Hong Kong, 19th century law remains constant in many situations represents the strength of the local courts, the vibrancy of Hong Kong law, and the capabilities of many of those dealing in the market place. Factors of note include:

(a) the apparent inconsistency that Hong Kong functions largely with a nineteenth century (and earlier) personal property system, although complemented by some progressive amendment by the introduction of modern legislation especially for 'consumer protection', in some quarters during later decades, but, for the most part, illustrating principles of the original law merchant whilst recognising the funding needs of the modern company, and often the modern consumer;

(b) novel developments, especially in the last half of the twentieth century with the progress of financial instruments such as 'derivatives' (*vide*: the nineteenth century 'differences' associated with dealing with company assets), the conditional sale of goods turned into the sophisticated *Romalpa* clause, and the consumer 'loans' for hire-purchase;

(c) the role of Equity in commercial transactions, considered to be at 'arm's length' but not for that reason denying extra-equitable relief through purpose loans, unconscionability, and restitution (in one of its forms, as the solution of the inherent problems with *quantum meruit*), together with other forms of relief such as the *Mareva* injunction or 'freezing order';

(d) the vitality and innovative approach of modern 'personal property securities' to suit the needs of Hong Kong as an international, commercial centre of excellence; and not forgetting the role of legislation dealing with land, in particular section 44(1) of the Conveyancing and Property Ordinance ('CPO') (for mortgages and charges) and its suitability to multi-storey building ownership based on contractual principles, as enhanced and protected by sections 39 to 42 of the CPO;

(e) the steps necessary to deal with 'novel interests' (including the first step being their classification as proprietary interests) including carbon sequestration or emission trading rights, plant varietal interest (see the Plant Varieties Protection Ordinance (Cap 490), and the vast number of interests loosely referred to as 'restrictive covenants', many of which combine contract and property principles;

(f) the manner in which Hong Kong functions in this area with some nineteenth century legislation, such as codifications of mercantile

law (for example, the Bills of Sale Ordinance (Cap 20); the Sale of Goods Ordinance (Cap 26), the Factors Ordinance (Cap 48)), with some transactions not subject to any specific legislation (for example, there is and has never been any hire-purchase legislation in force in Hong Kong despite an attempt to introduce such an ordinance in the 1980s), with what could be said to be limited consumer protection (for example the Control of Exemptions Clauses Ordinance (Cap 71), the Unconscionable Contracts Ordinance (Cap 458), the availability of the courts for assistance with transactions, although perhaps the reluctance of the community to take disputes to court in this area (see the role of the Small Claims Tribunal Ordinance (Cap 338);

(g) the manner in which some overseas common law countries have codified their 'personal property securities' for consumers as well as for corporate entities; see for example the Australian Personal Property Securities Act 2009 which provides for registration of dealings with personal property; but where there is no such need in Hong Kong with the combination of legislation and common law well-aided by the judiciary; and

(h) the attitude in Hong Kong in adopting external developments from other legal systems, such as Islamic financing principles, and relevant international codes applicable (as enacted, or as modified: *vide* the Arbitration Ordinance (Cap 609) which adopts and/or modifies clauses in the UNCITRAL Model Law on International Commercial Arbitration). Above all, the court system enables the judiciary to be active in promoting twenty-first century commercial requirements employing the former mercantile law concepts but also the stimulation of developments in contract, especially in relation to relief. The possibility of 'Hong Kong common law' developing to suit local conditions, and forgoing some traditional concepts and doctrines, based not on principle but more on ad hoc decisions, is under way: see for example the Court of Final Appeal in *China Field v Appeal Tribunal (Buildings)* [2009] 5 HKC 231 (CFA); and *A Solicitor v The Law Society of Hong Kong* [2008] 2 HKC 1 (CFA).

1.07 Two modern factors need consideration also. First is the concentration on financial mediation in the settlement of disputation; on this see the Financial Dispute Resolution Centre set up in June 2012. The second factor is that of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Services) Ordinance (Cap 615) which applies to registered corporations under the Securities and Futures Ordinance (Cap 571), institutions under the Banking Ordinance (Cap 155), insurance companies and agents under the Insurance Companies Ordinance (Cap 41), money service provides under the Anti-Money Laundering [etc] Ordinance, and to the Postmaster General under the Post Office Ordinance (Cap 98).

1.08 The themes introduced in this chapter are covered in more detail in subsequent chapters.

Introduction and Background to Security Transactions

Terminology

1.09 The elements of modern security transactions are often submerged into 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.

1.10 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, even though the transaction under consideration is in reality a hypothecation in form but a mortgage in substance: see section 44 of the CPO (subsection (1) dealing with the form of the transaction, and subsection (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.

1.11 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[1], and a varied group of transactions, largely purely contractual in nature, which seek to resemble the benefits of real securities, namely the 'quasi-securities'.

1.12 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.

1.13 Accordingly, in this book the word 'security' (or 'securities') will be used to represent:

(a) 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;

(b) 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

(c) 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.[2]

1.14 In the case of a contract, the remedy can be:

(a) a judgment debt requiring thereby court proceedings;
(b) perhaps action for the 'contract price' again requiring court proceedings;
(c) action for breach of contract; again requiring court proceedings.

In the case of (a) and (b), the amount sought is a liquidated sum. For (c), the amount sought is unliquidated requiring the plaintiff to show loss from the breach assessed on the basis of *Hadley v Baxendale* (1854) 23 LJ Ex 179, 9 Exch 341. In each case, 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.

1.15 There is another group of transactions referred to throughout.

1.16 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

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

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

CHAPTER 5

Some Commercial Principles and Rules

5.01 This chapter deals with general principles and rules which are relevant to most types of securities. Each has a different purpose. Several go to the interpretation of certain documents associated with securities. Others are principles which are applicable either in respect of all forms of securities, both real and quasi, or are pertinent to specific forms of contracts or of securities. Some underlie the interpretation of contracts. They include:

1. Attornment
2. As beneficial owner
3. The *bona fide* purchaser for value without notice rule
4. Commercial interpretation
5. Constructive notice and attribution
6. Feeding the estoppel
7. Freedom of contract
8. Good faith
9. Mechanics of payment

Attornment

5.02 In *Re Hang Fung Jewellery Co Ltd* [2010] 2 HKLRD 1; [2010] 2 HKC 301, it was said of attornment that:

> An attornment consisted of 'an overt or positive acknowledgement by a possessor' that he now held goods as bailee for someone other than the party who originally bailed them to him. An attornment gave rise to a form of estoppel and could not subsequently be denied or qualified by the attornor.[1]

5.03 Attornment occurs where a person is in possession of the property of another, and the possessor acknowledges either expressly or impliedly the better title of the other owner. It is found in situations such as leases and mortgages and bailments.[2] Attornment is treated as a form of estoppel because the attornor represents that another is the true owner. For example, a bailee *qua* attornor acknowledges that goods held by him as bailee are the property of the owner, although possession has passed

1 See also *Lawrie & Morewood v Dudin & Sons* [1926] 1 KB 223.
2 *Mumford v Collier* (1890) 25 QBD 279; *Green v Marsh* (1892) 2 QB 330 (CA); *Re Hang Fung Jewellery Co Ltd* [2010] 2 HKLRD 1; [2010] 2 HKC 301.

to the bailee. In *Laurie and Morewood v Dudin & Sons* [1926] 1 KB 223, Scrutton LJ at 237 said that 'to raise an estoppel there must be something of which the party setting up the estoppel has notice, and which influences his conduct'.

5.04 The principle of attornment applies in a variety of situations. For example, a lessee will attorn to the lessor thereby acknowledging the paramount title of the lessor. An attornment clause will be included in a mortgage document, to ensure the mortgagor acknowledges that the mortgagee has paramount title over the possession of the mortgaged property, both real and personal. This allows the mortgagee to take possession of the property as an incident of his 'ownership' (legal title only, but the equity of redemption recognises the right of the mortgagor to recover legal title on performance of his mortgage obligations) of the land without taking possession until default by the mortgagor. Where the mortgagor is an individual, and goods are mortgaged, then the document evidencing the mortgage should be registered under the Bills of Sale Ordinance (Cap 20). Compliance with the Ordinance is tedious and must be precise. The Ordinance does not apply to the transaction but to the documents evidencing the transaction.

5.05 A common example of attornment occurs in relation to a trust receipt when the bank, having paid for the goods on behalf of the buyer, releases the Bill of Lading to the buyer on the understanding that the buyer acknowledges the 'title' of the bank in the goods, until payment of the purchase price borrowed by the buyer from the bank.[3] A further example occurs under a legal mortgage (see section 44(1)) where the mortgagor, whilst retaining title because the form of the mortgage is that of a legal charge by deed, also retains possession until default, and throughout implicitly acknowledges the 'paramount title' of the mortgagee.[4]

5.06 For a company, a security over its goods commonly takes the form of a charge; this charge requires registration under section 80 of the Companies Ordinance to enable its enforcement as a secured interest, against the liquidator of the company and subsequent creditors. Where this charge is a floating charge, the company is entitled to deal with the goods in the ordinary course of its business, and this can include not only replacing or adding to the goods, but also selling them to third parties. In this situation, the attornment clause would contradict the essence of the floating charge. A fixed charge over company assets does have much the same effect as an attornment clause because the fixed charge prevents the chargor dealing with the assets.

3 *Re Far East Structural Steelwork Engineering Ltd (In Liq)* [2005] 2 HKC 18.

4 *Typhoon 8 Research Ltd v Seapower Resources International Ltd & Anor* [2001] 4 HKC 311.

5.07 As a general rule, attornment provides that:

(a) a mortgagor cannot dispute the title of his mortgagee. Traditionally, the clause was inserted in the mortgage where the mortgagor remained in possession to give the mortgagee an easy and expeditious remedy, by way of distress, for enforcing the payment of interest instead of having to take possession;

(b) the lessor cannot dispute the title of this lessee; and

(c) a grantor cannot dispute the title of his grantee.

5.08 In essence, these principles have nothing to do with estoppel, but with the refusal of the common law to permit a party to ignore the title of the superior party in a transaction.

5.09 In *Askrigg v Student Guild* (1989) 18 NSWR 738, a company which was trading in Bills of Exchange took money from depositors, quoting secured and unsecured rates of interest to them. When a deposit was received, the company would advise the depositors, by letter of the deposit, the relevant rate of interest, and what securities were pledged to secure the deposit. The Bills of Exchange were said to be held by the company on behalf of the depositor, but were able to be replaced or switched with others as the loan matured. The Bills of Exchange were set aside in separate envelopes marked with the name of the depositor, and held in the company's security box, lodged each night with the company's bank.

5.10 Upon liquidation of the company, the liquidator came into possession of the Bills of Exchange. The depositors claimed floating charges over the company property. Such a charge would have been unenforceable because it had not been registered. Had it in fact existed, failure to register it had reduced it to a debt.

5.11 The court held that the Bills of Exchange represented the company's stock in trade. The Letter had referred to a specific Bill of Exchange by way of pledge. Any switching of Bills meant that the original security had to be replaced or the loan repaid. On default, the depositor could only look to the particular Bill of Exchange which had been in the envelope. An oral agreement had amended the contract by providing that the company held the Bills as bailee for the depositor. Hence the company then held under attornment by bailment; the bills did not belong to the company.[5]

5.12 In *Dublin City Distillery (Great Brunswick Street Dublin) Ltd v Doherty* [1914] AC 823 (HL) it had been held that a book entry, without deposit, was insufficient to establish attornment on the part of the bailee.

'As Beneficial Owner'

5.13 These words denote a 'covenant for title' given, for example, by the owner of land when contracting to sell that property and which will be repeated

5 Compare this result with those in *Mac-Jordan Construction Ltd v Brookmount Erostin Ltd* [1992] BCLC 350; and *Re Goldcorp Exchange Ltd* [1995] 1 AC 74 (PC).

in the Assignment of the title, or by the seller of goods when selling them. The words imply, into a contract or instrument, various promises and warranties on the part of the vendor. Unlike similar covenants given in respect of English land sales, these covenants are not 'full title guarantee' or absolute when used in Hong Kong in land transactions. The covenant is implied in the land contract, unless there is a contrary intention in the document.[6]

5.14 In the contract for the sale of land, the phrase implies:

- A right to convey;
- Freedom from encumbrances;
- Quiet enjoyment;
- Further assurance.

5.15 The covenant is qualified, so the covenantor is liable only for:

- His own acts and omissions;
- Acts or omissions of a person through whom he claims otherwise than by purchase;
- Acts and omissions of persons claiming through him;
- Acts and omissions of persons claiming in trust for him.

5.16 The covenants given on the sale of goods are either expressed to be conditions or 'undertakings'.[7] They include:

(a) section 14 implied undertakings as to title including that the seller has the right to sell the goods, and that the goods are free from encumbrances;
(b) section 15 implied conditions that the goods correspond to the description in a sale by description;
(c) section 16 implied undertakings as to quality and fitness for purpose; and
(d) section 17 implied undertakings, including that goods sold by sample will correspond to the sample.

5.17 When the owner of assets enters into a mortgage, he also gives covenants to the mortgagee. This covenant acts as a guarantee or indemnity so that if the covenants are later breached, or proved to be ineffective, the covenantor-mortgagor will be liable, in contract, to the mortgagee for any loss suffered as a result.

5.18 For land covenants, see the Conveyancing and Property Ordinance: section 36 providing that certain covenants and conditions may be implied by reference into contracts and documents dealing with land and interests in land. See also Schedule 2: Part A concerns covenants and conditions in a contract for the sale of land; Part B concerns those in

6 See section 36 and Schedule 2 of the Conveyancing and Property Ordinance (Cap 219), and see section 14 of the Sale of Goods Ordinance (Cap 26).

7 Sections 14 to 17 of the Sale of Goods Ordinance.

equitable mortgages; and Part C concerns those in a legal charge (that is, a legal mortgage by way of legal charge by deed: section 44(1)).

5.19 Breach of a covenant or title, or for covenants for quiet enjoyment, at least enables the covenantee to take action for damages: the quantum is the difference between the property as received, and the property purported to be conveyed.[8]

Bona Fide Purchaser for Value

5.20 The bona fide purchaser rule, that is 'the bona fide purchaser for value without notice', imposes something akin to good faith in the establishment of priority between competing like-interests. It is commonly referred to in respect of land transactions. This purchaser, often called 'equity's darling', is favoured when he has no knowledge – actual or constructive – of a pre-existing interest which is adverse to that he is buying.

5.21 The words have their common meaning, so:

'bona fide' means a buyer in good faith who is not affected by fraud, deceit or dishonesty in his dealing with the other party to the transaction;

'purchaser' usually extends from the person who buys the property to others dealing with the title, such as mortgagees and lessees. The phrase uses the word 'purchaser' and by implication it includes these other parties. However in relation to land in Hong Kong, the expression 'purchaser and mortgagee' is used in the Land Registration Ordinance (section 3), seemingly therefore indicating a meaning which is less broad from that traditionally understood. It would seem, however, that such a distinction is not stressed upon.

'value' refers to the giving of consideration. In other situations, a common phrase is that of 'valuable consideration' but there does not seem much difference, in practice, as the quantum of value, to make it consideration, is variable.

'without notice' is used to indicate that the party seeking to show his bona fides, has no notice either actual or constructive, of a prior adverse interest, or any other factor which would prevent him taking as bona fide purchaser. There is no wilful blindness which results when a party deliberately fails to ask appropriate questions to establish whether or not there are any adverse interests which would affect him.

5.22 The rule usually includes references to consideration and notice. However, section 3(1) of the Land Registration Ordinance, in relation to dealings in writing for land or interests in land, has no reference to 'notice' provides:

8 *Yuen Kit Yee v Great Rich Development Ltd* [2001] 3 HKC 101 being diminution in value caused by the breach.

CHAPTER 14

Novel Securities

14.01 This chapter deals with novel forms of security, or with possible novel forms of security.

14.02 However the focus here is quite different from the chapters below dealing with the different forms securities and quasi-securities. Here there is a change in focus from those transactions. Speculation is relevant here. Matters such as:

1. The type of contract;
2. The classification of the evolving 'asset';
3. Available remedies, dependent on whether the asset is proprietary or personal; and
4. What remedies would provide the lender with adequate relief?

14.03 This chapter is looking ahead to indicate the way in which the courts can be innovative, despite the rigidity, hithertofore considered to be inviolate, of the classification of property under common law, namely land, chose in possession and chose in action.

Introduction

14.04 This chapter considers new forms of property or interests capable of being the subject-matter of a contract, and as creating remedial interests in the asset, and in respect of the asset. Sometimes the interest is achieved by creation of a contract, hence as personal rights and sometimes by legislation, and in other cases by reference to existing 'property' interests where hopefully the interest will be 'proprietary' rather than 'personal'.

14.05 Rules are not uniform. In some cases there are no rules, and instead speculation, that a remedy exists, will be the basis of relief. In other *ad hoc* cases, courts have interpreted the traditional principle differently from the usual interpretation simply because of the award of an equitable interest to accompany the right: *Latec Investments Ltd v Hotel Terrigal Pty Ltd (In liq)* (1965) 113 CLR 265 (HCA) where 'an equity to set aside for fraud' was converted into an equitable interest so as to run against the equitable interest of 'a bona fide purchaser for value without notice'. The holder of the equity lost the battle simply because the interest had not been protected; this was due to a lack of funds rather than to carelessness.

But having elevated the interest, the court went no further in altering the bona fide purchaser rule as well.

14.06 The main purpose behind the classification of novel interests and rights is to ascertain whether the *res* or thing (or chose) can be considered an item of commerce of interest more to investors than to creditors.

14.07 In seeking to introduce novel interests or rights, courts generally look backwards, apply precedent, and state that if it could not be done in the past, it cannot be done now. Reasons for the refusal are either because the elements of the interest claimed are inappropriate for the interest claimed, or because it has held that such a claimed interest cannot exist at common law. This leaves developments in the law for political, legal, or social reasons to the legislature.

14.08 In *Hill v Tupper* (1863) 2 H & C 121, Pollock CB said that at 127–128:

> It would be a new species of incorporeal hereditament. It has been contended that this is a sort of estate, but the owner of an estate must be content to take it with the rights and incidents known to and allowed by the law. A grantor may bind himself by covenant to allow what rights he pleases over his property, but the law will not permit him to carve out his property so as to enable the grantee of such a limited right to sue a stranger in the way here contended for. For these reasons, therefore, our judgment will be for the defendant.

14.09 In *The Path of the Law* (1897) 10 Harvard Law Review 457, at 469, Oliver Wendell Holmes wrote:

> It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past.

14.10 In *Bank of Montreal v Dynex* [2002] 1 SCR 146, [2001] SCJ No 30, Martin J in delivering the judgment of the Supreme Court observed:

> 17. The oil and gas industry, which developed largely in the second half of the 20th century and continues to evolve, is governed by a combination of statute and common law. The application of common law concepts to a new or developing industry is useful as it provides the participants in the industry and the courts some framework for the legal structure of the industry. It should come as no surprise that some common law concepts, developed in different social, industrial and legal contexts, are inapplicable in the unique context of the industry and its practices.
>
> 18. The appellant could not offer any convincing policy reasons for maintaining the common law prohibition on the creation of an interest in land from an incorporeal hereditament other than fidelity to common law principles. Given the custom in the oil and gas industry and the support found in case law, it is proper and reasonable that the law should acknowledge that an overriding royalty interest can, subject to the intention of the parties, be an interest in land.

14.11 Mention has been made earlier of some twentieth century innovations, such as the 'charge back' and section 15A of the Law Amendment and

Reform (Consolidation) Ordinance ('LARCO') which solidifies the interest, and of *Bank of Montreal v Dynex* where the Supreme Court of Canada was able to convert a personal right into a proprietary right in land because (a) the oil and gas industry treated the right in that way, and (b) the parties so intended. The later decades of that century became inundated with various financial instruments, and nominate interests, of which perhaps the derivative in all its forms was the most prominent. The trust became more versatile, saving the unsecured lender (the *Quistclose* form of the trust) from *pari passu* distribution, as well as granting shares in land to a variety of beneficiaries, in some cases in the form of a 'bare' or 'passive' trust.

14.12 One of the most effective new 'interests', rather as a remedy than an interest per se, has been that of restitution, combing the legal 'quasi-contract 'with the equitable unjust enrichment' to come up with an equitably fair and just remedy, under different names and forms: see for example the equitable compensation in *Akai Holdings Ltd (In Liq) v Kasikhornbank* [2011] 1 HKC 357 (CFA).

The Classification of Property – of Assets

14.13 There are layers of classification of property – types, examples within types, the interpretation of the interest by the courts, the attributes of the interest and so on.

14.14 First, the traditional *categories* of property, namely real property and personal property, are the starting point for ascertaining whether the interest (and especially the novel interest) meets the demands of investors and creditors. Generally these demands are for perfection, priority, and relief on default. Land is real property; but in Hong Kong, it is referred to as 'chattels real', hence an item of personal property; except for St John's Cathedral land[1] and of course Government land. Personal property consists of chattels real, choses in possession and choses in action.

14.15 Second, when considering personal, the most obvious difference is between tangible (movables) and intangible (immovabales) objects. A chattel is an example of tangible personalty. A chose in action is an intangible example of personal property – even if the interest is evidenced by a document.

14.16 Three, various differences reflect the categorisation of the asset. Land, even as 'chattels real' is different from other property because it is permanent, it can be productive providing income, as well as crops, and it can be dealt with in a variety of ways. Apart from rare or specifically manufactured items, goods can be fungibles; this means that the relevant goods can be replaced by equal quantities of the same type, and are usually traded by weight or number or measure. Goods can be present or future, ascertained or unascertained. This classification enables future

1 See the Church of England Trust Ordinance (Cap 1014).

property, or after-acquired property, to be the subject matter of a floating charge given by a company (acquiring the goods in the future) prior to that acquisition. The category of personal property, namely chose in action, is more elusive as the chose gives a right to action to 'obtain' the interest of the chose. Only equity was able to provide protection to the chargee of a charge of 'future' property, and hence developed the 'equitable charge' most commonly used by commercial parties to finance their affairs.

14.17 Four, rights in assets or property can be divided into two main categories, namely rights *in personam* and rights *in rem*. *In personam* rights are enforceable against the parties to the transaction; *in rem* rights are rights in the asset largely 'good against the world'.

14.18 Fifth, property rights cut across various areas of the law, and therefore across various barriers inherent to different areas of the law; these barriers include principles relevant to contract and tort where the interest or right is created by agreement, or by wrongdoing, or by reference to a dispute.

14.19 Sixth, property rights consist of:

(a) a bundle of rights of ownership, use, or enjoyment over goods, land or chose in action. These are given different terms for example for goods the terms title and property indicate ownership: and
(b) responsibility for others in respect of these rights.

14.20 The rights then:

(a) give a right to a remedy on loss or damage;
(b) in certain cases, can give:
    i. the right to assign to third parties;
    ii. to be enforceable against a third party;
    iii. to be enforceable by a third party;
(c) the ability to unlawfully interfere with the possession of the owner, the occupier, or the person in possession;
(d) can be equitable or legal;
(e) recoverable by action; and
(f) generally, capable of being owned, given as a gift, mortgaged, charged, leased, and so on.

14.21 In recognising novel or new examples of rights, the general rule is that the divisions of *in personam* or *in rem* rights will be retained, unless re-classification is relevant to giving the relief sought. The 'res' or thing identified can be a personal right, or an example of a recognised category of rights or interests, or the source of a new category. However, in many cases, attempts to create new rights are defeated by the statement that the 'categories are closed' so new examples of the old right can be established in the twenty-first century.

The Debt to Mercantile Law

14.22 Mercantile law, and then the common law into which mercantile law was subsumed, recognised various 'things' as commercial assets able to be dealt with, for example to be sold, leased, mortgaged and given as gifts. These are classed as one example of personal property, and of the sub-category as chose in action. Frequently these 'assets' are evidenced by some document; for example:

(a) Certain 'financial' assets; for example a promissory note;
(b) The interest evidenced in a share certificate;
(c) A credit balance in the bank;
(d) Choses in action 'reduced' to a dematerialised form;
(e) An entry in a clearing house.

14.23 The presence of 'paper' does not elevate these interests beyond their basic characteristics as choses in action. The common law treats these and other examples of intangible interests as objects i.e. as things, because people are willing to buy them – and mercantile law, and mercantile law as subsumed into the common law, required anything that is an object of commerce to be treated as a recognisable asset for the purpose of relief on default. Outside land law, it is commerce which has devised the innovations leaving it to lawyers to fit them belatedly into some scheme of recognition and protection.

14.24 Other pieces of paper may have 'magical' attributes, such as the Bill of Lading which for centuries has been the manifestation of the contract for the carriage of goods by sea, but which is treated as a document of title to the goods: he who holds the Bill holds the goods.

14.25 Generally, these inventions and innovations have been based on traditional principles of the law but by applying these in a different way.[2] Other courts have expanded existing doctrines to offer newer versions of the old thereby extending the old: for example, the 'wilful blindness' concept expands the notice rule in Equity[3], or where the concept of 'knowing receipt' from *Barnes v Addy* (1874) 9 Ch D 244 metamorphosed into a remedy for damages in tort for perhaps conspiracy, or deceit but one based on dishonesty[4]

Tort and Developments

14.26 Tort law shows that often policy could be the factor that some courts have relied on in establishing negligence as a new tort[5] or in developing

2 *Bank of Montreal v Dynex Petroleum Ltd* [2002] 1 SCR 146, [2001] SCJ No 70 (practice within the oil and gas industry enabled the right to the payment of a royalty to be treated as creating an interest in land).
3 Also known as contrived ignorance or 'Nelsonian' knowledge: *Akai Holdings Ltd (In Liq) v Kasikornbank PCL* [2010] 3 HKC 153 (CA).
4 *Royal Brunei Airlines v Tan* [1995] 2 AC 378 (PC).
5 See for example, *Donoghue v Stevenson* [1932] AC 562 (HL).

extensions to that tort[6], but there are limits for recovery for negligence which are now said to be requirements for the plaintiff to show proximity, that is the duty of care and the breach of the duty, foreseeability that the action or omission will cause loss, and that the relief must be fair, just and reasonable. Policy is not infinite. In *Donoghue,* the policy must have been to seek to prevent manufactures of goods for consumption from manufacturing harmful and defective products; there was no legislation to assist the consumer, so the court had to find a way[7], to put up some barriers against the manufacture of dangerous medical or beauty devices, many of which contained poisons. The other factor in establishing property rights, of various levels up to proprietary interests, is the re-interpretation or the extension of existing age-old principles, found it possible to invent new interests or rights, or to innovate existing interests and rights into new examples.

Remedies and Developments

14.27 An investor or creditor may well find that the nature of the asset is irrelevant; and instead the classification concentrates on the strength of the contract as creating the possibility of relief which, in line, with modern developments may produce substantive relief. The investor or creditor is not concerned with the finer points of classification, or identification. The important thing is whether or not the asset or the right will enable recovery of any money expended or lent. This has been broadened by developments in recent years, especially in regard to equitable relief, including:

(a) granting an account of profit and calling it 'common law damages';
(b) restitution to replace the traditional difficulty with quasi-contract eliminating the need for an implied promise, and not punishing the existence of an express promise; and
(c) acting to prevent the defendant receiving a windfall;

14.28 The interests and rights described in this chapter concern the classification of the interest, asset, rights, or property by reference to traditional principles with the modification of those principles to enable the 'right' etc to come into existence, often not as a universal interest or right, but more in relation to the basis of relief.

14.29 By and large, the novel interests in this chapter are those which an investor, rather than a creditor, will be interested in financially. However, they are also able to be the subject matter of a security or quasi-security contract so long as they are recognised for perhaps the purposes of perfection, but definitely for the purposes of a worthwhile remedy.

6 See for example, *Hedley Byrne & Co Ltd v Heller & Partners* [1964] AC 465 (HL).
7 See also the motive behind the re-classification of an invitation to treat in *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256 (CA).

14.30 An example of this exercise is that of the fitting the interests of a floating charge into the traditional classification of chose in action.[8] How were book debts to be classified? These are an amalgamation of present property (the entry in the books of the creditor – but which gave little relief on default unless there was a court order, a power of attorney in favour of the creditor, or perhaps the deposit of title deeds together with a blank document of transfer. The proceeds of the book debts represent the real value of the book debt. Until collected the right to the proceeds is a right to future or after-acquired property[9], where the court made use of the flexibility of equity to treat the chargor as trustee for the chargee as soon as the property came into the hands of the chargor. This development, new at the end of the nineteenth century and the beginning of the twentieth century, has made possible the lending of money in respect of these rights *in futuro* because equity will act on the conscience of the chargor who breaches the terms of the trust.

Historical innovations

14.31 The common law and equity (the trust alone justifies the existence of equity) are not strangers to developing forms and procedures when needed. The nineteenth century was a time of great legislative activity involving commercial matters, and this was so mainly because of the innovative manner in which the law adapted to then modern problems. It was also a time in which codifications of earlier enactments based on law merchant were enacted. In 1853, the Royal Commission in the United Kingdom had set up a committee to 'inquire and ascertain how far the merchant laws of the different parts of the United Kingdom of Great Britain and Ireland may be advantageously assimilated'. The legislation which was produced in the next few decades covered most areas of mercantile law either by the updating of existing legislation, or by new regulation in the form of codification of mercantile law principles. The Bills of Exchange Act, the Sale of Goods Act, the Bills of Sales Acts were all examples of legislative forms of mercantile law practice.

14.32 At the same time, regulation of the affairs of corporations was developing through a series of enactments such as the Stock Companies Act 1844, the Companies Clauses Act 1845, the Limited Liability Act 1855, the Joint Stock Companies Act 1856, and the Companies Act 1862, leading onto the Companies Act 1900 which is the framework for modern company law. The developments in company law showed the necessity for innovation in dealing with the assets of a company in various ways, not only in relation to the share itself, but also in relation to the use of the asset in company borrowing.

14.33 Whilst one traditional form of security over land, namely the mortgage, was available to a company in respect of land owned by it, problems

8 *Re Yorkshire Woolcombers* [1903] 2 Ch 284 (CA).
9 *Holroyd v Marshall* (1862) 10 HL Cas 191 (HL).