

1.001 Law influences all aspects of life. The business world and our personal lives are surrounded by law. No matter what professional field you enter—whether it is accountancy or business management, construction engineering or architecture, information technology or science, medicine or social welfare, public administration or politics, journalism or digital media—your world will be substantially affected by law and the legal system. An understanding of how law helps and regulates the work you do will be one key to your success as a professional.

1. LOVE ON THE STAR FERRY

1.002 Let us begin with an example. Suppose you want to set up a film production company in Hong Kong. A friend has agreed to assist you. You have been shown a screenplay for a movie tentatively titled *Love on the Star Ferry* and you like the story. In addition to the screenplay, you will need a director, actors, a cinematographer, a martial arts advisor, editors and other production specialists. You decide that you want a special musical theme for the movie and you want to use, as background music, several previously recorded Canto-pop romantic songs and various western love songs, including “Hong Kong Dream Girl” and “Slow Boat to China”. The movie will be filmed at various locations around Hong Kong, including several museums, a restaurant in Lan Kwai Fong, the Star Ferry the jet foil to Macao, and at several locations in Macao, including the Museum of Macao and the area around the A-Ma statue at the harbour. The film will be marketed in both Hong Kong and Macao and also in China and overseas.

1.003 What legal concerns would you face while embarking on this business venture?

2. CONTRACTS, TORTS, COPYRIGHTS AND OTHER MYSTERIES OF THE LEGAL WORLD

1.004 First, you will need to enter into employment contracts with actors and actresses, the director, the cinematographer, the martial arts advisor, film editors and the other production people. You will also need to enter into contracts with the author of the screenplay and the person whom you hire to write the musical theme for the movie. A “contract” is a legally-enforceable agreement between you and another person or company. Employment contracts set out the terms of employment—for example, how much you will pay the actors, director or songwriter and what their obligations are. The contract may provide that the actors must appear at the studio in good health and ready to begin work by 7 am each day for three months. The contract with one of the actors might provide that he has to lose weight or change his hairstyle for the movie role.

1.005 The contract with the screenwriter will deal with matters such as the price you will pay him for the script, the date on which you need the final script, whether the screenwriter has the right to object to any changes in the script and whether he can share in the income from future video sales or the sales of products connected with the movie. The agreement with the composer of the theme song for the movie will deal with issues such as who shares in the income from future sales of the song and whether the composer or you have the

copyright. (“Copyright” is the exclusive right to reproduce, sell or rent the song.) The contracts will be governed by the law of contract (probably the law of contract in Hong Kong, if the agreement is entered into in Hong Kong) and can be enforced either in a court of law or in arbitration. If one of the parties does not live up to his obligations, the other party can sue him in court (or before an arbitration tribunal, if arbitration has been selected as the manner of settling disputes in the contract).

1.006 You will also be concerned about being sued for any damage suffered by another person during the filming. This might involve an accident to an actor or a bystander during the filming of a martial arts scene; damage to or trespassing on someone’s property during filming or damage to the reputation of a real person portrayed in your movie (what the law calls “defamation”). If an injury to an actor or a bystander occurs, you can be sued for negligence under the law of torts. If your film crew enters someone’s property without permission, you can be sued for the tort of trespass. If a person’s reputation is injured through a false statement or a false representation in the film, you can be sued for the tort of defamation. To protect yourself and your company, you will need to take special precautions to avoid accidents; take out insurance policies (another type of contract); seek the permission of the owners of the property on which you may do your filming, through other special contracts; and ensure that portrayals and dialogues in the film do not damage the reputation of a person or company.

1.007 In most instances, a film producer will set up a corporation, under company law, through which to carry out business, attract investors and ensure that his own personal assets cannot be taken in a lawsuit. A “corporation” is a legal entity with assets (money and property) separate from the shareholders of the company. If you have shares in a company in the amount of, say, HK\$400,000, and the company collapses or is later sued for a breach of contract or for the tort of personal injury or defamation, you risk losing your HK\$400,000 (depending on the extent of the company’s assets). However, whoever sues the company cannot sue you to get your personal savings or the value of your house, car or other personal assets. The corporate form protects you as a film producer, as it does with investors in other incorporated businesses and professions.

1.008 In addition, you will need to seek permission to use musical pieces from the owners of the copyrights of the Canto-pop and other songs that you use. You undoubtedly will pay royalties (special fees) to the owners of the songs and/or the recording artists. You may also need to get copyright permission from the artists whose paintings or other artwork appears in your movie (the ones in the museums where you do some of your filming) and from the sculptor who created the A-Ma statue at the Macao harbour. You may need to get trademark use permission from the owner of the “Star Ferry” trademark, if the Star Ferry name features prominently in your movie. If passengers on the Star Ferry who are not actors appear in the film, you may need to obtain their permission so as not to run the risk of being sued for invasion of privacy.

1.009 The financing of the movie (through loans or investment) and the marketing and distribution of the film will involve contracts with banks, insurance companies and distributors. (One issue will be the law that will govern the particular contract—Hong Kong law or US law, for example, if the film is financed from or distributed in the United States.)

In addition, you would have to ensure that the laws of the countries in which the film is to be distributed are not violated (eg censorship and distribution laws in China).

1.010 You may also face problems with pirated copies of your movie being made and sold. This, of course, may represent a significant financial loss for you in those markets where the pirated videos are available. What can you do about this? If the pirated editions are being sold in Hong Kong, you can inform the police, and charges can be brought against the producers and sellers of the pirated editions under the criminal law of Hong Kong. Both those who make the pirated editions and those who sell them may be charged a fine (a "fine" is money that is paid to the court, not to you) and sent to prison. This may stop the sale of the unauthorised copies of your movie, but it would not compensate you for the financial losses you suffered as a result of the pirated editions being sold. To get compensation from the manufacturers or sellers of the pirated editions, you would have to sue them for copyright infringement or the tort of "passing off" (misrepresenting that their product comes from your company) in a civil lawsuit to recover your losses. You would be able to keep whatever money is recovered from the manufacturer or sellers of the pirated editions.

1.011 Finally, what will be the relationship between you and the friend who will work with you? Will you be full-fledged partners? Will he serve as your "agent" or will he serve as an "independent contractor" to carry out specific tasks on behalf of you or your company? If you intend to be partners, are both of you likely to enter into a partnership agreement under which you share profits on some percentage basis, as well as share some costs? The partnership agreement needs to specify the powers and authority of the partners. Can you partner enter into business or loan transactions that obligate the partnership financially or otherwise? Is your permission needed before your partner can take out a loan from a bank in the name of the partnership? If your friend is to serve as your agent for some purposes (eg negotiations with distributors), then what is the extent of his power to obligate you to certain things?

1.012 All of this may appear overwhelming. It seems that you have to worry about legal issues at every turn. Fortunately (here comes the commercial!), as a movie producer—or in whatever profession you are engaged—you will have the assistance of lawyers when needed. Once you begin discussions with prospective employees and other such people, once you think about setting up your company or once you recognise a potential legal problem, you will, in many instances, want to consult a solicitor for help. A solicitor will assist you in drafting contracts, identifying legal problems you are not aware of and creating legal safeguards and solutions to problems. The solicitor's primary role lies in planning, in helping avoid legal problems from arising and in protecting you from being sued and brought to court. If you are sued, you will be assisted by a solicitor and a barrister (the latter will argue your case either in court or in arbitration).

1.013 Careful planning at the outset, no matter what type of business venture you are involved in, will save you many headaches and much money later on. Planning and careful negotiation of contracts may help in avoiding costly lawsuits. The more you know about the law, the better prepared you will be in protecting both yourself and your company and also in recognising when the assistance of a lawyer is needed.

1.014 Of course, any legal assistance will cost you money. In the reference above to the civil lawsuit that you may file against the manufacturers and sellers of the pirated editions of your movie, it is mentioned that, if successful, you would be able to keep whatever is recovered from the manufacturers or sellers of the pirated editions. This is not completely accurate. You can keep whatever remains after paying your lawyer! Still, with regard to using a solicitor, there is a Chinese and Western proverb that says, "an ounce of prevention is worth a pound of cure". Good planning and carefully drafted contracts can go a long way in giving you peace of mind and financial protection. As for lawsuits—cases brought to court because they cannot be settled between you and the other party—sometimes cannot be avoided. However, lawsuits are the ultimate defence in protecting your rights. It is fair to say that, with a basic knowledge of law and the legal system, you are more likely to understand your interests and rights, and you will be able to use the services of lawyers more wisely. Try to avoid asking yourself, some years from now, "Why didn't I pay more attention in the business law class? Why didn't I read the book *Business Law in Hong Kong* more carefully?"

1.015 Before we finish this section, a bit more should be said about the negotiation of contracts. Some contracts are not negotiated—health insurance contracts or the warranty on your new automobile are two such examples. You have to either accept the terms given to you by the insurance company (eg reimbursement of up to HK\$40,000 for a single hospitalisation) or look for another insurance company that might provide you with better terms. You have to either accept the terms of the warranty from the automobile company (eg a one-year guaranty on parts) or look for another automobile company that might give you, say, a two-year guaranty on parts. The terms of these contracts are fixed and non-negotiable, but there are also many contracts that are negotiated, such as the contracts with the director, actors and songwriter in our *Love on the Star Ferry* example.

1.016 How can you be sure that you can negotiate what you want?

1.017 The most important thing is for you to understand (1) your interests and bargaining power, (2) the other party's interests and bargaining power, (3) your options and (4) your "walk-away" point.

(a) Interests and Bargaining Power

1.018 Assume you are about to negotiate an employment contract with actor X. Here are some questions to consider. How important is it for you to get this particular actor? Is he essential to the role? How much does the actor want for this role? Is it a role that he would think is important to his career? Can you get another actor for the role? If you do not have any alternatives to this actor (ie your interest in getting him is strong, and no other actor would suit your needs), then your bargaining power is weak. If there are other popular actors you could get for the role, then your bargaining power is strong.

(b) Options

1.019 How much can you afford to pay in salary and other benefits? How much are you willing to pay? If you have to pay a certain amount to the actor, then can you pay less to the composer of the music? Are there other things you could give to the actor instead of a high salary (eg a percentage of the profits if the film does well)?

(c) Walk-away Point

1.020 Suppose you want to pay the actor HK\$700,000 for doing the movie and he asks for HK\$1,000,000. If HK\$700,000 is not acceptable, then would you walk away from the negotiation and look for another actor, or would you be willing, ultimately, to pay as much as HK\$900,000 or HK\$1,000,000? At what point in the negotiation over salary is the actor likely to walk away from the negotiation?

1.021 You will be helped in your negotiation by standards:

- (1) What is the typical salary paid to leading actors in the movie industry in Hong Kong?
- (2) How much does this actor usually get paid?
- (3) Is there another good actor you can get for this role, who will accept less than HK\$1,000,000?

1.022 Once you have this information, your bargaining position is greatly strengthened.

1.023 Salary is just one of the terms that will be negotiated. Other issues might include matters such as the quality of accommodation for the actor during filming (eg a five-star hotel); whether the actor can fly first class if the film is shot outside Hong Kong; whether the actor can get a percentage of the profits from the movie; whether the actor can get days off during the filming; and whether the actor is prohibited from appearing in other movies for a fixed period of time.

1.024 Once you have negotiated the contract and once both sides have made specific promises, then the contract becomes a legal document (if it meets the conditions set out in Chapter 4 on Contract Law). You then have a contract that can be enforced by both you and the actor.

1.025 Note that the legal system allows you to create the terms of your contracts, as long as what you agree to does not violate the law or offend morals. You are in control. You are creating the rules under which your relationship with the movie director, actors or composer is carried forward. In this sense, the law facilitates your work and helps you achieve what you want to achieve. The law says, in effect, "You work out the terms of your relationship and the legal system will enforce the terms you have worked out if you need the legal system's help".

3. LAW AS THE FOUNDATION OF DEMOCRACY AND ECONOMIC PROSPERITY

1.026 The importance of understanding the law and the legal system is not just utilitarian; that is, it is not just to make you more successful and secure either as a professional or in the business world. An understanding of the law and respect for the law are the foundations of a democracy. They are essential for economic development, a peaceful society and a thriving commercial and political community. The law that surrounds us should be constantly examined and evaluated to ensure that it is serving appropriate social, economic and political goals. The effectiveness and fairness of the law cannot be evaluated unless it is understood. Without such

an understanding, favouritism, corruption and abuse of power in both the government and the business world will thrive. Discrimination against social and ethnic groups, favouritism to certain social or economic groups, corruption and abuse of power undermine democracy, and history has shown that, once democracy is undermined, so too, ultimately, are the economy and commercial development. The rights and freedoms that we take for granted can be slowly eroded, unless we are vigilant and express our concerns. Hong Kong has an enviable reputation in the world for having one of the lowest levels of corruption and possessing a vigorously enforced rule of law. Your job is to help ensure that this continues to be the case.

1.027 Around the world today, company executives and company directors are being subjected to greater scrutiny and higher standards of performance than has been the case in the past. As a result of a number of major companies and their executives in the United States, Europe, and Asia having been charged with mismanagement (this includes the Enron Corporation and Madoff enterprises in the United States, which serve as two prime examples.), new laws and stricter accounting standards have been introduced, and greater accountability and transparency are expected. The failure to understand and abide by relevant governing laws can result in significant personal (civil and criminal) liability for corporate executives, as well as in significant liability for the companies involved. Mismanagement may result in financial loss for both shareholders and those whose retirement funds (pension funds) are invested in corporate stock. In addition, such violations may have a major impact on world economies, as investor trust in corporations and their managers is undermined—just as trust in Asian financial markets suffered as a result of corruption and corporate mismanagement in a number of Asian countries in the 1990s.

1.028 As a professional—as a business manager, design engineer, accountant or public administrator, or in whatever career you pursue—you will be immediately concerned about the laws and regulations that affect your day-to-day work. You will want to know the law and regulations that govern your professional life. You will want to make sure that you, your subordinates and co-workers work within these laws and regulations. In some cases, you may feel that the law should be changed, because you believe it operates unfairly. In other cases, you may feel that the law either involves too much bureaucratic regulation or does not lead to the results anticipated by the legislature and those who proposed the law. At the same time, you may become concerned about other laws that affect Hong Kong, because you think they are not adequate for modern-day society (environmental protection laws, for example). You may feel that Hong Kong should have regulations in an area in which it does not have now. In this latter role, you are acting as a concerned citizen. In both cases, you need to know how the law is created and also how the law can be changed.

1.029 One major challenge faced by both Hong Kong and China is related to air pollution. This pollution results from the burning of fossil fuels for power plants and manufacturing plants and also from increasing automobile traffic. In Hong Kong, some of the pollution is cross-border, whereas some comes from the factories owned by Hong Kong companies. This pollution has a serious impact on the health of Hong Kong citizens and, if not adequately dealt with, will ultimately affect the attractiveness of Hong Kong as a venue for foreign investment and tourism. Future health-care costs for those affected by pollution and future lost income as foreign investors and tourists seek healthier environments could have a serious impact on Hong Kong's economic well-being. As a business manager, government official,

(e) Seller in possession	510
(f) Buyer in possession	510
8. Transfer of Property	510
(a) Passing of property—specific or ascertained goods	510
(i) Rule 1	510
(ii) Rule 2	510
(iii) Rule 3	510
(iv) Rule 4	510
(b) Passing of property—unascertained goods	510
(i) Rule 5(1)	510
9. Remedies for Breach of Contract	510
(a) Remedies of the seller	510
(i) Damages for non-acceptance	510
(ii) Who is an unpaid seller?	510
(iii) The unpaid seller's lien	510
(iv) Loss of lien	510
(b) Unpaid seller's right of stoppage in transit	510
(i) The effect of stoppage in transit	510
(c) Seller's right of re-sale	510
(d) Action for the price	510
(i) Action for damages	510
(e) Remedies of the buyer	510
(i) The right to reject the goods	510
(f) Buyer's loss of the right to reject	510
(i) Acceptance by express intimation	510
(ii) An act inconsistent with the ownership of the seller	510
(iii) Acceptance through lapse of reasonable time	510
(iv) Action for damages for non-delivery	510
(v) Specific performance	510

1. INTRODUCTION

5.001 A contract for the sale of goods is a specific type of contract and one of the most important ones in a commercial transaction. In a commercial city such as Hong Kong, it may not be possible to keep count of the number of sale of goods contracts, which are being entered into on a particular day. The examples include a myriad of sale of goods contracts, including those that are entered into by the government with various suppliers, by public corporations such as the MTR, by banks, companies and other business entities and by ordinary individuals buying goods in a wet market, "Park 'N' Shop", "7-11", at an "Apple" shop, a mall or the whole host of shops and business places which are in existence in Hong Kong. The amount of money, which changes hands in such contracts may amount to anything from a few cents to millions of Hong Kong dollars.

5.002 In Hong Kong, the legal framework¹ for dealing with such contracts is provided by the Sale of Goods Ordinance (Cap.26).² It was originally enacted in 1896 after the UK Sale of Goods Act 1893 came into effect. The Sale of Goods Ordinance codified the common law related to the sale of goods. It deals only with the law of the sale of goods and not with issues generally covered in contract law. A sale of goods contract involves the transfer of legal ownership in the goods from the seller to the buyer. Such contracts affect everyone in society.

5.003 In addition, there are a number of other statutes that have an impact on a sale of goods contract, such as the Control of Exemption Clauses Ordinance (Cap.71), the Factors Ordinance (Cap.48), the Supply of Services Ordinance (Cap.457), the Law Amendment and Reform (Consolidation) Ordinance (Cap.23), Electronic Transactions Ordinance (Cap.553) or even the Misrepresentation Ordinance (Cap.284), to name but a few. This chapter briefly deals with the definitions, concept and application of the laws to such sale of goods contracts. It looks into case law and legislation relevant to business students or others who are looking to unravel legal jargon into business language and those looking for simpler explanations to solving consumer difficulties in mundane and humdrum business transactions of the kind.

5.004 An illustration of a consumer contract for the purposes of the Sale of Goods Ordinance can be seen in the following case:

Cheung Kam Sing v International Resort Developments Ltd [2003] 2 HKLRD 113

Plaintiffs were made to sign a "timeshare" contract and paid an initial amount in respect of the membership fee. They subsequently discovered that the defendant's staff who explained the terms of the contract had not explained all relevant terms, including the requirement that plaintiffs pay an adjustable annual management fee, the prohibitions

¹ The rules of common law and equitable doctrines such as promissory estoppel, injunctive relief and rectification apply equally to sales contracts; see Bridge, *The Sale of Goods* (Oxford Press, 1997). On the application of innocent misrepresentation to sales contracts, judicial opinion, however, is divided: *Naughton v O'Callaghan* [1990] 3 All ER 191; *Riddiford v Warren* (1901) 20 NZLR 572; *Watt v Westhoven* [1933] VLR 458. See also *Re Wait* [1927] 1 Ch 606.

² The Sale of Goods Ordinance was amended in 1977 and 1994. Section 62 makes it clear that the Ordinance is not an exhaustive one. See *Chitty on Contracts—Hong Kong Specific Contracts* (Sweet & Maxwell Asia, 2012) 738, paras.11.001–11.003.

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*.³

³ Section 3(3) and (4) provides 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 and 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." In *Kaga (HK) Electronics Ltd v Sun Cupid Technology (HK) Ltd* (unrep., DCCJ 2088/2013, [2014] HKEC 180), it was established that not all future goods would be generally unascertained goods, however the court determined that the goods were unascertained goods in this case.

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.⁴ 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

⁴ Atiyah, *The Sale of Goods* (Longman, 2001) 65.

Sales of Goods, or the UK Sale of Goods Act 1979⁵ 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.⁶ 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*.⁷ Not only software programs but also virtual goods are classified as goods internationally.⁸

5.013 In Hong Kong, “emblems” 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.⁹ A timeshare contract has also been held to be a consumer contract for the *sale of goods or the provision of services*.¹⁰

5.014 Disputes may arise in certain situations where the parties might be under a misunderstanding with respect to the subject matter of the contract.

5.015 In *Perfect Share (Holdings) Ltd v Medipro International Ltd*,¹¹ the defence counsel tried to argue that the subject matter of the Contract was the machines with similar technology as EXILIS machines and not EXILIS machines. This dispute arose since the subject matter was only described and not explicitly named in the annex. The case supported the general legal principle that a document to which the primary document is expressly referred to be supplemental may itself be looked at in its entirety for the purpose of construing the primary document and a document executed contemporaneously with, or shortly after, the primary document to be construed may be relied upon as an aid to construction, if it forms part of the same transaction as the primary document.¹²

5 *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd* 1996 SLT 604; *Stratford City and District Council v International Computers Ltd* [1996] 4 All ER 481; *Eurodynamics Systems Plc v General Automation Ltd* (unrep., 4 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* 740, para.11.006.

6 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 (1st Cir 1991); sale of standard software goods held to be governed by CISG in Germany, see the decision of LG München 8 Feb 1995, No 8 HKO 24667/93, Case 131 CLOUT.

7 *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.

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

9 *Wong Ng Kai Fung v Yau Lai Chiu* [2005] 4 HKLRD 134 (pet dog purchased from a pet shop treated as “goods”). See also *Benjamin’s Sale of Goods* (6th ed., 2002) para.1-008.

10 *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)).

11 (unrep., DCCJ 2674/2012, [2014] HKEC 416).

12 *The Interpretation of Contract*, 5th ed., paras.3.02–3.03.

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

5.016 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.¹³ 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.¹⁴ 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 skill and experience of the artist in producing the article.¹⁵ 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.¹⁶ Sometimes, a sale of goods contract may be coupled with a contract for services, especially where the nature of the contract reflects mixed characteristics.

5.017 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.

13 *Halsbury’s Laws of England*, 4th ed., Vol.41, [603].

14 *Ibid.*

15 *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].

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

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.

5.018 Look at another example:

Morgan v Russell & Sons [1909] 1 KB 357

The defendant entered into an agreement with the plaintiff whereby he undertook to sell certain cinders and puddle slag, which were lying on the property of which he was a lessee. The defendant also undertook to sell to the plaintiff the cinders and puddle slag found on the adjoining properties on the basis that the plaintiff had a licence from the owners to remove them. After the plaintiff had removed a substantial quantity of cinders and puddle slag, the lessor and the owners of the adjoining properties intervened and prevented further removal. The plaintiff then sued the defendant for a breach of contract under the Sale of Goods Act.

Held: The agreement was not a contract for the sale of goods. It was not a contract to sell any definite quantity of mineral nor was it a contract for the sale of a heap of earth that could be said to be a thing separate from the land on which it was located. The cinders and slag had become the land itself, were not merely things attached to or forming a part of the land and, hence, could not be goods even if it was agreed that they be severed.

(b) Price¹⁷

5.019 The *price* in a sale of goods contract refers to money. A contract for the exchange of goods (barter) is not a contract of sale.

5.020 Read the following illustrations:

Angel agrees to buy the latest model of an MP4 player from Joe. Joe asks her for her new model "Swatch watch". Joe agrees to deliver the MP4 to Angel before her birthday on 16 September 2007. On Angel's birthday, Joe refuses to part with his MP4 player, although Angel has kept her part of the bargain. Can Angel sue Joe for a breach of contract under Sale of Goods Ordinance?

¹⁷ Sale of Goods Ordinance s.10.

No. There is no contract between Joe and Angel for the purposes of the Sale of Goods Ordinance, as a contract for exchange of goods (barter) is not a contract for sale. Such a contract has one thing missing—the price consideration, which is generally money.

Esso Petroleum Co Ltd v Customs and Excise Commissioners [1976] 1 WLR 1

The plaintiff "Esso", as a part of its promotional campaign, distributed free of charge one "World Cup Coin" to anyone purchasing four gallons of petrol. The Customs and Excise Commissioners argued that the coins were subject to purchase tax on the basis that they were being sold to the public.

Held: There was no contract for the sale of goods, because the consideration, which in this case was the obligation to buy four gallons of petrol, did not involve "money consideration" within the meaning of the Sale of Goods Act.

5.021 However, in the previous example, if Angel and Joe agree that the MP4 player could be bought and sold for a money consideration, for example, HK\$400 and Angel's new Swatch watch, there arises a contract for the sale of goods. If Joe does not deliver the MP4 player now, Angel has a cause of action, because, in a contract of sale of goods, consideration may be partly in money and partly in goods.

5.022 In *Aldridge v Johnson*,¹⁸ where the sale involved 52 bullocks valued at £6 each, the price was to be paid by the delivery of 100 quarters of barley valued at £2 per quarter. The difference in value was to be paid in cash. This was held to be a sale of goods contract.

5.023 In *Commission Car Sales (Hastings) Ltd v Saul*,¹⁹ a contract related to the part exchange of a car with the balance being paid in cash was treated without any argument as a sale of goods contract.

(i) How is the price fixed?

5.024 The price in a contract of sale may be fixed in the following manner:²⁰

- (1) It may be fixed by the contract itself (eg Donald agrees to sell business law books to Ray at HK\$200 per copy).
- (2) It may be left to be fixed in a manner agreed in the contract (eg Donald may agree with Ray that the price for the books be fixed by a valuer).
- (3) It may be determined by a course of dealing between the parties (eg Donald contracts to supply books to Ray at a fixed price for a specified period. After the expiration of the specified period, Donald continues to supply books to Ray without any express mention of the price. In such a situation, the prices charged and paid between the parties in their prior dealings with each other will be deemed applicable).

¹⁸ (1857) 7 El & Bl 885, 119 ER 1476.

¹⁹ [1957] NZLR 144.

²⁰ Sale of Goods Ordinance s.10. On the rights of a seller to demand an increase of the sale price in keeping with a price adjustment clause, see *Haneet Chandru Vasvani v Italian Motors (Sales & Services) Ltd* [1996] 1 HKLR 8.

1. INTRODUCTION

9.001 A company is a form of business organisation formed by incorporation under the Companies Ordinance (Cap.622).¹ There are basically five 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 without a share capital;
- (4) a private unlimited company with a share capital; and
- (5) a public unlimited company with a share capital.

9.002 By the end of April 2014, a total of 1,219,356 companies were incorporated in Hong Kong and registered at the Companies Registry.² 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 limited by shares 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) 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 67 of the Companies Ordinance provides that any one or more persons (whether a natural person or a body corporate)³ may, for any lawful purpose, by delivering to the Companies Registry for registration (1) a signed copy of the articles of the company intended to be formed and (2) an incorporation form, form a company.

¹ The Companies Ordinance (Cap.622) became effective on 3 March 2014. It comprises 21 parts (921 sections) and 11 Schedules. The previous Companies Ordinance (Cap.32) is retitled as "Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32)."

² Information available from the website of the Companies Registry: www.cr.gov.hk.

³ 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.

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 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 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.⁴ However, a company name with a combination of English letters and Chinese characters will not be accepted for registration.⁵ 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.⁶ 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.

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 associated with Artlane Furniture Co Ltd.

⁴ Companies Ordinance ss.81, 83 and 102.

⁵ Company Names Guideline 2014 issued by the Companies Registry.

⁶ Companies Ordinance ss.100 and 111.

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 (or too like) "Artlane".⁷

(b) Articles of association

9.008 The next step is to prepare the articles of association of the company. This is the constitutional document of a company. The articles of association serve two purposes. First, they regulate the relationship between the company and outsiders. Secondly, they prescribe regulations for the internal management of a company. The founder member(s) must submit a copy of the articles of association of the intended company to the Companies Registry for registration.

(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 founder members; (4) particulars of the first secretary and (5) particulars of the first directors. The Incorporation Form must be signed by one founder member. This form should be submitted to the Companies Registry along with the 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 articles of association and the Incorporation Form are submitted to the Companies Registry. The amount of the registration fee is prescribed in Schedules to the Companies (Fees) Regulation (Cap. 622K). 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 articles).

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 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). 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.⁸

⁷ *Ibid.*, ss.108 and 111.

⁸ s.72.

(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).⁹ 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 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.¹⁰ The first director(s) are appointed by the founder member(s) in the Incorporation Form submitted to the Companies Registry.¹¹
- (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.¹² The first secretary is also appointed by the founder member(s) in the Incorporation Form submitted to the Companies Registry.
- (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.

⁹ Business Registration Ordinance s.5.

¹⁰ Companies Ordinance s.454. Sections 641 and 648 provide that every company shall keep a register of its directors and secretaries.

¹¹ *Ibid.*, s.454.

¹² s.474.

- (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 (if the company chooses to have a common seal).¹³
- (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 articles of association 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.¹⁴ 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) Formation 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 document 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 articles of association.¹⁵ 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

¹³ s.124.

¹⁴ 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 ss.11 and 94 of the Companies Ordinance).

¹⁵ Companies Ordinance ss.98 and 116.

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.

(iv) *Difficulty and expenses in winding up*

9.027 One way of terminating the operation of a company is by winding up the company. This involves complicated procedures and can be time consuming and expensive. However, winding up is no longer the only way of terminating the operation of the company. Nowadays, it is possible to de-register (as opposed to wind up) a company under the Companies Ordinance. De-registration is less time consuming and less expensive than winding up.¹⁶

(c) *Conclusion*

9.028 Although it is open to an investor to choose which form of business vehicle he wants to use to start a business, private companies limited by shares are generally preferred, because they provide better protection to the investors. With the enactment of the new Companies Ordinance (Cap.622), the advantages of forming a sole proprietorship or a partnership become less obvious. In fact, partnerships have become less common, and it seems that the only partnerships that remain active are those professional firms such as accountants' firm or a solicitors' firm, which, by law, are not allowed to form limited liability companies.

5. CONCEPT OF SEPARATE LEGAL ENTITY AND LIMITED LIABILITY

(a) *General principle*

9.029 Upon incorporation under the Companies Ordinance, a company is a separate legal entity from its members or shareholders. That is to say, unlike a partnership, a company has a separate legal personality. In the simplest term, this means that a third party cannot treat the company and its shareholders as being the same. For example:

If X Ltd borrows HK\$1 million from Y Bank but fails to repay the sum owed, Y Bank cannot sue the shareholders of X Ltd for repayment of the money. This is because the borrower is X Ltd, not the shareholders of X Ltd. The shareholders can enjoy the advantage of a "limited liability" company. Basically, their liability is limited to the investment they put into X Ltd. In the event that the business of X Ltd fails, the shareholders will lose their capital invested in X Ltd, but they are not personally liable for the debts of X Ltd.

9.030 Note that the concept of limited liability only applies to the liability of the shareholders. The liability of X Ltd is itself unlimited. In the following sections, we will

¹⁶ *Ibid.*, ss.749-751.

see how the concept of separate personality is closely related to the concept of limited liability.

9.031 The shareholders' limited liability is the most obvious advantage of a limited liability company as compared with a sole proprietorship or a partnership. In the case of a sole proprietor, he is the sole owner of the business and has full control over it. However, a sole proprietor assumes unlimited liability; he is personally liable for the debts and liabilities of the business. A sole proprietor is not separate from his business and if the business cannot repay its debts, the creditors can look to the personal assets of the sole proprietor. Indeed, the sole proprietor risks personal bankruptcy in the event that his personal assets are not sufficient to discharge the business debts. This is why a sole proprietorship is not a suitable business vehicle for high-risk ventures.

Ken runs his shoe-making business as a sole proprietor under the business name of "Yau Yau Shoe Factory". He places orders from a supplier for leather (worth HK\$500,000) on credit. If he fails to pay for the leather at the end of the credit period, the suppliers can sue him for a breach of contract. Ken will be fully responsible for the debts incurred by Yau Yau Shoe Factory, as Ken and Yau Yau Shoe Factory are separate legal entities.

However, Ken will not incur any personal liability if he uses a limited liability company, "Yau Yau Shoe Factory Ltd" (the Company) to run his shoe-making business. This is because Ken and the Company are treated as separate entities. Thus, where Ken orders on behalf of the Company certain amount of leather (worth HK\$500,000) from a supplier, he does so as an agent of the Company. In the event that the Company is not able to pay for the leather, Ken will not be personally liable.

At all times, the debt is considered as being incurred by the Company, not by Ken. Ken is merely a shareholder of the Company, and his liability is limited to the capital he put into the Company. If the Company fails to pay, the supplier can only sue the Company, not Ken. If the value of the assets of the Company is insufficient to discharge its debts, the supplier can petition for the winding up of the Company, but cannot look to Ken for payment.

9.032 In other words, under a company structure, Ken, as a shareholder, can enjoy protection of limited liability. Ken's liability is limited to the extent of the number of the shares he has subscribed from the Company. If Ken has subscribed 500 shares from the Company at HK\$1 each, his total liability will be HK\$500 only. If he has already paid the share price (ie HK\$500), he need not pay any more. If he has not yet paid, then in the event of the winding up of the Company, he will have to be liable for the HK\$500.

9.033 The classic case on the concepts of separate entity and limited liability is *Salomon v Salomon & Co Ltd*.

18. Trade Unions.....	12.236
(a) Trade union activities	12.241
19. Termination of Employment.....	12.248
(a) Fraud or dishonesty by an employee as a valid reason for dismissal.....	12.288
(b) Habitual neglect of duties as a valid reason for dismissal.....	12.294
(c) Lack of capability by the employee as a valid reason for dismissal	12.296
(d) Ill-treatment by an employer	12.304
(e) Remedies for unreasonable dismissal.....	12.309
(f) Restrictions upon notice	12.312
(g) Termination payments	12.318
20. Apprenticeship Contracts.....	12.321
(a) Effect of Apprenticeship Ordinance	12.322
(b) Purpose of apprenticeship agreements	12.324
(c) Form of apprenticeship agreements.....	12.325
(d) Protection of apprentices	12.330
21. The Labour Tribunal	12.342
22. Discrimination, Disability and Sexual Harassment in the Workplace	12.374
(a) Gender discrimination	12.378
(b) Job advertisements and interviewing.....	12.383
(c) Marital status	12.385
(d) Pregnancy	12.389
(e) Disability discrimination	12.399
(f) Family status discrimination	12.408
(g) Race discrimination	12.411
(h) Definition of race	12.412
(i) Sexual harassment	12.418
(j) Disability harassment	12.424
(k) Racial harassment.....	12.431
(l) Anti-victimisation measures.....	12.432
(m) Employers' responsibility	12.435
(n) Problems of proof in discriminatory situations	12.440
23. Recruiting Workers from Overseas.....	12.446
(a) Getting a Hong Kong Identity Card	12.449
(b) Recruiting a domestic worker from overseas	12.450

1. INTRODUCTION

12.001 Hong Kong prides itself on being the freest market economy in the world. Traditionally, there has been little government interference in the way in which businesses operate. This has resulted in Hong Kong's employment law not being as comprehensive as in some other jurisdictions. Whilst some may see this as a positive feature for employers, it does raise issues about whether employees are adequately protected against bad or unscrupulous employers.

12.002 Since it is impossible to go into the employment law in depth in a single chapter, the authors intend to draw attention to the salient points of employment law in Hong Kong. This chapter will examine how contracts of employment are made and what they should contain. Attention will be paid on how the Employment Ordinance (Cap.57) impacts the freedom of contract and the rights and obligations of employers and employees. Because the Labour Tribunal has the sole jurisdiction in disputes arising from the contract of employment, attention will be given to the way in which the tribunal operates.

12.003 A fairly recent innovation in employment law in Hong Kong is the introduction of minimum wage requirement through legislation. Since this statutory requirement has a wide impact on the society, it will be examined in some detail in this chapter.

12.004 The Mandatory Provident Fund (MPF) Scheme has been introduced in Hong Kong since December 2000. A working knowledge of this scheme is important for both employers and employees. This scheme and its implications for both employers and employees will be examined.

12.005 A unique feature of the employment scene in Hong Kong is the large number of contract workers from overseas who come here to perform domestic work in private residences. The position of these Foreign Domestic Helpers (FDHs) is addressed in some detail. It is apparently not always appreciated that these workers from overseas are just as much entitled to the protection of the Employment Ordinance as other employees.

12.006 Reference will also be made to the anti-discrimination ordinances and the way in which they impact the workplace.

2. CONTRACTS OF EMPLOYMENT

12.007 A contract of employment is an agreement between two parties, which creates the relationship between an employer and an employee. This agreement may be written or oral, or partly written and partly oral. Such an agreement may be express or implied from the circumstances of the relationship between the parties.¹ The agreement may include either express or implied terms, or both express and implied terms. Terms may be implied into a contract of employment through the development of common law even if there exist relevant statutory protection provisions in the Employment Ordinance because those statutory provisions do not represent current high watermark of employee protection, but an irreducible minimum.²

¹ See the definition of "contract of employment" in s.2 of the Employment Ordinance.

² *Tadjudin v Bank of America National Association* [2010] 3 HKLRD 417.

12.008 When a dispute arises with regard to whether a contractual term has been varied, the court must examine all relevant circumstances, including, but not limited to, the character of the new terms or the document containing the new terms, eg the revised staff service handbook, to determine whether both parties have agreed to vary the existing terms of contract by those new terms.³

12.009 Whether there exists employment is a question of fact. There is no single test to determine whether a contract of employment exists. The courts will examine all aspects of the relationship. They will look at the method of payment, the regularity of the work, whether the person doing the work can refuse to work, whether there is a continuing obligation to work, under what circumstances the work can be ended, who provides the necessary equipment, who bears the risk of profit or loss, the part played by the worker in the enterprise for which the work is done and arrangements for holidays and time off, and so on. The test is whether, looking at the relationship as a whole, the person doing the work is carrying on his own business as opposed to working for another.⁴ The Court of Final Appeal said in *Poon Chau Nam v Yim Siu Cheung* that the question of the existence of an employer-employee relationship is "a matter of overall impression against the background of the indicia of employment".⁵ The Court of Final Appeal also said the following in the same case:⁶

"The modern approach to the question whether one person is another's employee is therefore to examine all the features of their relationship against the background of the indicia developed in the abovementioned case-law with a view to deciding whether, as a matter of overall impression, the relationship is one of employment bearing in mind the purpose for which the question is asked".

3. WHO CAN BE EMPLOYED?

12.010 Persons aged 18 and above are fully employable, provided always that they hold a Hong Kong permanent identity card or have a work visa authorising them to do the particular work. Before employing anyone in Hong Kong, an employer must inspect the employee's Hong Kong identity card. If an employee does not have a permanent Hong Kong identity card, he cannot be employed unless he has a work visa.

12.011 There are prohibitions and restrictions on the employment of persons under 18 years of age.

12.012 The employment of any child under 13 years of age in any occupation is generally prohibited by the Employment of Children Regulations (Cap.57B, Sub.Leg.). These regulations do not, however, apply to a child who is a family member of the proprietor of the business and with whom the child is residing, nor to registered apprentices.

³ *Chong Cheng Lin Courtney v Cathay Pacific Airways Ltd* [2011] 1 HKLRD 10.

⁴ *Cheng Yuen v Royal Hong Kong Golf Club* [1997] HKLRD 1132.

⁵ (2007) 10 HKCFAR 156. See also *Tang Chau Yuet v Fu Kin Po* [2011] 1 HKLRD 519, where *Poon Chau Nam v Yim Siu Cheung* was applied.

⁶ *Ibid.*, para.18.

The objective is to prevent the employment of persons too young to be employed. It makes no difference whether or not wages are paid or whether the employer is aware of the age of the child.

12.013 Children over 13 years of age may be employed in limited circumstances depending upon the level of schooling they have attained. Children aged over 13 and having completed Form 3 education may, with the written consent of their parent, be employed in non-industrial undertakings. There are limitations on the hours of work.⁷ Children who have not completed Form 3 education may be employed in non-industrial undertakings provided they are over 13, but the places where they may work and the hours they may work are more restricted than for children who have completed Form 3.⁸ The employment of young persons (persons aged between 15 years and under 18 years)⁹ is covered by the Employment of Young Persons (Industry) Regulations (Cap.57C, Sub.Leg.). These regulations prevent the employment of young persons in industrial undertakings.¹⁰

4. CONTRACTS FOR SERVICES

12.014 An employment contract is often contrasted with a contract for services, which does not create an employer-employee relationship. Under a contract for services, a self-employed person agrees to perform a particular task (or tasks) for another person. That self-employed person is normally referred to as an independent contractor. A good example of an independent contractor would be a taxi driver. The taxi driver agrees to take the passenger in return for a fare. There is no long-term relationship between the passenger and the taxi driver: it is a "one off" transaction. Contrast that with the position of the company driver. The company owns the vehicle, and the driver goes wherever directed and whenever directed. The company controls the driver; the driver is integrated into the company's activities. That relationship is much more indicative of an employer-employee relationship.

12.015 In the Australian case *Hollis v Vabu Pty Ltd*,¹¹ Vabu conducted a business by the name of Crisis Couriers (CC). Hollis, who was employed by Styled Couriers (SC) was struck down by a courier from CC when leaving a building in December 1994. The culprit remained unidentified. The question was whether the courier was from CC, an independent contractor or an employee of CC, in order to give rise to a claim against CC for vicarious liability. The court at first instance held that, as the couriers owned and maintained their own bicycles at considerable expense, they were independent contractors. However, on appeal, the High Court of Australia, by a majority, held that there were many factors that showed the couriers were employees. Those factors were: (1) the riders had very little control over the allocation of their work; (2) they had to wear Vabu Pty Ltd uniforms and; (3) the couriers did not have any control over taking leave between the months of November and December,

⁷ Employment of Children Regulations reg.5.

⁸ *Ibid.*, reg.6.

⁹ See definition of "young persons" in s.2 of the Employment Ordinance.

¹⁰ "Industrial undertaking" is defined in s.2 of the Factories and Industrial Undertakings Ordinance (Cap.59).

¹¹ (2001) 207 CLR 21.

as well as the Easter period. Therefore, they were deemed employees as they were "not running their own enterprise".

12.016 In *Cheng Yuen v Royal Hong Kong Golf Club*,¹² an 82-year-old caddie at a golf club had been trained by the club, had his uniform provided by them, had been disciplined by them, as well as being told whom he was to caddy for. He was paid in cash by the club; the club would then debit the member for whom the plaintiff caddied. He could work when he wanted and received no sick pay or holiday pay. He sought wages in lieu of notice and a long-service payment. The Labour Tribunal held that he was an employee and not an independent contractor. The defendants argued that they were merely agents for the member and that, in fact, it was the member who controlled the caddie and not the golf club. The plaintiff's view was upheld in the High Court; however, the Court of Appeal held for the appellants, as did the Privy Council.

12.017 As can be seen, it is difficult to establish absolutely whether an employment contract or a contract for services exists. This is due to an increasingly more sophisticated and complex economy, whereby people can work within a company yet never be supervised by anyone within that organization.

5. APPLICATION OF THE EMPLOYMENT ORDINANCE

12.018 Whether or not there is an employer-employee relationship is a question of fact in each case.¹³ The definition of a contract of employment in s.2 of the Employment Ordinance tells us what a contract of employment is. It does not give us a clear test to decide whether there is, or is not, a contract of employment. But this question of fact is very important. For example, an employer seeking to avoid the Employment of Children Regulations¹⁴ may argue that a child is an independent contractor and as such the contract was a *contract for services* and not an *employment contract*. Of course, this is subject to the principle of *contractual capacity* (*Nash v Inman*).¹⁵ More importantly, this question of fact determines whether the person who claims to be an employee is entitled to various benefits such as holiday pay, sick pay, long-service payment and so on under the Employment Ordinance. It is because the Employment Ordinance applies, with a few exceptions, only if there is an employer-employee relationship.

12.019 The Employment Ordinance applies to all employees, apart from family members living in the same dwelling as the employer, employees within the Contracts for Employment Outside Hong Kong Ordinance (Cap.78) and certain members of the crews of ships.¹⁶ The Employment Ordinance has only limited application to apprentices whose contracts are registered under the Apprenticeship Ordinance (Cap.47). Apprentices will look primarily to the Apprenticeship Ordinance for their entitlements.

¹² [1997] HKLRD 1132.

¹³ *Pan Wen Tsai v Wing Luen Universal Laundry Ltd* (unrep., HCLA 46/1997, [1998] HKLRD (Yrbk) 352).

¹⁴ *Ibid.*, 5.

¹⁵ [1908] 2 KB 1.

¹⁶ Those serving under a crew agreement under the Merchant Shipping (Seafarers) Ordinance (Cap.478) or on board a ship which is not registered in Hong Kong.

6. APPLICATION OF CONTRACT LAW

12.020 An employment contract is subject to the general rules of the law of contract. Apart from contracts of apprenticeship and contracts to employ overseas contract workers (OCWs), which must be in writing, no special form is necessary. There are, however, obvious advantages in having a written contract of employment. Writing makes for certainty. If the contract is in writing, the employee is entitled to a copy of the contract.

12.021 If not all the terms of the contract are in writing, the employer must provide the employee with written details about the amount of wages, how they are calculated, when they are to be paid, the length of notice required to terminate the contract, and whether an end of year payment is to be made if the employee requests such details.¹⁷ Even if the employee does not request these details, a prudent employer will provide them. An employee who does not dispute those details at the time of entering into the employment will face practical difficulties later on if there is a dispute about the terms of the contract of employment.

12.022 The employer must also notify the employee of any changes in the terms of the employment.¹⁸ The parties can agree to vary the terms of the contract of employment if they wish. If this happens, it is sensible for the employer to give the employee written notice of those variations and to ask the employee to sign a copy of that notice to confirm the changes. Any changes that detract from the employee's rights under the Employment Ordinance will not have any effect. As the Employment Ordinance is designed to provide a basic level of protection, employees cannot contract out of that protection. Any provision in the contract of employment to that effect is not binding upon the employee. A problem with variations in the contract of employment is that the parties are not on equal terms. That underlines the advantage to the employer of obtaining the employee's consent to any variations and showing the employee freely agreed to the variation.

My wages are HK\$15,000 per month. My employer says that business is not good and wants to reduce my monthly wage to HK\$12,500 per month. Do I have to agree to this?

12.023 Apart from meeting the statutory requirement of minimum wages,¹⁹ wages in Hong Kong are governed by market conditions. Wages are for agreement between the employer and the employee. There is nothing to prevent an employee agreeing to take a reduction in wages, provided they do so voluntarily. If the employee does not wish to agree to a reduction in wages, the employer could bring the employment to an end by giving the notice required by the contract of employment or laid down in the Employment Ordinance. In that event, the employee might have a claim for unreasonable dismissal or a severance payment.

¹⁷ Employment Ordinance s.44.

¹⁸ *Ibid.*, s.45.

¹⁹ There are two kinds of minimum wages, one is set for FDHs by the government every year, another is set by the Minimum Wage Ordinance (Cap.608), which came into effect on 1 May 2011. Both will be discussed in later sections.

7. RIGHTS UNDER THE EMPLOYMENT ORDINANCE

12.024 To qualify for most of the rights conferred by the Employment Ordinance, the employee must have a certain period of continuous employment. Paid maternity leave, for example, will only be given to an employee who has been employed by the same employer under a continuous contract for not less than 40 weeks before the date of the expected confinement.²⁰ Schedule 1 to the Employment Ordinance defines what is meant by continuous employment.

12.025 Assuming that there is an employer-employee relationship, whether there is sufficient continuity of employment for the purpose of the Employment Ordinance depends upon the duration of the employment, the days worked each week, and the number of hours worked on each day. An employee who has worked for the same employer for four weeks or more and who in each week has worked for 18 hours or more is treated as working under a continuous contract. A "week" is a week ending on Saturday.²¹ The burden of proving that a contract of employment is not a continuous contract is upon the employer.²²

12.026 Days when an employee is absent from work because of sickness or injury count as working days, provided that absence in excess of 48 hours is supported by appropriate medical certificate.²³ It should, however, be noted that sickness may make an employee incapable of performing his side of the contract when considerations of whether the contract can continue to arise. A person employed as a driver might, for example, develop an illness making him unfit to drive. The basis of the contract has then gone and the employer can justifiably put an end to the contract of employment.

12.027 Very often, the agreement between the parties does not address all aspects of the relationship. Employment contracts, like any other contracts, are frequently the subject of litigation. Over time, the courts have supplemented the freedom of persons to make their own contracts, by interpreting employment contracts to take account of the inequality of bargaining power between employers and employees. Legislation now plays an increasingly important part in the employer-employee relationship. Employees are given basic rights and protection by legislation. Those basic rights and protections are deemed to be incorporated into the contract of employment.

12.028 The law gives employees certain basic rights in an attempt to prevent employees from being exploited by unscrupulous employers. Employers who breach the relevant legislation leave themselves open to substantial penalties in the criminal courts. Employees cannot contract out of the rights given to them under the law. Any provision in a contract of employment whereby an employee agrees to forego statutory rights is void and unenforceable.

12.029 Whether or not a contract of employment exists is important not only to the parties to the contract but also to third parties. As a general rule, an employer is vicariously

liable for injuries or loss sustained by a third party as a result of wrongdoing by his employees in the course of their employment.²⁴ Where, however, the injury is caused by the wrongful act of an independent contractor, the injured person does not generally have recourse against the person who commissioned the work. The injured person has to sue the independent contractor.

8. PROBATION

12.030 An employment contract may provide for a period of probation. There is nothing unlawful or unreasonable about that, provided there is mutual agreement to the probationary period. The probationary period gives the employer an opportunity to assess the employee's long-term capability. The employee can similarly assess the quality of the employer and the working conditions.

12.031 As contracts of employment can be made orally, the probationary terms may be agreed orally. There are, however, many advantages in the contract being in writing and the probationary term being made a part of that contract. By signing the contract, the employee confirms agreement to the probationary period. If the contract is not in writing, the employee should be given a written summary of the contract terms, including the probationary period.

My contract contains a provision for three months of probation and requires me to give 28 days notice if I want to leave during the first three months. I have worked for one month. I am not happy in this job and I want to leave now. Can I do so?

12.032 Section 6(3) of the Employment Ordinance sets out how contracts containing a term of probation can be terminated. The probation period is intended to enable each party to evaluate the other. If, before the end of the specified period, either party does not want to continue, there is no logical reason why it should be forced to continue.²⁵ Either party may terminate the contract at any time during the first month without notice or payment in lieu of notice. After the first month, either party may terminate the contract by giving not less than seven days notice to the other party. It makes no difference that the contract provides for a longer period of notice.

12.033 Failing to specify the length of the probationary period is not good practice. It makes for uncertainty as to exactly what was intended.²⁶

9. SICKNESS PAY

12.034 The employment contract may contain provisions about time off for sickness and payment to an employee unable to work because of sickness or injury. Where the

²⁰ Employment Ordinance s.14(2)(a).

²¹ *Ibid.*, Sch.1, para.7.

²² s.3(2).

²³ Sch.1, para.3(2).

²⁴ *So Wing Kwong v Cheng Chi Kwong* [1999] 3 HKLRD 689. See also Chapter 11 on Tort Law.

²⁵ *Negat v Trend Telecommunications Ltd* (unrep., CACV 70/1997, [1997] HKLY 457).

²⁶ *Lai Foon Yung v Tin Sum Valley Public Primary School* [1986] HKLR 128.