

**Re: Advice on the interpretation of the  
Deed of Mutual Covenant for Discovery Bay**

**Introduction**

1. I am instructed to give an advice on the interpretation of the Deed of Mutual Covenant for Discovery Bay in relation to whether compound interest is chargeable by the Discovery Bay Services Management Limited, the current manager of Discovery Bay (the “Manager”), on unpaid management fees.
2. For the purpose of my advice, I have been provided with the following documents:-
  - a. City Site Plan and Principal Deed of Mutual Covenant for Discovery Bay City, R.P. of Lot 385 in D.D. 352 & Extension(s) dated 30 September 1982 (the “DMC”); and
  - b. Hillgrove Village Site Plan and Sub-Deed of Mutual Covenant re. Hillgrove Village Discovery Bay, R.P. of Lot 385 in D.D. 352 & Extension(s) dated 15 June 1988 (the “Sub-DMC”).
3. The question on whether compound interest is chargeable on management fees involves the interpretation of Paragraph 2 of Part E, Section IV of the DMC, which states that:-

“2. If any Owner shall fail to pay any amount payable hereunder or under any Sub-Deed of Mutual Covenant within 30 days of the date on which the demand is made as aforesaid he shall further pay to the Manager:-

  - (1) Interest calculated at the rate of \$1.50 for each \$100 or part thereof remaining unpaid for each period of 30 days or part thereof for which it remains unpaid;
  - (2) Such collection charge as the Manager shall decide to cover the cost (other than legal costs of proceedings as hereinafter mentioned) of the extra work occasioned by the default.”

(emphasis added) (the “Interest Clause”)

4. A summary of my advice is as follows:-

- a. Parties to an agreement, such as the DMC and the Sub-DMC, may expressly agree on the payment of compound interest.
- b. There is an arguable case (although not absolute due to the lack of direct authority) that the Interest Clause in the DMC may be interpreted to the effect that compound interest is chargeable on unpaid management fees. Where an agreement expressly stipulates that monthly interest or interest on every 30 days be payable, *prima facie*, the intention of the parties is that the interests are to be compounded on a monthly basis or on every 30 days. Parties would not provide for a 30-day interest rate if their intention is that interests are to be computed annually instead of monthly.
- c. If the case on breach of the DMC for default in payment of the management fees is brought to Court, then the Court should give effect to parties' intention in the Interest Clause.

#### **Salient clauses of the DMC and Sub-DMC**

##### **The Management Expenses**

5. Each owner in Discovery Bay shall pay "Management Expenses". "Management Expenses" is defined as "[t]he costs, charges and expenses for the management and maintenance as provided in this Deed and/or any Sub-Deed of Mutual Covenant entered into pursuant to the provisions herein contained." (Recital 1(a) of the DMC)
6. The Management Expenses include, *inter alia*, crown rent and all sums payable under the conditions; the cost of carrying out the Manager's duties; the cost of purchasing or hiring all necessary plant equipment and machinery including road vehicles; the cost of employing staff to administer the management of Discovery Bay; any rent or other sum payable for the use of any buildings or other parts of Discovery Bay for management or administrative offices or for accommodation for any staff

employed by it in connection with the management of Discovery Bay; all reasonable professional fees and costs incurred by the Manager; all water, gas, electricity, telephone and other service charge; the cost of all fuel and oil incurred in connection with the operation of the plant, equipment, machinery and vehicles provided by the Manager for the benefit of Discovery Bay; the cost of providing and operating emergency generators and the cost of providing emergency lighting of Discovery Bay; the cost of effecting insurance in respect of and in connection with the management of Discovery Bay; all charges, assessments, impositions and other outgoings payable by the owners in respect of the common areas; the cost of postage, stationery and other sundry item incurred in connection with the management of Discovery Bay; the cost of maintaining in good order and repair; the creation of a reserve fund; and any other expenditures which are in the absolute discretion of the Manager necessary for the good estate management (Paragraph 2 of Part D, Section IV of the DMC).

### **Owners' obligation to pay Management Expenses**

7. Each owner in Discovery Bay shall pay to the Manager an advance payment equal to 1/12<sup>th</sup> of the total budgeted Management Expenses of Discovery Bay and the village in Discovery Bay for that year payable by that owner as provided by the DMC and Sub-DMC on the first day of each calendar month (Paragraph 15 of Part D, Section IV of the DMC).
8. Each owner shall pay to the Manager on the due date his due proportion of Management Expenses payable by such owner as provided in the Sub-DMC (Paragraph 2, Section IV of the Sub-DMC).

### **Effect of default in payment of Management Expenses**

9. Where an owner is in default of payment of the said budgeted Management Expenses, he is subject to the Interest Clause.
10. In addition, all such amount shall be recoverable by civil action at the suit of the Manager (Paragraph 3 of Part E, Section IV of the DMC).

11. Further, the Manager shall be entitled without prejudice to any other remedy to register a Memorial of charge in the District Lands Office against the undivided shares of the defaulting owner and the residential unit or commercial unit or other unit held therewith (Paragraph 4 of Part E, Section IV of the DMC).

#### **Manager's duty to collect outstanding management fees and interests**

12. The management of Discovery Bay shall be undertaken by the Manager (Paragraph 1 of Part A, Section IV of the DMC). The Manager shall be bound by and shall observe and perform all of the conditions, duties and obligations in the DMC and Sub-DMC (Paragraph 3 of Part A, Section IV of the DMC).
13. The Manager shall have the duty to demand, collect and receive all amounts payable by the owners of Discovery Bay under the provisions of the DMC or Sub-DMC (Paragraph 1(26) of Part B, Section IV of the DMC).
14. All moneys paid to the Manager by way of interest and collection charges shall be applied towards the Management Expenses of Discovery Bay in such manner as the Manager may from time to time decide (Paragraph 3 of Part F, Section IV of the DMC)

#### **Legal principles on the interpretation of a deed of mutual covenant**

##### **Principles on the interpretation of a deed of mutual covenant**

15. The approach to the construction of a deed of mutual covenant is well established. The object of the exercise is to ascertain the meaning of the document – what it would convey to the reasonable man, in the light of the words used and the circumstances reasonably available to the parties when the contract was entered into:

“The construction of a document is not a game with words. It is an attempt to discover what a reasonable person would have understood the parties to mean. And this involves having regard,

not merely to the individual words they have used, but to the agreement as a whole, the factual and legal background against which it was concluded and the practical objects which it was intended to achieve.”

*per* Lord Hoffman in *Jumbo King Ltd v Faithful Properties Ltd* [1999] 3 HKLRD 757 at 773F-774A, further adopted by Barma JA in *Tat Fat Development (Holding) Co. Ltd v Incorporated Owners of Gold King Industrial Building* (unreported) CACV 22/2014, judgment dated 23 December 2014 at §15.

16. As in commercial contracts, the construction should generally accord with commercial common sense if there is an ambiguity:

- a. “... If a clause is capable of two meanings ... it is quite possible that neither meaning will flout common sense. In such circumstances, it is much more appropriate to adopt the more rather than the less commercial construction.”

*per* Longmore LJ in *Barclays Bank Plc v HHY Luxembourg SARL* [2010] EWCA Civ 1248 (at [26])

- b. “If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other...”

Where the parties have used unambiguous language, the court must apply it.”

*Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 at §§21 and 23

### **Principles on the interpretation of contractual compound interest**

17. Where parties to a contract expressly or impliedly agree that compound interest is chargeable, parties’ intention should be given effect. The cases below illustrate the interpretation of the provision of contractual compound interest.

18. In *The Hongkong and Shanghai Banking Corporation Ltd. v. Dr. Philip Ling Lee*

*Kang and another* [2001] 3 HKLRD 255, the plaintiff bank granted to the defendant banking facilities consisting of two term loans and one revolving loan, to be drawn up in three tranches.

19. Tranches A and B were a term loans with interest rate to be charged at 2% per annum over 1, 2, 3 or 6 months SIBOR (ie Singapore Interbank Money Market Offer Rate) and payable at the end of each interest period to the debit of the borrowers account to be opened with the lender (at §10, judgment). Tranche C was a revolving loan with interest rate to be charged at 1.75% per annum over 1, 2, 3 or 6 months SIBOR and payable at the end of each interest period to the debit of the borrower's account to be opened with the lender (at §12, judgment).
20. Based on these terms, the Court found that compound interest was chargeable by the bank (at §§30-32, judgment):-

“Under the terms of the facility letters, the interest at the agreed rate was to become “payable at the end of each interest period to the debit of the borrower’s account”.

The second defendant appears to take no issue as to the amount of interest debited to its account but disputes the plaintiff’s right to charge interest on that interest.

The express provision in the facilities letters that the interest due on the loans was “to the debit” of the current account made it plain that such interest was to be treated as another advance by the plaintiff, which itself attracts interest. This was the offer made, which the second defendant had unreservedly accepted.” (emphasis added)

21. In *Bank of East Asia Ltd. v. Yip Chi Wai and others* [2011] 5 HKLRD 761, the plaintiff bank, of its own volition, debited on a monthly basis the preceding month’s overdraft loan interest from the defendant’s overdraft loan account, converted it into principal of the current month’s overdraft loan and then earned interest from it, incurring compound interest. The defendants contended that the bank had no contractual right to charge compound interest. The Court stated that whether the bank could

charge compound interest boils down to a matter of interpretation of the parties' agreement (at §41, judgment):-

“I am of the view that the questions whether a lender is entitled to charge interest on a loan, at what rate and in what ways such interest, simple or compound, are to be calculated, all turn on the terms of the loan agreement reached between the borrower and lender. Such terms can be express or implied. BEA [the plaintiff bank] has the burden to prove the contractual terms for charging compound interest and the rate thereof.” (emphasis added)

22. In this case, there was no express terms permitting the charging of compound interest. However, having analyzed the circumstances and the industry practice, the Court found that compound interest was chargeable by reason of an implied contractual term (at §55):-

“In the present case, the third defendant opened an account with BEA in June 1997 for an overdraft facility. Since September 1997, when the account began to have a negative monthly balance, BEA debited on a monthly basis the interest on the sum due for the month to the overdraft (account). Combining that month's accrued interest with the outstanding loan to form the total amount due for the month, BEA then brought it forward as the loan principal of the ensuing month and then charged interest thereon. BEA had been issuing a monthly statement to the third defendant every month and, until the filing of the defence in July 2009, the defendants had never disputed BEA's method of handling the overdraft facilities and charging compound interest as such. It shows that they knew and acknowledged BEA's method of handling the overdraft facilities concerned. The banking industry's usage of charging compound interest on overdraft facilities had become an implied term in the contract between the third defendant and BEA concerning the overdraft facilities. BEA had the contractual right to charge compound interest on such facilities.” (emphasis added)

23. In *Feco Development Corporation v. Bonny Forward Company Limited* (unreported) HCA 1456/2005, judgment dated 18 July 2012, the parties entered into a

Chinese “Termination Agreement” which would immediately terminate a “Co-operation Agreement” previously made between them for the joint beverage business venture into Mainland China.

24. Under the Termination Agreement, the defendant agreed, *inter alia*, to pay to the plaintiff the sum of US\$600,000 (to be paid by 2 instalments), and in return the plaintiff agreed to give up all its interests and rights under the Co-operation Agreement upon its termination. The plaintiff may by writing extend the payment period, during which time the delayed outstanding amount would be subject to a 1% monthly interest rate.<sup>1</sup>
25. The plaintiff claimed, *inter alia*, for an outstanding principal together with contractual interest. At issue was whether a compound interest rate was chargeable based on the terms of the Termination Agreement.
26. In this case, no attempt had been made by the plaintiff to prove loss of interest as damages. There was no evidence adduced by the plaintiff of the loss suffered by it, whether in terms of costs of borrowing funds, or loss of opportunity to invest the promised money, or any other loss.
27. However, Recorder H. Wong SC held that based on the Termination Agreement, parties had agreed on a contractual compound interest. Hence, the Court should give effect to such parties’ intention and award compound interest accordingly.
28. In reaching his decision, the learned judge provided the following analysis to the terms of the Termination Agreement which provide for a monthly interest rate (at §§81, 82, judgment):-

“That said, it must not be forgotten that the basis of the Plaintiff’s claim for compound interest is based on the contract itself. In my judgment, where the contract expressly stipulated that monthly interest be payable, prima facie the intention of the parties was that interests were to be compounded on a monthly basis. It would not make sense for the parties to provide for a monthly interest rate if their intention was that interests were to be computed annually instead

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<sup>1</sup> “延期的款項以月息 1%計算利息”。



of monthly. And if they intended that interest be computed on a monthly basis, it seems to me plain that they intended that the interest be compounded on a monthly basis.

I see no reason why this Court should not give effect to the contractual intention of the parties. Accordingly, I accede to the Plaintiff's request that the Defendant be ordered to pay interest, compounded on a monthly basis, for the delayed payments under the Termination Agreement" (emphasis added).

29. Of the three cases cited above, the first two cases involve banking facilities, while the third case concerns with a commercial contract. Although there are ample cases on the claim for outstanding management fees, I am unable to find a direct authority on the interpretation of the deed of mutual covenant in the property law context in relation to the question of simple and compound interest.
30. In those cases involving claims of outstanding management fees, the court simply awarded interests based on what the plaintiff pleaded. For instance, in *Incorporated Owners of So Tao Centre v. Lam Kong Wan* (unreported), DCMP 4250/2004, judgment dated 20 December 2006; on appeal to the Court of Appeal, (unreported), CACV 158/2007, judgment dated 7 December 2007, the relevant clause of the deed of mutual covenant provides that an owner who fails to pay any amount due by way of management fee within seven days from its due date is liable to pay interest at the rate of 1.5% per calendar month on the amount unpaid. In calculating the default interest for 2 years, the Court of Appeal adopted the calculation of the District Court, being the [principal amount X 18% X 2]. It is noted that the "18%" is a simple interest calculation. However, there was no dispute as to the question of simple or compound interest so pleaded, and as explained in paragraphs 32 and 33 below, a claim in interest as damages is to be specifically pleaded and proved.
31. Hence, even if in various cases involving the claims of outstanding management fees, the court adopted a simple interest calculation, they should be not considered as the authority that the calculation of default interest must be based on simple interest. The court in those cases

simply did not consider the question of simple/compound interest and decided the case based on what the parties pleaded and proved.

32. In a claim for interest, one must not overlook the authoritative statement by Lord Nicholls of the House of Lords in the leading case of *Sempra Metals Ltd. v Inland Revenue Commissioners* [2007] UKHL 34 on interests. The House of Lords held in this case that a taxpayer who had paid tax too early in breach of the then European Community law could establish that the Inland Revenue Commissioners (the IRC) had been unjustly enriched, with the enrichment consisting of the amount paid and the use value of the amount paid until it was properly due. The enrichment in relation to the use value was valued with reference to compound interest which the IRC would have had to pay to borrow an equivalent amount of money to that which had been received from the taxpayers.
33. Although this case was based on a restitutionary claim, Lord Nicholls also made reference to a contractual claim situation. In short, the learned judge recognized that contractual interest, simple or compound, may be awarded as special damages (as opposed to general damages)<sup>2</sup> if pleaded and proved, subject to the rule of remoteness and the duty to mitigate (at §§94-95, 99-100):-

“To this end, if your Lordships agree, the House should now hold that, in principle, it is always open to a claimant to plead and prove his actual interest losses caused by late payment of a debt. Those losses will be recoverable, subject to the principles governing all claims for damages for breach of contract, such as remoteness, failure to mitigate and so forth.

In the nature of things the proof required to establish a claimed interest loss will depend upon the nature of the loss and the circumstances of the case. The loss may be the cost of borrowing money. That cost may include an element of compound interest. Or the loss may be loss of an opportunity to invest the promised

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<sup>2</sup> In ordinary legal usage general damages comprise losses which must be pleaded and proved but which are quantified in money terms by the court. Special damages comprise losses which must be pleaded and proved in money terms (§85, judgment in *Sempra Metals*).

money. Here again, where the circumstances require, the investment loss may need to include a compound element if it is to be a fair measure of what the plaintiff lost by the late payment. Or the loss flowing from the late payment may take some other form. Whatever form the loss takes the court will, here as elsewhere, draw from the proved or admitted facts such inferences as are appropriate. That is a matter for the trial judge. There are no special rules for the proof of facts in this area of the law.

But an unparticularised and unproved claim simply for ‘damages’ will not suffice. General damages are not recoverable. The common law does not *assume* that delay in payment of a debt will of itself cause damage...

[The statutory provision] is concerned with interest on debts and damages. The section says nothing about the principles to be applied by a court when assessing the amount of damages for which it gives judgment. The section does not preclude a court from taking interest losses into account when awarding damages for breach of contract. This has long been the general understanding. This is shown by the string of reported cases where interest losses have been recovered as damages in claims for breach of contract or in respect of torts, or would have been so recovered if the losses had been proved. These interest losses have included losses calculated on a compound basis where appropriate...

For these reasons I consider the court has a common law jurisdiction to award interest, simple and compound, as damages on claims for non-payment of debts as well as on other claims for breach of contract and in tort.” (emphasis added)

### Interpretation of the DMC in the present case

34. In the present case, the Interest Clause stipulates that:

“If any Owner shall fail to pay any amount payable hereunder or under any Sub-Deed of Mutual Covenant within 30 days of the date

on which the demand is made as aforesaid he shall further pay to the Manager:- Interest calculated at the rate of \$1.50 for each \$100 or part thereof remaining unpaid for each period of 30 days or part thereof for which it remains unpaid” (emphasis added)

35. According to the Interest Clause, the interest rate is “\$1.50 for each \$100 or part thereof remaining unpaid for each period of 30 days or part thereof”. This is 1.5% for each 30-day period.
36. The important question then is, whether this 1.5% per 30-day interest rate is chargeable only on the principal amount of management fees in default, in which case it is a simple interest; or is chargeable on such principal amount plus the interest accrued every 30 days or part thereof, in which case it has added interest on interest, and is thus a compound interest.
37. Reading the plain wordings of the Interest Clause, interest is chargeable on the amount “for which it remains unpaid”, and such amount seems to be “any amount payable...on which the demand is made”.
38. If the Manager has issued a demand note for management fees to be settled on the first day of each month in accordance with the DMC, then clearly the amount of the management fees is “on which the demand is made”.
39. If an owner defaults in payment of the management fees “on which the demand is made” and for each 30 days from the default date thereafter, the Manager issues an additional demand note for management fees demanding both the management fees in arrears and the 1.5% per 30-day interest accrued therein, then it seems clear that interest on interest is triggered (ie. compound interest) under the Interest Clause.
40. This is the situation analogous to *The Hongkong and Shanghai Banking Corporation Ltd.* (above) where the term of the agreement states that interest was payable at the end of each interest period “to the debit of the borrower’s account”, and the bank would debit the interest payable in the borrower’s account to charge interest therein. The Court interpreted this to mean that an express term existed to permit charging of a compound

interest in this situation.

41. Even if the express term of contractual compound interest is not found, the Court may still imply such a term in appropriate situations, as in *Bank of East Asia Ltd.* (above) where the bank debited on a monthly basis the interest on the sum due for the month to the overdraft account, and combining that month's accrued interest with the outstanding loan to form the total amount due for the month, the bank could then charge compound interest therein.
42. Hence, there should be less difficulty if the Manager does issue additional demand notes demanding for both the principal and interest therein for each 30 days.
43. However, if the Manager only issues the demand note once for the principal amount of the upcoming management fees and has not actively made demands for interests accrued for management fees in arrears thereafter, would the situation be different?
44. In this situation, the Interest Clause may be open to more than one possible interpretations. Interest chargeable "for which it remains unpaid", being "any amount payable...on which the demand is made" may be interpreted as:-
  - a. The principal outstanding amount in the demand note only; or
  - b. The principal outstanding amount in the demand note, plus the interest accrued therein.
45. Both of these interpretations will not flout common sense. In such circumstances, it is more appropriate to adopt the one with more commercial construction and makes more business sense: *Barclays Bank Plc* (above) and *Rainy Sky SA* (above).
46. Following Record H. Wong SC's judgment in *Feco Development Corporation v. Bonny Forward Company Limited* (above), where the contract expressly stipulated that monthly interest be payable, *prima facie* the intention of the

parties was that interests were to be compounded on a monthly basis. It would not make sense for the parties to provide for a monthly interest rate if their intention was that interests were to be computed annually instead of monthly. If they intended that interest be computed on a monthly basis, it seems plain that they intended that the interest be compounded on a monthly basis.

47. Similar reasoning may be adopted to a provision of interest rate for every 30 days, which is in effect close to a monthly interest. Hence, it makes commercial sense that the intention of the parties entering into the DMC is that interest be compounded on a 30-day basis. Otherwise, it would not make sense for the parties to provide for a monthly (or close to monthly) interest rate.
48. Of course, the possibility of distinguishing the *The Hongkong and Shanghai Banking Corporation Ltd.* (above); *Bank of East Asia Ltd.* (above) and *Feco Development Corporation* (above) exists because they concerns with different contexts. In particular, the first two cases involves banking facilities, and it is common industrial practice to charge compound interest. The contractual compound interest chargeable is in fact an interest as damages, as opposed to an interest on damages. The actual loss, being the use value of money during the period of delayed payment, can be proved more easily on a compound interest basis. The same applies to the third case involving a commercial settlement.
49. In the present case, however, the management fees collected are for the “Management Expenses”, which as defined and explained in paragraph 6 above, are for building and estate management purposes. The delay in the Manager in receiving the management fees *per se* would unlikely justify it to borrow money from institutions which charge compound interests. This distinguishes the present case from the three cases cited above, particularly as the contractual compound interest is an interest as damages which normally requires proof of actual loss and the duty to mitigate.
50. Be that as it may, in *Feco Development Corporation* (above), Recorder H. Wong SC, despite recognizing that there was no evidence adduced by the plaintiff to prove loss of interest as damages (at §80, judgment),

nonetheless gave effect to parties' intention of charging compound interest by reason of the stipulation of the monthly interest rate.

51. This seems to be contrary to Lord Nicholls' statement in *Sempre Metals* (above), where the judge stated that contractual interest is recoverable if pleaded and proved, subject to the rule of remoteness and the duty to mitigate.
52. However, while Lord Nicholls' statement in *Sempre Metals* (above) is much authoritative (especially given that Lord Nicholls was a Non-Permanent Judge of the Hong Kong Court of Final Appeal from 1998 to 2004), it is an English case post-1997 and is not strictly speaking binding on Hong Kong courts. On the contrary, *Feco Development Corporation* (above), being a Hong Kong Court of First Instance case, is at least binding on such court or below. This means that applying *Feco*, there is at least an arguable case that the compound interest is chargeable under the Interest Clause.

### **Manager's duties**

53. Under the DMC, the Manager is charged with the duty to demand, collect and receive amounts payable by the owners of Discovery Bay under the provisions of the DMC or Sub-DMC. The DMC further provides for the Manager to enforce the default payment pursuant to the Interest Clause, to bring civil action and to register a Memorial of charge in the District Lands Office.
54. Accordingly, if the Interest Clause stipulates the charge of compound interest for outstanding management fees, it is the duty of the Manager to so demand, collect and receive amounts payable by the owners of Discovery Bay.
55. Although there is an arguable case that the Manager may charge compound interest for management fees in arrears from the aforesaid analysis, due to the lack of direct authority, there is potential for disputes of such interpretation between owners and the Manager.
56. If these disputes cannot be resolved within the power of the Manager,

then they may be referred to the Lands Tribunal which has an extended jurisdiction under the section 45 and Schedule 10 of the Building Management Ordinance (Cap. 344) to hear and determine proceedings relating to the calculation or apportionment of any sums payable or purported to be payable under a deed of mutual covenant.

### **Conclusion**

57. In conclusion, by reason of the aforesaid analysis, there is an arguable case that the Interest Clause may be interpreted as permitting the charge of compound interest on management fees in arrears at an interest rate of 1.5% per 30 days. The Manager has a duty to enforce the Interest Clause in accordance with the DMC. Any dispute between the Manager and the owners concerning the calculation of the sums payable or purported to be payable under the DMC may be referred to the Lands Tribunal for resolution.

Dated 2 December 2016

A handwritten signature in black ink, appearing to read 'Carol Wong', with a large, stylized initial 'C'.

**Carol Wong**  
**Barrister-at-Law**  
**Sir Oswald Cheung's Chambers**