

LETTERHEAD OF THE BANK OF EAST ASIA, LIMITED

CB(1)1590/00-01(01)

David K.P. Li

Chairman and Chief Executive

14th June, 2001

BY HAND

STRICTLY PRIVATE & CONFIDENTIAL

The Hon. Albert C.Y. Ho,
Messrs. Ho, Tse, Wai & Partners,
Rooms 901-2 Takshing House,
20 Des Voeux Road, Central,
Hong Kong.

Dear Albert,

As the Member of the Legislative Council proposing the Bank of China (Hong Kong) Limited (Merger) Bill ("Bill"), I would like to express my sincere gratitude to you for bringing to my attention your concerns at the effect which the Bill may have on the obligations of customers and third parties, who have provided securities or guarantees of an all monies nature to one of the merging banks.

The apprehension of customers and third parties that their obligations under such securities or guarantees owed in respect of liabilities to one of the merging banks, may be extended by reason of the Bill to debt obligations to the entire merged group and thereby greatly increased, are very understandable. I am very pleased that you have drawn these justifiable concerns to my attention, and thereby given me an opportunity to address the issue.

I have discussed the matter at great length with Dr. Liu Jinbao of the Bank of China, and his team dealing with the Bill. Dr. Liu has also asked me to convey to you his deep appreciation for having raised your concerns at this stage, thereby providing a timely opportunity to resolve these issues.

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THE BANK OF EAST ASIA, LIMITED

The Hon. Albert C.Y. Ho,
Messrs. Ho, Tse, Wai & Partners,

14th June, 2001

As I believe you may be aware, the legal advisers to the Bank of China Group in connection with the proposed merger, including the drafting and preparation of the Bill, are the leading international law firm, Messrs. Clifford Chance. On learning the points which you have raised regarding the possible effect of the Bill on securities provided to one or more of the merging banks, Dr. Liu immediately directed his legal team to obtain an opinion from Messrs. Clifford Chance setting out in detail the legal position in this regard.

I am pleased to enclose herewith a copy of the opinion issued by Messrs. Clifford Chance to Bank of China on 13th June, 2001. The opinion deals with the effect of the Bill on securities situations which have been classified as first party security, third party security and guarantees by both customers and third parties to one of the merging banks, in the event that the Bill is enacted by the Legislative Council and promulgated as an ordinance in the form in which it has been published in the Government Gazette.

As you will note, from the analysis of the legal position as set out in the opinion of Messrs. Clifford Chance, in the absence of express language in the relevant documentation relating to a particular security to the contrary, the effect of the Bill would not be to enable the merged bank to enjoy a windfall benefit by way of having a loan which was unsecured prior to the merger, transformed into a secured one, as a result of the merger process effected by the enactment of the Bill.

In other words, the obligations of a customer or third party providing security to one of the merging banks by way of either first party security, third party security or guarantee, would not be enlarged as a result, solely, of the passage of the Bill, and the extent of the liability of those security providers would remain unchanged by the provisions of the Bill.

I trust that the opinion of Messrs. Clifford Chance satisfactorily settles any concerns which you may have in respect of this most important issue, and that your mind is accordingly put at ease on these points as a result.

The Hon. Albert C.Y. Ho,
Messrs. Ho, Tse, Wai & Partners,

14th June, 2001

However, should you require any further details concerning this issue, or if there are any other points which you would like to raise, please do not hesitate to contact me and I shall deal with the matter without delay.

With warmest personal regards,

Yours sincerely,

c.c. Dr. Liu Jinbao
Vice Chairman, Bank of China

The Honourable Rita Fan
President
Legislative Council

Encl.

Letterhead of CLIFFORD CHANCE

YOUR REFERENCE

IN REPLY PLEASE QUOTE
B1602-6.RMD.WWL.JCXG

DATE
13 June 2001

DIRECT DIAL
2825 8887

BY HAND
STRICTLY PRIVATE AND CONFIDENTIAL

Bank of China
16/F Bank of China Tower
1 Garden Road
Central
Hong Kong

Attn: Ms. Isabelle Tsang, Legal Consultant

Dear Sirs.

Bank of China (Hong Kong) Limited (Merger) Bill (the "Bill") - Scope of charges/guarantees after merger

We refer to the e-mail from Isabelle Tsang requesting our advice regarding the following hypothetical scenarios:

1. **First party security:** Merging Bank A grants a loan ("**Loan A1**") to Customer C1 secured by a charge given by Customer C1 which is expressed to cover all Customer C1's liabilities to Merging Bank A; Merging Bank B grants an unsecured loan to Customer C1 ("**Loan B1**"), in each case before the merger. At the appointed time for the merger, all Hong Kong law governed property and liabilities of Merging Bank A and Merging Bank B shall transfer to Bank of China (Hong Kong) Limited ("**BOCHK**") by virtue of the Bill. Assuming the value of the property secured by the charge exceeds the value of the Customer C1's liability under Loan A1, would this charge also secure Customer C1's obligations under Loan B1 after the merger?
2. **Third party security:** Merging Bank A grants a loan ("**Loan A2**") to Customer C2 secured by a charge given by Third Party T1. This charge is expressed to cover all Customer C2's liabilities to Merging Bank A; Merging Bank B grants an unsecured

loan to Customer C2 ("**Loan B2**"), in each case before the merger. At the appointed time for the merger, all Hong Kong law governed property and liabilities of Merging Bank A and Merging Bank B shall transfer to BOCHK by virtue of the Bill. Assuming the value of the property secured by the charge exceeds the value of the Customer C2's liability under Loan A2, would this charge also secure Customer C2's obligations under Loan B2 after the merger?

3. **Guarantee:** Merging Bank A grants a loan ("**Loan A3**") to Customer C3 and Third Party T2 executes a guarantee in respect of this loan (this guarantee is expressed to cover all Customer C3's liabilities to Merging Bank A); Merging Bank B grants an unsecured loan to Customer C3 ("**Loan B3**"), in each case before the merger. At the appointed time for the merger, all Hong Kong law governed property and liabilities of Merging Bank A and Merging Bank B shall transfer to BOCHK by virtue of the Bill. Assuming the guarantee is not subject to a maximum amount, would this guarantee also cover Customer C3's obligations under Loan B3 after the merger?

Assumptions

For the purposes of our analysis below, we assume that:

- (a) in each of the scenarios described above there is no foreign law element (i.e. each loan document, security document or guarantee is governed by Hong Kong law and is subject to the jurisdiction of the Hong Kong courts; and the customers and the third party security providers (including guarantors) in question are all incorporated in or resident in Hong Kong);
- (b) the Bill is enacted by the Legislative Council and promulgated as an ordinance in the form published in the Government Gazette on 25 May and 1 June 2001;
- (c) all the loans in question are bilateral loans; and
- (d) the documentation for all the loans and security (including guarantees) in question is in "standard" form i.e. it does not contain any provision which deals specifically with the situations under consideration.

We note that in the e-mail setting forth the hypothetical situations, an assumption is made regarding the value of the existing security (or, as the case may be, the cap on an existing guarantee) being in excess of the existing indebtedness being currently secured thereby (e.g. the principal amount outstanding under Loan A1 exceeds the current value of the property secured under the charge provided by C1). We believe that such assumption is not necessary and the absence of such assumption would not affect the analysis set out below.

Analysis

Although the analysis set out in the numbered paragraphs below focuses the first party security scenario above, this analysis would apply equally to the third party security scenario and the guarantee scenario.

1. Whether the relevant charge or guarantee would collateralise both existing loans (e.g. Loan B1 as well as Loan A1) is a question of statutory interpretation. The clauses of the Bill which are relevant to this analysis are clauses 5 and 8.

Clause 5

2. Clause 5(1)(a) of the Bill provides that, at the appointed time:

"(a) the merging branches shall by virtue of this Ordinance and without further act or deed be transferred to, and vest in, Po Sang to the intent that Po Sang shall succeed to the merging branches as if in all respects Po Sang were the same person in law as the relevant transferring bank..."

3. Clause 5(1)(a) would therefore transfer (a) Loan A1 and the all monies charge collateralising it (or, in the case of Loan A3, the all monies guarantee by T2) and (b) Loan B1 to BOCHK to the intent that Po Sang shall succeed to (i) Loan A1 and the all monies charge collateralising Loan A1 (or, in the case of Loan A3, the guarantee by T2) and (ii) Loan B1 as if in all respects Po Sang were the same person in law as the relevant merging bank.
4. One therefore needs to consider the legal effect of the relevant charge or guarantee being transferred to BOCHK *"to the intent that BOCHK shall succeed to the relevant charge or guarantee as if it were the same person in law as the merging bank"*.
5. Clause 5(1)(a) is the main vesting provision by virtue of which all property of the merging branches which are governed by Hong Kong law or the transfer of which are governed by Hong Kong law will transfer to and vest in BOCHK. Any "security interest" (as defined in the Bill and which includes both a charge and a guarantee) granted to secure a liability of a merging bank will constitute an item of property for the purposes of the Ordinance. Clause 5(1)(a) will therefore transfer and vest a security interest granted to a merging bank in BOCHK as if BOCHK is the successor to such a security interest. In the absence of clear wording in the documentation providing otherwise, the better view is that clause 5(1)(a) would not result in the scope of that security interest being expanded to cover a previously unsecured obligation, and any view to the contrary would be an aggressive one to take.

Clause 8

6. Clause 8 of the Bill contains supplementary provisions expanding upon the main vesting provision in clause 5(1)(a). Because clause 8 is expressed to be *"without prejudice to the generality of any other provision of this Ordinance"* clause 8 does not limit the general effect of clause 5(1)(a). Moreover, because clause 8 is expressed to be *"subject to any provision of this Ordinance to the contrary effect..."* if there is any conflict between clause 8 and clause 5(1)(a), clause 5(1)(a) would prevail. But in the absence of any conflict between clause 8 and clause 5(1)(a) (and we do not think there is any conflict in the scenarios considered in this letter) the more specific provisions in

clause 8 will supplement and expand upon the effect of the general vesting provision in clause 5(1)(a).

7. The relevant paragraphs of clause 8 here are paragraphs (a) and (g). Each is considered below.

Clause 8(a)

8. Clause 8(a) provides that:

"(a) *All existing ... documents granting or comprising any security interest ... shall be construed and have effect at and from the appointed time as if -*

(i) *Po Sang had been a party thereto instead of such bank;*

(ii) *for any reference (however worded and whether express or implied) to such bank there were substituted, as respects anything falling to be done at or after the appointed time, a reference to Po Sang..."*

9. To test the effect of clause 8(a), one can apply it to a situation involving an all monies charge. For example, if the all monies charge is in the following (fairly standard) form:

"The Chargor charges, as beneficial owner and by way of first fixed charge, in favour of Merging Bank A, all of its right, title and interest to the Collateral for the payment and discharge of all of its Secured Obligations.

"Secured Obligations" means all obligations owing to Merging Bank A by the Customer..."

Applying Clause 8(a)(i) *simpliciter* would mean replacing all references to "Merging Bank A" with references to "BOCHK", so that the all monies clause could be deemed to read as follows:

"The Chargor charges, as beneficial owner and by way of first fixed charge, in favour of BOCHK, all of its right, title and interest to the Collateral for the payment and discharge of all of its Secured Obligations.

"Secured Obligations" means all obligations owing to BOCHK by the Customer..."

10. Thus, at first blush, clause 8(a)(i) alone might give the impression that the security granted by customer C1 will, as from the appointed time, secure both Loans A1 and B1. However, we also need to consider the other parts of clause 8, in particular, Clause 8(a)(ii) and 8(g).

11. Clause 8(a)(ii) substitutes a reference to a merging bank (e.g. Merging Bank A) with a reference to Po Sang (i.e. BOCHK) but only *"as respects anything falling to be done at or after the appointed time"*. The effect of clause 8(a)(ii) is that the substitution to be effected is in respect of matters to be done at or after the appointed time. For example, if the credit facility under which Loan A1 is currently outstanding is a revolving credit, then, as from the appointed time onwards, BOCHK will have "taken over" (as the "successor" to Merging Bank A) the continuing obligation to lend under such revolving facility and, equally, any repayment obligation by customer C1 will, as from the appointed time, have to be performed in favour of BOCHK.

Clause 8(g)(i)

12. Clause 8(g)(i) provides that:

"Any security interest held immediately before the appointed time by a merging bank ... as security for the payment or discharge of any liability shall, at and from the appointed time, be held by ... Po Sang ... as security for the payment or discharge of that liability." (emphasis added)

13. When interpreting this clause, one first has to consider what is the "liability" in respect of which the merging bank holds its security interest. A typical all monies charge (such as the one set out in paragraph 9 above) would be expressed to secure *"all obligations owing to Merging Bank A by the customer"*. Therefore clause 8(g)(i) would result in BOCHK holding the all monies charge as security for the payment or discharge of the liability which the all monies charge is expressed to cover (i.e. all obligations owing to Merging Bank A). As a result, clause 8(g)(ii) would result in BOCHK holding the security interest as security for the discharge and payment of Merging Bank A's obligations to BOCHK, but not in respect of Merging Bank B's obligations to BOCHK.

Conclusion

14. In light of the analysis set out above, the better view is that, in the three hypothetical situations mentioned earlier and in the absence of express language in the documentation for the transactions concerned to the contrary, the effect of the statutory engineered succession would not have the effect of enabling BOCHK to have a windfall benefit (i.e. to have an unsecured loan transformed into a secured one through the merger when such variation of the commercial understanding or intention is not clearly addressed or contemplated by the documentation or the Bill). Although one could argue that clauses 5 and 8 should be given a wide interpretation (i.e. so an unsecured loan would be transformed into a secured loan through the merger), we consider that such a view would be an aggressive one to take. If BOCHK were to pursue a claim on the basis of such an aggressive stance, then the court would, in the absence of express wording permitting the expansion of the scope of such security (which is currently absent from the Bill), have to ascertain the intention of the parties. In order to do this

the court would have to look at the original documentation creating such security between the merging bank and the security provider. In the absence of any wording to the contrary effect in such security documentation, it is likely that the courts would construe the parties' intentions as being to secure the obligations of the debtor to the merging bank only (but to no others).

Yours faithfully,

Clifford Chance

LETTERHEAD OF ALBERT HO CHUN YAN'S OFFICE
THE HONOURABLE LEGISLATIVE COUNCIL MEMBER

本署檔號 Our Ref:

來函檔號 Your Ref:

電話 TEL: 2522-7721 (direct) 2868-2919 (O)

16th June 2001

傳真 FAX: 2868-2797

Dr. Hon. David Li Kwok-po, JP
The Bank of East Asia, Limited
10 Des Voeux Road Central,
Hong Kong

BY HAND

Dear David,

Re: Bank of China (Hong Kong) Limited (Merger) Bill

Thank you for your letter of 14th June 2001 together with the legal opinion of Messrs. Clifford Chance.

I note that Messrs. Clifford Chance having analysed the provisions in clause 5 and 8 opine that "the better view" is that "in the absence of express language in documentation for the transactions concerned to the contrary, the effect of the statutory engineered succession would not have the effect of enabling BOCHK to have a windfall benefit (i.e. to have an unsecured loan transformed into a secured one...)". However it would appear that Messrs. Clifford Chance do not dispute that clauses 5 and 8 are capable of giving a wider interpretation though in their words "such a view would be an aggressive one to take".

In the circumstances and in view of the fact that BOCHK have no intention to take a windfall benefit consequential upon the merger, I would have thought that the better course is to move a Committee Stage Amendment to clarify the legislative intent of the two clauses and ensure that any possible doubt mentioned above is removed. The same consideration should also apply to the other Bill concerning the Bank of East Asia.

16th Floor, BOC Tower,
1 Garden Road, Hong Kong
Phone: (852) 2826 6257
Fax: (852) 2840 0677

**Bank of China,
HongKong-Macau Regional Office**

Fax

To: The Hon. Albert Ho Chun Yan **From:** Isabelle Tsang
Fax: 2868 2797 **Date:** June 18, 2001
Phone: 2522 7721 **Pages:** 2 (Including this page)
Re: Bank of China (Hong Kong) Limited **CC:** Mr Jonathan Grant
(Merger) Bill Clifford Chance (Fax 2825 8800)

Urgent For Review Please Comment Please Reply Please Recycle

Dear Mr Ho,

Thank you for your letter of the 16th addressed to Dr. Hon David Li Kwok-po, JP which was copied to me.

We have noted your comment of putting beyond doubt the effect of the legislative intent of clauses 5 and 8 of our Bill. For stylistic consistency, we have asked Clifford Chance to prepare a draft for the intended purpose. We are of the view that the proposed draft should have taken into account your concern and would give the requisite assurance. A copy of our proposal has been sent to the advisors of the Bank of East Asia for their comments. In the interest of time, we attach a copy of the same for your perusal and consideration whilst we await comments from the advisors of the Bank of East Asia.

Thank you for your kind attention in this matter.

Yours sincerely,



Date: 18 June 2001

New proviso to clause 8(g)

Provided that nothing in this Ordinance shall result in a security interest which is vested in Po Sang, held by Po Sang or held by a nominee or agent of or trustee for Po Sang as a result of the provisions of this Ordinance securing payment or discharge of a debt or liability the payment or discharge of which was not, prior to the appointed time, secured by a security interest or intended or contemplated to be so secured unless:

- (i) the terms of the security interest expressly provide otherwise; or
- (ii) the provider of the security interest and Po Sang expressly agree otherwise at or after the appointed time.

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