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(58) in C2/1/55(03) Pt.17

LS/B/15/01-02

22 January 2003

Miss Monna Lai
Assistant Legal Adviser
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Miss Lai,

**Bills Committee
on Companies (Amendment) Bill 2002**

I refer to your letter of 3 January 2003 on the above subject.

Our responses to your comments on the paper “Provision of Financial Assistance to Directors” are as follows -

Paragraph 6

- (a) We agree that the criterion is that the property/ownership will only be passed upon payment of the purchase price. In this respect, we do not intend for the criterion adopted for land to differ from that adopted for goods. However, another element of the “hire-purchase agreement” or “conditional sales agreement” is that the purchaser will ordinarily take possession of the goods/land before the full purchase price is paid. This is one of the main purposes of this type of transaction, i.e. to enable a person to take possession of the goods/land and to make use of them but without requiring the purchaser to pay the full purchase price in advance. The last sentence of paragraph 6 was written with this understanding in mind. In the case of ordinary transactions for the sale of property, the purchaser does not

normally take possession before the ownership of the property has been passed to the purchaser. You may wish to note that we would define the term “conditional sales agreement” along the lines in the UK Companies Act 1985, which incorporates the definition used in the UK Consumer Credit Act 1974.

- (b) As regards the question of whether these terms would cover an agreement for sales and purchase of uncompleted property which has a provision that upon the occurrence of certain events, the purchaser will be given possession of the property prior to payment of the purchaser price, we wish to confirm that there is no provision in the agreements for sales and purchase on uncompleted property under the Lands Department’s Consent Scheme for the purchaser to be given possession of the property prior to payment of the balance of the purchase price upon the occurrence of certain events. We also understand that the standard form of agreements for sales and purchase on uncompleted property not under the Lands Department Consent Scheme, which is administered by the Law Society of Hong Kong, do not contain such a provision. Hence, the sale and purchase of uncompleted property should not ordinarily fall within the scope of the terms as the purchaser is not given possession of the property before the payment of the full price of the property.

Paragraph 12

- (a) The new section 157I(2) provides that subject to subsection (3), a guarantee entered into or any security provided by a company in contravention of section 157H(1), (2) and (4) shall be unenforceable against the company. This section does not restrict the persons to whom the guarantee or security is given.
- (b) The phrase “shall be unenforceable against the company” in the new section 157I(2) means that any person (chargee) who has obtained security against the company (chargor) cannot enforce the terms of the security against the company. For example, if a director fails to repay the loan in accordance with the terms of the loan agreement to a bank, the bank (chargee) cannot, without the consent of the company (chargor), obtain possession of the property and sell it with a view to satisfying the outstanding debt due to him.

This, however, does not mean that an “interest in any property” in the new section 157I(3)(b) has not been/will not be passed to the chargee. A helpful explanation extracted from the *Chitty on Contracts* (28th edition, 1999) is reproduced below-

“..... the fact that by reason of illegality the transferee could not have enforced the agreement under which the transfer [of property] was made does not necessarily mean that delivery to him of property thereunder will not pass to him the property or the interest in question. Thus, where goods are delivered in pursuance of an illegal contract of sale, the property in them passes to the purchaser who will be entitled to damages against anyone, including the vendor, who thereafter wrongfully deprives him of those goods.”

As can be seen from the above, unenforceability of a contract including the rights purported to be conferred thereunder and the passing of ownership or an interest in the property under that contract are two separate matters. A contract for the sale of goods may be illegal and therefore unenforceable against the other party to the contract e.g. the buyer cannot sue the seller for damages for non-delivery. However, if the goods have already been delivered to the buyer, it was held that property in the goods had been effectively transferred. As regards the new sections 157I(2) and (3), on one hand, the right to sell the property conferred under the charge cannot be enforced by the chargee. For example, if the director fails to repay in accordance with the terms of the loan, the chargee cannot enforce the right to sell the property conferred under the charge if the company opposes. A court of competent jurisdiction will refuse to assist the chargee by enforcing the charge against the company. On the other hand, the interest in the property that is purported to be passed to the chargee under the charge has been effectively passed. Hence, if the company wishes to sell the property, it must first repay all outstanding amounts owing to the chargee to obtain a release of the property from the charge. Furthermore, if the company seeks to further charge the property, the second chargee will take the property subject to the prior interest of

the earlier chargee.

Clause 14

We wish to clarify that the phrase “that has entered into a transaction of arrangement in contravention of sections 157H(1), (2) or (4)” in the new section 157I(4) qualifies a company rather than a director of the company.

Clause 38

Under the existing section 228A(4B), a provisional liquidator, who fails to notify the Registrar of Companies of his appointment in accordance with section 228(4A), shall be subject to a maximum daily default fine of \$200. The new section 228A(13) reinstates this requirement except that we have taken the opportunity to add a reference to a maximum fine of \$10,000, having regard to the same level of maximum fine imposed under the existing section 87 in respect of failure to report the appointment of a receiver etc.

Yours sincerely,

(Esmond Lee)
for Secretary for Financial Services
and the Treasury