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The Dependency of Business and Finance on the Common Law in Hong Kong : A Paradigm Jurisdiction[1]

1. It is a characteristic of common law jurisdictions that there are perennial debates on judicial activism. These discussions usually take place in the context of public law but a cogent argument can be made for this debate to be engaged regarding the law of business and finance. In common law jurisdictions, much of the law that is referred to as commercial law has been driven, if not created, by the courts; to the extent that one can quite comfortably say that business and finance are actually dependent on the common law and on the good commercial sense of its judges[2] to deliver commercial justice. However, in the same way that the concept of justice[3] (beyond the simple definition that merely equates it with a rudimentary sense of fairness) requires a mix of different components to be evaluated depending on context, it is important to analyze this concept as it applies to commercial law bearing in mind the tensions that can pull in different directions. These include certainty or predictability, a just result in any given case, the practice of particular markets and also the public interest in preventing unconscionable or inequitable

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[1] I am grateful for the assistance I have received from the Judicial Assistants of the Hong Kong Court of Final Appeal : Mr Harry Chan, LLB (Hong Kong), BCL (Oxon); Mr Griffith Cheng, LLB (Hong Kong), LLM (LSE); Ms Samantha Lau, BSc (Hong Kong), LLB (Hong Kong), LLM (Harvard); Mr Adrian Lee, BA (Oxon), LLM (University College, London); Mr John Leung, LLB (University College, London), BCL (Oxon); Mr Wing So, LLB (City University, Hong Kong), BCL (Oxon), MPhil (Oxon), PhD (Oxon); Ms Hayley Wong, LLB (Birmingham), LLM (University College, London); Mr Jasper Wong, BA (Cantab).

[2] This is where the activism comes in. As we shall presently see, judges have for a long time been utilizing the tool of commercial good sense in deciding business and financial cases.

[3] This, after all, is the core business of the courts and judges. In the words of Justice Benjamin Cardozo, "Law is Justice".

behaviour. It is by no means a perfect system, but it is a workable one in practice, albeit not without occasional difficulties or criticism.

2. Hong Kong is very much a paradigm jurisdiction. From its commercial beginnings in the 1840s through to the financial and business centre it has become today, commerce has always depended, indeed critically depended, on the common law. This has helped Hong Kong to try to fulfil the ambition desired by all financial centres : a flourishing commercial environment supported not only by effective and just commercial laws, but also by a sound legal system. In short, a trading and financial hub underwritten by the rule of law.

3. This reference to the rule of law is an important qualification. We have often heard reference to the term "laissez faire" applied to economies and, on a superficial level, commercial people on the whole think this to be good rather than bad when doing business.[4] A laissez faire policy (sometimes called positive non-intervention) is often said to apply to Hong Kong's economic policy and this dates back to a number of Financial Secretaries of the 1970s.[5] On 2 February this year, the Hong Kong Government welcomed the Heritage Foundation's ranking of Hong Kong as the world's freest economy for the 24th consecutive year.[6] The Heritage Foundation bases this assessment on factors such as fiscal health, business freedom, trade freedom, low tolerance for corruption, high degree of government transparency, an efficient regulatory framework, openness to global commerce and legal framework. It is the last

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[4] The term is said to have originated from a meeting between the great 17th Century French Minister of Finances Jean-Baptiste Colbert and a group of businessmen. The Minister asked how the State could best serve the business community, to which the answer was "laissez-nous faire" ('just leave us to get on with it' is a fair translation).

[5] Mainly Sir John Cowperthwaite and Sir Philip Haddon-Cave.

[6] The Heritage Foundation is a think tank based in Washington DC, having over the years considerable influence on US public policy making.

factor that interests me the most because it is a recognition that it is not enough simply to leave it to market forces and market players to "get on with it" without a proper legal system in place to ensure that all who are affected by economic forces, become subject to the law. I have earlier referred to the Benjamin Cardozo catchphrase and justice (and particularly relevant for present discussion purposes, the administration of commercial justice) is essentially the constitutional function of a judiciary. I suppose that in a commercial environment where there is no proper system of law, the existence of detailed rules and regulations is desirable compared with nothing at all. However, the weakness with having rules and regulations in abundance seeking to govern every aspect of commerce – in particular, the resolution of disputes – is that flexibility is perhaps sacrificed, and flexibility is key to justice. Government policy is largely dictated by many non-legal factors such as politics and economic considerations. Yet the resolution of disputes requires considerations of justice, equity and commercial fairness for all concerned, and these matters are very much encapsulated in the term the spirit of the law. This is where the common law steps in.

4. But can the common law justifiably claim credit in Hong Kong or indeed anywhere else for contributing to business and finance in the way I have just introduced this Lecture? I hope to explore some aspects of how the common law has operated in the sphere of commercial law to make out a reasonable case to this effect. In doing so, I am of course mindful of the premise for this series of lectures, being a comparison between civil law and common law systems in the context of business and finance.[7] I am of course not qualified to comment meaningfully on civil law jurisdictions but the test of a

[7] The 1998 Paper "*Law and Finance*" published by La Porta, Lopez-de-Silanes, Schleifer and Vishny (Journal of Political Economy 106(6) : 1113) makes a detailed comparison between common law and civil law jurisdictions. This Paper has been described as seminal : it is a comprehensive study of these jurisdictions from the point of view of important economic factors.

system, common law or otherwise, is how it copes with the aftermath of crises; in other words the litigation fallout. Litigation fallout can manifest itself in a number of ways : company collapses resulting in windings up, collapses in the property market and claims for damages and other relief arising from breaches of contract. Courts naturally do not only come into the picture when there have been severe financial crises; they also have to deal with everyday problems arising from commercial disputes. The challenge for the courts can at times be difficult : while legislators and financial institutions can learn from crises and legislate afresh on the basis of lessons learnt (in other words, using hindsight), courts on the other hand have to deal with disputes without the benefit of measures, legislative or administrative, that have focused on the particular problem before them. Courts have to utilize existing principles to deal with at times novel situations. That they are able to do so most of the time shows the strength of the common law.

5. I shall presently of course look at a number of cases, with an emphasis on Hong Kong cases, particularly those decided following financial crises. I will on the whole refer to cases decided by the Court of Final Appeal (the CFA), Hong Kong's highest court. My aim is not to enter into a discussion as to the correctness of what was determined nor to embark on a detailed legal analysis of them. There is more useful literature elsewhere. The objective is to provide an introduction into how the operation of the common law benefits business and finance.

6. I should first introduce Hong Kong. By the Treaty of Nanking, Hong Kong Island was formally ceded in perpetuity to the British Crown in August 1842.[8] This came in the aftermath of the Opium War and trade was the

[8] Article III thereof. However, the establishment of the British presence in Hong Kong is usually dated 26 January 1841 when the British first occupied the territory. The Kowloon peninsula was added to the

reason for the British presence in the Far East.[9] Albeit Hong Kong was described by the Foreign Secretary, Viscount Palmerston as a "barren rock with scarcely a house on it", the British interest in Hong Kong was for one reason alone : a foothold to develop commerce. In 1841, the population of Hong Kong numbered 7,450,[10] hardly a significant population. Ten years later the population had more than quadrupled, ten years after that it quadrupled again. By the start of the 20th Century, the population stood at 368,987; at the outbreak of the 2nd World War, it was 1,640,000. By 1971, the population was nearly 4 million, by the beginning of the 21st Century, it was 6,714,300. Now the population stands at nearly 7.5 million. For those who reckon in Gross Domestic Product terms, in 1961 Hong Kong's GDP *per capita* was (in today's terms) US$412; last year it was US$46,189. There is no doubt at all that commerce has been the historical reason for Hong Kong's development and importance.

7. Commerce is a complex activity that depends on a number of interconnecting factors in combination : natural resources, geographical advantages,[11] human activity and proper governance. Underlying all these factors which loosely make up the term "commerce" is the existence of not only a set of governing rules and regulations but also of a sound legal system, for it is the latter that allows the effective enforcement of legal rights and determination of liabilities.

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colony in 1860 and in 1898, it was further expanded to include a 99-year lease, ending on 30 June 1997, of the New Territories.

[9] The loss of the American colonies in the late 18th Century spurred on the need to expand into India and the Far East.

[10] Census and Statistics Department, Hong Kong Government.

[11] Hong Kong is a deep water port.

8. The legal system that was introduced in Hong Kong in 1841 was the common law system, which remains in place today.[12] One of the earliest ordinances[13] passed in Hong Kong was Ordinance No. 15 of 1844 which[14] stated that the law of England applied in Hong Kong except where local circumstances dictated otherwise. This followed a proclamation that had been issued on 2 February 1841 by Sir Charles Eliot[15] in which it was said that, "All British subjects and foreigners residing in, or resorting to, the island of Hong Kong, shall enjoy full security and protection, according to the principles and practice of British law." What was meant by these references to British law was, apart from the criminal law, commercial law.

9. The small population of Hong Kong in 1841 (it was therefore unlikely there was any meaningful legal system in place), the absence of established institutions to pass legislation afresh and the need to develop business and finance as quickly as possible meant that an existing (and preferably tried and tested) legal system had to be introduced to Hong Kong. There was nothing particularly innovative about this approach; after all this was essentially the experience in the American colonies. "In 1844, just months after the Treaty of Nanking was ratified, a virtual 'colonization kit' of ordinances was unpacked in Hong Kong. These ordinances present a full institutional picture of what laws a port needs to operate smoothly. One cluster of ordinances provided rules for commercial activity, from merchant shipping and harbour regulation to weights and measures, the registration of wills and deeds, rules on slavery and a

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[12] See para. 14 below.

[13] As statutes are referred to in Hong Kong.

[14] By section 3.

[15] The Chief Superintendent of British trade in China.

definition of usury."[16] This was virtually an instant transplanting of a ready made set of laws, not unlike many civil law jurisdictions which have incorporated the Napoleonic Code or German Civil Code.

10. Not only were laws incorporated wholesale into Hong Kong, thus providing the territory with a more or less sound basis in commercial law, there was also introduced the system of courts as we know it today : first instance courts, a court of appeal and ultimately a final court of appeal. The judges of Hong Kong would have at their disposal the corpus of the collective wisdom from previously decided cases. This was obviously a significant advantage compared with having to establish legal principles from "square one" : use could be made of the experience not only from England, but also from other colonies. The first appeal from Hong Kong to the Judicial Committee of the Privy Council was the 1853 case of *Yorick Jones Murrow v Charles James Eife Stuart*,[17] a case dealing with the issue of restrictive indorsements on bills of exchange. The judgment of the Supreme Court of Hong Kong, which was upheld by the Privy Council,[18] referred to a number of English authorities and textbooks.[19] Among the authorities was *Edie v The East India Company*,[20] a decision of Lord Mansfield CJ. It is perhaps an understatement to remark that a legal system that can rely on the commercial wisdom of judges like

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16 See David C Donald "*A Financial Centre for Two Empires : Hong Kong's Corporate Securities and Tax Laws in its Transition from Britain to China*" (Cambridge University Press) at Pg. 25. Such ordinances included the Merchant Shipping Ordinance No. 4 of 1844, the Harbour Regulation Ordinance No. 18 of 1844, the Weights and Measures Ordinance No. 22 of 1844, the Registration of Deeds, Wills & C. Ordinance No. 3 of 1844, the Slavery Ordinance No. 1 of 1844 and the Usury Laws Ordinance No. 7 of 1844.

17 [1842-1910] HKC 9; (1853) VIII Moore, P.C. 267.

18 Judgment of Sir John Patteson which agreed with the judgment of the Supreme Court.

19 Such as Chitty on Bills of Exchange (9th ed.).

20 (1761) 2 Burr 1216.

Lord Mansfield, is one that can instill confidence in the business and financial community.

11. There are a number of characteristics of a common law court system that are of considerable importance in this context. I begin by mentioning arguably the most important : the reasoned judgment. The common law, as applied to all areas and certainly in the context of business and finance, in its objective of arriving at commercially acceptable outcomes to legal disputes, requires not only firm and clear decisions but equally important, the existence of compelling reasons for such decisions. Ultimately, the main yardstick for determining the correctness and utility of any decision is the coherence and cogency of the reasoning in support. Another way of putting this is that the common law requires judgments be made on a principled and reasoned basis. It is the reasoning, at times lengthy, behind the determination of a legal dispute that enables the law to be properly understood as applied to particular facts. It is the application of principles to specific factual situations that enables the law to be understood by those affected by it and also to be developed. It is no wonder that the words of Justice Oliver Wendell Holmes ("The life of the law has not been logic; it has been experience ….. it cannot be dealt with as if it contained the axioms and corollaries of a book of mathematics")[21] are often used to describe the impact of the common law on business and finance. Only when novel and hitherto unforeseen factual situations emerge can the law truly be understood and developed.

12. The importance of reasoning can be seen in the doctrine of precedent, often used as the prime characteristic whenever one is asked to define the common law. This doctrine (*stare decisis*) has as its foundation the properly reasoned judgment, for it is the reasoning of judgments that is utilized

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[21] *The Common Law* (1881) Pg. 1.

in future cases. In the area of commercial law, the features of consistency, certainty and predictability (the polar opposites of arbitrariness) are promoted by reason of the doctrine of precedent. No doubt bad precedents can be created and it is a fair criticism that the doctrine can perpetuate a bad state of affairs, but on the whole the benefits have outweighed the disadvantages. The advantages can quite easily be seen when one looks at the wisdom displayed by great commercial judges in their judgments, whose wisdom continues to influence commercial law to this day.[22]

13. The doctrine of precedent became firmly rooted in the common law of Hong Kong. Before the resumption of the exercise of sovereignty over Hong Kong by the People's Republic of China on 1 July 1997, the highest appellate body in Hong Kong's legal system was the Judicial Committee of the Privy Council.[23] Decisions of the Privy Council were naturally binding on all lower Hong Kong courts. Since the membership of the Judicial Committee of the Privy Council often mirrored that of the House of Lords, the decisions of the House of Lords on matters on which there was no material difference between the United Kingdom and Hong Kong, were equally binding from a practical point of view. In *De Lasala v De Lasala*,[24] in which the Privy Council had to look at the provisions of the Hong Kong Matrimonial and Property Proceedings Ordinance,[25] which were identical to the equivalent provisions in the English Matrimonial and Property Proceedings Act 1970, Lord Diplock said this,[26]

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[22] I have earlier referred to Lord Mansfield. Many great commercial lawyers spring to mind : Lord Reid, Lord Devlin, Lord Diplock, Lord Wilberforce, Lord Goff of Chieveley, Lord Bingham of Cornhill, to name just a few. They are good companions to have along the way to deciding a case.

[23] Strictly speaking not a court as such although functioning of course as the highest appellate court. Technically, an appeal was to the Sovereign who sought advice from the Privy Council.

[24] [1980] AC 546.

[25] Cap. 192.

[26] At 558A-B.

"looked at realistically its decisions [that is the decisions of the House of Lords] on such a question will have the same practical effect as if they were strictly binding and courts in Hong Kong would be well advised to treat them as being so".

14. Since 1 July 1997, the constitutional document governing Hong Kong is known as the Basic Law.[27] This document sets out the constitutional position of Hong Kong, which is described as a Special Administrative Region of the People's Republic of China. For present purposes, a number of provisions should be highlighted :-

(1) Articles 2, 19 and 85 refer to the concept of judicial independence.

(2) Article 8 states that the common law and rules of equity continue to apply in Hong Kong.

(3) Article 81 states that the "judicial system previously practised in Hong Kong shall be maintained". This is a direct reference to the common law system.

(4) Article 82 states that the power of final adjudication is vested in the CFA (as I mentioned earlier, this now being the highest appellate court in Hong Kong replacing the Judicial Committee of the Privy Council) "which may as required invite judges from other common law jurisdictions" to sit on the Court.[28]

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[27] The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, promulgated on 4 April 1990.

[28] On every substantive appeal heard by the Court of Final Appeal since 1 July 1997 (except for about 5 or 6 appeals), the Court has included one overseas common law jurisdiction judge. The panel of judges from common law jurisdictions come from the United Kingdom, Australia, Canada and New Zealand, and

(5) Article 84 states that the Hong Kong courts may refer to precedents of other common law jurisdictions.

15. The doctrine of precedent continues to apply. The CFA in *Solicitor (24/07) v Law Society of Hong Kong*[29] made authoritative statements regarding the doctrine :-

(1) Decisions of the Judicial Committee of the Privy Council from Hong Kong continue to be binding on the Hong Kong courts below the level of the CFA.[30] Decisions of the CFA are also binding on the lower courts but the CFA itself may depart from its own decisions or the decisions of the Judicial Committee of the Privy Council.[31]

(2) It is important that precedents from other common law jurisdictions should be used in Hong Kong. This is one of the great benefits of a common law system, that guidance can be obtained from precedents from overseas jurisdictions, commonly but not restricted to decisions from common law jurisdictions. It was said by the Chief Justice,[32] "After 1 July 1997, in the new constitutional order, it is of the greatest importance that the courts in Hong Kong

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include Baroness Hale of Richmond, Lord Neuberger of Abbotsbury, Lord Phillips of Worth Matravers, Lord Hoffmann, Lord Walker of Gestingthorpe, Lord Millet, Lord Collins of Mapesbury and Lord Clarke of Stone-cum-Ebony (from the United Kingdom), the former Chief Justice McLachlin (from Canada), the former Chief Justices of Australia Sir Anthony Mason, Sir Gerard Brennan, Gleeson CJ and French CJ, the former Chief Justice of New South Wales, Spigelman CJ and judges from New Zealand such as Lord Cooke of Thorndon, Sir Ivor Richardson, Sir Thomas Eichelbaum and Sir Thomas Gault.

29 (2008) 11 HKCFAR 117.

30 At para. 8.

31 At para. 18.

32 At para. 16.

should continue to derive assistance from overseas jurisprudence". In the area of a human rights law, the Hong Kong courts have derived much assistance from jurisprudence of the European Court of Human Rights.

(3) The significance of the doctrine of precedent regarding business and finance was expressed in the following way by Chief Justice Li, "It gives the necessary degree of certainty to the law and provides reasonable predictability and consistency to its application. Such certainty, predictability and consistency provide the foundation for the conduct of activities and the conclusion of business and commercial transactions." And then caution is expressed : "But at the same time a rigid and inflexible adherence by this Court to the previous precedents of Privy Council decisions on appeal from Hong Kong and its own decisions may unduly inhibit the proper development of the law and may cause injustice in individual cases. The great strength of the common law lies in its capacity to develop to meet the changing needs and circumstances of the society in which it functions."[33]

16. No doubt these words have both a familiar as well as an obvious ring to them, but these aspects of predictability, certainty, flexibility and justice feature in a significant way in how courts deal with commercial law. The courts have been trusted to come up with the right answer and this characteristic of many common law jurisdictions certainly applies in the case of Hong Kong. I use the word "trusted" deliberately because a compelling case can be made for the proposition that the way many statutes are drafted presuppose a reliance, quite deliberate in my view, on courts to formulate and apply principles of law

[33] At para. 19.

in order to solve at times very complex problems in a just manner. This is particularly so in the sphere of business and finance.

17. A ready example of this is seen in the case of money lending. I have earlier referred to usury laws as being one of the first statutes to be enacted in Hong Kong.[34] The governing statute in this area is the Money Lenders Ordinance.[35] Some of its provisions were taken from English, Australian or New Zealand legislation, but the bulk of the Ordinance was taken from the English Money Lenders Acts of 1900 and 1927, although substantial amendments were made to the Ordinance in 1980. The point here is that even though money lending legislation has all but disappeared in England,[36] it has been left fairly intact in Hong Kong. The Ordinance does not apply to institutions such as banks,[37] but it applies to the many institutions in Hong Kong which are in the business of lending money. The reason for the disappearance of money lending legislation in the United Kingdom was that it was seen to be excessively technical, given the severe civil and criminal consequences for breach, and therefore having an unhealthy and inhibiting effect on commercial lending.[38]

18. Historically,[39] the purpose of the usury laws was to protect the public from the obvious potential for abuse in this area. With the advent of the Industrial Revolution in England came vastly increased numbers in the working class. This led to an increased demand for credit among this class : work could

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[34] See para. 9 fn 16 above.

[35] Cap. 163.

[36] The Consumer Credit Act 1974 represented a major shift away from the previous money lending legislation.

[37] Section 3.

[38] See Bob Allcock "*The Money Lenders Ordinance*" (1981) HKLJ 293.

[39] See *The Oxford History of the Laws of England* Vol. XII at Pg. 834 et seq. for a useful historical account.

be irregular in many occupations, leading to unemployment; hence the need for borrowing in order to keep afloat. The Victorian notion of the freedom of contract, the consequent repeal of the usury laws in 1854[40] and the treatment of money as a commodity like any other, led to the cost of borrowing (in other words, interest) being dictated by powerful lenders. However, there was no effective freedom to bargain as far as many borrowers were concerned if they came from the working class, whatever may have been the theory. It was with this background that the money lending statutes came into being to combat the obvious abuse. As mentioned earlier, such statutes have been repealed in England (the Consumer Credit Act 1974 heralded a new approach to consumer credit), but the Money Lenders Ordinance remains in Hong Kong. The present legislation was last substantially amended in 1980 when abuse was rampant : when the Attorney General explained the legislation, reference was made to interest rates being charged between 100% and 350%, and even cases of up to 1,400% were not unheard of.[41]

19. One of the major protections under the Money Lenders Ordinance is contained in s. 18 which prescribes the form of a loan agreement requiring a memorandum containing the salient terms of the agreement including the rate of interest to be charged expressed as a rate per annum. Where there is a breach of this requirement, no agreement for the repayment of money lent by a money lender or for the payment of interest thereunder shall be enforceable.[42] However, the strictness of this is tempered by s. 18(3) which states :-

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[40] By s. 1 of the Usury Laws Repeal Act 1854. Parliament was persuaded by laissez faire economists and philosophers that the usury laws were no longer necessary.

[41] Hong Kong Legislative Council Official Record of Proceedings Wednesday, 28 May 1980 at Pg. 848.

[42] See s. 18(1).

> "Notwithstanding subsection (1), if the court before which the enforceability of any agreement or security comes in question is satisfied that in all the circumstances it would be inequitable that any such agreement or security which does not comply with this section should be held not to be enforceable, the court may order that such agreement or security is enforceable to such extent, and subject to such modifications or exceptions, as the court considers equitable."

20. This provision is a critical one. It is one which recognizes that there may be situations in which the justice of the matter would make it unfair not to permit enforcement of certain loan agreements, notwithstanding a breach of the requirements of the statute. More important for our purposes is the recognition on the part of the legislature that the responsibility for determining the consequences of a breach of the Ordinance rests not in setting out in the legislation the various situations in which relief may be possible or to enumerate the criteria to be applied, but to leave it to the courts to develop the applicable principles on a case by case basis, applying equitable considerations. That this was clearly the thinking behind this provision can be seen when one examines the background to the English Money Lenders Act 1900. Before the Act was passed, the House of Commons appointed a Select Committee which published a report recommending the enactment of the 1900 Act. The report stated in part :-

> "The two fundamental proposals made to the Committee were – '… (2) That the Courts should have power to go behind any contract with a money-lender, to inquire into all the circumstances of the original loan and of the subsequent transactions, and to make such order as may be considered reasonable.' … As regards the

> second proposal … the Committee say, 'After carefully considering the whole of the evidence and opinions, your Committee have arrived at the conclusion that the only effective remedy for the evils attendant upon the system of money-lending by professional money-lenders is to give the Courts absolute and unfettered discretion in dealing with these transactions." [43] (emphasis added).

21. The report led to the enactment of s. 1(1) of the Money Lenders Act 1900 giving the court the power to reopen a transaction where the interest was excessive and "the transaction is harsh and unconscionable, or is otherwise such that a court of equity would give relief". This reference to equity was deliberate and was a recognition of the court's power to grant relief in equity in order to prevent an oppressive bargain. This can be illustrated by *Barrett v Hartley*,[44] a case decided after the abolition of the usury laws in 1854, where Sir J Stuart VC said :-

> "But it is an observation of some importance now that the usury laws are repealed, that one effect of such repeal was to bring into operation, to a greater extent than formerly, another branch of the jurisdiction of this Court which existed long before them — I mean, that principle of the Court which prevented any oppressive bargain, or any advantage exacted from a man under grievous necessity and want of money, from prevailing against him. Whoever has attended to the subject must have seen that the moment the usury laws were repealed, and the lender of money became entitled to exact anything he pleased in the name of

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[43] "Money-Lending", Report from the Select Committee, Imperial Parliament, 29 June 1898.

[44] (1866) LR 2 Eq 789, at 795.

> interest, from that moment that jurisdiction of the Court which prevailed independently of the usury laws was likely to be called into active operation."

22. Considerations of equity require the court to look at the breach in question, its consequence for the parties and other relevant circumstances : see *Emperor Finance Ltd v La Belle Fashions Ltd*[45] This case involved the trading in share index futures in which positions are taken on the movement of underlying shares or market indices over a specified period. Connected to the trading was a margin account under which credit was extended to the borrower to enable trading in futures to take place on a leveraged basis.[46] This is interesting for our purposes, for it illustrates the point that despite the fact that the origin and purpose of the Money Lenders Ordinance was the protection of lenders from abuse in relatively simple loan situations, the court has had to adapt the application of an old statute and to apply basic equitable principles to increasingly sophisticated and complex financial transactions.

23. This point is also illustrated by another decision of the Court of Final Appeal : *Strong Offer Investment Ltd v Nyeu Ting Chuang*.[47] This case was one of the cases in the aftermath of the stock market crash of 1997 and involved the trading this time in securities on margin by the defendant borrower

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[45] (2003) 6 HKCFAR 402 at para. 119 (Ribeiro PJ).

[46] A margin account operates typically in the following way. Whereas in a straightforward purchase of, say, shares, the full amount becomes payable (number of shares x price of share), in a margin account, credit is given to the investor by the lender so that shares can be purchased without the full or any amount of money being paid for them by the investor; the money is lent to the investor. If the price of the shares moves upwards, no problems arise and the borrower investor takes profits less the cost of the shares. Where, however, the market moves against the borrower and the price of the shares drops, then losses occur. Since, typically in a margin trading account, a period of time is stipulated under the contract for open positions to be closed out, there may be a requirement to provide monies to cater for any potential losses (these are called margin payments) depending on the market movement of the securities in question. In a rapidly changing market, the credits effectively extended to a borrower can change on a daily basis.

[47] (2007) 10 HKCFAR 529.

under two loan agreements. Following the crash, the defendant became substantially indebted to the lender but alleged that there had been breaches of the Money Lenders Ordinance. Given that, as analyzed in the *Emperor Finance* case, the granting of credits in a margin trading account constituted separate loans, strictly speaking, a fresh note or memorandum had to come into existence each time such a credit was given. In an actively traded margin account, this would literally mean that a vast amount of documentation would be required just to comply with the formal requirements of s. 18. Though a breach of the Ordinance had taken place, the court exercised its powers under s. 18(3) to enforce the agreement against the borrower because it was equitable to do so. In doing so, the court took into account the fact that in a margin trading account, full compliance with the requirements of the Ordinance was "difficult if not impossible"[48] and that the borrower in the case was a "highly educated" and "sophisticated investor" who was fully aware of the risks and understood what he was doing.[49] It was observed that s. 18 (indeed the money lending legislation generally) was there to protect the "uneducated, ignorant and unsophisticated"[50] and was not intended "to stifle genuine money-lending transactions or to let the money lender lose all the money he has lent out and all the security he has because of a failure to comply with all such requirements [of the Ordinance], however trivial or unintentional the breach may be".[51]

24. As these cases show, the court is entrusted with the responsibility, not only to arrive at a just result, but also to do so while adapting the law to novel situations. Human ingenuity has not reached a stage such that all scenarios can be safely predicted (by say the legislature); it is experience that

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48 At para. 25.

49 At paras. 5 and 64.

50 At para. 18.

51 At para. 19.

forces the law to be developed. In a common law jurisdiction, it is left to the courts to develop the law through experience, and none more so than in the area of business and finance.

25. The Money Lenders Ordinance contains further references to the application of equity in the context of the enforcement of loans by unlicensed money lenders.[52] Where a loan is deemed extortionate,[53] the court has the power to reopen the transaction "so as to do justice between the parties". Such open textured phrases in relation to the court's power are to be found in many statutes. For example, in consumer protection in the Unconscionable Contracts Ordinance,[54] one finds references to "unconscionable" contracts. In the Control of Exemption Clauses Ordinance,[55] contractual terms have to satisfy the requirement of "reasonableness".

26. It is however of critical importance always to bear in mind that the approach of common law courts to the wide powers given to them is a principled one. There is no question of an arbitrary approach to the resolution of cases based on vague and undefined concepts of fairness.[56] Indeed, the definition of equity is not a loose concept of fairness at all. There is of course an ethical or moral element in it but this is superimposed in a principled manner onto existing rules, providing flexibility where those rules are seen to be

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52 Section 23.

53 Where the applicable interest rate is excessive i.e. over 48% per annum.

54 Cap. 458.

55 Cap. 71.

56 We have all been taught early in our law studies that cases were never to be decided according to the length of the "Chancellor's foot". This is a reference to the criticism made of the courts of equity in the 17th Century when it was perceived that the Lord Chancellor could be arbitrary in the way cases were decided. John Selden, the 17th Century jurist and philosopher referred to the Chancellor's foot being "long, short or indifferent" depending on who occupied the office (from *Selden, Table-Talk Writings*, 1689).

inadequate or too rigid.[57] The common law courts do not operate as a jury might and if it is to secure the interests of business and finance, it must lay down principles that not only deal with the dispute at hand but also to provide guidance in the future.

27. Company legislation contains a number of references to equity. Perhaps the most well-known is the ground for winding up based on the court being of the opinion that it is "just and equitable" to do so. One of the most common consequences of a financial crisis is the collapse of companies. While the content of company legislation is voluminous, it is surprising that provisions dealing with the collapse of companies and the consequences are fairly sparse and, where they exist, deceptively simple. It has largely been left to the courts to devise and develop the law on insolvency, and this is far from being a simple task. As a matter of legal history, the involvement of the courts in company collapses intensified particularly during the "boom and bust" years experienced in England in the 19th Century. The Industrial Revolution led to a proliferation of companies asking the public to invest in increasingly diverse and risky ventures. There were regular stock market booms and slumps. In 1845, "railway mania" took over. 1,520 companies were provisionally registered, giving the public a somewhat false sense of confidence in their viability and solvency : many of them were to fail.[58] Courts were directly in the firing line of having to deal with the aftermath of crises. As early as the beginning of the 19th Century, Lord Ellenborough warned the public against engaging in "mischievous and illegal" speculative projects.[59]

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57 For a useful introduction, see *Snell's Equity* (33rd ed.) at paras. 1-002 to 1-004.

58 *The Oxford History of the Laws of England* Vol. XII at Pg. 623.

59 *R v Dodd* (1808) 9 East 516, at 528.

28. In Hong Kong, there is an abundance of family owned companies and these companies own substantial assets. In a study published in 2000,[60] it was estimated that as at 1996, 84.2% of Hong Kong's listed companies were owned by 15 families and that 72.5% of Hong Kong's 20 largest companies were family owned. These figures are now out of date (there has not been a more recent study) and may not even be entirely reliable but the point remains a valid one that family dominated companies are common in Hong Kong. In 2002, Standard & Poor commented that "the predominance of family owned companies in Hong Kong creates concerns about ownership transparency and the influence of dominant shareholders".[61] The question of how minority shareholders are protected becomes an extremely relevant question, but one which has largely been left to the courts to develop.

29. In *Kam Leung Sui Kwan v Kam Kwan Lai*,[62] the CFA had to deal with disputes that had arisen between family members in a BVI company which, through its subsidiaries, carried on business in Hong Kong (a famous roast goose restaurant business). There were allegations of unfair prejudice. This brought into play the old s. 327 of the Hong Kong Companies Ordinance[63] which stated that a foreign registered company "may" be wound up "if the court is of opinion that it is just and equitable that the company should be wound up". There are equivalents to this provision in many jurisdictions. Within this simple legislative framework came two important questions for determination : first, under what circumstances would it be appropriate for the Hong Kong Companies Court to assume jurisdiction given that the company in question was

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60 Claessens, Djankov and Lang "*The Separation of Ownership and Control in East Asian Corporations*" (2000) 58 Journal of Financial Economics 81, at 106, 108.

61 Standard & Poor : Corporate Governance in Hong Kong (22 January 2002) at 9.

62 (2015) 18 HKCFAR 501.

63 Now reproduced as s. 327 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance Cap. 32.

a BVI company; and secondly, what were the applicable principles to determine whether it would be just and equitable to wind up?

30. The first question involved examining the exercise of the jurisdiction (which there undoubtedly was) to wind up a foreign company, a jurisdiction that has been described as "exorbitant" or as "usurping the functions of the courts of the place of incorporation".[64] In the joint judgment,[65] reference was made to a number of English authorities dealing with creditors' petitions to wind up an overseas company, although in the case before us, this involved a shareholders' petition. The governing principle was, however, the same in both types of petition, namely to find out the closeness of the connecting factors with the *lex fori*, Hong Kong. In the case of a creditors' petition, the emphasis is usually on the location of assets; in a shareholders' petition (in which the company itself often plays no part at all) it is the presence of the warring shareholders within the jurisdiction that will matter.[66] The notable feature of this case was that, as the court remarked, there was a dearth of authorities on shareholders' petitions involving foreign companies. Though rare in a jurisdiction like England where there was often no occasion to use an overseas incorporated company, this was not the case for Hong Kong owing to the likelihood of the presence of more family-owned companies.[67] This illustrates well the ability of the common law applying different factors to deal with new situations even though the underlying legislation may be the same in many jurisdictions.

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64 Re. *Drax Holdings Ltd* [2004] 1 WLR 1049, at 1054 (Lawrence Collins J as he then was).

65 Of Ma CJ and Lord Millett NPJ (with which the other members of the court agreed).

66 See para. 27.

67 At para. 28.

31. The way the court dealt with the second question (whether it was just and equitable to wind up the company) reaffirmed the point I was making earlier that even though wide powers are given to the court, it exercises these powers in a principled, not random and certainly not arbitrary, way. The joint judgment contains the following statement,[68] "As numerous cases made clear ….. this [the exercise of the power vested in the court to wind up] does not mean that a judge can do whatever he or she happens to regard as fair. The law relating to corporations needs to be as clear and defined as possible so that companies (and their legal advisers) know as much as possible where they stand."

32. One of the cases referred to in *Kam Leung Sui Kwan* was *O'Neill v Phillips*.[69] The point I have already made about the legislation entrusting the court with the ultimate responsibility to do what was right and develop the law in a principled way was made by Lord Hoffmann[70] in relation to s. 459 of the English Companies Act 1985[71] :-

> "In section 459 Parliament has chosen fairness as the criterion by which the court must decide whether it has jurisdiction to grant relief. It is clear from the legislative history (which I discussed in *In re Saul D. Harrison & Sons Plc.* [1995] 1 B.C.L.C. 14, 17-20) that it chose this concept to free the court from technical considerations of legal right and to confer a wide power to do what appeared just and equitable. But this does not mean that the

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68 At para. 45.

69 [1999] 1 WLR 1092.

70 At 1098.

71 As amended by the Companies Act 1989. This is the unfair prejudice provision. It is now to be found in s. 994(1) of the Companies Act 2006.

> court can do whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. As Warner J. said in *In re J.E. Cade & Son Ltd* [1992] B.C.L.C. 213, 227: "The court … has a very wide discretion, but it does not sit under a palm tree."

33. The same point was made again by the CFA when dealing with the Hong Kong equivalent of s. 459 : s. 724(1)(a) of the Companies Ordinance.[72] Under s. 725(1)(a), where the court is of the view that the affairs of a company have been conducted in an unfairly prejudicial manner, then the court can "make any order that it thinks fit for giving relief in respect of the matter". In a situation where unfairly prejudicial conduct on the part of a shareholder has caused loss to the company, can relief be sought in the form of restitutionary relief being granted in favour of the company by the defaulting shareholder? This question arose in *Re. Chime Corp Ltd*.[73] This was an offshoot of one of the most publicized and colourful incidents in Hong Kong's corporate history. Mr Teddy Wang and his wife, Nina Wang, controlled one of the largest property owning groups in Hong Kong.[74] In 1990, Mr Wang was kidnapped for ransom and although his body was never recovered, he was presumed dead. Mrs Wang then took over control of one of the companies in the group (among others), Chime Corp Ltd. It was alleged that she caused the company to make a loan of some $4.5 billion to a company in which she was beneficially interested. The pleadings (the petition) sought relief against her (and other allegedly errant directors) including orders to make restitution to the company. Reliance was

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[72] Cap. 622.

[73] (2004) 7 HKCFAR 546.

[74] The Chinachem group of companies.

placed on the then equivalent of s. 725(1)(a).[75] The Court of Appeal permitted this pleading to proceed essentially on the basis that the statutory provision was in such wide terms that an order for restitution must have been included as one of the possible remedies.[76] The CFA was of a different view. After referring to cases following the Rule in *Foss v Harbottle,*[77] the court held that where misconduct was the essence of the complaint, the proper course was for the company to claim against those who had misconducted themselves in a derivative action, rather than seek relief in an unfair prejudice petition. The important aspect of this case is again the reiteration that notwithstanding wide powers given to the court, it is important that the court should adopt a principled and disciplined approach.[78] In this instance, the court adopted a strict approach regarding the proper procedure for resolving the question of misconduct in the running of a company's affairs.

34. The unfair prejudice provisions in a statute are but one example where the courts have had to formulate principles in developing the law almost from scratch without any real guidance from the wording of the statute. We have just seen how the courts have dealt with the aspect of winding-up. Another aspect which can be mentioned is the law on schemes of arrangement. Again, the relevant statutory wording is simple, yet no guidance is given as to how schemes are to be considered in practice. Schemes of arrangement are one of the most important measures to be considered in the aftermath of a financial crisis when the existence of companies are threatened. In Hong Kong, schemes

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75 Section 168A(2) of the Companies Ordinance Cap. 32.

76 The decision is reported as *Tan Man Kou v Chime Corp Ltd* [2004] 2 HKC 115 (Ma CJHC).

77 (1843) 2 Hare 461.

78 This is abundantly clear in the judgment of Lord Scott of Foscote NPJ. At para. 40 he said this, "The fact, however, that the terms of a statute create or confer a jurisdiction in very wide terms does not necessarily mean that the courts have an unlimited jurisdiction to make any orders that are within the wide statutory terms."

of arrangement are dealt with under Part 13, Division 2 of the Companies Ordinance. The language used is again deceptively simple : section 670 refers only to the power vested in the court to order a meeting of creditors as a whole or of a particular class of creditors. No guidance is given as to how classes of creditors are to be determined to enable all relevant classes to be properly represented and to ensure that persons with perfectly legitimate interests are not prejudiced. This is the important question for the court to consider when asked to convene a meeting of creditors for the purpose of a scheme of arrangement. In *UDL Argos Engineering and Heavy Industries Co Ltd v Li Oi Lin*,[79] the CFA considered this question. In that case, there were different classes of creditors comprising both preferential creditors and unsecured creditors. The company involved was a parent company (which was listed on the Stock Exchange) with more than 100 direct and indirect subsidiary companies. The group was engaged in the business of building services, marine engineering, contracting and structural steel. The whole group was a victim of the Asian Financial Crisis[80] and it collapsed, with numerous creditors' petitions to wind up being presented. In determining the question of how classes of creditors should be convened, the court sought guidance from the jurisprudence of England, Australia, New Zealand, South Africa and elsewhere in the Commonwealth which spanned the course of a century. These were regarded as "of great weight" in considering the application of the relevant provisions in the Hong Kong Ordinance.[81] This reflects one of the great strengths of the common law that reference is made to the relevant case law of similar jurisdictions. In

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79 (2001) 4 HKCFAR 358.

80 I have already mentioned the effects of this crisis on the Hong Kong stock market : see para. 23 above. This was the name given to the financial crisis that took place in East Asia in 1997 following the collapse of the Thai Baht. Among ASEAN (Association of South Eastern Nations) countries the debt to GDP ratios reached 180%. The IMF needed to inject approximately US$40 billion to stabilize the currencies of South Korea, Thailand and Indonesia (who were the hardest hit). The Hong Kong stock market dropped to such an extent that the Government bought about US$15 billion worth of shares to support the market.

81 At paras. 11, 15 and 16 in the judgment of Lord Millet NPJ.

determining the issue, the court would have regard to the views of the business community[82] but balance these against other interests to prevent any oppression by the majority on minority groups.[83] Lord Millett's statement of the applicable principles regarding schemes of arrangement[84] is a stark example of the point I have been trying to make that it has been deliberately left to the courts to consider the law in detail and develop it, and then apply it in a flexible manner depending on the particular facts of any given case before them. And it scarcely needs saying that flexibility is the key to ensuring that justice is done, provided that this is achieved by adopting at all times a principled approach. The decision in *UDL* is a significant one and has been applied to schemes of arrangement following the global financial crisis of 2008[85] : see, for example, *Re. Lehman Brothers Futures Asia Ltd*.[86]

35. I have earlier made several references to the massive economic growth following the Industrial Revolution, which gave rise to a prosperity that had hitherto been unparalleled in history. Commercial people – those involved in business and finance – understandably expected their interests to be protected by the courts. The following extract[87] captures this sentiment : "Until the 1830s, the approach of the judges was influenced by the ideas of a pre-industrial moral economy; after 1830, they were increasingly sympathetic to the approach of new political economists and utilitarian thinkers, which sought to encourage

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82 At para. 25.

83 At para. 26.

84 At para. 27.

85 This crisis began with the bursting of the subprime mortgage bubble in the US giving rise to a massive banking and investment crisis leading to the collapse of Lehman Brothers. It was the worst of its kind since 1929. The aftermath saw massive changes in laws and regulations in the banking and regulatory fields, but of course none of the troubles was anticipated by any government. It was left to the courts to try to resolve the many problems that arose.

86 [2017] 2 HKLRD 871.

87 From *The Oxford History of the Laws of England* Vol. XII at Pg. 297-8.

commercial enterprise, and free market individualism." This, it could be said, was the confirmation of the approach that had begun with Lord Mansfield, to mould commercial law in accordance with the expectations of the commercial community. It was clear that legislation could not keep up with the times but the courts seriously attempted to do so. "Cases which came before the courts often involved significant fractures in the economic system, for which no solution had been anticipated by the legislation. Judges had, of necessity, to be social and economic policy makers, with policy made through the artificial prism of the case before them."[88] It was in this environment that the law of contract made significant advances during the 19th Century in cases involving offer and acceptance, consideration, mistake, fraud, anticipatory breach and a topic with which I shall deal in more detail presently, damages. The judicial mindset was one in which the law followed commercial practice, or at least very much took it into account. This is clearest in the law relating to sale of goods, with the courts looking to the practice of merchants regarding aspects such as the passing of risk or property.

36. In the court structure, the need to meet the expectations of the commercial community led to the establishment of the Commercial Court in England (Hong Kong followed suit). As Devlin J said in *St. John Shipping Corporation v Joseph Rank Ltd*,[89] "The Commercial Court was introduced in England ….. so that it might solve the disputes of commercial men in a way which they understood and appreciated, and it is a particular misfortune for it if it has to deny that service to any except those who are clearly undeserving of it."

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[88] At Pg. 300.

[89] [1957] 1 QB 267, at 289.

37. At its most basic, business and finance are about money and profits. To a commercial person, nothing else really matters. It is certainly not about what might or might not be regarded as commercial morality. Commercial parties who went to court in the 19th Century had no desire for their rights and liabilities to be settled "according to the moral economy of a jury".[90] It was only from the beginning of the 19th Century that there was a noticeable decline in the significance of jury trials. This coincided with the growth in commerce and in commercial litigation. The jury system was inadequate to cope with the complexities of commercial law; in practice considerable delays were encountered when judges had to send the jury away for deliberation time and time again. One of the methods of taking matters away from the jury was to treat aspects of a dispute as questions of law (which were the province of the judge) rather than as fact. One such question was that of damages.

38. The treatment of damages by the courts provides a good final case study in relation to the theme of this series of lectures. It exemplifies the role of common law courts in creating and developing the law in a principled but flexible way, all of this directed towards serving business and finance. In this area, the law has been virtually entirely created by the courts. I will concentrate on one aspect of the law of contractual damages : loss of profits.

39. In the early part of the 19th Century, courts were unsympathetic to awarding damages to reflect loss of profits, regarding them as too speculative.[91] The breakthrough came in the seminal decision of the Court of Exchequer in *Hadley v Baxendale*,[92] said by the authors of *McGregor on Damages*[93] to be

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90 *Oxford History of the Laws of England* Vol. XII at Pg. 530.

91 See, for example, *Clare v Maynard* (1837) 6 Ad. and El. 519, at 524.

92 (1854) 9 Ex 341. This was the case in which the plaintiff (Hadley) owned and operated a flour mill in Gloucester. It contracted with the defendant (Baxendale) to deliver a broken crank shaft from the mill to

"the most celebrated case in the field of contract damages". Whether the case ought to enjoy this iconic status is perhaps open to debate but this is immaterial for present purposes. The importance of the decision, as every law student knows, lay in the statement of the consequences of a breach of contract. The contract breaker will be liable for damages "as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."[94] (emphasis added). It is the second part of this statement that is particularly relevant to the award of loss of profits.

40. *Hadley v Baxendale* marked a significant milestone in legal history and in particular in the law of contract. It has gained almost mythical status as being the first to introduce the concept of the damages that can be awarded for loss of profits. For our purposes, the significance of this case can be stated in the following way :-

(1) This was another example of common law courts creating and developing the law to meet the needs of the commercial community. One of the judges in *Hadley v Baxendale* was Martin B. He was later, in *Wilson v The Newport Dock Co.*[95] to refer to the need to have regard to "the exigencies of commerce and the business of life."

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the manufacturer so that a new shaft could be made. There was a delay in delivery with the result that Hadley suffered loss of profits through the mill being out of operation for the period of delay. Hadley claimed damages representing loss of profits.

93 20th ed., 2018 (HH Justice James Edelman of the High Court of Australia) at paras. 8-158.

94 At 355 (Alderson B).

95 (1866) LR 1 Ex. 177, at 189.

(2) Though the point of law determined in the case was novel, it was not based on some random thought or theory. It was firmly rooted in principle. The court was referred to previous authorities, one of which was *Black v Baxendale,*[96] in which Pollock C B had intimated that if the defendant carrier had in contemplation certain matters, it might have been liable for loss of profits.[97] More telling is a reference to a remark made during argument by another of the judges in *Hadley v Baxendale*, Parke B, who expressly referred to provisions in the French Civil Code[98] and stated their effect as follows[99] : "The damages due to the creditor consist in general of the loss that he has sustained, and the profit which he has been prevented from acquiring, subject to the modifications hereinafter contained. The debtor is only liable for the damages foreseen, or which might have been foreseen at the time of the execution of the contract ….." It is clear that the judgment of Alderson B must have been guided by statements of principle, particularly from the French Civil Code,[100] and credit should be given here where credit is due. For our purposes, this illustrates the approach of common law courts to seek guidance, not just from other common law sources, but from any source that can shed light on particular problems. It is part of the flexibility of a common law court that it is open to seeking guidance from whatever source, as long as it is relevant.

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96 (1847) 1 Exch. 410.

97 At 411.

98 Articles 1149, 1150 and 1151.

99 At 347.

100 And possibly even by the writings of Robert Joseph Pothier whose *Traité des Obligations* has been immensely influential.

41. It was of course wrong to treat what was said in *Hadley v Baxendale* as a final word on the law of damages. It was in reality only the beginning and it would be left to courts to develop and refine the principle through experience. One of the main difficulties of the second principle in *Hadley v Baxendale* is to gauge the limits of the extent of liability in terms of what is contemplated. In many situations, one can imagine the contemplation by the parties of what might turn out to be a massive liability, yet it would appear to be unjust to saddle a contract breaker with such liability. An early case which hinted at this potential problem was *British Columbia and Vancouver's Island Spar, Lumber and Saw-Mill Co Ltd v Nettleship*,[101] in which Willes J[102] said in relation to the requisite contemplation on the part of the contract breaker, "The knowledge must be brought home to the party sought to be charged under such circumstances that he must know that the person he contracts with reasonably believes that he accepts the contract with the special condition attached to it." (emphasis added). Willes J relied on these remarks in *Horne v Midland Railway Co.*[103] These words echoed the writings of John D Mayne who said this,[104] "The question is not what profit the plaintiff might have made, but what profit he professed to be purchasing. Not what damage he actually suffered, but what the other contemplated and undertook to pay for." (emphasis added).[105] It is this concept of an acceptance and undertaking of responsibility that is of interest.

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101 (1867-68) LR 3 CP 499.

102 James Shaw Willes (Willes J) was counsel in *Hadley v Baxendale*.

103 (1871-72) LR 7 CP 583, at 591. This was upheld on appeal to the Exchequer Chamber (1872-73) LR 8 CP 131.

104 In his "*Treatise on the Law of Damages*" (1856).

105 It is right to note that both *Nettleship* and *Horne* were criticized in subsequent cases : see the speech of Lord Upjohn in *The Heron II* [1969] 1 AC 350; *GKN Centrax Gears Ltd v Matbro Ltd* [1976] 2 Lloyd's Rep. 555, at 574 (Lord Denning MR). The legal purists do not go beyond the reasonable contemplation concept. For an interesting early insight into the question, see "*The Rule in Hadley v Baxendale*" (1900) 16 LQR 275 by F E Smith (later Lord Birkenhead). It was said of this article by Professor R F V Heuston "No other Lord Chancellor, or indeed Law Lord, is known to have contributed to this scholarly quarterly at such

42. This aspect was directly addressed by the House of Lords in 2009 in *Transfield Shipping Inc. v Mercator Shipping Inc. (The Achilleas)*[106] in the context of a failure by a time charterer (the defendant) to redeliver a vessel to the owner (the plaintiff) by the stipulated contractual date for redelivery. The facts were essentially as follows. By a time charter the plaintiff let a vessel to the defendant with a redelivery date of 2 May 2004. During April 2004, charter hire rates had more than doubled so that the plaintiff was able to fix a lucrative follow on charter of the vessel with the date for delivery to the new charterer of 8 May. Delays took place. By 5 May, it became clear to the plaintiff that redelivery could not take place within such time so as to enable it to deliver the vessel to the new charterer on 8 May. In the meantime, freight rates had plummeted and the plaintiff had to agree a substantial reduction in freight for the follow on charter. Redelivery under the original charter was only effected on 11 May. The plaintiff claimed as damages the difference between the hire originally agreed with the new charterer and the reduced rate for the whole 191-day period of the new charter.

43. In the House of Lords, Lord Hoffmann concluded that a party should not be liable for foreseeable losses if they are not "of the type or kind for which he can be treated as having assumed responsibility."[107] The concept of an assumption of responsibility was also adopted by Lord Hope of Craighead.[108] Both Lord Hoffmann and Lord Hope were of the view that on the facts of the case, the defendant had not assumed responsibility for the loss that was claimed, namely the difference in charter hire rates between the more lucrative fixture

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a youthful age." (*The Lives of the Lord Chancellors 1885-1940* (OUP 1964) at Pg. 357). F E Smith was a student at Merton College at the time he wrote this article.

106 [2009] 1 AC 61.

107 At para. 21.

108 At para. 30.

and what the plaintiff had eventually to settle for, in relation to the whole of the 191-day period. It was held that the plaintiff was entitled only to the difference in hire for the 9-day period of delay in redelivering the vessel. This was despite the fact that it could be argued (and as found by the majority of the arbitrators who had initially determined the dispute, whose finding was upheld by the Court of Appeal) that the full extent of the losses claimed were within the contemplation of the parties.

44. This concept of an assumption of responsibility has given rise understandably to much debate and controversy.[109] Baroness Hale of Richmond was sceptical of this approach in her speech in *The Achilleas*[110] :-

> "Another answer to the question, given as I understand it by my noble and learned friends, Lord Hoffmann and Lord Hope, is that one must ask, not only whether the parties must be taken to have had this type of loss within their contemplation when the contract was made, but also whether they must be taken to have had liability for this type of loss within their contemplation then. In other words, is the charterer to be taken to have undertaken legal responsibility for this type of loss? What should the unspoken terms of their contract be taken to be? If that is the question, then it becomes relevant to ask what has been the normal expectation of parties to such contracts in this particular market. If charterers would not normally expect to pay more than the market rate for the days they were late, and ship-owners would not normally expect to

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[109] See, for example, the Paper by Professor Andrew Burrows QC "*Lord Hoffmann and Remoteness in Contract*" (*The Jurisprudence of Lord Hoffmann* (Oxford : Hart Publishing, 2015)). The controversy lies in the superimposing of an additional requirement – that of an assumption of responsibility – beyond mere contemplation.

[110] At paras. 92 and 93.

> get more than that, then one would expect something extra before liability for an unusual loss such as this would arise. That is essentially the reasoning adopted by the minority arbitrator ….. Although its result in this case may be to bring about certainty and clarity in this particular market, such an imposed limit on liability could easily be at the expense of justice in some future case. It could also introduce much room for argument in other contractual contexts."

45. However, for the majority who embraced this concept,[111] this development in the law (which had been hinted at in previous decisions and in legal writings as indicated above[112]) was consistent with market expectations and reflected the understanding in the trade.[113] Even Baroness Hale acknowledged this in the reference to "certainty and clarity in this particular market". Lord Hoffmann has written extrajudicially on this aspect, in discussing *The Achilleas*[114] :-

> "Secondly, I would rely upon what appears to have been the common assumption in the trade. Owners and charterers, or at any rate their legal advisers, would have assumed from previous authorities and textbooks that, in the absence of contrary provision in the agreement, the liability of the charterer for late delivery was limited to the difference between the market rate

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111 Apart from Lord Hoffmann and Lord Hope of Craighead, this included also Lord Walker of Gestingthorpe. Despite *McGregor on Damages* being of the view that there is some doubt over Lord Walker's agreement with the principle (see para. 8-174), as we shall see, it has been held by the Hong Kong Court of Final Appeal (of which Lord Walker was a member) that he did in fact concur.

112 See para. 41 above.

113 See paras. 6, 7 and 36. At para. 65, Lord Walker refers to the need to "uphold commercial certainty".

114 "*The Achilleas : Custom and Practice or Foreseeability*" (2010) 14 Edin LR 47.

> and the charter rate for the period of the overrun. The purpose of the law of contract is to fulfil reasonable expectations and such expectations should therefore be self-fulfilling. Businessmen do not like surprises. If an owner wants greater protection for the profit he might secure on a following charter, he can stipulate for a suitable clause at the time of the contract. All that the law provides is a default provision and it seems to me right that this should reflect what the parties would have assumed to be their respective rights and liabilities. None of this can be taken into consideration if foreseeability is the only test."

46. In Hong Kong, the assumption of responsibility principle has been applied, crucially, in the context of the volatile and extremely expensive property market where liabilities for loss of profits and other losses can be very large indeed. In *Chen v Lord Energy Ltd*,[115] the CFA had occasion to deal with what parties to a contract for the sale and purchase of land would have in contemplation in the event of a breach. The context of the case was the volatile market in 1998. The defendant vendor was in breach of a sale and purchase agreement, in respect of which the plaintiff purchaser sought specific performance. Pending the appeal to the CFA, a stay was granted in respect of the order for specific performance. Eventually, the defendant's appeal was dismissed. The plaintiff sought damages based on the difference in market price of the property between the date the stay was granted and the date the property was eventually assigned. The treatment of damages suffered as a result of a court order was the same as for a breach of contract.[116] The defendant claimed that unless it knew of an intention on the part of the plaintiff purchaser to resell

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[115] (2002) 5 HKCFAR 297.

[116] See *Jaques v Millar* (1877) 6 Ch. D. 153.

after assignment, damages should only be measured based on the loss of rental during the relevant period. This was rejected by the CFA. The legal question was of course what was within the reasonable contemplation of the parties. Lord Hoffmann (who concurred with the judgment of Chan PJ) emphasized the need to have regard to the specific context of the case; in the case before him, the application of principle to the context of the Hong Kong property market. It had been submitted by the defendant that while it could be accepted that in commodities like oil or sugar, a resale would be within the contemplation of the parties, this was not so in the case of a sale of land. Lord Hoffmann said this,[117] "in a society in which the value of land is relatively stable, purchases are almost always for occupation and the contemplated period of delay is relatively short, it will usually be the case that a resale is not within the reasonable contemplation of the parties. But that was not the position which prevailed in Hong Kong in 1998. The market was volatile, purchase for resale was common and the period of delay contemplated when a stay was granted pending appeal was relatively lengthy."

47. Purchasing for resale with a line of buyers in a chain[118] with all contracts having more or less the same date for completion (and being all mutually dependent) can cause difficulties in the assessment of damages in the event of breach. In a normal sale and purchase agreement in respect of land between two parties, when the vendor or purchaser defaults, the position is usually straightforward in that the innocent party is able either to resell the property and claim any damages if there is a loss or insist on specific performance (when the innocent party is the vendor) or to purchase an equivalent property and claim damages if there is loss or to claim specific performance (when the innocent party is the purchaser). In a confirmor sales

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[117] At para. 44.

[118] In Hong Kong, these are known as confirmor sales.

situation, when the ultimate purchaser is in breach, the immediately preceding vendor (who fails to complete his purchase because he needs the sales proceeds from his onward sale in order to complete his own purchase and accordingly does not therefore hold the property) cannot of course resell. What is the extent of the damages for which the defaulting purchaser is liable, particularly when it is contemplated that there is a series of chain contracts with accompanying liabilities down the line? Is the purchaser in breach to be held liable for all liabilities which occur down the chain, such liabilities being within the parties' contemplation? These can be very substantial. This was the question addressed by the CFA in *Richly Bright International Ltd v De Monsa Investments Ltd*.[119] In limiting the damages to be awarded, the court adopted the assumption of responsibility principle (stated in *The Achilleas*) as representing the law in Hong Kong, finding it "compelling".[120] The assumption of responsibility principle is a practical and principled approach to real commercial problems. It may perhaps only apply in specialized markets or trades. This is the approach of the common law.

48. I have now gone through a number of different areas of commercial law in order to demonstrate the approach of common law courts (including Hong Kong) in dealing with problems arising in business and finance. It is right to say that the courts have largely been left to develop the law, if not create it. For the reasons mentioned earlier, I believe this to be deliberate. It is deliberate because the whole methodology and approach of common law courts is designed to provide guidance to the commercial community by dealing with real life situations, often in specialized trades, and their many nuances. It is a recognition that all principles of law must be and can only be developed through

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[119] (2015) 18 HKCFAR 232.

[120] See the joint judgment of Ribeiro and Fok PJJ at para. 41. Incidentally, the joint judgment also analyzes why it could be taken that Lord Walker of Gestingthorpe similarly adopted this principle in his speech in *The Achilleas*.

real experiences and not just theoretical ones. It is often said that the approach to solving a legal problem can be converted into a simple formula : a + b = x, where ‘a’ is the relevant legal principle to be applied, ‘b’ represents the facts and ‘x’ the result. However, life tells us that within ‘b’ is such a wide range of situations that the formula really should be a + b + c = x, where ‘c’ is the approach of the courts based on flexibility and, in a commercial context, having regard always to commercial realities and expectations, but above all, adherence to recognizable legal principles. Business and finance depend on such an approach. Perfection, as Lord Goff of Chieveley reminds us, is unattainable[121] but the common law tries its best and does deliver most of the time.

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[121] In the Postscript of his speech in *Spiliada Maritime Corporation v Cansulex Ltd* [1987] 1 AC 460, at 488.