

**IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
ACTION NO. 1886 OF 2001**

BETWEEN

FONFAIR COMPANY LIMITED

Plaintiff

and

UNIVERSAL DOCKYARD LIMITED

Defendant

Before: Deputy High Court Judge To in Chambers

Date of Hearing: 20 December 2001

Date of Decision: 25 January 2002

DECISION

The background:

1. This is an appeal by the Defendant against Master Wong's decision dismissing the Defendant's summons to strike out the Plaintiff's statement of claim; granting the Defendant conditional leave to defend the above action; and ordering that unless the Defendant pays the outstanding

rent and mesne profit, the Plaintiff may enter final judgment against the Defendant.

2. The Plaintiff company was originally incorporated and owned by the Defendant in 1980 to hold the premises at 44 Ko Fai Road (hereinafter called "the Property"). In September 1991, pursuant to an agreement between Mr YK Leung (hereinafter called "YKL") and Mr YT Leung (hereinafter called "YTL") and as part of their plan to facilitate the floatation of UDL Holdings Limited, the Plaintiff company was spun off from the Defendant. With this spin-off, the beneficial interest previously owned by the Defendant in the Plaintiff was transferred as to 32.96% to YTL, as to 1.25% to Mr YW Leung (hereinafter called "YWL") representing the estate of Mr MK Leung, and as to 65.79% to Money Facts Limited (hereinafter called "Money Facts") which was owned by YKL and YTL in equal shares. YKL, YTL and YWL are sons of MK Leung. According to the shareholders agreement entered into between YKL and YTL dated 5 June 1990 (hereinafter called "the Shareholders Agreement"), the arrangement was to make Money Facts the majority shareholder in the Plaintiff so as to:

- (1) ensure that the rental and other income received by the Plaintiff are properly administered and that after reasonable provisions for expenses such income are distributed to the shareholders of the Plaintiff;
- (2) ensure that the Plaintiff shall pursue and negotiate any future development and other business to safeguard and maximize the interest of the Plaintiff's shareholders;

(3) safeguard and maximize the interest of YKL and YTL in the Plaintiff company.

3. YKL, YTL and their respective companies, Marcon Investment Limited (hereinafter called "Marcon") and Fire Full Investment Limited (hereinafter called "Fire Full") were appointed directors of the Plaintiff.

4. The Property, formerly owned by the Defendant, was leased back to the Defendant and the rental income from 1991 to 1996 was applied towards mortgage repayments of the loan taken out by the Plaintiff from Hongkong and Shanghai Banking Corporation Limited (hereinafter called "HSBC") for payments to the Defendant to facilitate the spin-off of the Plaintiff. This arrangement continued until November 1996 when a loan of \$30 million was obtained from the Standard Chartered Bank (hereinafter called "SCB") against the Plaintiff's assets to discharge the HSBC loan. The proceeds were then distributed between YKL and YTL in accordance with the ratio of their shareholding in the Plaintiff. YKL and YTL became responsible for the monthly repayment of the SCB loan. From then on, with the Plaintiff having been freed from the burden of making mortgage repayments, the rental income net of incidentals became available for distribution to the Plaintiff's shareholders, i.e. effectively to YTL and YKL in the approximate ratio of 2 to 1. YTL, who had the management of the Plaintiff, overdrawn in favour of himself. This led to the appointment of an independent accountant firm, Messrs Lau & Au Yeung Certified Public Accountants Limited (hereinafter called "Messrs Lau & Au Yeung") to review the accounts of the Plaintiff. As a result, it was revealed that YTL had overdrawn from the Plaintiff's account \$2,652,363, while YKL had been underpaid \$1,988,432. The

reconciliation account prepared by Messrs Lau & Au Yeung was accepted by both YTL and YKL. On 27 November 1997, the Plaintiff duly paid YKL the amount which he had been underpaid, while YTL was required to refund the amount overdrawn.

5. In view of the misappropriation by YTL, it was agreed that Messrs Lau & Au Yeung be engaged to administer the accounts of the Plaintiff whereas the administration of the lease of the Property to the Defendant be managed by YKL to avoid further conflict of interest with YTL representing both the Plaintiff as landlord and the Defendant as tenant at the same time. That agreement, however, was never implemented due to lack of cooperation from YTL. That was the position towards the end of 1997.

6. Prior to that, the Plaintiff and the Defendant had entered into a tenancy agreement for the lease of the Property for a term of one year commencing on 1 September 1997 at a monthly rental of \$333,333. The lease was extended by a supplemental agreement at a reduced monthly rental of \$226,000. On 10 September 1999, the Plaintiff entered into another tenancy agreement in respect of the Property with the Defendant for another term of one year at the same rental of \$226,000 with an option to renew for a further term of one year. The term expired on 31 August 2000 but the Defendant continued to hold and use the Property. There is no dispute that the Defendant has not paid any rental since 1 December 1999 and the rental which ought to have been paid as at 31 August 2000 amounted to \$1,863,250. The Defendant's case is that on 30 August 2000 the parties entered into a new tenancy agreement for a term of two years commencing on 1 September 2000 until 31 August 2002 at a monthly rental of \$150,000; and that the rentals have been fully paid by way of

set-off against a debt of \$6,350,695.14 allegedly owing by the Plaintiff to YT Leung Trading Company Limited (hereinafter called “YTL Limited”) which had been assigned to the Defendant. A further defence is that the Plaintiff is not authorised to commence these proceedings.

The law

7. If the Defendant is unsuccessful in its appeal against the Master’s order in granting summary judgment in favour of the Plaintiff, its appeal to strike out the Plaintiff’s statement of claim must necessarily fail. In an application for summary judgment under Order 14, a plaintiff has to show on uncontrovertible evidence supported by affidavits verifying the facts on which the claim is based that the defendant has no defence to his claim, except as to quantum. Once the plaintiff achieves that standard of proof, the burden shifts to the defendant to raise a triable issue, i.e. that there is an issue or question which ought to be tried or that for some other reason there ought to be a trial. The defendant need not show a complete defence, merely an issue to be tried would suffice.

8. There is no dispute that the Plaintiff is the landlord of the Property and that the Defendant has been in occupation of the Property without paying any rental since 1 December 1999. The issues are whether the Defendant’s defence of new tenancy at reduced rental and assignment and set-off are credible. While the court shall not engage in a “mini-trial” on affidavits, the defendant has the burden to show that its assertions in support of the issues it sought to raise are believable. It does not have to go that far as to show that they are to be believed.

Whether the new tenancy agreement at reduced rental is credible

9. Mr Ip argues that the Defendant has a track-record of persistent defaults in paying rent and has stopped paying rent since 1 December 1999 owing the Plaintiff substantial sums of \$795,935, \$1,193,246 and \$699,475 respectively at the end of each of the financial years in 1998, 1999 and 2000. He submits that under such circumstances, a reasonable landlord acting at arm's length with such a tenant would not have agreed to renew the tenancy on such unfavourable terms, including substantial reduction in rental and an option to renew. The Defendant is a company practically owned and controlled by YTL, while the Plaintiff is a company owned by YTL and YKL who are brothers, and controlled by them through Money Facts. As the Plaintiff is indebted to YTL Limited which is owned and controlled by YTL, the rental is reasonably secured. This case cannot be viewed through the eyes of a reasonable landlord acting at arm's length in isolation of the relationship between YTL, YKL and their related companies, their peculiar background and the Shareholders Agreement. In the circumstances, I do not think the Defendant's poor track-record in paying rent is conclusive that the Plaintiff would not have agreed to enter into a new tenancy agreement with the Defendant.

10. Ms Wu refers to the new tenancy agreement dated 30 August 2000 purportedly entered into between YTL on behalf of the Plaintiff on the one part and his co-director on behalf of the Defendant on the other as evidence of the existence of the tenancy for a term of two years at a reduced monthly rental of \$150,000. The document is chargeable with stamp duty but has not been stamped. Mr Ip objects to its production because under section 15(1) of the Stamp Duty Ordinance, no instrument chargeable with stamp duty shall be received in evidence in proceedings or be available for any other purpose whatsoever unless such instrument is

duly stamped. Ms Wu submits that the question of admissibility of the document is distinct from the issue whether the agreement existed and that I should leave the question of admissibility to be determined at trial. I think for the purpose of resisting an Order 14 application, the onus on the Defendant is to raise a triable issue only. Thus the fact that the tenancy agreement was not stamped is not fatal for the purpose of such proceedings. The defect could be cured anytime before trial if leave to defend is granted. Thus for the purpose of the present proceedings, I shall admit the unstamped tenancy agreement in evidence.

11. Mr Ip argues that the existence of the new tenancy agreement is inconsistent with the contemporaneous documents so that it is clear that the alleged new tenancy agreement was not brought into existence until after 18 April 2001 when YTL had ceased to be the Plaintiff's director upon his bankruptcy on 1 March 2001. He refers to YTL's letter dated 15 December 2000 and the Defendant's letter dated 18 April 2001.

12. In its letter of 15 December 2000, YTL requested the Plaintiff's board of directors to discuss the new tenancy agreement. Mr Ip submits that it is difficult to see from that letter how the new tenancy agreement could have existed when it was not raised until three and half months after the expiry of the earlier tenancy on 31 August 2000. Ms Wu submits that the letter is consistent with YTL seeking ratification of a pre-existing tenancy agreement. I think whether the tenancy agreement existed could not be determined by looking at this letter in isolation of the circumstances in which it was written. That letter is the product of a series of events between the parties.

13. Since the safeguards agreed in November 1997 were not implemented, for the period up to December 1999 almost all the rental

income received by the Plaintiff from the Defendant was misappropriated by YTL into the account of YTL Limited as shown in the account movement record. Thereafter, the misappropriation took a different form by YTL simply allowing the Defendant to continue in occupation of the Property without making any rental payment. On 7 January 2000, YKL raised the question of distribution of the rental income with YTL at a meeting, but failed to obtain a satisfactory answer from him. He wrote to YTL again on 14 January 2000 demanding the issue be addressed. Again YTL did not respond. Then on his instruction, his solicitors, Messrs. KF Wong & Co., issued a notice to YTL and other directors of the Plaintiff to convene a meeting to consider demanding full payment by YTL Limited of misappropriated funds; commencing legal proceedings against YTL Limited and against the Defendant to enforce the landlord's rights under the tenancy agreement in respect of the Property; and engaging Messrs Lau & Au Yeung as independent accountant to receive and administer all future income of the Plaintiff in accordance with the terms of the Shareholders Agreement. YTL and Fire Full refused to attend the meeting, which collapsed due to insufficient quorum.

14. On the instruction of YKL, on 18 February 2000, Messrs KF Wong & Co. wrote to YTL and Harbour Front to whom YTL's shares in the Plaintiff and in Money Facts have been transferred. Messrs KF Wong & Co. referred to the Shareholders Agreement and sought to procure a written resolution by all the shareholders of Money Facts for the appointment of the YKL as representative of Money Facts to enforce the terms and conditions of the Shareholders Agreement. Neither YTL nor Harbour Front responded. Then, on 6 March 2000, YKL in his personal capacity commenced proceedings against YTL and Harbour Front for breach of the Shareholders Agreement via High Court Action No 2328 of

2000. The proceedings against YTL were stayed as a result of the bankruptcy order made against him on 1 March 2001. Those proceedings formed an important part of the setting in which the two letters referred to by Mr Ip should be considered.

15. On 13 December 2000, Messrs KF Wong & Co. wrote to YTL giving notice to convene a meeting of directors of the Plaintiff company to discuss and pass resolutions in relation to the renewal or termination of the tenancy agreement in respect of the Property upon expiry of its term. It was in that context YTL wrote on 15 December 2000 giving counter-notice to discuss and to pass resolutions “to renew the tenancy in respect of the [Property] – an offer by the tenant (Universal Dockyard Limited) for renewal at monthly rental of HK\$150,000 for 2 years from 1st September 2000 to 31st August 2002 has been received.”

16. The tenancy over the Property and the distribution of the rental proceeds formed the subject matter of litigation in HCA No 2328 of 2000 in March 2000. At the time, the management of the Plaintiff as landlord and the Defendant as tenant were in the hands of YTL. If YTL wearing his hat as the landlord, wished to renew the tenancy with himself wearing his other hat as the tenant, he could have done so easily as he purportedly did, signing on behalf of the Plaintiff and had his co-director signing on behalf of the Defendant. But in view of the on-going litigation, if YTL on behalf of the Defendant had offered to renew the tenancy at a reduced rental, and YTL on behalf of the Plaintiff was intending to accept that offer, it is also unlikely that YTL would not have informed YKL forthwith. For the same reason, had the new tenancy agreement been in existence, it is most unlikely that YTL would not have had the tenancy agreement stamped, whether in his own interest or that of the Defendant. There is a total lack

of explanation as to both the delay in informing YKL and the failure to have the agreement stamped. YTL only sought ratification of the alleged tenancy more than three months after the term has expired. This casts serious doubts if the tenancy agreement was a contemporaneous document. It is more likely than not that the tenancy agreement was a recent creation sparked from YKL's notice to convene a meeting to discuss the tenancy.

17. The Defendant's lack of credence in its defence of new tenancy is also shown in its response to Messrs KF Wong & Co's demand on 3 April 2001 for payment of outstanding rental at the rate of \$226,000 per month. To that demand the Defendant replied in its letter dated 18 April 2001 that rental should be paid in the usual way, without disputing the amount of monthly rental (see below). If at the time, the parties had entered into a new tenancy agreement at the reduced rental of \$150,000, it is most surprising that the Defendant did not assert in its reply that under the terms of the new tenancy, the monthly rental was only \$150,000. This again casts doubts on the existence of the new tenancy agreement.

18. Another criticism of this aspect of the defence is that the tenancy is a connected transaction for which the Defendant as a listed company is obliged to make a public announcement. It has made such an announcement on 6 October 1999 in respect of the earlier tenancy agreement, but no such announcement has been made in respect of the alleged new tenancy agreement for two years. The Defendant should be aware of this obligation. Ms Wu sought to explain from the bar table that the omission was due to an oversight by the new secretary. I consider that explanation far too convenient to be true in the light of the other unfavourable evidence against the Defendant. The inference to be drawn

from its failure to make the announcement is that the alleged new tenancy is just an afterthought.

19. Further, evening assuming that the Plaintiff and Defendant had entered into the new tenancy agreement as alleged, it is not binding on the Plaintiff because YTL had never been authorised by the Plaintiff to enter into such new tenancy agreement. The board meeting convened in December 2000 to discuss the renewal of the tenancy whether as proposed by YKL or as counter-proposed by YTL was never held. As such, YTL had no authority to enter into the new tenancy agreement binding on the Plaintiff. It appears that the rule in *Turquand's case* as adopted by the Court of Appeal in *Pacific Foundation Finance v Fairyoung Holdings* [1999] 3 HKC 448 at 452 had been relied on by counsel appearing on behalf of the Defendant before Master Wong. That line of argument was not pursued by Ms Wu at this appeal. Instead Ms Wu argues why the Plaintiff should object to the new tenancy agreement signed by YTL alone when the agreement preceding it for the period ending 31 August 2000 was signed by YKL only. I think that is beside the point as the lack of authority in relation to that tenancy agreement was not called in question, whereas YTL's authority to bind the Plaintiff in relation to the alleged new tenancy agreement is in dispute.

20. Furthermore, any argument based on the rule in *Turquand's case* is only to be dismissed as that rule is of no assistance to a party if that party has actual or constructive notice of the irregularity: see *Pacific Foundation Finance v Fairyoung Holdings* [1999] 3 HKC 448 at 452, per Mortimer VP. Here, so far as reliance on the alleged new tenancy agreement is concerned, the Defendant did not deal with the Plaintiff in good faith. It took advantage of YTL's position in the Plaintiff to enter

into the alleged tenancy agreement. YTL, as common director of the Plaintiff and the Defendant, must be fully aware of his lack of authority from the Plaintiff to enter into the tenancy agreement and of the need to seek the board's approval for the renewal of the tenancy at a reduced monthly rental. That knowledge must be attributed to the Defendant as YTL was also the controlling mind of the Defendant at the time. The Defendant could not be said to be a bona fide third party without notice of YTL's lack of authority.

21. Thus not only that the defence of new tenancy agreement is blatantly incredible in the light of the circumstances, it has no merit as well.

Whether the defence of assignment and set-off is credible

22. In respect of the second aspect of the defence, i.e. the assignment and set-off, Mr Ip refers to the Defendant's letter dated 18 April 2001 in which the Defendant wrote to Messrs KF Wong & Co. alleging that "the monthly rent should be paid in the usual way to avoid [its] being in breach of [its] obligations under the existing tenancy." He submits that the response to pay "in the usual way" is inconsistent with the Defendant's defence of set-off. Ms Wu argues that expression adequately covers payment by way of set-off.

23. Again, that letter could not be looked at in isolation. It is important to examine the circumstances leading to the issue of that letter by the Defendant. At the time, YKL and YTL were engaged in litigation, the subject matter of which is the rental in respect of the Property and its distribution. It was in those circumstances that Messrs KF Wong & Co. wrote to the Defendant and demanded for rental outstanding since 1 December 2000. Fire Full, which is owned by YTL and appointed to the

board of directors of the Plaintiff to protect YTL's interest, wrote to the Defendant on 9 April 2001 warning the Defendant against payment of rental to Messrs Lau & Au Yeung. Obviously Messrs KF Wong & Co's demand has been brought to the attention of YTL as Fire Full's letter was written by YTL's wife as director of Fire Full. She wrote as follows:

"You are hereby put on notice that:

1.

2.

3. We consider that notwithstanding what is being alleged by Messrs. KF Wong & Co, in the absence of valid authority to alter the existing payment instructions to you for settlement of the rent and other payments, you have no right and are under no obligation to comply with the demands made to pay rent and other amounts for the property to Messrs Lau & Au Yeung.

4. In the event that you pay rent and other amounts in respect of the tenancy otherwise than in accordance with the standing instruction as which were given under the authority of the board of directors of [the Plaintiff], we consider that you would be in breach of your obligations under the existing tenancy and in the respect, all rights against you for failure and to make payment of rent and other moneys under the existing tenancy will be reserved and appropriate action will be taken.

5. We will endeavour to notify you once the present dispute concerning [the Plaintiff] has been resolved, but until then, we must ask that in your own interests and so as to avoid moneys being wrongly paid to unauthorised recipients, all rent and other payments in respect of your tenancy are to be paid in the normal way without regard to the requests and demands issued by Messrs KF Wong & Co."

recall that Fullfire was a director

24. Thus Fire Full was referring to some existing payment instructions or standing instructions to the Defendant about payment of rental. Armed with that letter, the Defendant replied to Messrs KF Wong & Co. on 18 April 2001 that "rent should be paid in the usual way". It wrote as follows:

“We reject your allegation that we have failed to pay rent since December 2000. You are requested to provide your substantiation to your claim that our rents were in arrears of rent..... [referring to and enclosing the above mentioned letter from Fire Full] Unless and until [the Plaintiff] resolves the disputes concerning who is being authorized to receive rents and the management of the company, we consider that the monthly rent should be paid in the usual way to avoid our being in breach of our obligations under the existing tenancy.”

25. In these two letters, neither Fire Full nor the Defendant was specific about what the existing payment instructions or the usual mode of payment were. Neither of them referred to the set-off or assignment of the Plaintiff's indebtedness to YTL Limited to the Defendant. If there were such an arrangement in place, it was most surprising that the Defendant did not refer to it but instead invited the Plaintiff to substantiate its claim. Then on 26 May 2001, the Defendant for the first time raised in its defence assignment of the Plaintiff's debt to the Defendant and the set-off.

26. At the hearing, the Defendant produced a series of documentation in support of the assignment and agreement to set-off. These are:

- (1) a statement of account as at 29 August 2000 acknowledging the indebtedness of \$6,350,695.14, signed by YTL on behalf of the Plaintiff and by his wife on behalf of YTL Limited;
- (2) an assignment dated 30 August 2000 signed by YTL's wife on behalf of YTL Limited as the assignor;
- (3) a notice of assignment dated 30 August 2000, signed by YTL's wife on behalf of the assignor and by YTL on behalf of the Plaintiff;

- (4) a letter dated 31 August 2000 from the Defendant acknowledging the outstanding rental of \$1,863,250 and the rental from 1 September 2000 to 31 August 2002 as \$3,600,000 and offering to set-off the outstanding rental and two years pre-paid rental against the debt assigned by YTL Limited;
- (5) a letter dated 31 August 2000 signed by YTL on behalf of the Plaintiff acknowledging the set-off of \$1,863,250; and
- (6) another letter dated 1 September 2000 offering to set-off the rate payable by the Defendant in the amount of \$5,950 and pre-paid rental up to 31 August 2002 of \$3,600,000 acknowledged by YTL on behalf of the Plaintiff.

27. There is such an abundance of documents in support of the assignment and set-off. Despite that, none of them has been mentioned by Fire Full in its letter to the Defendant on 9 April 2001 or by the Defendant in its reply to Messrs KF Wong & Co. on 18 April 2001. It would have been so easy for Fire Full or the Defendant to refer to the assignment and set-off instead of using the ambiguous language of payment “in the usual way” and “standing instructions” and requiring the Plaintiff to substantiate its claim.

28. Furthermore, reference in Fire Full’s letter and the Defendant’s reply to Messrs KF Wong & Co’s letter to payment “in the usual way” and to “standing instructions” is inconsistent with the Defendant’s case that the rental for the entire two year tenancy had already been set-off as pre-paid rental on 31 August 2000, eight months ago. If there had been such a set-off, there could be no recurrent monthly payments to be settled “in the usual

way” or need for “standing instructions”. In the face of these documents and in the particular circumstances, I am unable to agree with Ms Wu that the words “payment in the usual way” were intended to mean the set-off. It is more likely than not that in April 2001, that the idea or the defence of assignment of debt and set-off was not yet born. Obviously this defence is another recent creation. It is unbelievable and could not be genuine.

29. Apart from whether this defence is credible, this aspect of the defence is untenable. As explained by the Plaintiff’s auditor, the amounts due to YTL Limited as shown in their draft report for the financial year ended 31 March 2000 was \$6,281,948.14, consisting of \$3,813,581.47 current liabilities and \$2,468,366.67 long term liabilities. So far as the current liabilities are concerned, according to the auditor’s report, the loan is interest free and without a fixed term of repayment. In accordance with the Shareholders Agreement, the loan would only be repayable to YTL Limited if there was rental income received by the Plaintiff which could be made available for distribution. The amount so payable to YTL (and his related companies) would be about two-thirds of the amount available for distribution. As for the long term liabilities, the loan was extended to the Plaintiff by YTL Limited in consideration for the Plaintiff’s agreement to pledge the Property as security for the bank loan extended to, inter alia, YTL Limited. That was the arrangement referred to earlier to enable the Plaintiff to discharge the HSBC loan by the SCB loan. According to the auditor’s report, such loan was not wholly repayable within one year. In accordance with the Shareholders Agreement, it would be repaid subject to income having been received by the Plaintiff. Thus the Plaintiff’s debt to YTL Limited is not a simple outright trade debt. It is part of the Shareholders Agreement and to be repaid in accordance with the terms of the Shareholders Agreement to the extent of two-thirds of the rental

proceeds received from the Defendant. YTL Limited which is wholly owned by YTL, and the Defendant which is owned and controlled at the time by YTL were fixed with the knowledge of the Shareholders Agreement through YTL. Thus unless rental has been received from the Defendant, the Plaintiff is not obliged to repay the debt to YTL Limited. And even if rental has been received, the Plaintiff's obligation to repay would only be to the extent of two thirds of the rental proceeds and no more, because the other one third would have to be distributed to YKL or his related companies. The alleged assignment and set-off would be in violation of the terms of the Shareholders Agreement and, if brought to effect, would be a misappropriation of the rental proceeds. Such a misappropriation of rental proceeds could not be raised as a defence. The defence of set-off is bound to fail.

30. Clause 1 of the tenancy agreement expressly provides that the rental is payable in advance on the first day of each and every calendar month without any deduction. While such expression is insufficient to exclude a tenant's equitable right of set-off, the Defendant is not relying on any equitable right of set-off but on YTL's agreement to set-off. The alleged right of set-off is wholly unrelated to the tenancy and thus unless the set-off was validly agreed to by the Plaintiff, there was no right of set-off in the first place. For the same reasons as explained above, the set-off would be in breach of the Shareholders Agreement, and the Defendant must be aware of YTL's lack of authority to agree to such set-off as YTL was the directing mind of the Defendant.

31. Furthermore, the agreement to set-off as recorded in the letters of 31 August and 1 September 2001, even if it were genuine, was made during the period beginning with the day of presentation of YTL's

bankruptcy on 14 June 2000. This is a disposition of property, namely the Plaintiff's cause of action against the Defendant for outstanding rentals purportedly made by YTL agreeing to the set-off arrangement as proposed by the Defendant. Notwithstanding that the property is not comprised in the bankrupt's estate, this is a disposition of property within the meaning of section 42 of the Bankruptcy Ordinance. As it occurred during the period beginning with the day of presentation of the bankruptcy petition, such disposition is void by virtue of section 42 of the Bankruptcy Ordinance. While the court may ratify such a disposition, in the light of the above background, I do not think any court would ratify such a disposition which would be in breach of the Shareholders Agreement. On this ground alone, the defence is untenable.

32. Ms Wu submits that in view of the documents in support of the assignment and set-off, there must be a triable issue and YTL should be given the opportunity to go to the witness box to give evidence in support of the defence. In my opinion, the documents are self serving documents signed by YTL or his wife. For reasons as explained above, these documents lack credence. Thus the defence of assignment and set-off is both unbelievable and untenable.

Plaintiff's authority to commence these proceedings

33. Ms Wu also challenges the Plaintiff's authority to commence these proceedings. There were four directors in the Plaintiff. They were YTL and Fire Full representing the interest of YTL, and YKL and Marcon representing the interest of YKL. YTL had the management of the Plaintiff and the directors were at a deadlock. When YTL was disqualified as a director by reason of his bankruptcy ordered on 1 March 2001, YKL and Marcon seized the opportunity to resolve the deadlock by

invoking Article 6 of the Articles of Association of the Plaintiff company.

Article 6 provides:

“A resolution in writing signed by the majority of directors shall be as valid and effectual as if it has been passed at a meeting of the directors duly called and constituted.”

Pursuant to Article 6, YKL obtained a resolution in writing signed by Marcon and himself authorising YKL to take control of the management of the Plaintiff company, to enforce the rights and remedies of the Plaintiff under the tenancy agreement in respect of the Property and to commence legal proceedings against the Defendant tenant.

34. Ms Wu submits that Article 6 could not be read in isolation of Article 5 which requires a quorum of three directors for all meetings of directors. Hence she submits that the written resolution was invalid as it has not been passed at a meeting of the directors duly called and constituted. The general rule of interpretation of document is to attempt to discover what a reasonable person would have understood the parties to mean, having regard to the words used, the document as a whole, the factual and legal background against which it was concluded and the practical objects which it was intended to achieve. If the ordinary meaning of the words makes sense in relation to the rest of the document and the factual background, then the court will give effect to that language, even though the consequences may appear hard for one side or the other. The document is the articles of association of a company. It sets rules and procedures for proceedings in the company. Article 5 provides for the necessary quorum at directors meetings in which resolutions may be passed. A resolution in writing to be passed under Article 6 must be intended as an alternative means to pass a resolution without calling a meeting. When a resolution is to be passed as a paper exercise, without holding a meeting, the question

of quorum is meaningless. Article 6 must mean what it plainly says, i.e. a resolution in writing signed by the majority of directors shall have the same force as if it has been passed at a meeting of the directors duly called and constituted. I fail to see how Article 6 could be read together with Article 5 when there is no meeting to be held. It could not have the meaning given to it by Ms Wu, namely that the resolution shall be valid if but only if it has been passed with the necessary quorum required under Article 5.

35. The majority requirement for passing resolutions at a directors meeting is different from that required for passing resolutions in writing. At a directors meeting, a majority of the directors present at the meeting, subject to the requirement of the quorum, would suffice. If the minimum number of three directors forming the quorum is present, a resolution could be passed with two directors voting in favour of the resolution. Where there are four directors in a company, a resolution to be passed under Article 6, would require a majority of three, as if all four directors were present and voting at a meeting. In theory, the requirement for passing a resolution under Article 6 is more stringent than that for passing a resolution at a directors meeting. Of course, in the present case, the disqualification of YTL has rendered the situation different. The consequence may appear to be hard for YTL, who was disqualified of his directorship by reason of the bankruptcy order made against him. But such an interpretation is fully supported by the plain and ordinary meaning of Article 6.

36. In my view, there is no need for a quorum for proceedings under Article 6. With YTL's disqualification as a director of the Plaintiff company, there were only three directors at the time. The resolutions, having been passed by two out of three directors in writing, is therefore

valid and effectual to give YKL the authority to commence proceedings against the Defendant, as if such resolution were passed in a meeting properly convened and held.

Conclusion – Summary judgment and leave to defend

37. In my view, the Defendant's omissions in the present case are remarkable. The alleged new tenancy agreement was not stamped and not announced as a connected transaction. The alleged ratification of the new tenancy agreement was not raised until Messrs KF Wong & Co. sought to convene a directors meeting to discuss the tenancy. The reduced rental and assignment of the debt and set-off was never mentioned when Messrs KF Wong & Co. demanded for payment of rent. The use by the Defendant of ambiguous language of payment "in the usual way" and "standing instructions" to describe what in its defence is that all pre-paid rentals have been set-off is contradicting in terms. When all these omissions are put in the setting of this case, in particular, the undisputed misappropriation of rental income as at November 1997, the continued misappropriation of rental income by payment to YTL Limited, the Defendant's assertions of a new tenancy at reduced rental and assignment and set-off are inconsistent with contemporaneous documents and bear the hallmark of recent concoctions. They are unbelievable in the light of the contemporaneous documents and surrounding circumstances, especially the on-going litigation relating to the subject matter in dispute.

38. Furthermore, YTL had no authority to enter into the alleged new tenancy agreement and the Defendant had knowledge of that lack of authority. Even if a new tenancy agreement had been signed by YTL and

the Defendant, it is not binding on the Plaintiff. The set-off is also void because of section 42 of the Bankruptcy Ordinance.

39. Not only that the defence of new tenancy, assignment and set-off are unbelievable, they are totally devoid of merit as a matter of law. The Defendant has failed to show it has a fair or reasonable probability of showing a real or bona fide defence. There are no points which are fairly arguable to be argued on behalf of the Defendant. There is no genuine defence which justifies the time and expense involved in a full trial with oral evidence. As such, the parties' rights and obligations fall to be determined in accordance with the tenancy agreement dated 10th September 1999. Rental and mesne profits have to be assessed on the basis of the rental under that tenancy agreement. In the circumstances, the Defendant should only be given leave to defend on the terms as to payment as imposed by the Master and failing that the Plaintiff may enter final judgment against the Defendant.

Conclusion - Defendant's application to strike out

40. The Defendant also appeals against the Master's order in dismissing its application to strike out the Plaintiff's claim on the ground that it discloses no reasonable cause of action against the Defendant, it is frivolous and vexatious and is an abuse of the process of the court. Ms Wu has not developed any of these grounds in her submission. There is no dispute that the Plaintiff is the landlord and the Defendant is in occupation of the Property and has not paid rental. Thus there is a reasonable cause of action. For reasons as given above, the Defendant's defence is unbelievable and practically moonshine. The Plaintiff's action is not frivolous and vexatious or an abuse of process of the court. The

Master's decision to dismiss the Defendant's summons to strike out the Plaintiff's statement of claim must be right.

Cost

41. Both appeals of the Defendant are therefore dismissed with costs to the Plaintiff, to be taxed if not agreed.

(Anthony To)
Deputy High Court Judge

Mr Francis Ip of Messrs K F Wong & Co., for the Plaintiff

Ms Teresa P C Wu, instructed by Messrs Joseph C T Lee & Co.,
for the Defendant