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FOREWORD

I am delighted to write this Foreword to mark the 15th anniversary of the Hong Kong Journal of Legal Studies (HKJLS).

Bernard Shaw once lamented that, while youth was wonderful, it was wasted on the young. Two common reasons for dismissing the writings of youthful law students are that (1) their ideas are naïve and impractical and (2) they selfishly focus on their material well-being instead of addressing the needs of society and the world at large. But a cursory look at the contents of the present and last few HKJLS volumes readily dispels these stereotypes of the young. Volume 13 (2019) discussed comparative advertising, cross-border torts, data protection, the implications of *Cavendish v Makdessi*, colocation, and re-building trust between Beijing and Hong Kong in the post-Occupy Central era. Volume 14 (2020) tackled affordable housing, public interest environmental legislation, umbrella contracts in employment law, e-justice reform, asset tunnelling in Hong Kong family companies, and the deregulation of drug prices. This Volume deals with indirect discrimination, illegality in connection with Hong Kong's small house (*ding uk*) policy, data privacy issues arising from distributed ledger technologies (such as blockchain), the effects of the EU's Taxonomy Regulation (2020/852) on environmental, social and governance (ESG) in the finance industry, cross-border insolvency between Hong Kong and Mainland China, and the compatibility of AI with Hong Kong privacy law. The articles all confront social problems of immediate concern to ordinary citizens in Hong Kong, Mainland China, and the rest of the world. It is true that the articles typically express impatience with the status quo, characterising supposed solutions to the problems analysed as little more than "old wine in new bottles". However, that sense of urgency is a prerogative of the young and a corollary of their deep engagement in a wide range of contemporary issues calling for reform. We may not agree with the analyses or proposals put forward in HKJLS articles over the years. Nevertheless, the individual pieces merit our close attention and serious consideration.

On a personal note, I have benefitted greatly from the insights and skills of the HKJLS' line of student editors (many of

whom have gone on to distinguished careers). Over the years, many of those students have served as my judicial marshalls, assisted in the projects of the Hague Conference's Regional Office Asia Pacific during my time there, or commented on draft papers that I have written. Working on the editorial board of the HKJLS is a thankless task of ensuring not just that contributors meet deadlines, but also that the published versions of submissions will stand up to the scrutiny of the HKJLS' discerning readers. This anniversary edition is a special occasion to express my deep gratitude and appreciation to past and present editors.

Professor Anselmo Reyes

Cheng Yu Tung Visiting Professor
The University of Hong Kong
21 September 2021

PREFACE

It is our honour to present to you Volume 15 of the Hong Kong Journal of Legal Studies.

Throughout the last 15 years since its founding in 1994, the Journal has distinctively remained as the only student academic law journal in Hong Kong that is entirely edited and published by law students at the University of Hong Kong. Our editorial board this year is no exception, comprised of exceptionally skilled individuals from a diverse range of backgrounds and law programmes.

Following the footsteps of our predecessors, we seek to demonstrate collaboration, integrity, and academic excellence. We strive to expand our readership and build onto the reputation already established in the local legal community and beyond, as we continue to make our copies available in all local university libraries, overseas university partners, the High Court and District Court Libraries as well as on Westlaw and HeinOnline.

The COVID-19 pandemic has shown us that resilience and wisdom are all the more important in surmounting hardship and challenges under exceptional times. In this year's Volume, our authors continued to demonstrate their meticulous efforts in resolving complex legal problems in Hong Kong, Asia and beyond. Maintaining diversity of legal scholarship in this Volume, we are delighted to have covered a wide variety of topics in public and private law, ranging from anti-discrimination, the unique Small House Policy and 'Ding' rights in Hong Kong, to cross-border insolvency, sustainable finance and data privacy issues.

We extend our sincere gratitude to Professor Anselmo Reyes for penning the foreword, in special celebration of the 15th anniversary of the Journal and all of its past intellectual contributions to legal scholarship in Hong Kong. We sincerely thank all contributors and our editorial team for their hard work and collaboration, which has led to the successful publication of this Volume. We also express heartfelt thanks to our patrons for their generous support towards the Journal.

We hope that you will enjoy this Volume and continue to support future volumes to come.

Florence Li and Jacky Tam
Editors-in-Chief

A COMPARATIVE ANALYSIS: SHOULD HONG KONG FOLLOW THE UK MODEL OF INDIRECT DISCRIMINATION UNDER THE EQUALITY ACT 2010?

Oliver Tse*

Anti-discrimination law enshrines the notion of equality. Yet, its development has not been satisfactorily progressive in Hong Kong. A few years ago, the Equal Opportunities Commission (EOC) conducted a public consultation on the review of anti-discrimination law, which is increasingly outdated and unable to sufficiently promote equality. In particular, indirect discrimination is an easily neglected theme, not frequently discussed in the academia. Thus, a decade after the enactment of the Equality Act 2010 in the UK, this paper compares the existing statutory framework of indirect discrimination in both Hong Kong and the UK. It critically assesses, with the insights from the EOC consultation results and recent authorities from the UK Supreme Court, whether and how the UK standard/model for indirect discrimination under the Equality Act 2010 can be adopted in Hong Kong, and what are the factors that drive or inhibit harmonisation or unification of scattered legislations into a unified paradigm of anti-discrimination law in Hong Kong. It ends with a succinct and pragmatic advice on how our law on indirect discrimination should move forward for the time being.

* BCL (Oxon, 2022); BBA(law) & LLB (HKU, 2021). The article was written under the supervision of Professor Johannes Chan, to whom gratitude is conveyed. The article would not have been possible without his encouragement during the early days of topic selection, and his insightful reviews at the later stage. Special acknowledgment is also extended to the HKJLS Editorial Team for their diligence, dedication and professionalism demonstrated in the course of proofreading the work. However, all views expressed in the article, and any errors therein, if any, remain to be the author's alone.

> *'The challenge of eradicating discrimination in Hong Kong has been complicated.'* (Carole Peterson, 'The Right to Equality in the Public Sector: An Assessment of Post-Colonial Hong Kong' (2002) 32 HKLJ 103)

INTRODUCTION

Anti-discrimination law enshrines the notion of equality. Yet, its development has been stagnated in Hong Kong. It is increasingly outdated and cannot sufficiently promote equality.[1] In particular, indirect discrimination is an easily neglected area, for it receives little attention in academic literature. This paper seeks to analyse whether and how the UK standard of indirect discrimination under the Equality Act 2010 can be adopted in Hong Kong, and the direction towards which we should move.

I. CURRENT DEVELOPMENT OF ANTI-DISCRIMINATION LAW IN HONG KONG

The legal protection against discrimination in Hong Kong chiefly comes from statutes. There are four key anti-discrimination ordinances, namely Sex Discrimination Ordinance (Cap 480) (SDO), Disability Discrimination Ordinance (Cap 487) (DDO), Family Status Discrimination Ordinance (Cap 527) (FSDO) and Race Discrimination Ordinance (Cap 602) (RDO).[2]

They have come into being only in the past two decades, with SDO and DDO coming into force in December 1996; FSDO in November 1997 and RDO as late as July 2009.[3] They exist much later than some of their UK counterparts enacted in the 1970s.

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1 Equal Opportunities Commission (EOC), 'Discrimination Law Review for Public Consultation' (*Equal Opportunities Commission*, 7 October 2014) 6 <www.eoc.org.hk/EOC/Upload/UserFiles/File/DLRConsultationDocument(Eng).pdf> accessed 1 January 2021 (EOC Consultation).

2 ibid 5.

3 ibid.

In 2014, the Equal Opportunities Commission (EOC)[4] commenced its first comprehensive review of anti-discrimination law. Three documents are of particular significance to this paper: the Consultation Paper, the Consultation Summary and the Consultation Report. There were in total 125,041 responses from the public.[5]

The reform is still at the initial stage and this paper comes timely to provide a detailed probe.

II. CURRENT PRINCIPLES OF INDIRECT DISCRIMINATION IN HONG KONG AND THE UK

Protection against indirect discrimination is subsumed under the four ordinances in Hong Kong. As the context of indirect discrimination is derived from the respective statutes, its scope of application is circumscribed by the ambit of the ordinances. In other words, currently in Hong Kong, there is merely statutory indirect discrimination on the ground of gender, race, disability and family status. In particular, indirect discrimination is stipulated under s 5(1)(b) (for women) and s 6(1) (for men) of SDO; s 4(1)(b) of RDO; s 6(b) of DDO and s 5(b) of FSDO. This is the result of our statutes being mirrored from the corresponding obsolete UK Acts.[6]

In general, there are four constituent elements of indirect discrimination:

(1) the discriminator applies to the victim a requirement or

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4 For those who are not familiar with the function of the EOC: it is an independent statutory body whose duties include reviewing anti-discrimination ordinances and submitting proposals for amendment. It is one of the most significant public bodies for advancing anti-discrimination law in Hong Kong.

5 Equal Opportunities Commission (EOC), 'Discrimination Law Review: Submissions to the Government (Executive Summary)' (*Equal Opportunities Commission*, March 2016) 1 <www.eoc.org.hk/eoc/upload/DLR/20163241415020000459.pdf> accessed 1 January 2021 (EOC Summary).

6 EOC, EOC Consultation (n 1) 17-18. For instance, s 5(1)(b) and s 6(1) of SDO use the exact wording as s 1(1)(b) and s 2(1) of the UK Sex Discrimination Act 1975 respectively.

condition which he applies or would apply equally to another group of people (the Requirement Element);
(2) the proportion of persons of same characteristics as the victim who cannot meet the requirement or condition is considerably smaller than the proportion of other persons (the Proportion Element);
(3) this is to the detriment to the victim *because* they cannot comply with it (the Detriment Element); and
(4) the requirement or condition cannot be shown to be justifiable (the Justification Element).[7]

Meanwhile, the UK has replaced over 116 pieces of legislation with the Equality Act 2010.[8] Section 19(2) of the Equality Act 2010 also requires four elements to constitute indirect discrimination:

(1) the discriminator applies to the victim a *provision, criteria or practice* which he applies or would apply equally to persons with whom the victim does not share the characteristics (s 19(2)(a));
(2) this puts or would put persons of same characteristics as the victim at a *particular disadvantage* than those who do not share the characteristics (s 19(2)(b));
(3) this puts the victim himself at that disadvantage (s 19(2)(c)); and
(4) the discriminator cannot show that the measure is a *proportionate means* of achieving a legitimate aim (s 19(2)(d)).

The net of protection, as listed in s 19(3), covers age, disability, gender reassignment, marriage and civil partnership, race, religion or belief, sex and sexual orientation. It is much wider than that in Hong Kong.

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7 EOC, EOC Consultation (n 1) 60.

8 Equality and Human Rights Commission, 'What is the Equality Act?', (*Equality and Human Rights Commission*, 19 June 2019) <www.equalityhumanrights.com/en/equality-act-2010/what-equality-act> accessed 1 January 2021.

III. A COMPARATIVE ANALYSIS OF INDIRECT DISCRIMINATION IN HONG KONG AND THE UK

This section involves a detailed analysis. It begins by comparing each element with the UK standard with explanations on how our model is narrow and unsatisfactory. If appropriate, landmark cases will be assessed. After that, relevant suggestions on whether and how the Hong Kong model should be modified would be evaluated.

Before moving on, three matters are highlighted at the outset. First, it should be reminded that even if it is considered that the current statutory framework has not created much trouble at court, it does not mean that reform is unnecessary. The reasons are twofold: there may be few problems at court simply because there are limited claims under this head, not because the legislation itself is satisfactory. Besides, courts deal with specific facts only, but since we are concerned with legislative draftsmanship in this paper, it is important to remain meticulous as to how each constituent element should be laid out to accommodate the wide varieties of factual matrices.

Second, it bears emphasis to explain why the UK is selected as the regime for this comparative analysis. The reasons are again twofold: for one thing, anti-discrimination law in the UK has always posed a great influence on that in Hong Kong. As noted above, some of our current anti-discrimination statutes find their roots in obsolete UK Acts, and UK cases have always been a primary source of foreign legal authorities to be considered and applied at our courts. This can be observed in cases cited below. Apart from this, before the Equality Act 2010, anti-discrimination law in the UK was also scattered like our current model, and so their legislative approach presents to us an alternate framework in shaping our anti-discrimination law. Thus, the UK is used as a reference point to provide insight on how we can unify our law, and how potential problems can be resolved.

Third, despite the fact that this article draws reference on the EOC consultation materials as a roadmap, there are three areas where this paper distinguishes itself from them, so as to

underscore its contribution to academic literature. To start with, it is important to appreciate that this article analyses the issue from a condensed legal framework while the EOC reports are less legalistic in nature and are based on public consultation. Besides, this article seeks to compare the different approaches between Hong Kong and UK law, so as to see how any reformed position can play out at court. Further, this article goes beyond the EOC reports. Apart from discussing how to reform individual elements of indirect discrimination, it strives to highlight the inadequacy of a compartmentalised approach to reforming anti-discrimination law, and what are the factors that hinder the harmonization of law in Hong Kong.

With these in mind, each element of indirect discrimination shall be assessed below.

A. The Requirement Element

In Hong Kong, the phrase 'requirement or condition' refers to *a formal and absolute* request and demand from the discriminator. This is referenced from an old UK Court of Appeal case, which held that if a requirement or condition was not absolute, the employers could escape liability (the 'absolute bar' standard).[9] A simple analogy by the EOC is that if an employer applies a common criterion to all candidates, which is that full-time workers are given preference, this is not a 'requirement or condition'[10] because it is not a must or an 'absolute bar' to all candidates.

Indeed, many Hong Kong cases on indirect discrimination involve absolute requirement or condition. Examples include a formal regulation requiring every user in the fitness centre to place the weights back to the racks after use[11]and

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9 *Perera v Civil Service Commission (No.2)* [1983] IRLR 166 436F-437B, adopted in *Meer v London Borough of Tower Hamlets* [1988] IRLR 399. However, the 'absolute bar' standard was heavily criticised in *Falkirk Council v Whyte* [1997] IRLR 560. In *Chief Constable of Avon & Somerset Constabulary v Chew* EAT/503/00 [42] (Charles J), the Employment Appeal Tribunal also lauded counsel for dropping the argument of 'absolute bar'. Such controversy has ended in the UK with the introduction of the PCP standard under the Equality Act 2010.

10 EOC, EOC Consultation (n 1) 61.

11 *Chen Raymond v Lo San* (DCEO 1/2003, 11 July 2007) [27].

a common assessment criterion compulsorily applied to all administrative officers.[12]

In sharp contrast, the UK test is wider by implementing the 'provision, criterion or practice' (PCP) standard as in many other countries.[13] It broadly includes policies, procedures and arrangement, both mandatory and discretionary.[14]

Thus, under this broad test, the preferential criterion in the above analogy, despite it not being an absolute requirement, can be a PCP that brings women into a particular disadvantage as they are more likely to work part-time.[15]

Therefore, Hong Kong is encouraged to follow the UK in this regard so that more requirements or practice can be subject to the review of indirect discrimination. This enhances the protection of our law. Although there may be policy concerns that a PCP standard will be a burden on employers, it is submitted that the remaining Detriment and Justification Elements can play as safety valves in balancing the rights between employees and employers. As a whole, there is more good than harm in preventing employers from escaping liability by imposing discriminatory yet informal, conditional or unspoken policies. Indeed, the adoption of the PCP standard is precisely the recommendation of the EOC to the government,[16] which the majority of the public supports.[17] We are

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12 *M v Secretary of Justice* (DCEO 8/2004, 16 July 2007) [245].

13 This includes Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, the Former Yugoslav Republic of Macedonia, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Montenegro, the Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom. See European Commission, 'A Comparative Analysis of Non-Discrimination Law in Europe 2020' (*European Commission Directorate-General for Justice and Consumers,* December 2020) 40 <www.equalitylaw.eu/downloads/5349-a-comparative-analysis-of-non-discrimination-law-in-europe-2020-1-31-mb> accessed 1 January 2021.

14 *British Airways Plc v Starmer* [2005] UKEAT 0306_05_0607, [2005] IRLR 863, cited in EOC Consultation (n 1) 60.

15 EOC, EOC Consultation (n 1) 61.

16 EOC, EOC Summary (n 5) 11.

17 Equal Opportunities Commission (EOC), 'Discrimination Law Review: Report on Responses to the Public Consultation' (*Equal Opportunities Commission,* March 2016) 68-69 <www.eoc.org.hk/eoc/upload/DLR/20163241415549215158.pdf> accessed 1 January 2021 (EOC Report).

on the right track.

B. The Proportion Element

This element seeks to analyse whether a common requirement disfavours a group of persons. Yet, it hinges the evaluation of disadvantage on a superficial analysis of *quantity and capability*. It wrongly assumes that indirect discrimination may exist only when a large proportion of these persons cannot comply with the requirement. The problems can be articulated in two hypothetical questions.

First, if only a small proportion of persons cannot comply with the requirement, does it justify the discrimination? Apparently not. Our own court has accepted the submission that even where there is only one person unable to comply with a certain requirement, indirect discrimination can still be established if disparate impact is resulted to a certain group,[18] citing the UK case *London Underground Ltd v Edwards (No.2)*.[19]

Second, if one can comply with a requirement, does it mean there is no disadvantage? Again, no. "Compliance" essentially refers to one's capability to perform a certain requirement. For instance, requiring a disabled employee to help lift wheelchairs just like other staff constitutes indirect discrimination as he is unable to perform it.[20] However, the definition of "disadvantage" should be broader and should not merely encompass the notion of one's inability to comply with or perform a certain formal requirement. This view has also been supported by our court.[21]

For instance, as rightly put by the UK Supreme Court in

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18 *Siu Kai Yuen v Maria College* [2005] HKDC 55, [2005] 2 HKLRD 775 [57].

19 [1998] IRLR 364.

20 *Kan Che Sing v Lucky Dragon Boat (Belvedere) Restaurant Ltd* (DCEO 10/2010, 7 August 2012) [53]-[55].

21 *Wong Kwok Mui Enoch v Lee Yuen Tim* (DCEO 9/1999, 8 March 2001), following *Chief Constable of West Yorkshire Police v Khan* [2001] UKHL 48, [2001] 1 WLR 1947 and *Ministry of Defence v Jeremiah* [1980] QB 87.

Onu v Akwiwu,[22] "requiring all employees to sport a moustache is obviously indirectly discriminatory against women". Compliance of such a requirement is not difficult at all (just put on a fake moustache), but the requirement disfavours women. A similar analogy is where all staff are given a birthday gift from the company to increase their sense of belonging. That gift, however, is a skirt, and this applies to everyone. In such a case, the staff is not required to perform anything, and so compliance is *not* even at issue. Yet, this policy or practice is obviously putting all male staff at a disadvantage.[23]

The UK thus has rightly changed the law into assessing whether *a particular disadvantage* is put on persons of the same characteristics in concern.[24] This is a direct and just formulation. The difference with the old element is subtle, but significant. For instance, in the birthday gift analogy above, it is already noted that compliance is not even at issue and thus the Proportion Element is difficult to be passed. Yet, under the UK standard, there is certainly a particular disadvantage, and thus the adjusted element can be passed. The inadequacy of our Proportion Element is tested by pushing its application to the furthest.

Further, the inadequacy of the Proportion Element is highlighted in the Court of Appeal case *QT v Director of Immigration*.[25] In *QT*, the court found indirect discrimination because the policy put homosexual couples at *a serious disadvantage*.[26] Instead of applying the proportion analysis, the Court relied heavily on the UK Supreme Court case *Preddy,*[27] and Privy Council case *Rodriguez*[28] (which essentially applied s 19(2)

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22 *Onu v Akwiwu v Olaigbe* [2016] UKSC 31, [2016] 1 WLR 2653 [32].

23 Of course, under the current formulation in Hong Kong, this 'birthday gift' policy may not even qualify as a 'requirement or condition' applied to the employees because the employees are not asked to do something. Yet, assuming Hong Kong adopts the PCP model, this would qualify as a practice or procedure.

24 Equality Act 2010, s 19(2)(b).

25 [2017] HKCA 489, [2017] 5 HKLRD 166. This case involved the Director of Immigration refusing to grant QT a dependent visa to Hong Kong because she was not married to her same sex partner. The case went up to the Court of Final Appeal, where the Court of Appeal's judgment was upheld.

26 ibid [125]-[128].

27 *Preddy and Hall v Bull* [2013] UKSC 73, [2013] 1 WLR 3741.

28 *Rodriguez v Minister of Housing of Gibraltar* [2009] UKPC 52, [2010] UKHRR 144.

of the Equality Act 2010).[29] The Court of Appeal judgment in *QT* was upheld by the Court of Final Appeal.

One may argue that in *QT*, the Proportion Element could have reached the same result as the particular disadvantage test. Yet, *QT* is used here to illustrate that our court has, when appropriate, adopted the particular disadvantage test instead of the current standard. This shows strong support for the reform.

Therefore, we can adopt the UK approach and this is preferred. Alternatively, the Proportion Element can be deleted, as recommended by the EOC to the government (without public consultation on this point).[30]

Some may further argue that such a progressive move to a simpler test of 'particular disadvantage' may bring about unmeritorious claims and floodgates arguments. This is because if only a handful of victims suffers a disadvantage owing to their own predisposition and susceptibility, then it is questionable whether there is discrimination at all, given that there is no prejudicial treatment to different categories of people. However, one may still defend that the Justification Element is the safety valve against unmeritorious claims.[31]

C. The Detriment Element

In Hong Kong, this element erroneously focuses on *capability and justification* of the detriment. First, a requirement or condition is only to the victim's detriment *because* he lacks the *capability* to comply with or perform it. However, same as above, 'detriment' should include any particular disadvantage,[32] not only inability to perform a requirement.

Such a position seems to be supported by some local cases and local practitioners' texts, which advise that detriment may simply mean disadvantage,[33] despite it not being the most

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29 through the Equality Act (Sexual Orientation) Regulations 2007, s 3(3).
30 EOC, EOC Summary (n 5) 11.
31 See *London Underground (No.2)* (n 19).
32 *Garry v Ealing LBC* [2001] IRLR 681.
33 Duncan Abate and Hong Tran, *Discrimination Law & Practice in Hong Kong* (Sweet & Maxwell 2011) para 4.060, citing *Aquino Celestina*

direct interpretation from the language of the statutes. In such circumstances, there is more reason to change the expression or wording of this element in statutes to avoid any confusion.

Second, the more unjust point is the need to *prove a narrow causal link* between the detriment and the requirement, with the inability to comply with the requirement being the *sole prerequisite*. In other words, we must prove that the victim suffers detriment *because* he cannot perform the requirement. However, as mentioned, detriment comes in various forms. Narrowing it down to one cause is unnecessarily strict.

The Equality Act 2010, however, only requires the victim to be at that particular disadvantage. This is it. It does not depend on compliance at all. Yet, it is silent on whether a claimant has to *show why* a PCP puts him in that particular disadvantage.

This point has been recently clarified in the UK Supreme Court case *Essop.*[34] Lady Hale held that 'there is *no requirement*…[to] show why the PCP…puts…[the claimant(s)] …at a particular disadvantage. *It is enough that it does*' (emphasis added).[35] For instance, as her Ladyship highlighted, if women are poorer chess players, a requirement to hold high chess grade disadvantages them. That is the end of the matter. There is no need to prove why. It is sufficient that by social expectations or statistical evidence that it does.[36] Indeed, the EOC recommended to the government to modify this element into finding indirect discrimination upon the presence of '[a PCP] which is or would be to the detriment of the person with the protected characteristic',[37] with the part on non-compliance removed. This is a laudable approach.

One may challenge that the UK position is too favourable to the claimant that it may render many PCPs discriminatory as

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Valdez v So Mei Ngor Betty (DCEO 3/2004, 12 September 2005) [12].

34 *Essop v Home Office (UK Border Agency)* [2017] UKSC 27, [2017] 1 WLR 1343. In this case, black employees complained that it was discriminatory to require them to pass an assessment test for promotion. Statistics showed that they generally had a lower pass rate than white candidates. See [7]-[10] for the facts.

35 ibid [24].

36 Essop (n 34) [24], [26], [28].

37 EOC, EOC Summary (n 5) 11.

long as a group of people *and* a claimant is disadvantaged for whatever reason.[38] Therefore, the Hong Kong and UK standard actually represent two ends of a spectrum, with the former being too conservative and the latter too liberal. Yet, it is submitted otherwise. As noted above, the Justification Element will be the eventual safety valve to prevent floodgates arguments. This is particularly so when the burden of proof remains on the complainant of any discrimination. It is also recognised in both the UK and Hong Kong that the evidential burden does not shift to the defendant at any stage. [39]

One may further argue that reform is unnecessary because the phrase "comply with" is not narrowly limited to physical capability. This argument is supported by *Essop* again, where Lady Hale said that '*the reasons* why …it [is] harder to *comply with* the PCP…are *many and various*…They can be genetic [factors]…social expectations…traditional employment practices…' (emphasis added).[40] However, it is submitted that reform remains necessary. First, as illustrated earlier, sometimes compliance is not even at issue. Secondly, as her Ladyship commented, 'the concept of indirect discrimination…[is] more difficult to define in statutory terms.'[41] Therefore, if there are controversies on whether "compliance" focuses solely on the *physical* capability to perform a certain requirement, why not simply omit it for clarity? Thus, it is suggested that we should follow the UK standard in this regard.

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38 An example would be that if statistics show that on average, boys get poorer results in public examinations, a common and unified admission requirement in the law school or any faculty would be constituting indirect discrimination because boys and the claimant are unable to meet the standard, being at a particular disadvantage.

39 Abate and Tran (n 33) para 4.061. This, however, may be subject to two potential caveats. First, if primary facts have demonstrated a possibility of discrimination and the defendant has not provided any justifications, the court may infer discrimination as a matter of 'almost common sense'. Second, the court may bear in mind the difficulties 'which face a person who complains of unlawful discrimination and the fact that it is for the complainant to prove his or her case': see *King v Great Britain China Centre* [1992] ICR 516, 529A-529C (Neill LJ). In short, the court would seek to strike a balance in burdening and protecting the victim but in general, the burden of proof remains on him/her.

40 *Essop* (n 34) [26].

41 *Essop* (n 34) [18].

D. The Justification Element

The final element is less controversial. The only problem is that the exact justification test is not set out on paper.[42] Only RDO has included the express test in s 4(2), which is '[whether the alleged measure] serves a legitimate objective and bears a rational and proportionate connection to the objective.'

In reality, however, our court has routinely applied the UK case *Crizzle,*[43] which provides a more structured test of proportionality with no material difference with the Equality Act 2010. There are quite some cases on this.[44]

Therefore, we may simply adopt the RDO model or the *Crizzle* test with regard to this element.[45] Although some legal groups suggest doing nothing,[46] it is submitted that the justification or proportionality test should be put clearly on paper for the sake of completeness, convenience and public interest.

IV. EXPANDING THE SCOPE OF INDIRECT DISCRIMINATION THROUGH LEGISLATIVE HARMONIZATION

Even if each of the elements above is modified, the statutory protection against indirect discrimination in Hong Kong is still inadequate because there are only four major bases of claims. The frontiers of indirect discrimination, as mentioned earlier, is circumscribed by the scope of each statute. For indirect discrimination on grounds not covered by statutes, further case laws of other jurisdictions are needed.

This is precisely the situation in *QT*, where there was alleged indirect discrimination on the basis of sexual orientation, a ground unprotected in Hong Kong. As mentioned, the court in

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42 EOC, EOC Consultation (n 1) 61.

43 *Board of Governors of St Matthias Church of England School v Crizzle* [1993] IRLR 472.

44 See *Siu Kai Yuen* (n 18) [59]; *Chen Raymond* (n 11) [28]; *M v Secretary of Justice* (n 12) [249].

45 EOC, EOC Consultation (n 1) 62.

46 EOC, EOC Report (n 17) 69.

QT relied on *Preddy* and *Rodriguez,*[47] which applied the Equality Act 2010 as the legal basis.

Although *QT* has yielded a successful outcome, expanding the scope of indirect discrimination on paper is still of public and judicial interest. There are three reasons. First, there are other unprotected grounds in Hong Kong, including age, religion or belief.[48] Expanding the scope brings broader protection. Second, some victims are more vulnerable because they are not statutorily protected. The extension will then provide express protection to them and also bring caution to employers or other discriminators. Third, courts will have clearer guidance and counsel an easier route of claim at court, rather than relying merely on foreign cases.

Therefore, the Equality Act 2010 is a good model for legislative consolidation and consideration of additional protected grounds. This is the ultimate reform preferred by the EOC.[49] It is also submitted that it serves the purpose of harmonizing our anti-discrimination law without repeating the same elements in scattered pieces of legislations.[50]

However, the public does not seem to support such a move towards the unification of the law. The Consultation Report shows that 55% of the organizations prefer tighter protections on existing grounds.[51] Most shockingly, 99% of the 69,399 individuals disapprove it and believe it would prevent a targeted approach to tackling discrimination by rendering the law too simplistic.[52] As conceded by the EOC at the Legislative Council (LegCo) Panel Meeting, further public reviews are needed. [53]

It is further submitted that three other factors also contribute to the reluctance of the public to harmonise the law.

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47 *QT* (n 25) [127]-[128].

48 See Equality Act 2010, s19(3).

49 EOC, EOC Summary (n 5) 19.

50 See EOC, EOC Consultation (n 1) 23-24.

51 EOC, EOC Report (n 17) 19.

52 ibid.

53 Panel on Constitutional Affairs, Legislative Council, 'Updated Background Brief (prepared by the Legislative Council Secretariat) for the Meeting on 20 March 2017', LC Paper No. CB(2)981/16-17(03) (17 March 2017) para 8.

First, there remains no public consensus whether certain grounds serve as the basis for anti-discrimination law. For instance, there are still polarised views on homosexuality in the society, which render it quite dangerous to conclude a different treatment on the otherwise sexually-oriented as a discriminatory act.

Second, harmonisation of the law may seem elegant from a legal perspective, but may bring upheaval in social welfare and government policies, and further, political rights. *QT* is an example of how the government's practice of issuing dependent visas is affected. Besides, will the refusal to give your seat to an elderly on public transport, or the absence of a priority queue for the elderly to vote, be age discrimination? There is a line between the lack of social courtesy, and illegal discrimination. Where this line is drawn is bound to be the centre of debate in the extension of anti-discrimination law.

Finally, harmonisation of the law takes much more time. Given the debate surrounding the grounds of discrimination, it is understandable that the public would prefer reforming the existing statutes to provide better protection sooner, than to leave the law at its present unsatisfactory state, while awaiting years for a unified legal framework.

Thus, the pragmatic approach for the time being is to reform the individual elements in each statute based on the Equality Act 2010, and to start exploring a blueprint project for the ultimate unification of our anti-discrimination law.

CONCLUSION

The Equality Act 2010 has been enacted for more than a decade in the UK. Insofar as indirect discrimination is concerned, it is a more comprehensive model than our current statutory framework, and the major ambiguity therein can be resolved by taking reference of cases such as the *Essop* case. As we learned from the UK yesterday, we should also do so today.

Indeed, expanding the frontiers of indirect discrimination may seem one small step in legislation, but is a giant leap in our

anti-discrimination law, in our personal dignity, and most importantly, in equality.

We have already started late, and we have no time to waste. We must move on.

SMALL HOUSE POLICY AND THE ILLEGALITY DEFENCE: THE WAY FORWARD FROM *TINSLEY V MILLIGAN*

Alan Sham Yen Guo*

The English law on illegality has long been considered controversial and unsatisfactory. In 2016, a panel of nine Supreme Court Justices re-examined the issue in Patel v Mirza. There, the 'trio of considerations' approach has emerged and replaced the reliance principle adopted in Tinsley v Milligan. Through the lenses of these two cases, this article will survey three approaches pertaining to the Developer Schemes which abuse the Small House Policy in Hong Kong: the reliance principle in Tinsley, and both the majority and minority approaches in Patel. It further proposes a refined approach that has proper regard to the underlying policy objectives, and provides the flexibility to avoid the issue of windfall gain in different scenarios.

INTRODUCTION

The Small House Policy (SHP) is heavily debated in recent years. Of all the legal issues it has presented,[1] this article focuses on the illegality defence in the realm of trust law.

The scarcity of land resources has been a prominent problem in Hong Kong. This is evidenced by the fact that Hong

* LLB (CUHK); PCLL (CUHK). The author would like to thank Professor Michael Lower for his helpful guidance and comments, as well as the HKJLS editorial team for their feedback and revisions. All remaining errors are the author's own.

1 Such legal issues majorly concern with sex discrimination, illegal occupation of government land, and the illegality defence. Lisa Hopkinson and Mandy Lao, *Rethinking the Small House Policy* (Civic Exchange 2003) 14-27.

Kong has the 3rd highest monthly rent in the world[2] and the Legislative Council has been considering to implement rent control.[3] In addition, the general public has increasingly expressed discontent with the SHP as out-dated and unnecessary, evidenced by the recent judicial review.[4] Any abuse of the SHP will now be under microscopic scrutiny. Therefore, the need to tackle illegal schemes operated between villagers with 'Ding' rights and property developers (Developer Schemes) that exploit the SHP is of momentous public importance. On one hand, these schemes defraud the Lands Department allowing property developers to sell houses to non-villagers with significant savings in cost. On the other hand, the participation of villagers in such fraudulent schemes defeats the objectives of the SHP. As of 2019, it is estimated that over 10,000 houses in the New Territories involved similar illegal schemes.[5]

The law on illegality defence has been in a state of flux. In England, the Supreme Court decision in *Patel v Mirza*[6] has fundamentally replaced the reliance principle in *Tinsley v Milligan.*[7] However, it has been ruled on several occasions in Hong Kong that it is only by the Court of Final Appeal (CFA) that can decide whether to dispose of the reliance principle.[8] As we will observe, the reliance principle has yet to produce a satisfactory outcome in tackling the Developer Schemes. This article seeks to answer the question that, should a case of the Developer Scheme come before the CFA, whether the CFA should dispose of the reliance principle and adopt the 'trio of considerations approach in *Patel.* In light of the research and

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2 Jennet Siebrits, 'Global Living 2020' (CBRE 2020) 7 <www.cbreresidential.com/uk/sites/uk-residential/files/CBRE-Global%20Living_2020_Final.pdf> accessed 13 July 2021.

3 Research Office of the Legislative Council Secretariat of HKSAR, 'Rental Subsidy and Rent Control in Selected Places' (*Legislative Council*, 3 January 2020) <www.legco.gov.hk/research-publications/english/1920rt05-rental-subsidy-and-rent-control-in-selected-places-20200103-e.pdf> accessed 22 November 2020.

4 *Kwok Cheuk Kin v Director of Lands* [2019] HKCFI 867, [2020] 1 HKLRD 988.

5 Erin Hale, 'Build New Housing in Hong Kong Using This One Weird Trick' *Bloomberg* (New York, 8 February 2019).

6 [2016] UKSC 42, [2017] AC 467.

7 [1994] 1 AC 340.

8 *Loyal Luck Trading Ltd v Tam Chun Wah* [2008] HKCA 111, [2008] 4 HKLRD 681 [48] (Tang VP); *Kan Wai Chung v Hau Wun Fai* [2016] HKCA 305, [2016] 5 HKC 585, [8.7] (Cheung JA).

analysis conducted, the answer is affirmative. Although the 'trio of considerations' approach may not be perfect, it provides a more welcoming framework to resolve such a contemporary problem. Moreover, in light of the practical concerns over the 'trio of considerations' approach, this article also envisages two modifications to the original approach to best address the problem of Developer Schemes.

In the following sections, Part I illustrates the background of the SHP and the emergence of Developer Schemes. Part II describes the applicable legal principles in trust law regarding the illegality defence in Developer Schemes. Part III and IV review three approaches adopted by the courts in *Tinsley* and *Patel* to address the illegality defence. Part V illustrates the current development of the illegality defence in Hong Kong. Part VI analyses the strengths and weaknesses of the three approaches with respect to the Developer Schemes.

I. THE SMALL HOUSE POLICY

The SHP was introduced in 1972, with the purpose to 'allow an indigenous villager to apply for permission to erect for himself during his lifetime a small house on a suitable site within his own village'. [9] Under this policy, any male over the age of 18 who can trace his ancestry through the male line back to 1898, where the lease for the New Territories was signed, to an indigenous villager of an established village in the New Territories, is entitled to an once-in-a-lifetime application for building a small house. This is referred to as a 'Ding' right.[10]

A. Objectives of the SHP

The objectives of the SHP are 'to improve the standard of living and provide for the future housing needs of indigenous

[9] Lands Department of HKSAR, 'The New Territories Small House Policy - How to Apply for a Small House Grant' (*Lands Department of HKSAR*, December 2014) 4 <www.landsd.gov.hk/doc/en/small-house/NTSHP_E_text.pdf> accessed 6 November 2021.

[10] Hopkinson and Lao (n 1) 5.

villagers'.[11] Additional and oft-cited benefits[12] are 'to preserve the cohesiveness of the indigenous villager community', 'to retain the rural village character' and 'to provide some revenue to the Government'.[13]

B. The Developer Scheme

Under the Building Ordinance (Applicant to the New Territories) Ordinance, buildings in the New Territories are exempted through a Certificate of Exemption from certain sections of the Building Ordinance in respect of building, site formation and drainage works.[14] Small houses can therefore be built without employing an Authorised Person[15] and submitting formal building plans to the Building Authority for approval.[16] Thus, small houses can be erected fast while saving money on professional service.[17] Besides, villagers do not have to pay a premium which would otherwise be payable to the government to develop the land or erect such a house.[18]

Given the significance savings in building a small house, real estate developers see the SHP as a gold mine and come up

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11 ibid 13.

12 ibid.

13 ibid. In addition to the administrative fees for processing of small house grants, there are premiums payable on the sale of certain type of small houses.

14 Buildings Ordinance (Cap 123) ss 4, 9, 9AA, 14, 21, 30, 30A, 30B, 30C, 30D, 30E and 30F and the regulations made under Cap 123 shall not apply. Building Ordinance (Applicant to the New Territories) Ordinance (Cap 121), s 7.

15 The Authorised Person appointed in respect of any building works or street works shall give such periodical supervision and make such inspections as may be necessary to ensure that the building works or street works are being carried out in general accordance with the provisions of the Building Ordinance (Cap 123) and the Building (Administration) Regulation (Cap 123A). Building (Administration) Regulations (Cap 123A), s 37.

16 Building Ordinance (Applicant to the New Territories) Ordinance (Cap 121), s 7; Buildings Ordinance (Cap 123), ss 4, 14.

17 Roger Nissim, 'Land Administration and Practice in Hong Kong' in Lisa Hopkinson and Mandy Lao (eds), *Rethinking the Small House Policy* (Civic Exchange 2003) 8.

18 Lands Department of HKSAR (n 9), Section II(f); Information Services Department of HKSAR, 'LCQ13: Land Premium Assessment Mechanism' (*HKSAR Government Press Release*, 9 May 2009) <www.info.gov.hk/gia/general/200905/06/P200905060136.htm> accessed 28 November, 2020.

with a scheme, the Developer Scheme. Villagers with 'Ding' rights are first recruited by developers who own land to sell their eligibility. Villagers are then assigned land from developers while some 'security documentations' are drawn up to prevent villagers from taking full advantage of their titles to the lot. After the villagers completed the small house grant applications to the Lands Department and built the houses, they would assign the small houses and the land to the developers, who would then resell the houses to non-villagers.[19] From this arrangement, the villagers gain monies from selling their 'Ding' rights while the developers reap the savings and profits from building and selling small houses.

Illegality occurs when a villager falsely declares himself as the owner of the land in applying for a small house grant from the Lands Department. Currently, the applicant must indicate that he is the 'sole legal and registered owner of the land' on the application form.[20] Moreover, the application form includes a warranty provision that states that the applicant has never made any plans to sell his interest in developing a small house or his eligibility to apply for a small house grant.[21] In the realm of criminal law, the Developer Scheme amounts to common law offence of conspiracy to defraud.[22]

The question is, when the Developer Scheme falls apart, can a developer retrieve the land and houses which are now under the names of villagers? To understand the issue fully, we must first delve into the fundamentals of presumed resulting trust.

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19 Hopkinson and Lao (n 1) 15-16.

20 Legislative Council of HKSAR, 'Small House Policy' <www.legco.gov.hk/research-publications/english/essentials-1516ise10-small-house-policy.htm#endnote7> accessed 18 November 2020.

21 ibid.

22 ibid; see *HKSAR v Li Yam-pui David* (DCCC 25/2015, 27 November 2015) as an example, Danny Mok, 'Builder and 11 Villagers Accused of Defrauding Lands Department in "Small-House" Scam' *South China Morning Post* (Hong Kong, 14 January 2015) <www.scmp.com/news/hong-kong/article/1679688/builder-and-11-villagers-accused-defrauding-lands-department-small> accessed 2 June 2021.

II. PRESUMED RESULTING TRUST

Presumption of resulting trust arises when an owner voluntarily transfers the legal title of his/her property to another without consideration.[23] Generally, it arises in two scenarios:

i. there is a gratuitous transfer of property from A to B;[24] or

ii. A pays all or part of the purchase price for property that is transferred to B.[25]

The default position is that 'B is intended to hold the property as trustee for A'.[26] However, in both scenarios, this presumption can be rebutted when there is evidence that a gift[27] or a loan[28] was intended.

Alternatively, there is the presumption of advancement, which presumes that a gift was intended.[29] This applies between parties who are in 'special relationships' (such as husband and wife,[30] parent and child).[31] Again, the presumption of advancement can be rebutted by proving indeed a resulting trust is to be established. Ultimately, the court looks for the parties' genuine intentions.[32]

III. *TINSLEY V MILLIGAN – THE RELIANCE PRINCIPLE*

When a party seeks to enforce a resulting trust, he/she cannot plead an illegal purpose to prove the existence of the resulting trust, or to rebut the presumption of advancement.[33] This is established in

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23 *Westdeutsche v Islington* [1996] 2 AC 669.
24 *Hodgson v Marks* [1971] Ch 892, 996.
25 *Dyer v Dyer* [1788] 30 ER 42.
26 Steven Gallagher, *Equity and Trusts in Hong Kong: Doctrines, Remedies and Institutions* (1st edn, Sweet & Maxwell 2017) 308
27 *Fowkes v Pascoe* (1875) LR 10 Ch App 343, 349 (WM James LJ).
28 *Re Sharpe (a bankrupt)* [1980] 1 WLR 219.
29 Gallagher (n 26) 321.
30 *Tinker v Tinker* [1970] 1 All ER 540.
31 *Wong Fu Cheung v Wong Pui Hung Peter* (HCMP 170/2011, 29 June 2012) (CFI).
32 Gallagher (n 26) 332.
33 Gallagher (n 26) 336.

Tinsley v Milligan.[34] Tinsley and Milligan bought a house on the understanding that they would each pay half of the purchase price. Yet, legal title was put under Tinsley's name so Milligan could defraud the government of benefits. After the couple fell out, Tinsley tried to evict Milligan. The issue before the court was whether Milligan could rely on the illegality (i.e. illegal arrangement made to defraud the government) to prove the existence of a resulting trust. The House of Lords held that Milligan could not rely on the illegality to establish a resulting trust. However, she could establish a beneficial interest because she paid half of the purchase money. Thus, the illegality was irrelevant.

However, there are too dissenting voices. Lords Goff and Keith opined that the equity maxim 'He who comes to Equity must do so with clean hands' should apply strictly and bar Milligan from enforcing her equitable interest.[35]

A. The Doctrine of *Locus Poenitentiae*

The doctrine of *locus poenitentiae*, as qualified by Lord Browne in *Tinsley v Milligan*,[36] is a well-established exception to the reliance principle. The doctrine is summarised in the case of *Tribe v Tribe*,[37] where '[A] person who has transferred property for an illegal purpose can nevertheless recover his property provided that he withdraws from the transaction before the illegal purpose has been wholly or partly performed'.[38] There, a father transferred company's shares to his son to evade claims from his creditors. However, the unlawful purpose was never carried out as the father had settled the dispute with the creditors without having to deceive them. Subsequently, the son refused to return the shares to his father. Since the transfer was from father to son, the presumption of advancement applied. In order to rebut the presumption, the father had to rely on the illegality that had never been carried out. Although the reliance principle was in play, Millet LJ held that a transferor can recover property 'where the illegal purpose has not

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34 *Tinsley* (n 7) 371F (Browne-Wilkinson LJ).
35 ibid 351-355 (Goff LJ, Keith LJ).
36 ibid 374 (Browne-Wilkinson LJ).
37 [1996] Ch 107.
38 ibid 124 (Millet LJ).

been carried out'.[39] An important point to add is that genuine repentance is not required, one only needs to voluntarily withdraw from an illegal transaction before any of the illegality commences.[40]Therefore, the father could introduce evidence of the unperformed illegality to rebut the presumption of advancement and retrieve the shares under the operation of resulting trust.

IV. *PATEL V MIRZA*

The Law Commission of the United Kingdom considered that the reliance principle presented serious problems of complexity, uncertainty, arbitrariness and lack of transparency.[41] Instead, it recommended that regard should be given to the policy rationales that underlie the illegality defence and apply them to the facts of the case.[42] Yet, the UK Government 'are minded not to implement the Commission's proposals' with 'reform of this area of law cannot be considered a pressing priority for the Government at present'.[43] Since then, the sharp division of opinions circled around whether a strictly rule-based approach (the reliance principle) or a flexible policy-based approach is more of a proper approach. This was manifested in three recent UK Supreme Court decisions, *Hounga v Allen*,[44] *Les Laboratoires Servier v Apotex Inc*[45] and *Jetvia SA v Bilta (UK) Ltd*.[46] In the last case, Lord Neuberger and Lord Mance considered that the conflict in case law had left the law in urgent need of resolution by a panel of seven or nine Justices.[47]

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39 ibid 134F (Millet LJ).

40 ibid 135 (Millet LJ).

41 Law Commission of UK, *The Illegality Defence* (LAW COM No.320, 2010 <http://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/03/lc320_Illegality_Defence.pdf> accessed 18 November 2020.

42 ibid 4.

43 Ministry of Justice of UK, *Report on the Implementation of Law Commission Proposals* (2012) 14 <www.justice.gov.uk/downloads/publications/corporate-reports/MoJ/2012/implementation-of-law-commission-proposals.pdf> accessed 18 November 2020.

44 [2014] UKSC 47, [2014] 1 WLR 2889.

45 [2014] UKSC 55, [2015] 1 AC 430.

46 [2015] UKSC 23, [2016] AC 1.

47 ibid [15] (Neuberger LJ), [34] (Mance LJ).

Finally in 2016, a case before a panel of nine Supreme Court Justices, *Patel*[48] came to rescue. In this case, Patel transferred a sum of money to Mirza for the illegal purpose of betting on share price movement based on insider information. The betting did not take place as the insider information was not forthcoming. However, Mirza refused to repay Patel the money. As such, Patel sued Mirza to recover the payment on ground of unjust enrichment. The Supreme Court unanimously allowed Patel's claim, overruled the reliance principle 8:1. Still, the Lordships were split 6:3 on the new approach to be adopted for the illegality defence. Led by Lord Toulson, the majority adopted a 'trio of considerations', whereas Lords Mance, Clarke and Sumption favoured a restitutionary approach.

A. Trio of Considerations

Under the 'trio of considerations' approach, one has to take into account all circumstances of a case to determine whether it would be contrary to the public interest to allow a claim tainted by illegality. To determine whether it would be contrary to the public interest, a trio of considerations is to be accounted for:

i. 'to consider the underlying purpose of the prohibition and whether that purpose will be enhanced by denial of the claim;
ii. to consider any other relevant public policy on which the denial of the claim may have an impact; and
iii. to consider whether denial of the claim would be a proportionate response to the illegality'.[49]

In considering limb (iii), Lord Toulson borrowed the 'range of factors' test from Professor Burrows in recognising seven non-exhaustive factors:[50]

a) how seriously illegal the conduct was;

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48 *Patel* (n 6).
49 ibid [120] (Toulson SCJ).
50 Andrew Burrows, *A Restatement of the English Law of Contract* (2nd edn, OUP 2016) 229-230; *Patel* (n 6) [93] (Toulson SCJ).

b) whether the party seeking enforcement knew of, or intended the conduct;
c) how central to the contract the conduct was;
d) whether denying enforcement will further the purpose of the rule which the conduct has infringed;
e) whether denying enforcement will act as a deterrent to the illegal conduct;
f) whether denying enforcement will ensure that the party seeking enforcement does not profit from the conduct; and
g) whether denying enforcement will avoid inconsistency in the law.

Thus, a claim is allowed if it is reconcilable with the policies under limbs (i) and (ii). If a claim is not reconcilable with policies, it will still be allowed if it is disproportionate to refuse relief under limb (iii)'s range of factors. Nevertheless, Lord Toulson emphasised that 'the essential rationale of the illegality doctrine is that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system'.[51] Within this framework, cases will be considered on a case-by-case basis rather than by a rule-based application of the reliance principle which depends on a single procedural aspect, i.e. whether the applicant pleads the illegality or not.

Applying this approach to the facts of *Patel*, Lord Toulson concluded that there was no obvious policy reason to override the normal law of unjust enrichment in a situation where the claimant was seeking to unwind the illegality.[52] While there may be rare exceptions, the crime of conspiracy to commit an offence of insider dealing was not as severe as the exceptional examples given by Lord Toulson (i.e. contracts for murder[53] and drug trafficking).[54] The standard law on restitution of unjust enrichment should apply.

51 *Patel* (n 6) [120] (Toulson SCJ).
52 ibid [116] (Toulson SCJ).
53 ibid.
54 ibid [110] (Toulson SCJ).

B. The Minority's Restitutionary Approach

Sumption, Mance and Clarke LJJ all believed that a restitutionary approach should be applied – that is to unravel the illegality and restore the parties to the *status quo ante* (as if the illegality had not taken place). Per Lord Mance, 'since the court is reversing, rather than enforcing the illegality, the court could also take into account both the objective fact of joint contributions and the parties' legal purpose of joint ownership'.[55] Therefore, if we apply this approach to the case of *Tinsley*,[56] Milligan should be able to enforce her equitable interest by setting aside the illegal transactions. Therefore, the court could 'on that basis, order the property to be registered in their joint names'.[57] He added that 'the effect of illegality should not deprive claimants the opportunity to obtain damages for wrongs or to put themselves in the position in which they should have been',[58] where possible, even if the illegality has been wholly or partly carried into effect.[59]

Lord Clarke raised a caveat to this restitutionary approach. He stated that there should be a principle which denies recovery if it would undermine the integrity of the justice system.[60] Further, he gave two examples such limited 'well-defined circumstances'[61] would occur, i.e. 'by permitting the plaintiff to profit from an illegal act or, to evade a penalty prescribed by criminal law'.[62]

Lord Sumption is the only Supreme Court Justice who did not overrule the reliance principle, favouring the certainty offered by the rule-based approach. He argued that the problem about the principle is not the test itself, but it was applied incorrectly in *Tinsley*. He justified his stance by illustrating that the arbitrary outcomes brought by the equitable presumptions (presumptions of resulting trust and advancement) only arose in

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55 ibid [197]-[200] (Mance SCJ).
56 *Tinsley* (n 7).
57 *Patel* (n 6) [201] (Mance SCJ).
58 ibid [192] (Mance SCJ).
59 ibid [202] (Mance SCJ).
60 *Hall v Herbert* [1993] 2 SCR 159 [169E]-[169F] (McLachlin J) cited in *Patel* (n 6) [214] (Clarke SCJ).
61 *Patel* (n 6) [214] (Clarke SCJ).
62 *Hall* (n 60) (McLachlin J) cited in *Patel* (n 6) [213] (Clarke SCJ).

property cases.[63] Rather, the reliance principle should be applied without those presumptions.[64] Moreover, the consideration of 'whether the illegality had been performed or not' in limiting the operation of *locus poenitentiae* was never sound.[65] Therefore, restitution should be granted where 'mutual restitution of benefits remains possible'.[66]

In *Patel*, where the right to restitution flows from the legal ineffectiveness of a contract under which the money was paid[67] and all that being sought was restitution of money paid than to enforce the illegal contract, restitution should be made available.

V. THE CURRENT LAW OF ILLEGALITY DEFENCE IN HONG KONG

In Hong Kong, although the *Patel*'s majority approach has seen its appearance in the context of Developer Schemes, the current law remains the reliance principle.

The first judgement which puts *Patel* into its central analysis is an application by the plaintiff to re-amend his amended statement of claim, *Chung Tin Pui v Li Pak Sau*.[68] The facts of this case resonate with *Kan Wai Chung v Hau Wun Fai*[69] (see below) and the plaintiff pleaded illegality of the agreement to void the contract, because the defendant villagers made false declarations to the government under the SHP. On issue of illegality, Louis Chan J considered the 'trio of considerations' approach to be 'of very high persuasive authority'.[70]

Yet, such is the only case regarding Developer Schemes in Hong Kong that followed the *Patel* analysis. In an earlier case, *HKSAR v Lau Kam Ying*,[71] the CFA applied the reliance principle

63 *Patel* (n 6) [239] (Sumption SCJ).
64 ibid.
65 ibid [253] (Sumption SCJ).
66 ibid.
67 ibid [252] (Sumption SCJ).
68 *Chung Tin Pui v Li Pak Sau* (HCA 568/2007, 29 September 2017).
69 *Kan Wai Chung v Hau Wun Fai* (CACV 7/2016, 22 July 2016).
70 *Chung Tin Pui* (n 68) [51] (Chan J).
71 [2013] HKCFA 81, (2013) 16 HKCFAR 595.

in *Tinsley*, but said it was unnecessary to come to a concluded view on the matter.[72] This was accepted in *Kwan Hung Shing v Fong Kwok Shan*[73] in 2019, where the Court of Appeal noted the change of law in England, however felt pressure to be bounded by the CFA decision in *Lau Kam Ying*.[74] Wilson Chan J applied the reliance principle and stated that *Tinsley*[75] remains good law in Hong Kong.[76] In fact, the reliance principle has been widely followed by the Court of Appeal in Hong Kong.[77]

The then Chief Justice of the CFA, Ma CJ has shed some light on the way forward of the illegality defence in *Ryder Industries Ltd (Formerly Saitek Ltd) v Timely Electronics Co Ltd*:[78]

> I am not in favour of applying [a] test for illegality [which]… suggest[s] that [a] judicial discretion to be exercised… The question of illegality must be based on firmer principle and policy.

It can be inferred that the CFA is unlikely to adopt the 'trio of considerations' with Ma CJ criticising the discretion imported by the policy-based approach. At this juncture, we await another decision of the CFA to consider whether to alter the law and follow *Patel.*

VI. WHICH APPROACH IS BETTER IN THE CONTEXT OF DEVELOPER SCHEMES?

It is important for us to distinguish the strengths and flaws of the above three approaches to select the best approach in addressing the issue of Developer Schemes should a case of such nature come before the CFA. In the following paragraphs, we will examine all

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72 ibid [20]-[21] (Tang PJ).
73 HCA 265/2012 (9 July 2019).
74 ibid [22] (Chan J).
75 *Tinsley* (n 7).
76 *Kwan Hung Shing* (n 74).
77 *Loyal Luck Trading Ltd v Tam Chun Wah* [2008] HKCA 111, [2008] 4 HKLRD 681; *Wong Kwok Learn Baldwin v International Trading Co Ltd* [2010] HKCA 51, [2010] 2 HKLRD 334; *Lau Kwai Kiu v Bian Xintian* [2012] HKCA 160, [2012] 2 HKLRD 954.
78 [2015] HKCFA 85, (2015) 18 HKCFAR 544 [1] (Ma CJ).

three approaches by directing our focus to remedy the exploited SHP.

A. *Tinsley v Milligan* – The Reliance Principle

Applying the reliance principle in the context of Developer Schemes, *Kan Wai Chung v Hau Wun Fai*[79] illustrates that the developer could retrieve his land and the houses by proving the existence of resulting trust without relying on illegality. Like many other Developer Schemes, the facts of this case are trite: the villagers entered into an illegal agreement with a property developer, where the latter advanced land to the villagers, and the villagers exercised their 'Ding' rights to erect small houses which were funded by the developer. Under this arrangement, the villagers would subsequently assign ownerships of the houses and the land back to the developer for monetary consideration. Eventually, the scheme fell apart as the villagers attempted to sell the houses to a third party because they were not paid the agreed consideration. The Court of Appeal held that the villagers held the land and the houses on a resulting trust for the developer as the villagers paid no consideration.[80] It reconciled with *Tinsley* that the illegality of the agreement was irrelevant so long as the developer did not have to rely on it to enforce his equitable interest. Moreover, the villagers would have to rely on the illegal arrangement to rebut the presumption of resulting trust, which is not allowed under the reliance principle.

1. ARBITRARINESS

Given that the *Tinsley* test premised solely on the procedural aspect of whether to plead the illegality or not, the outcome depends on which presumption to apply.[81] For example, in *Collier v Collier*.[82] Collier put his night club and recording studio under the name of his daughter to keep them out of hands from creditors

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79 *Kan Wai Chung* (n 69).

80 ibid [7.4] (Cheung JA).

81 Mark Law and Rebecca Ong, '"He Who Comes to Equity Need Not to Do so with Clean Hands?" Illegality and Resulting Trust after Patel v Mirza, What Should the Approach Be?' (2017) 23 Trusts & Trustees 880, 886.

82 [2002] EWCA Civ 1095.

threatening his bankruptcy. His daughter later refused to return the premises. Since the presumption of advancement operates in a parent-child relationship,[83] Collier had to provide evidence that the transfer is of a trust rather than a gift. However, he was unable to show the real purpose of the transfer without pleading illegality. Undoubtfully, his claim failed. If we compare *Collier v Collier*[84] with *Tinsley*,[85] both cases have uncanny similarities on facts. Nonetheless, since the relationship between Milligan and Tinsley is not one of the recognised 'special relationships', the presumption of resulting trust operated instead of the presumption of advancement. Consequently, the illegality was irrelevant. Indeed, Lord Browne-Wilkinson has noticed in *Tinsley* such a distinction between *Tinsley* and a case where the presumption of advancement would apply.[86]

The categorisation of 'special relationships' provides no legal justification for the arbitrary outcomes of the above two cases, and there is no rationale for treating these circumstances differently as there is no material distinction on facts. Imagine a case where the manager of the developer was married (or a child) to the villager where they both collude in the same Developer Scheme, the developer would be unable to retrieve his property due to the operation of presumption of advancement. The difference of outcomes between this hypothetical case and typical cases such as *Kan Wai Chung* is unsound and unsatisfactory to convince confidence into the courts.

2. The Issue of Windfall Gain / Stultification

Another issue that the reliance principle does not account for is one party will acquire an undeserved windfall gain no matter which side wins. Take *Tinsley v Milligan*[87] as an example, in finding for Milligan, she would have otherwise gained government benefits which she deceived had she not repaid and settled it. Conversely, had Tinsley been Milligan's wife, the presumption of advancement would apply, and Tinsley would

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83 *Wong Fu Cheung* (n 31).
84 *Collier* (n 82).
85 *Tinsley* (n 7).
86 ibid 372 (Browne-Wilkinson LJ).
87 *Tinsley* (n 7).

have kept the whole house when she only paid half the purchase price. In the context of Developer Schemes, as seen in *Kan Wai Chung,* the developer could enforce his right over the houses and the land. This left the developer a windfall of being able to construct small houses without paying premiums to the government and hiring an Authorised Person. The villagers on the other hand lost their 'once-in-a-lifetime' rights to build small houses and were not compensated for it.[88]

This is objectionable as Lord Toulson in *Patel v Mirza*[89] considered the obtainment of a windfall gain goes against the maxims behind illegality:

> Looking behind the maxims, there are two broad discernible policy reasons for the common law doctrine of illegality as a defence to a civil claim. One is that a person should not be allowed to profit from his own wrongdoing. The other, linked, consideration is that the law should be coherent and not self-defeating, condoning illegality by giving with the left hand what it takes with the right hand.[90]

The first maxim recalls the criticism made by Lords Goff and Keith in *Tinsley* that the reliance principle defeats the equity maxim 'he who comes to Equity must do so with clean hands'.[91] Secondly, the maxim of 'the law should not be self-defeating', as Birks put it, stultification[92] of other areas of the law can be demonstrated by the facts of *Tinsley.* While the transferor is performing an illegal design, the 'contract' provides that the transferee will maintain the property and will not deny the transferor's right.[93] The transferee then denies the transferor's right. By declaring a trust, it stultifies contract law, as an illegal

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88 Law and Ong (n 81) 898.

89 *Patel* (n 6).

90 ibid [99] (Toulson SCJ).

91 *Tinsley* (n 7).

92 Peter Birks, 'Recovering Value Transferred under an Illegal Contract' (2000) 1 Theoretical Inquiries in Law 155, 162-176 cited in Mark Law and Rebecca Ong, '"He Who Comes to Equity Need Not to Do so with Clean Hands?" Illegality and Resulting Trust after Patel v Mirza, What Should the Approach Be?' (2017) 23 Trusts & Trustees 880, 886-887.

93 ibid.

agreement will be void and unenforceable.[94] More severely in the context of Developer Schemes, it stultifies criminal law when a resulting trust is operated. In 2015, a developer and eleven villagers were convicted[95] by the District Court of common law conspiracy to defraud when operating a typical Developer Scheme. The developer as well as the eleven villagers were sentenced to up to three years in prison.[96] If a civil case was filed, the developer would still be able to retrieve his property on operation of a presumed resulting trust and the law would be 'giving with the left-hand what it takes with the right hand'. Ultimately, the application of the reliance principle affects the general coherence within and between different areas of the law.

3. No Regard To The Merits Of The Case

Tied closely to the issue of windfall gain, the reliance principle pays no attention to the severity of the illegality performed by the parties. As Lord Goff observed in *Tinsley*, 'the reliance principle [allows] unmeritorious or mala fide claimant [to] recover regardless of the seriousness of the illegality'.[97] Hence, application of the reliance principle may produce an unfair and disproportionate result. Law raised an example slightly modifying the facts of *Tinsley*:

> Had the amount that Milligan defrauded been larger than her share value (or had the house value dropped), allowing Milligan to enforce her equitable interest would be unfair to Tinsley based on the amount.[98]

This article agrees with the proposition made by Law, by assuming all illegality is equally serious, substantive fairness is not achieved between the parties and it may produce a disproportionate result on the losing party.

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94 ibid.
95 Legislative Council of HKSAR (n 22).
96 ibid.
97 *Tinsley* (n 7) 362 (Goff LJ).
98 Law and Ong (n 81) 887.

It follows that the deterrent effect under the rule-based approach is simply non-existent. One may question, why is it the proper role of civil law to deter when the developers and villagers can be 'punished' under criminal law for fraud anyway? The UK Law Commission in its recommendations emphasised that one of the objectives in the development of illegality defence is to deter people from using financial arrangements/structures for serious wrongdoings, particularly when a trust is used for illegitimate purposes while concealing the true ownership of the property, e.g. to defraud creditors or tax authorities.[99] Such an argument is also backed with judicial support, as Justice Coulson stated in *K/S Lincoln v CB Richard Ellis Hotels Ltd*[100] that the illegality defence is expressed not so much a principle as a policy, and the underlying policy rationale for the illegality defence was one of deterrence,[101] 'that the courts will not encourage illegal acts by allowing claims based upon them'.[102] Further, the 2009 consultative report on the illegality defence published by the UK Law Commission pointed out that 'in some cases which involve the breach of a minor technical statutory provision, the potential unenforceability of a contract may provide a far more serious deterrence than criminal law'.[103] This is because the prospect of criminal punishment for violating the clause is insignificant, and the amount at risk in any civil suit might far outweigh the fine imposed by criminal law.[104] For other cases where the breach of provision is serious but the risk of discovery is slight with the criminal law imposing a higher standard of proof for fraud, the civil law fills in the gap to provide the required deterrent effect.

On a deeper analysis, the deterrent effect in civil law is deployed with a fair amount of flexibility than criminal law, e.g. if the perpetrator is unaware of the law, allowing the claim would be less likely to compromise the legal system's integrity. Conversely, if the unlawful purpose was initiated by the perpetrator, then denying the claim may serve as a significant

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99 Law Commission of UK (n 41) 79.

100 [2009] EWCH 2344 (TCC), [2009] BLR 591.

101 *Gray v Thames Trains Ltd* [2009] UKHL 33, [2009] 1 AC 1339 [30] (Hoffmann LJ) cited in *K/S Lincoln v CB Richard Ellis Hotels Ltd* [2009] EWCH 2344 (TCC), [2009] BLR 591 [19] (Coulson J).

102 *K/S Lincoln* (n 101) [22] (Coulson J).

103 Law Commission of UK, 'The Illegality Defence, A Consultative Report (Law Com No 189, 2009) [2.20].

104 ibid.

deterrence to others from engaging in similar schemes.[105] That being said, the rationale of the deterrent effect of civil law differs from that of criminal law in maintaining the integrity of the legal system, rather than the criminal aspect of 'punishment'.

Therefore, if we apply the reliance principle in the context of Developer Schemes, developers can engage in large-scale development by assigning a huge amount of land to a large number of villagers in an attempt to build a full-scale luxury estate,[106] when they know they would be treated by an indiscriminate fashion and eventually they could retrieve all their properties back if the schemes fall apart. On the bright side, it highlights the usefulness of the proportionality limb under the 'trio of considerations' approach in these scenarios.

4. Brief Summary

Although the rule-based reliance principle provides clarity and consistency of its operation, such benefits are outweighed by the risk of producing an arbitrary outcome that may lead to an undeserved windfall on either party. Further, it lacks the necessary deterrent effect. Rather, it can be said that it encourages perpetrators of the law to engage in illegal arrangements in full tilt when severity of the illegality is discounted. As far as clarity and legal consistency are important, the idea of 'artificially forcing the myriad circumstances of the illegality cases into the straitjackets supplied by the current rigid illegality rules'[107] is unrealistic. More importantly, it leads to an incoherence among and within different areas of law. Any rule should maintain the overall integrity of the legal system.[108]

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105 Law Commission of UK (n 41) 24 [2.67].

106 Shirley Zhao and Gary Cheung, 'The battle over Hong Kong's controversial small-house policy is not finished' *South China Morning Post* (Hong Kong, 1 May 2019) <www.scmp.com/news/hong-kong/law-and-crime/article/3008261/battle-over-hong-kongs-controversial-small-house> accessed 22 November, 2020. As Zhao and Cheung say, '[r]ecently in 2019, a luxury housing estate in Tuen Mun comprising 28 small houses was found to have been built by a single developer representing 28 male villagers.'

107 Tsuan Hang Tey, 'Reforming Illegality in Private Law' (2009) 21 Singapore Academy of Law Journal 218, 259.

108 *Hall* (n 60) [17] (McLachlin J); cited in Tsuan Hang Tey (n 107) 239 [52].

B. *Patel v Mirza* – The Minority Restitutionary Approach

Under the minority's restitutionary approach, it attempts to undo the illegality and restore the parties to their original position, subject to a residual power to deny recovery in 'well-defined circumstances'.[109] Should a case of Developer Scheme come before a court applying the restitutionary approach, this article predicts that the developer would be able to enforce his equitable interest to retrieve the land assigned to villagers, with the 'Ding' rights restored to the villagers and the houses built demolished. Although such an approach does not lead to the arbitrariness as seen in the reliance principle, nor does it result in a windfall gain on either party (save for the analysis of the doctrine of *locus poenitentiae* under Section VI(B)(3)), there are three major flaws that will be discussed in the following paragraphs.

1. Floodgate of the Court

The restitutionary approach is 'theoretically possible but impractical'.[110] Its impracticality stems from two issues. First, any houses built on the developer's land will have to be demolished.[111] Considering the sizeable scale of these Developer Schemes, it may require demolishing a whole estate which is uneconomic and will cause nuisance to other villages living nearby. Second, while the 'Ding' rights will be restored to the villagers, Law raised that such an approach will lead to a floodgate of litigation:

> Other Dings in similar agreement could seek to restore their rights if they were not satisfied with the deal they got, with a view to repeating this exercise on better terms.[112]

From a deterrence perspective, it works right the opposite. The restitutionary approach unintentionally adds to the

109 *Hall* (n 60) [214] (Clarke SCJ).
110 Law and Ong (n 81) 899.
111 ibid.
112 ibid.

bargaining power of villagers when they knew they could certainly revive their 'Ding' rights, and therefore developers would have to come up with better terms when negotiating with villagers. Additionally, a 'once-in-a-lifetime right' should not be returned from a policy perspective.[113] If not and as revolting as it can get, the villagers may abuse the legal system as an avenue to revive their 'Ding' rights when a scheme falls out or when a term from the developer is not favourable to them.

2. THE DISREGARD OF PRESUMPTIONS

According to Lord Sumption, the equitable presumptions of resulting trust and advancement were distorting the reliance principle and the correct approach was to apply the principle without those presumptions.[114] However, it posed an issue pointed out by Professor Burrows:

> It is still not entirely clear what the Lord Sumption version of the reliance rule entails, still less what its justification is. On what logical basis can one simply ignore the standard law on presumptions?[115]

Although the relabelled version of the reliance principle, namely the restitutionary approach poses no problem when it comes to the facts of *Patel* as it is a case of unjust enrichment, further questions will emerge if we apply such an approach to trust and property cases in the context of Developer Schemes. For instance, are the standalone status of the presumptions completely abolished? With regard to what other principles (apart from illegality) should the presumptions not exercised? These questions need to be dealt with to ensure the ease and consistency of the application of presumptions to different sets of facts. The certainty entailed by such an 'one-size-fit-all' amendment to the presumptions across

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113 ibid 960.

114 Andrew Burrows, 'Illegality after Patel v Mirza' (2017) 70 Current Legal Problems 55, 62-63; cited in *Patel* (n 6) [237]-[238] (Sumption SCJ).

115 Burrows (n 114) 63-64; James Goudkamp, 'The End of an Era? Illegality in Private Law in the Supreme Court' (2017) 133 LQR 14, 16.

all spectrums of civil law is nominal at best and would not be borne out in the application to the facts in any particular case.

3. OLD WINE IN A NEW BOTTLE

Along with Lord Mance, Lord Sumption suggested that 'restitution is available for so long as mutual restitution of benefits remains possible'.[116] Therefore, the restitutionary approach seems to completely disregard the doctrine of *locus poenitentiae* and however heinous the illegality is,[117] except for the 'well-defined circumstances' put forward by Lord Clarke.[118]

Heroic as Lord Sumption's effort to save the reliance rule, the restitutionary approach will run into the same problem encountered by the *Tinsley*'s reliance principle under Section VI(A)(3), namely by assuming all illegality is equally serious, it lacks the deterrent effect. Although the restitutionary approach and the reliance principle remove the moral undertone from the law on illegality, ultimately enhancing consistency between judges' decisions, this article believes that the notion of proportionality, and the moral judgements required of judges in differentiating illegality into different degrees of iniquity are necessary in achieving a just and proportionate outcome in litigation.

Take the following two SHP scenarios as an example. Villager A sells his small house to a non-villager after falsely declaring he would reside in the small house when applying for the small house grant.[119] Villager B conspires with other villagers and developers in the sale and purchase of their 'Ding' rights by falsely declaring he is the sole and legal owner of the land a luxurious estate is going to be built on. Both arrangements are illegal and if both parties would like to seek restitution, one would hardly imagine villagers A and B are to receive the same level of judicial treatment. It follows that the degree of illegality has to be distinguished if justice is seen to be done. In a broader sense, since

116 *Patel* (n 6) [253] (Sumption SCJ).
117 ibid [254] (Sumption SCJ).
118 *Hall* (n 60) [214] (Clarke SCJ).
119 A villager must warrant that he has never made any arrangements to dispose of his interest to develop a small house in applying for a small house grant. See Legislative Council of HKSAR (n 20).

the illegality defence interacts with different policies promulgated by the government each carrying a different social priority and impact, one would also logically distinguish between the nature of illegality. For example, a party who entered into a contract to murder should not be allowed restitution. On the other end of the spectrum, a judge should have more room to manoeuvre in allowing restitution if the contract entered into was a contract to trespass. Without the above distinction, it is questionable to understand how the laws are enforced with such an indiscriminate nature, which may affront public conscience and the dignity of the court. Yet, there is still a valid concern as to subjectivity of judges in forming the required moral judgements. This article further explains that a judge's discretion is not unfettered in such a balancing exercise under Section VI(C)(2).

Regarding the doctrine of *locus poenitentiae*, Lord Sumption criticised that the concept of voluntary withdrawal leads to an investigation into a party's mental state, which the law rarely evaluates[120] and such a doctrine should be dispensed with. Rather, a contract that has been partly or even fully executed can still be rescinded. Take Professor Burrows' own example,[121] C contracts with D for the delivery of C's good for $25,000. Both parties know that in order for D to complete the contract on time, D would have to break the speed limit. Applying Lord Sumption's reasoning, if C then seeks restitution on the basis that the contract was illegal as it was performed, he would been entitled to restitution of the $25,000 even though the contract has been fully performed.[122] With respect, this may not be desirable, and it shows once again that devising a rule to cover all situations of illegality will end up producing harsh results. C would end up getting the whole performance for free and D would be deprived of the contract price.[123] Instead, this article believes that by incorporating the doctrine of *locus poenitentiae* under the proportionality limb of the 'trios of considerations', it would help to avoid a windfall gain on either party and to produce a more proportionate outcome (*see* Section VI(C)(4)). Voluntariness should be assessed holistically

120 *Patel* (n 6) [252] (Sumption SCJ).
121 Burrows (n 114) 65.
122 ibid.
123 ibid 65-66.

taking into account the circumstances of the case – which is simply an unavoidable step if one is to reach satisfactory results.

4. Brief Summary

The restitutionary approach proved the effort by Lord Sumption to save the reliance principle in *Tinsley*. However, it sends the wrong message to potential perpetrators of the law to continue abusing the legal system to their benefit. Moreover, the disregard of the presumptions is unjustified. A silver-lining in the above analysis is that it revealed the usefulness of the element of proportionality with the doctrine of *locus poenitentiae* and the severity of illegality as factors to be considered under it moving forward from *Tinsley v Milligan*.[124]

C. *Patel v Mirza* – The 'Trio of Considerations'

This article proposes that the 'trio of considerations' approach is the better model to begin with in the context of Developer Schemes. The word 'to begin' is carefully chosen as the original 'trio of considerations' approach leaves out the issue of windfall gain and hence leads to stultification of the law. Certain modifications to the original approach are illustrated below to produce a more satisfactory outcome. However, even without these modifications, this approach accounts for the merits of a particular case and the severity of illegality involved under the proportionality element. By entailing a policy-based approach, it avoids producing arbitrary outcomes and does what the reliance principle and the minority restitutionary approach fails to, which is to further the purposes of the SHP and criminal law and to maintain the overall integrity of the legal system.

Lord Toulson did not provide the 'trio of considerations' with any priorities or weighting, meaning that proportionality is always in play.[125] Should a case such as *Kan Wai Chung* come before the application of the 'trio of considerations', it is true that the decision could have swung either way as we could not predict

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124 *Tinsley* (n 7).
125 Burrows (n 114) 67.

the judge's discretion regarding the proportionality element. However, this article posits that the developer's claim to retrieve the houses built and the land assigned under the operation of presumed resulting trust will be barred.

At the outset, the Developer Scheme transgresses two policy grounds.

First, the Developer Scheme amounts to common law conspiracy to defraud.[126] Although the offence of conspiracy to defraud is similar to the offence in *Patel* (in which the claim was allowed) and does not fall within the rare exceptions provided by Lord Toulson, there remains a significant difference. In *Patel*, the claimant was seeking to unwind the illegality. Here, if we allow the developer's claim to retrieve his land and the houses, the effect in reality would be to 'enforce' the illegality rather than to unwind it. The developer would have the houses ready for sell without paying the premiums required.

Secondly, the policy objective of the SHP is to, 'improve the standard of living and providing for the future housing needs of indigenous villagers'.[127] By perpetrating the policy in an attempt to build houses for sale to non-villagers, it defeats the whole purpose of the SHP. One may argue that since Lord Toulson would allow the similar claim in *Tinsley* (to defraud the government of benefits), [128] the developer's claim should also be allowed. Again, the Developer Scheme is distinctive from *Tinsley* in two ways. First, given the controversial nature of the SHP,[129] courts will be more stringent in approaching relevant matters. Secondly, the severity of the illegality (which goes under the proportionality limb) is quite high as the premiums defrauded are of an enormous amount,[130] not to mention the condemning nature of these schemes in light of the land shortage in Hong Kong.

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126 Legislative Council of HKSAR (n 20).

127 Hopkinson and Lao (n 1).

128 *Patel* (n 6) [181] (Toulson SCJ).

129 Shirley Zhao and Gary Cheung (n 106).

130 HK$4.3M in total for the 11 villagers: South China Morning Post Editorial, 'Rights and Wrongs: Hong Kong's Small-House Policy for Indigenous Villagers Is Outdated and Unfair' *South China Morning Post* (Hong Kong, 14 December 2015) <www.scmp.com/comment/insight-opinion/article/1891091/rights-

Under the proportionality limb, the illegality is central to the scheme as the false declaration is the key component of the scheme. Arguably, on issue of severity, it is difficult to envisage what amount of premiums (how many villagers are involved in the scheme) before it will become too severe for the developer to enforce his equitable interest.[131] Nevertheless, most of the other factors under the 'range of factors' test point to the claim being barred, namely, denying enforcement will further the purpose of the rule which the conduct has infringed, acts as a deterrent to the illegal conduct, ensures that the party seeking enforcement does not profit from the conduct and the party seeking enforcement knew of, or intended the conduct. Thus, it is highly likely that such a claim will be barred.

1. The Issue of Windfall Gain / Stultification

The only factor under the 'range of factors' test that does not point to the developer's claim being barred is that it introduces inconsistency in the law. Following the predicted outcome, the villagers will be left a huge windfall retaining the entire plots of land and houses for which they paid no consideration. Normatively, it leads to the stultification of criminal law. Yet, on a broader picture, the losses suffered by the developer (the plots of land and financial resources used to build the houses) would send a clear message to the whole real estate industry that such illegality would not be condoned by our legal system. This article believes that, to resolve the issue of illegality within the SHP, the benefit of the deterrent effect outweighs the windfall gain obtained by villagers in the early stage adoption of the 'trio of considerations'. While most Developer Schemes are initiated by developers.[132] Without the initiatives from developers, we could expect less of them.

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and-wrongs-hong-kongs-small-house-policy-indigenous> accessed 22 November 2020; cited in Law and Ong (n 81) 898.

131 Law and Ong (n 81) 893.

132 Audit Commission of HKSAR, 'Small House Grants in the New Territories' (*Audit Commission of HKSAR,* 2002) 9 <www.aud.gov.hk/pdf_e/e39ch08.pdf> accessed 18 November 2020.

2. A RULE BECOMES A POWER?

Under Section VI(B)(3), this article suggests that the notion of proportionality and the moral judgements required of judges to consider the severity of illegality are vital to produce a proportionate outcome. Yet, other criticisms of the 'trio of considerations' approach surround the judicial discretion to be deployed by judges. As mentioned above, Ma CJ does not welcome the judicial discretion to be exercised in assessing illegality, rather he favours resting on firmer principle and policy.[133] Additionally, there are concerns that 'the judicial function becomes that of a law reform agency',[134] and the courts may not be competent enough to assess and adjust the competing social and financial interests which appear to be involved. What follows are the uncertainty and inconsistency in applying such an approach. Without a clear guidance as to how courts are to consider the underlying purposes of the policies or the weight given to each of the factors under the proportionality limb, judges can rely no other than their own subjective gut feeling.[135]

Under the doctrine of separation of powers, theoretically, judges are neither competent nor constitutionally mandated to undergo a policy balancing exercise. Such is the hallmark in governing the law of judicial review, administrative law. However, it is not the conventional view favoured in the realm of civil law. Take the development of tort law as an example, in matters of the duty to rescue and claims for psychiatric damages, the court had relevant concerns about opening the floodgate of litigations.[136] Further, judges may be required to make an assessment of social utility in determining the standard of duty of care.[137] A recent example is the increase of sexual abuse cases[138]

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133 *Ryder Industries Ltd* (n 78) [1] (Ma CJ).

134 William Gummow, 'Illegality and Statute in Hong Kong' (The Hochelaga Lecture 2017) (*Hong Kong Court of Final Appeal*, 26 March 2018) 4 <www.hkcfa.hk/filemanager/speech/en/upload/1199/Illegality%20and%20Statute%20in%20Hong%20Kong,%20the%20Hochelago%20Lecture%202017%20(as%20at%2026.3.18).pdf> accessed 23 November 2020.

135 Law and Ong (n 81) 893.

136 *Alcock v Chief Constable of South Yorkshire Police Respondent* [1992] 1 AC 310, 383 (Stocker LJ).

137 Burrows (n 114) 69.

138 *Lister v Hesley Hall Limited* [2001] UKHL 22, [2002] 1 AC 215.

in religious institution-controlled foster cares prompted a re-examination of the traditional criteria for establishing vicarious liability.

More importantly, a judge's discretion is not unfettered. Under the 'trio of considerations' approach, judges are not only obliged to take into account the surrounding circumstances of a case in a holistic view, they are also bounded by the precedence before them with the doctrine of stare decisis. When they are uncertain with applying the approach in particular cases, judges can refer to Hansard or legislative documents in making a decision more aligned with the Legislature's wishes. These are the backstops in maintaining the consistency of the whole body of the law.

We live in a multi-facet society with ever-changing circumstances and public policy considerations. If we reduce the complex body of the law of illegality to simple all-embracing terms, it ignores these changes and the certainty to 'predict' consistent outcome is overrated. On the other hand, the flexibility provided under the policy-based approach allows judges to catch up with these changes. And more, we have witnessed the injustice brought upon parties when a rule pays no regard to the purposes of the underlying policies and the merits of a case. As noted by Tey:

> Even if the discretionary policy-based approach does bring about greater uncertainty, it is a price worth paying for the greater justice that it may bring to the realm of private law.[139]

3. Modification I – Resolving the Issue of Windfall Gain / Stultification

As described above, when the developer's claim is barred, the villagers would acquire a windfall gain of the assigned plots of land and houses built. Conversely (and less likely), the developer would have defrauded the government of premiums that are originally payable to develop the land. To resolve the issue of

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[139] Tey (n 107) 253-254.

windfall gain, this article suggests that for a party to enforce his equitable interest (developer) or to retain the land and the houses (villagers), statutory benefits must be repaid to the government. Since the illegality defence applies across different areas of civil law, the effect of an enactment of an appendix to the Building Ordinance (Application to the New Territories) Ordinance[140] will only be restricted to cases of Developer Schemes. Instead, a judge's discretion in terms of remedies should be expanded. The outcome of the Australian case *Nelson v Nelson*[141] is particularly innovative and helpful in this regard. In *Nelson,* Mrs. Nelson was statutorily eligible to purchase a house with subsidies from the state if she did not have equitable interest in another property. In defrauding the state to receive subsidies, she provided her children with purchase money of a house under their names with the common intention that Mrs. Nelson was the beneficial owner. Her children later sold the house and refused to return the proceeds to Mrs. Nelson. The High Court of Australia refused to follow *Tinsley* (1995 at the time) and granted a declaration that Mrs. Nelson's children held the proceeds on trust for her, with statutory subsidies required to be paid back to the state.

Referencing *Nelson*, if the courts in Hong Kong rule in favour of a developer, the developer should repay the premiums defrauded and comply with other formalities required to enforce his equitable interest in the houses (or to erect one) and the plots of land assigned. Vice versa, the villagers should pay the market rate of the assigned plots of land and the houses to the government. In situation where the villagers do not want to retain the houses and the plots of land, the 'Ding' rights 'should be revived subject to an undertaking that the villagers are not to engage in a similar illegal scheme, with the sanction of contempt of the court'.[142] It follows that the plots of land and the houses built would be confiscated by the government.

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140 The Small House Policy is an administrative policy and for the most part does not require legislation. However, the legislation governing the exemption of small houses from the provisions of the Building Ordinance (Cap. 120) is the Building Ordinance (Application to the New Territories) Ordinance (Cap. 121).

141 [1995] 132 ALR 133.

142 Law and Ong (n 81) 900.

Indeed, the modified approach resembled minority's restitutionary approach in *Patel* – to put the parties into a position which they should be in as if the illegality had not happened. However, with the addition of potential sanction from the court, it avoids the issue of floodgate of litigation. Most significantly, it preserves all the advantages for the court to undergo the balancing exercise of 'trios of considerations' before opening the gate to restitution.

4. Modification 2 – Locus Poenitentiae as a Factor Under the Proportionality Limb

Seemingly so, the doctrine of *locus poenitentiae* was swallowed by the 'trio of considerations' approach. Lord Toulson in his judgement gave us a definitive answer:

> It is not necessary to discuss the question of locus poenitentiae which troubled the courts below, as it has troubled other courts, because it assumed importance only because of a wrong approach to the issue.[143]

However, it has been suggested that the preservation of the doctrine appears to be strongly consistent with the 'trio of considerations' approach.[144] Leung justified his stance by referring to the UK Law Commission's report, 'if the beneficiary was unaware that the purpose of the arrangement was illegal, or had already repented and withdrawn from the crime, then allowing the claim would be less likely to abuse the integrity of the legal system'.[145] This article agrees with Leung that instead of operating as a separate doctrine, *locus poenitentiae* should now form one of the non-exhaustive factors under the proportionality limb.

Therefore, in scenarios where a villager withdraw from the Developer Scheme before applying to the Lands Department,

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143 *Patel* (n 6) [116] (Toulson SCJ).

144 Leung Hoi Ming, 'Post-Patel Era: Does the Doctrine of Locus Poenitentiae Still Stand?' (*Chinese University of Hong Kong Issues in Property Law*, 28 February 2018) <www.iiplhk.law.cuhk.edu.hk/post/post-patel-era-does-the-doctrine-of-locus-poenitentiae-still-stand> accessed 21 November 2020.

145 Law Commission of UK (n 41) 24.

judges should take such a factor into account to prevent an unduly harsh outcome. The point of 'no turning back' should be drawn at the instant where a villager submits the application form consisting of false declaration. This modification will encourage the withdrawal of illegal conduct, ensure the policy objectives of criminal law and SHP being achieved and strengthen Modification 1 to prevent windfall gain on either party as exemplified under Section VI(C)(1).

CONCLUSION

This article explores a prominent issue in Hong Kong – the abuse of the SHP by Developer Schemes and the importance to formulate a proper approach to address such an issue. By identifying the strengths and flaws of the reliance principle in *Tinsley v Milligan*[146] and the 'trio of considerations' approach and minority restitutionary approach in *Patel v Mirza*[147], this article believes that Hong Kong should consider departing from the reliance principle and adopting the 'trio of considerations' with necessary modifications illustrated above. The best way forward, is not to over-glorify the certainty and the ease of application of a rule that does not maintain the integrity of the law and further the underlying policy objectives. No matter how certain a rule can be, if it produces arbitrary outcomes it cannot justify, such certainty is only artificial and meaningless. What renders the law more certain is the fact that greater transparency in judges' reasoning allows parties to know where the law stands vis-à-vis illegality, and such is a merit that the new flexible approach can offer.

The beauty of the law lies with its dynamic nature. While the new modified approach may not be perfect, it provides a general framework for the illegality defence to go forward. In time, new exceptions will flourish to reflect the development of different policy considerations, as well as the unpredictable context of cases that come before the courts. After decades of blindly chasing certainty, the knot of the blindfold is starting to loosen.

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146 *Tinsley* (n 7).
147 *Patel* (n 6).

DISTRIBUTED LEDGER TECHNOLOGIES: POTENTIAL RESPONSE TO DATA PRIVACY ISSUES IN HONG KONG

Andrew Tsang*

Distributed ledger technology (DLT) or 'blockchain' represents the next step in data storage and execution. The technology has great potential in creating new business models and disrupting existing ones. However, there is also considerable tension between the technology and the Personal Data (Privacy) Ordinance in Hong Kong, which this paper explores. Certainly, much of this tension is due to core characteristics of DLT; namely, the immutability of data, the availability of records to all participants, and the decentralization of data. Against this backdrop, this paper explores how a dual chain platform raised by the Hong Kong Monetary Authority may be best-positioned to achieve the objectives of the PDPO while retaining some of the core features of DLT. This paper also examines the current data privacy protection framework in Hong Kong and as well as its tensions with distributed ledger technologies.

INTRODUCTION

Distributed ledger technology (DLT) or 'blockchain' challenges conventional notions of personal data privacy and protection. At its core, DLT is a system that enables information or transactions to be sent over the Internet from one party to another without the oversight of a central party. Individuals are meant to safely transact without needing to trust or even know their counterparties. [1] Even though the technology continues to

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develop, it remains of interest to governments, regulators, and companies. In 2016, the Hong Kong Monetary Authority issued its inaugural study on DLT that explored, amongst other things, data privacy challenges that could arise from the technology's use. [2] The 2016 study considered various 'permissioned' configurations where all participants are identified and pre-authorised as one way to mitigate data risks.[3] These ideas were further explored in a follow-up study in the 2017 where the HKMA considered a DLT that stored information within the platform (on-chain) and outside the platform (off-chain).[4] This author argues that while 'permissioned' configurations represent one possible approach, a 'dual chain' approach would be more desirable because it retains the technology's disruptive characteristics while complying with the principles of the Personal Data (Privacy) Ordinance (PDPO).

The issue of data privacy and protection in DLT is important. Legal uncertainty surrounding the application of the PDPO affects the market's perception of DLT. Practically speaking, if users, governments, and commercial organisations are reluctant to adopt the technology, distributed ledgers would fall into disuse. DLTs would not be used, stress-tested, or developed in any fruitful sense. In order to avoid commercial and technological flight, but instead to attract greater market inflows, Hong Kong should be interested in a legal framework that preserves confidence and flexibility in DLT.

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1 ASTRI, 'Whitepaper on Distributed Ledger Technology' (*Hong Kong Monetary Authority,* 11 November 2016) 5 <www.hkma.gov.hk/media/eng/doc/key-functions/finanical-infrastructure/Whitepaper_On_Distributed_Ledger_Technology.pdf> accessed 5 October 2020>.

2 ibid 55.

3 ibid 6.

4 Deloitte, 'Whitepaper 2.0 on Distributed Ledger Technology' (*Hong Kong Monetary Authority*, 25 October 2017) 14 <www.hkma.gov.hk/media/eng/doc/key-functions/finanical-infrastructure/infrastructure/20171025e1a1.pdf> accessed 5 October 2020.

This paper has four sections. Section I section provides an overview of different configurations of distributed ledger technology as well as their disruptive characteristics. Section II analyses data privacy and protection challenges that arise from the technology's use. Section III considers the idea that 'permissioned' DLTs, rather than 'unpermissioned' DLTs, can address various data privacy issues. Section IV explores how a 'dual chain' approach would be better-positioned to comply with the PDPO's objectives.

I. WHAT ARE DISTRIBUTED LEDGER TECHNOLOGIES?

Distributed ledger technology is in essence a replicated, shared, and synchronised recording system.[5] Records can be validated and accurately maintained without the administration of a central authority. Structurally, distributed ledgers can be understood as being comprised of interlinked 'blocks' which hold collections of recorded entries on the ledger.[6] Each block contains not only the most recent transaction, but every transaction conducted since inception.[7] Data are represented by mathematical functions called 'hash' which incorporate pointers to the immediate upstream block.[8] Since the hash is an active function, any alterations to the original data lead to drastic changes to the numerical expression; this severs the link between blocks.[9] The remaining chain of blocks would be shorter than the others and would be rejected.[10] This is one of the reasons why DLTs are described as immutable and unalterable.

During normal operations, participants referred to as 'nodes' collaborate to build and update the ledger. In a simple

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5 Andrew Tsang, 'Money Laundering and Distributed Ledger Technology in Hong Kong' (2017) 48(2) HKLJ 577, 579.

6 ASTRI (n 1) 16.

7 Hossein Kakavand, Nicolette Kost De Sevres, 'The Blockchain Revolution: An Analysis of Regulation and Technology Related to Distributed Ledger Technologies' (2017) 12 <http://ssrn.com/abstract=2849251> accessed 5 October 2020.

8 ASTRI (n 1) 19.

9 ibid 16.

10 ibid 16.

case, one node sends transaction data to another. Typically, there are two categories of data concerned. First is the payload – the substantive contents of the transaction.[11] Second is various meta-data related to the payload.[12] This might include a time stamp, information about the previous block, and a public key from the sender.[13] When a party sends a transaction, that transaction must be marked by the party's digital signature, or 'private key' to confirm the sending party's identity.[14] The receiving party uses a public key received from the sender to verify the digital signature. This indicates that the transaction was authentic and genuinely sent by the sending party.[15] Since transactions must be reflected throughout the ledger, DLTs generally update via two stages: validation and broadcast.[16] These stages are necessary particularly if there is no central authority to audit transactions.[17] During validation, nodes determine if the contents of the transaction are legitimate.[18] For example, in a sale and purchase, this might mean verifying that the seller is the true owner of the subject asset and that the buyer has sufficient funds.[19] After validation, the node responsible for the validation broadcasts this information to other nodes.[20] Broadcast allows nodes to agree on which transactions should remain validated.[21] This resulting system-wide agreement is distributed consensus. The net effect of distributed consensus is that data is stored and recorded onto the ledger.[22] As an illustration, Bitcoin, a pioneer cryptocurrency, used DLT as the infrastructure to enable peer-to-peer payments

11 Winston Maxwell and John Salomon, 'A Guide to Blockchain and Data Protection' (*Hogan Lovells,* 19 November 2017) 20 <www.hlengage.com/_uploads/downloads/5425GuidetoblockchainV9FORWEB.pdf> accessed 5 October 2020.
12 ibid 20.
13 ibid 20.
14 Ledger Academy, 'What Are Public Keys and Private Keys' (*Ledger*, 23 October 2019) <www.ledger.com/academy/blockchain/what-are-public-keys-and-private-keys/> accessed 1 May 2020.
15 ASTRI (n 1) 26.
16 Trevor Kiviat, 'Beyond Bitcoin: Issues in Regulating Blockchain Transactions' (2015) 65 Duke LJ 569, 578.
17 ibid 578.
18 ibid 578.
19 ASTRI (n 1) 10.
20 Kiviat (n 16) 578.
21 ASTRI (n 1) 10.
22 ibid 10.

between participants.[23] Bitcoin requires no central bank or clearinghouse to move payments.[24]

A. Unpermissioned and Permissioned DLTs

Distributed ledgers are usually configured to be 'permissioned' or 'un-permissioned' operations. The distinction is important as it impacts the regulatory considerations that apply. Unpermissioned operations are freely accessible by anyone. They have no central authority.[25] A user simply needs to download the application and ledger. There are no network owners, no registration procedures, and no permissions. As a result, unpermissioned DLTs are regarded as 'anonymous' and decentralised. Parties are not known to one another and yet can safely transact since all transactions are authenticated and automatically verified through protocols.[26] Unpermissioned DLTs are meant to encourage network effects.[27]

As a contrast, 'permissioned' operations are controlled and administered by a central authority.[28] These are not publicly accessible: users must be pre-approved and invited to join. Since there is an onboarding element, identifying information will usually be required.[29] Given their design, permissioned DLTs are usually set-up within companies, such as financial institutions, for internal purposes.[30] As an example, permissioned DLTs could

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23 Patrick Kirby, 'Virtually Possible: How to Strengthen Bitcoin Regulation Within the Current Regulatory Framework' (2014) 93 North Carolina LR 189, 192.

24 ibid 192.

25 Allens, 'Blockchain Reaction: Understanding the opportunities and navigating the legal frameworks of distributed ledger technology and blockchain' (2016) 7 <www.allens.com.au/general/forms/pdf/blockchainreport.pdf> accessed 5 October 2020.

26 ibid 7.

27 Vitalik Buterin, 'On Public and Private Blockchains', (Ethereum Foundation Blog, 7 August 2015) <http://blog.ethereum.org/2015/08/07/on-public-and-private-blockchains> accessed 5 October 2020.

28 Allens (n 25) 7.

29 ibid 7.

30 Tsang (n 5) 581.

improve the clearing and settlement process that occurs after a securities trade. [31]

B. Data Privacy and Protection Challenges in Unpermissioned DLTs

Distributed ledger technologies involve a variety of data privacy issues. In Hong Kong, the primary legislation regulating data privacy and data protection is Personal Data (Privacy) Ordinance (Cap 486) (PDPO) (the Ordinance). The PDPO governs the use, collection, and storage of personal data within the jurisdiction. Its main provisions are contained in the six data protection principles (DPP). Harmony between the PDPO and a DLT depends on the specific technical and governance features contained in that DLT.

1. Whether The PDPO Applies

One important issue is the PDPO's role in respect of transactions on unpermissioned DLTs. The Ordinance only applies where personal data is involved. For data to be personal, the PDPO provides that data must:[32]

- Relate directly or indirectly to a living individual;
- Be in a form in which access to or processing of the data is practicable; and
- Be in a form where it is practicable for the identity of the individual to be directly or indirectly ascertained.

All three limbs are required for data to qualify as personal data. As personal data relates to living individuals only, the PDPO does not cover data regarding the deceased.

Against this background, transactions which pass through an unpermissioned DLT may involve information caught by the Ordinance. Thus, the applicability of the PDPO turns on whether any of the information passing through amounts to personal data. In this connection, two features of distributed

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31 Allens (n 25) 8.

32 Personal Data (Privacy) Ordinance (Cap 486) (PDPO), s 2(1).

ledgers are worth discussing. The first is public keys, the second is the use of hashing.

A. WHETHER PUBLIC KEYS ARE PERSONAL DATA

A core feature of unpermissioned DLTs is that transactions are connected to a user's public key, which is broadcast and known to all nodes.[33] Public keys are subject to cryptography so that anyone who accesses the DLT would not be able to *directly* identify an individual.[34] The nature of public keys, despite their encryption, seems to take unpermissioned DLTs outside the scope of the PDPO. Strangely, this would suggest that the data protection of the PDPO do not apply in respect of the public keys. Yet there are problems with this view.

Public keys re-appear because of the regular activities of their user. This is necessary because the purpose of public keys is to ensure that the sender and the recipient of a transaction are the correct parties. However, this link means that users may also be singled out as a result of their public key. Any data that directly or indirectly relates to an individual and from which it is practicable to ascertain that person's identity falls under the PDPO.[35] Accordingly, the PDPO would continue to apply as it may not be impracticable to identify such individuals directly or indirectly.

As an illustration of this concept, in the case of *Cinepoly Records Co Ltd v Hong Kong Broadband Network Ltd*, the Court explained that IP addresses did not in and of themselves reveal the identity of Internet users.[36] They represent specific computers. Yet the Court also reasoned that cross-checking an IP address against activity logs (which may show certain downloading activity, for example) *could* lead to information that is sufficiently personal. Similarly, even though public keys in a DLT are represented by strings of code, it would still be possible

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33 Kirby (n 23) 194.
34 ibid 193.
35 Personal Data (Privacy) Ordinance (Cap 486), s 2(1).
36 *Cinepoly Records Co. Ltd v Hong Kong Broadband Network Ltd* [2006] 1 HKLRD 255 [12]-[14].

to link a public key to a specific individual. Once that connection occurs, the entire transaction history of a user can be mapped out. Consider a situation where Mr. X purchases a magazine from the local bookstore using cryptocurrency on a public DLT. The transaction would be recorded alongside a time stamp and payment amount. Mr. Y, having observed Mr. X pay at the bookstore, could in principle identify Mr. X by linking the time and dollar-value of the purchase to a public key. Thus an absence of names, addresses, or other obvious identifiers may not be enough to categorise data as non-identifying, especially if there is other data containing sufficiently unique descriptions.[37] There will still be a connection between pseudonymised data and the data subject, particularly if the transaction was effected for real world goods, and the parties are known.[38] Similarly, the data generated by an unpermissioned DLT may not be sufficiently non-personal or anonymous to take it outside the PDPO.[39] The approach in the *Cinepoly* case can be compared with *Shi Tao v Privacy Commissioner for Personal Data*. In *Shi Tao*, Yahoo! China, the popular web services provider, disclosed registration information including the IP address and email contents of the claimant to mainland authorities. Unlike *Cinepoly*, the Board in *Shi Tao* expressed that the IP address, even when paired with the disclosed data could not reveal the identity of the claimant.[40] However, on the facts, there was no certainty that registration data provided by the claimant was authentic or reliable. Both *Cinepoly* and *Shi Tao* reinforce the idea that IP addresses alone do not constitute personal data under the PDPO. Rather, the court will examine whether the particular data disclosed could directly or indirectly identify a data subject.

As a contrast, in the European Union, the Court of Justice (CJEU) previously ruled that a person's IP address *is* personal data. In the cases of *Scarlet Extended SA v Societe belge*

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37 Office of the Privacy Commissioner for Personal Data, 'Guidance on Personal Data Erasure and Anonymisation' (April 2014), 5 <www.pcpd.org.hk/english/publications/files/erasure_e.pdf> accessed 5 October 2020.

38 Matthias Berberich and Malgorzata Steiner, 'Blockchain Technology and the GDPR – How to Reconcile Privacy and Distributed Ledgers' (2016) 2 European Data Protection Law Review 422, 424.

39 Office of the Privacy Commissioner for Personal Data (n 37) 5.

40 [2007] AAB 16 [31].

de auteurs and *Patrick Breyer v Bundesrepublik Deutscheland*, the CJEU applied Data Protection Directive 95/46/EC (an EU directive on data privacy, since repealed) determined this to be the case.[41] In *Scarlet Extended*, IP addresses held by ISPs amounted to personal data because the CJEU was of the view that IP addresses enabled Internet subscribers to be sufficiently identified by reference to their online activity.[42] Similarly, in *Patrick Breyer*, a German Government body captured the IP address of Mr. Breyer, alongside dates and times of access. The CJEU found that the Mr. Breyer's IP address amounted to personal data because it could be paired with additional information to determine identity.[43] Specifically, the website operator in *Patrick Breyer* had the legal means to compel a competent authority to retrieve information from an Internet Service Provider if legal proceedings ever arose. Accordingly, the General Data Protection Regulation (GDPR) codifies this position by indicating that online identifiers including IP addresses amounts to personal data.[44] Finally, as a practical matter, a public key might still amount to personal data if someone else also holds a decryption key or private key. Users may also export their private key to secondary locations which means that theft of those private keys remains a possibility.[45] This analysis suggests that public keys which pass through an unpermissioned DLT are personal data which means that data privacy protections would apply.

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41 Case C-70/10 *Scarlet Extended SA v Société belge des auteurs, compositeurs et éditeurs SCRL (SABAM)* (Scarlet Extended) [2011] ECR I-12006, [51]; Case C-582/14 *Patrick Breyer v Bundesrepublik Deutschland* (*Patrick Breyer*) [2016] OJ C475/03, [47]-[48].

42 *Scarlet Extended* (n 41) [51].

43 *Patrick Breyer* (n 41) [47]-[48].

44 Council Regulation (EC) 679/2016 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) [2016] OJ 2016 L 119/1, Recital 26 (GDPR).

45 Eric Piscini, David Dalton and Lory Kehoe, 'Blockchain & Cybersecurity. Let's Discuss' (*Deloitte,* 2017) 6 <www2.deloitte.com/content/dam/Deloitte/tr/Documents/technology-media-telecommunications/Blockchain-and-Cyber.pdf> accessed 5 October 2020.

B. WHETHER HASHES ARE PERSONAL DATA

Hashes are also data which may be subject to coverage by the PDPO. As an overview, hashing is a process which transforms data into a fixed-length numerical output. The process works one-way.[46] This means that outputted hash cannot be reversed into the original data. Thus if a hacker were to obtain a list of hashes representing passwords, the hacker would not be able to directly reconstitute the underlying information. On this basis, one view would be that hashed information is outside the PDPO since hashing is irreversible – it would be impracticable to identify an individual directly or indirectly.[47] Despite this, a hacker could theoretically guess passwords and check for the matching hash. This is because the same input leads to the same output, provided that the cryptographic hash function is known.[48] Thus hashing makes brute force attacks impractical, though such attacks do not fully prevent a hacker from determining the original password. There would still be indirect methods to determine the underlying data, particularly if there are known inputs.[49]

Similar to public keys, hashing preserves linkability between transactions. For example, consider a situation where a user buys and sells products on an application that records the transaction by posting a one-way hash of the user's address. If the hash stays the same with each transaction, the user's entire transaction history could be mapped out and tracked. In 2009, Netflix released a list of anonymised movie reviews as part of a coding competition to improve the algorithms used in recommending movie titles. Despite the absence of names, researchers were able to link the anonymised entries with reviews from the Internet Movie Database (IMDB) to re-identify a large number of Netflix customers. Certain of the Netflix customers

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46 Michele Finck, Blockchain and the General Data Protection Regulation: Can Distributed Ledgers be Squared with European Data Protection Law? (*European Parliamentary Research Service Study*, 2020) <www.europarl.europa.eu/RegData/etudes/STUD/2019/634445/EPRS_STU(2019)634445_EN.pdf> accessed 1 September 2020.

47 Personal Data (Privacy) Ordinance (Cap 486) (PDPO), s 2(1).

48 Finck (n 46) 30.

49 ibid 30.

also had their political and religious beliefs revealed.[50,51] In the United States, a mass retailer determined that a teenager was pregnant based on her purchasing habits, revealing her pregnancy to family members.[52] Demonstrably, big data and analytics are able to generate significant insights including personal data using only a handful of data points.

The above analysis shows that the risk of re-identification remains with hashed data. Since these data would only be pseudo-anonymous, the PDPO would most likely apply.

A similar view could also be taken in Europe under the General Data Protection Regulation. While the regulation applies to EU-established organisations, it also applies to Hong Kong organisations that process personal data of EU data subjects. GDPR enjoys wide territorial coverage as well as shared features with the PDPO.[53] Like the PDPO, the GDPR only applies to personal data. It does not apply to anonymised data.

For data to be anonymous, the GDPR requires that it must:[54]

- not relate to an identified / identifiable natural person or to personal data; and
- be rendered anonymous in such a manner that the data subject is no longer identifiable.

Data is identifiable if a natural person can be directly or indirectly identified with reference to name, ID number, location data, or any factors specific to the physical, physiological, genetic, mental, economic, or cultural, identity of that person.[55]

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50 Stephen Wong, 'Engineering Privacy Through Accountability' (66th ABA Section of Antitrust Law Spring Meeting, Washington DC, April 2018) 6 <www.pcpd.org.hk/english/news_events/media_statements/files/PCPDABA2018.pdf> accessed 1 March 2020.

51 Julianne Pepitone, '5 data breaches: From embarrassing to deadly' (*CNN,* 14 December 2010) <http://money.cnn.com/galleries/2010/technology/1012/gallery.5_data_breaches/index.html> accessed 1 March 2020.

52 Wong (n 50) 5.

53 'A Closer Comparison between GDPR and PDPO' (*Deacons,* 4 June 2018) <www.deacons.com/news-and-insights/publications/a-closer-comparison-between-gdpr-and-pdpo.html> accessed 1 March 2020.

54 General Data Protection Regulation (n 44) Recital 26.

55 General Data Protection Regulation (n 44) art 4(1).

The GDPR regards data about a natural person to be personal data.[56]

Practically, for data to be anonymous it needs to be stripped of identifiable information so that even the party responsible for the anonymisation is unable to re-identify the subject. Under the GDPR, data would be regarded as pseudo-anonymous where, for example, subjects can be identified if data is paired alongside 'additional information'. [57] If there is additional information, such as a decryption key, it would need to be kept separate and subject to technical and organisational safeguards.[58]

Accordingly, the GDPR does not regard data as anonymous if the risk of identification remains. Data subjects might still be associated via online identifiers including IP addresses, Radio Frequency Identifications (RFIDs), and cookies. [59] On this view, public keys, even though they are represented by code, contain meta-data that are not wholly unidentifiable. Similarly, hashing might be regarded as an anonymizing technique, but this conclusion is not apparent under the GDPR. Hashing masks data with a pseudonym but it does not transform personal data into anonymous data, particularly if the range of inputs are known.[60] Accordingly, the Article 29 Working Party, an EU advisory body on data privacy, expressed that hash functions may reduce the 'linkability' of a dataset with the original identity of a data subject; however this is only 'a security measure and not a method of anonymisation'.[61]

From the above discussion, hashes and public keys are unlikely to qualify as anonymous data. While in some cases additional information may be needed to create linkage with a data subject, such information would merely be pseudonymised

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56 Finck (n 46) 16.
57 General Data Protection Regulation (n 44) art 4(5).
58 ibid.
59 General Data Protection Regulation (n 44) Recital 30.
60 Finck (n 46) 30.
61 Art 29 Working Party Opinion 05/2014 of 10 April 2014 on anonymisation techniques' (0829/14/WP216) [2014] <www.ec.europa.eu/justice/article-29/documentation/opinion-recommendation/files/2014/wp216_en.pdf> accessed 9 August 2021.

and thus would still be personal data. This suggests that both PDPO and GDPR would apply to a DLT's operation.

2. Roles and Responsibilities in an Unpermissioned DLT

Given that personal data are likely to pass through unpermissioned DLTs, the PDPO is likely to apply. Accordingly, the obligations arising from the Ordinance and any data protection principles are expressly imposed on 'data users' though such roles require deeper exploration within a permissioned DLT. Section 2(1) of the PDPO provides that, a data user, in relation to personal data, means a person who either alone or jointly or in common with other persons, control the collection, holding, processing, or use of that data.[62] Obligations are not imposed on 'data processors,' individuals that deal in data solely on behalf of other parties and not for any of their own purposes.[63] Instead, data users must ensure that the data processor does not retain the data for an unnecessary time-frame and that data is secure from unauthorised use.[64] As part of this duty, data users must adopt contractual or other means to ensure that data processors avoid unauthorised access, processing, or erasure.[65]

As comparison, the GDPR contemplates two key actors: 'data controllers' and 'data processors'. Data controllers are the natural or legal persons (including public authorities and agencies), which alone or jointly with others determines the purpose of processing data. Where data processing is conducted by a public body, involves large-scale monitoring or large-scale processing of sensitive data, a data protection officer must be put in place.[66] Data processors are the entities which handle personal

62 Personal Data (Privacy) Ordinance (Cap 486), s 2(1).
63 Personal Data (Privacy) Ordinance, sch 1, DPP2(4).
64 Personal Data (Privacy) Ordinance, sch 1, DPP2(3) and DPP 4(2).
65 ibid.
66 General Data Protection Regulation (n 44) art 37; Peter Lancos and Jennifer Boyse, 'GDPR and Hong Kong's PDPO: Are They So Different?' (*Regulation Asia,* 6 November 2018) <www.regulationasia.com/gdpr-and-hong-kongs-pdpo-are-they-so-different> accessed 1 May 2020.

data on behalf of the data controller.[67] Thus, if a data processor mishandles data, the data controller which provided the data would also be liable for breach.[68] As such, data controllers are ultimately the ones accountable if there is non-compliance. These roles are complicated when understood within an unpermissioned distributed ledger. Indeed, data protection even under the GDPR, requires centralised control from a data controller that can implement and comply with relevant data protection legislation and privacy protection measures.[69]

Firstly, unpermissioned DLTs operate with no central authority. Even though there are specific parties to a transaction, the recording and validation of the transaction is carried out by all nodes. As such, nodes in a permissioned DLT may operate as a data user or data controller in some circumstances, and as a data processor in others. This complicates privacy responsibilities since more than one party could be responsible for meeting regulatory requirements. But this complication can be explored.

In the Hong Kong case of *Eastweek Publisher Limited v Privacy Commissioner for Personal Data*, the Court of Appeal expressed that the collection of data by a data user would only occur if a key condition was met: the data user had to be compiling data about an individual that he *intends or seeks* to identify.[70] Ribeiro JA (the Appellate Judge) indicated that the identity of the individual had to be an important piece of information to the data collector in order for personal data collection to occur.[71] For example, a market researcher may ask someone questions of a very personal nature such as their income, the amounts they spend, or how frequently they've dined at a restaurant. Ribeiro JA found that such information would constitute personal data if it related to an identified person. Yet, Ribeiro JA did not regard this as personal data collection because the market researcher in the example does not know nor is he

67 General Data Protection Regulation (n 44) art 4(8).
68 General Data Protection Regulation (n 44) art 37; Lancose and Boyse (n 66).
69 Berberich and Steiner (n 38) 424.
70 [2000] HKCA 442, [2000] 1 HKC 692, 700A (Ribeiro JA).
71 [2000] 1 HKC 692, 700A.

concerned with the identity of the respondent.[72] The survey information was only being used to construct a statistical picture of a class of individuals. Ribeiro JA applied this reasoning to the facts of the case in *Eastweek*: a photographer captured an image of a woman because of her fashion sense. Yet, this did not amount to personal data collection since her identity was never known, nor was it relevant. The sole purpose of that photograph was to mock the woman's dress.[73]

The principles of *Eastweek* are useful in understanding the obligations of nodes. Unlike the magazine photographer in *Eastweek*, nodes in an unpermissioned DLT are very much interested in the identity of their data subjects, insofar that each node has a unique digital signature. During a typical transaction, and where the parties rely on asymmetric encryption, the receiving node must decrypt the sender's unique private key (their digital signature) using a public key and recalculate a hash to confirm the identity of the sender and thus the integrity of the contents.[74] Identity in terms of the private key is relevant to nodes as it goes to the validation and broadcasting function of the network. All nodes participate to verify the identity of counterparties.[75] This suggests that nodes in an unpermissioned DLT are very likely to operate as data users, because they drive the collection and processing of personal data.

On this basis, one idea is that a 'passive' node which initiates no transactions would be able to avoid the PDPO because of their inactivity, but this view is based on an incomplete understanding of the updating process. As discussed above, transactions need to be validated and broadcast before they are accepted into the ledger. The fact that the work is part of a pre-programmed protocol does not mean that nodes which carry out validation and broadcast for the network act solely on the instruction of others. There are independent purposes served by validation and broadcast.[76] The outcome of a transaction is that every node holds an updated and true copy of the ledger. Having

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72 ibid 701C.
73 ibid 700F.
74 ASTRI (n 1) 26.
75 ibid 10.
76 ibid 10.

a true and updated ledger is also an outcome which is independently sought by nodes of the wider network, even if it is pursuant to a technical protocol. In this way, even passive nodes can be regarded as data users, because their handling of data serves a purpose that is held by themselves, alongside all other participants of a network. Finally, nodes are free to adopt or reject new versions of a DLT protocol.[77] Thus, by downloading and running the software, participants choose and influence the application for their own purposes; for example, by giving consent to a new protocol or by withholding it and choosing to operate on old rules. As a point of comparison, the Commission Nationale de l'informatique et des libertés (CNIL) suggested that if no central management could be identified, all participants in a DLT should be deemed as data users in order to ensure accountability.[78]

The data privacy and data security requirements imposed on nodes under the PDPO are complicated by three important features in unpermissioned distributed ledgers. The first is the need for the ledger to achieve distributed consensus. The second is the immutability of records. The third is the decentralisation of data.

Distributed consensus occurs when transactions are verified, agreed upon by the network, and broadcast.[79] This makes personal data visible to all nodes.[80] As such, distributed consensus engages data protection principles 1, 3, and 4 (DPP). DPP1 requires that any personal data collected must be related to the data user's functions. More importantly, it indicates that data collection cannot be excessive. DPP3 provides that personal data cannot be used for any new purpose unless there is prescribed consent from the data subject. Finally, DPP4 states that data users must take all practicable steps to ensure that personal data are protected against unauthorised access, processing, erasure, and

77 ibid 37.

78 Commission Nationale de l'informatique et des libertés (CNIL), 'Blockchain: Solutions for a Responsible Use of the Blockchain in the Context of Personal Data' (*CNIL*, 6 November 2018), 2 <www.cnil.fr/sites/default/files/atoms/files/blockchain_en.pdf> accessed 9 August 2021.

79 ASTRI (n 1) 10.

80 Kakavand and Kost De Sevres (n 7) 9.

loss. First, aside from successful transactions, mere requests to transact are recorded amongst nodes: parties that wish to transact must broadcast this so that the wider network can determine the transaction's authenticity before it is accepted.[81] A normal running of a DLT automatically gives rise to a significant amount of meta-data collection, which could be regarded as excessive. In addition, all information is public and available to the nodes on the network.[82] Minimally, this means that nodes can view each other's public key and all the transactions carried out under that key. There are no real measures or steps which protect against unauthorised access if participants insist on using an unpermissioned DLT. Second, because of easy access to meta-data, public keys, and transaction histories, such data may be re-purposed or analysed using big-data tools to satisfy objectives that are different from the stated purposes of the DLT. Third, the very nature of DLT means that there are numerous nodes which hold complete copies of the ledger. This may not be satisfactory as it would be difficult to ensure that there is no unauthorised use, access, or processing of data amongst all nodes.

The immutability of an unpermissioned DLT also poses an issue. Data immutability is attractive from an auditing perspective since past records can be reviewed. Yet this means that data cannot be altered, removed, or modified once accepted onto the ledger (unless it is matched with a subsequent transaction to offset it).[83] Nevertheless, the PDPO provides for a variety of circumstances in which personal data *must* be altered or erased. First, section 26 of the PDPO requires data users to take all practicable steps to erase personal data when the data is no longer required for the purpose for which it was used.[84] Second, DPP2 requires data users to take all practicable steps to ensure that personal data is kept no longer than necessary.[85] Third, data subjects should be able to correct their personal data.[86] These circumstances conflict with the system's immutability since records cannot be removed. Ultimately, the PDPO requires data

81 Kiviat (n 16) 578.
82 Kakavand and De Sevres (n 7) 8.
83 Kiviat (n 16) 579.
84 Personal Data (Privacy) Ordinance, s 26.
85 Personal Data (Privacy) Ordinance, sch 1, DPP2(2).
86 Personal Data (Privacy) Ordinance, sch 1, DPP6(e).

users to erase personal data to prevent it from being stored longer than necessary or when it is no longer required.[87] This may be impractical. DPP4 also encourages secure destruction of data.[88] Normally, data on digital storage devices can be wiped using specialised software or destroyed physically. [89] Nevertheless, deletion is not applicable in the case of an unpermissioned DLT. Aside from its immutability, using software to forcibly modify specific records ultimately break the chains that link blocks together. [90] A shorter chain would be regarded by other participants as being tampered with and would be rejected. [91] Physically destroying a storage device would also have limited effect since the records in a DLT are held across the network.

The issue with decentralisation is that data in an unpermissioned DLT can cross multiple borders. Personal data may be uploaded inside Hong Kong and subject to the PDPO, but it may also be transported outside the jurisdiction. Section 33 of the PDPO prohibits the transfer of personal data to a place outside Hong Kong, save under a set of circumstances.[92] Even though section 33 has yet to come into operation, its principles conflict with unpermissioned DLTs. The most straightforward way a data user can comply with section 33 is by obtaining the written consent of the data subject.[93] Beyond this, all other modes of compliance under section 33 require a level of knowledge and judgment of the external jurisdiction that are not typically available to the data users of an unpermissioned DLT. For example, a transfer of personal data outside the jurisdiction is not prohibited under section 33(2) if the place that the data is sent to is specified by the Commissioner as having laws which are substantially similar to or serve the same purposes as the PDPO.[94] Alternatively, the data user can comply with section 33 if he has reasonable grounds to believe that the transfer was meant to avoid adverse action against the data subject; that it was not practicable to obtain written consent from the data subject; and that the data

87 Personal Data (Privacy) Ordinance, s 26.
88 Personal Data (Privacy) Ordinance, sch 1, DPP4.
89 Office of the Privacy Commissioner for Personal Data (n 37) 3.
90 ASTRI (n 1), 16.
91 ibid.
92 Personal Data (Privacy) Ordinance, s 33.
93 Personal Data (Privacy) Ordinance, s 33(2)(c).
94 Personal Data (Privacy) Ordinance, s 33(3).

subject would have given such consent if asked.[95] Demonstrably, a data user can only rely on the complying provisions of section 33(2) if the data user has a specific awareness of the circumstances of the data subject as well as knowledge of the place where personal data is being sent to. However, the data user would not be able to come to a view as to the existence of adverse action against a particular data subject, nor can the data user regard an unknown jurisdiction outside Hong Kong as having similar laws in force, either by reference to their own judgement or by reference to the Commissioner's direction. Still, even if consent could be obtained, repeated requests for consent would impede the smooth running of the system. As a response, even though section 33 is not in force, parties can also impose contractual restrictions on any onward transfer to places outside Hong Kong.[96] Clearly, unpermissioned DLTs encounter many challenges when looking to comply with the PDPO.

II. HOW UNPERMISSIONED DLTS CAN COMPLY WITH THE PDPO

Unpermissioned DLTs give rise to interesting data privacy and protection issues. Without entirely prohibiting unpermissioned DLTs, there are possible responses that are consistent with the PDPO. These include designing policies in a DLT and implementing a licensing regime.

A. Policies and Governance

The PDPO was drafted to be flexible and principle-based. It is meant to be technology-neutral. This means that policies could be implemented into a DLT so that there is compliance with the Ordinance. For example, prospective participants of a DLT should be informed that personal data would be shared amongst all parties. Those who wish to join would also need to agree to

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95 Personal Data (Privacy) Ordinance, s 33(2)(d).

96 Office of the Privacy Commissioner for Personal Data, 'Cross Border/ Boundary Data Transfer in Hong Kong' (18 March 2020) 9 <www.pcpd.org.hk/english/news_events/speech/files/CrossBorderBoundaryDataTransferb.pdf> accessed 1 September 2020.

data-collection purposes that are clearly defined by the DLT, notwithstanding the argument that a user who joins is de facto providing consent to have their data shared. Participants would need to be notified that their personal data could leave the jurisdiction. There would also need to be provisions detailing how personal data is to be destroyed once the basis of collection is met or when some other triggering event occurs. Finally, each node should only receive data that is relevant to it, rather than a complete copy of the ledger.

The policy-based approach requires specific technological designs. First, read-write permissions of personal data would need to actively change depending on the agreements that participants give in respect of policies. These permissions also need to be flexible enough to restrict access where appropriate, for example if a request to re-purpose data is not consented to. Second, destruction of personal data needs to be effective: one possible approach is that if each entry of the ledger is encrypted, deleting the encryption key would be tantamount to deleting the data itself.[97] Finally, as there is a duty on data users to take reasonable steps against unauthorised access, processing, and loss, data users need to adopt contractual or other means to ensure that data processors comply with retention and security requirements. [98]

Nevertheless, there are gaps. While the policies proposed may tally with the PDPO, their implementation requires centralised control. This does not square with the nature and design of an unpermissioned DLT. Generally, unpermissioned DLTs require unanimous approval before transactions are accepted. This is why distributed consensus forms a part of the updating process. As a result, changes in read-write permissions, deletion of encryption keys, and the updating of security patches need to be approved of by all participants if they are to be implemented. [99] This may not be practical if an unpermissioned DLT involves hundreds of thousands of nodes.

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97 Piscini, Dalton and Kehoe (n 45) 7.

98 Personal Data (Privacy) Ordinance, sch 1, DPP2(3) and DPP 4(2).

99 ASTRI (n 1) 6.

B. Licensing Regime

Authorities could insist on a licensing regime where prospective participants must register in order to join an unpermissioned DLT. Registration means that participants would have enough knowledge of their counterparties to determine the safeguards needed in respect of certain transactions. Furthermore, having a user population to refer to enables the Privacy Commissioner to serve enforcement notices upon contraventions of the Ordinance.[100] Yet a licensing regime would not be complete. As previously mentioned, all activity on an unpermissioned DLT is public record; already this engages data protection principles. If identifying information were made readily accessible through a licensing regime, it would be highly worthwhile to re-purpose this combination of data even if no express consent were obtained. Furthermore, such a licensing regime means that people can no longer transact quickly and without knowing each other. This stifles the characteristics that make unpermissioned DLTs disruptive. Still the licensing regime does not completely address the problem of data immutability.

III. THE DATA PRIVACY AND SECURITY BENEFITS OF PERMISSIONED DLTs

As seen from the above discussion, unpermissioned distributed ledgers pose a variety of data challenges. Even the potential responses do not completely lead to PDPO compliance because of the technology's disruptive characteristics. By contrast, permissioned distributed ledgers may simplify the regulatory approach because of their ability to exert centralised control.

A. Regulatory Attractiveness of Permissioned DLTs

A permissioned distributed ledger can meet the provisions of the PDPO. This is because a permissioned distributed ledger has

[100] Personal Data (Privacy) Ordinance, s 50.

centralised governance and control.[101] The paper suggests that many of the complying policies that could be implemented effectively if there was a central administrator. Under a permissioned arrangement, a central administrator could modify read-write and sharing permissions of DLT users. It could ensure that data is selected for deletion once the original purposes of collection are fulfilled. It could also update protective measures in the form of new policies or security protocols. All this could be achieved without requiring the collective majority approval from nodes, as would be the case in an unpermissioned DLT.[102]

Central control also means that there is a single point of accountability that authorities can engage. The PDPO provides a statutory defense in respect of various breaches including disclosure of personal data without consent, or contravening an enforcement notice.[103] In general, a statutory defense is raised if the data user can show that they exercised all due diligence or had reasonable grounds to have committed the breach. The organisation acting as central administrator could be examined for any measures the DLT has adopted, contractual or otherwise in safeguarding data. In this way, the statutory defense can be meaningfully engaged, and an identifiable population can be held accountable.

B. Regulatory Shortcomings of Permissioned DLTs

These considerations show that permissioned DLTs may be more attractive from a regulatory perspective since much of the guidance and obligations under the PDPO could be addressed. However, permissioned DLTs are not entirely without issues. Permissioned DLTs still have security risks.[104] In fact, permissioned DLTs controlled by a single player would be very similar to traditional databases.[105] A permissioned DLT would lack the disruptive security features of distributed ledgers if it

101 Allens (n 25) 7.
102 Kiviat (n 16) 603.
103 Personal Data (Privacy) Ordinance, s 50 and s 64.
104 Tsang (n 5) 594.
105 ibid.

does not embrace decentralisation, open protocols, and open source development.[106] This means that permissioned DLTs would face the same risks as conventional databases.[107] On this basis, permissioned DLTs could simply be likened to traditional databases.[108] On the other hand, unpermissioned DLTs have unique features that regulators also appreciate. The risk of data fraud is lowered since information is held collectively amongst participants and not by any one party. Unpermissioned DLTs encourage free and open participation since no one party can unilaterally control the ledger. The openness of an unpermissioned ledger ensures its accountability.[109] Data security and integrity are also derived from distribution. Malware or data hacking activities which seek to alter data would need to successfully and simultaneously affect all individual nodes in the network.[110]

IV. THE DUAL CHAIN APPROACH

Both permissioned and unpermissioned DLTs offer something useful from a data protection perspective. In its 2017 study, the HKMA raised the concept of storing information on the DLT (on-chain) and outside the DLT (off-chain).[111] As this paper will explore, a dual chain approach might balance the flexibility of unpermissioned DLTs with the regulatory certainty of permissioned DLTs.

In a dual chain approach, nodes perform public operations on a DLT as part of the normal updating process. However instead of handling personal data, the on-chain operation would only deal with hash.[112] These hash values would function as a pointer to personal data, which would be stored on an off-chain database under the management of a central administrator.[113] Certainly, this would not alter the nature of the

106 ibid.
107 ibid.
108 Tsang (n 5) 594.
109 ibid.
110 Buterin (n 27).
111 Deloitte Consulting (n 4) 14.
112 ibid 43.
113 ibid 43.

personal data, but the overall arrangement would be more in line with PDPO requirements as the DLT transaction would only access personal data located on an off-chain database. This approach is not *entirely* permissioned since nodes would continue to collectively update the ledger. Yet, as per the exploration below, it is also more resilient from a data privacy perspective.

A. Achieving Data Privacy and Protection Under the PDPO

In a dual chain, nodes would continue to carry out validation and broadcast work such that authentic copies of the ledger would be held and synchronised across all participants. This means that any unauthorised alterations would need to be registered on all copies of the ledger to be accepted. Open permissions which allow users to freely join would also lead to network effects.[114] An increasing user base increases the commercial value of the network. This is important if the dual chain was used as a marketplace. Participants could transact quickly and cost-effectively without trusting counterparties, as is the case in an unpermissioned DLT. Since the on-chain ledger deals solely with hash values, nodes could achieve distributed consensus with limited access to personal data (in compliance with DPP1 for example). As discussed earlier, hash values are numerical expressions which serve a variety of functions. Accordingly, the hash would simply point to blocks on an off-chain database.[115] The pointing function is meant to reduce the amount of data contained on-chain. As such, the DLT would not hold data directly but would only function as a gateway. This means that contents of the transaction remain undisclosed.[116] The on-chain arrangement would retain the disruptive security features of unpermissioned DLTs without breaching data protection principles.

Since a conventional database sits off-chain, specific personal data could be selected for deletion or modification if, for

114 Buterin (n 27).
115 Maxwell and Salomon (n 11) 9.
116 ASTRI (n 1) 24.

example, original purposes have been fulfilled.[117] This maintains the validity of past transactions while enabling the erasure of selected data. In this way, the off-chain database could function in compliance with any data policies implemented. It would not be restricted by the immutability of the on-chain ledger. Data could be meaningfully purged from the off-chain platform itself. Similarly, data could also be corrected to ensure its accuracy. Such corrections could be achieved without appending further entries to the ledger, which keeps the database lean. Each node on the unpermissioned DLT would continue to retain the hash value, but the linkage would not connect to any original data in the off-chain database. Finally, the retention of the hash value on-chain would be useful from an auditing perspective.

Since there is an administrator, participants would be informed that personal data *could* leave Hong Kong. They could also be made aware of the purposes of data and the conditions in which personal data would be destroyed. As part of larger data privacy efforts, the off-chain database could be subject to further security measures. These might include selective access rights, encryption, and scheduled data deletion. Security updates and patches could be implemented to protect against the unauthorised activities which are set out in DPP4. Data interactions would need to be digitally signed to create a basic level of accountability. This way, the Commissioner could examine the data controls and policies that have been implemented. Similarly, an identifiable organization could be asked to demonstrate that they exercised due diligence, took reasonable steps in avoiding, or had reasonable grounds for committing breaches.[118] Users could also monitor who has access to their data and what it is being used for. Finally, the statutory defense under the PDPO could be meaningfully engaged. Certainly, the off-chain database could be located within Hong Kong so that it would comply with section 33 of the PDPO if and when it comes into effect. Nevertheless, even if the database was *not* kept inside the jurisdiction, the location of storage would be ascertainable, and the sufficiency of the overseas regulation could be assessed by the Commissioner.

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117 Personal Data (Privacy) Ordinance, sch 1, DPP2 and DPP4.

118 Personal Data (Privacy) Ordinance, s 50 and s 64.

Ultimately the attractiveness of the dual chain approach is that it creates a point of accountability while maintaining complete transparency about transactions and user identity. Still, a dual chain approach would need to strike the appropriate balance in storing data on-chain and off-chain. Data need to be stored on-chain to be trusted such that it is subject to validation and broadcast. However, storing too much on-chain would lead to various data privacy issues that were previously discussed. Finally, data stored off-chain would need to be secured via conventional measures which guard against, amongst other things, fraud.

B. Whether a Dual Chain Has Data Users

The PDPO only imposes obligations on a dual chain platform if its participants are regarded as data users. The Ordinance indicates that data users are individuals who alone, jointly, or in common with other persons control the collection, holding, processing, or use of personal data.[119] Two parties are relevant to this analysis. First are the nodes on the DLT. Second, are the administrators of the off-chain database. The nodes that originate and receive transactions would likely be regarded as data users since the use of data is directly related to their own purposes in completing a transaction. Uncertainty arises in relation to nodes that do not originate or receive transactions. But this could be overcome on the basis that even non-transacting nodes participate in the record-keeping function of the DLT, as discussed earlier. The purpose sought by non-transacting nodes, even if they do not originate transactions, is to ensure the accuracy and integrity of the network. Further, nodes which check hash values for their authenticity must solve computationally demanding problems and are participating in a broader scheme of validation and broadcast.[120] This means individual purposes are being served, notwithstanding the fact that all nodes benefit from the smooth running of a DLT.

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119 Personal Data (Privacy) Ordinance, s 2(1).

120 ASTRI (n 1) 10.

Another issue arises when considering the role of administrators that manage the off-chain database. Seemingly, the administrator's role is restricted to providing a data storage function. Consider the example of an Internet Service Provider (ISP). An ISP enables the activity of Internet subscribers by providing access to the Internet. Nevertheless, it would be improper to impose data privacy obligations on the ISP in respect of, for example, social media activity carried out by Internet subscribers. By simply providing access to the internet, an ISP has no control over the collection, holding, use, or processing of personal data.[121] Accordingly, the Privacy Commission does not regard ISPs to be data users under section 2(12) of the PDPO.[122] By analogy, the administrator of an off-chain database might fall outside the definition of section 2(12). This would mean that they are not subject to the obligations of data users.[123] Of course, there are problems with this comparison. First, the two roles are distinguishable. Unlike an ISP, the off-chain administrator not only collects data, it also regards the identity of nodes as an important item of information to be collected. This is because the off-chain administrator needs to ensure that transactions are valid and that nodes behave in compliance with the PDPO. By contrast, ISPs may receive data regarding the activity of Internet users, but this information is incidental to the ISP's main function of facilitating online access. Second, any dual chain arrangement that seeks to address the shortcomings of unpermissioned DLTs would likely require a degree of control vested with the off-chain administrator. This is because the off-chain administrator has a variety of tasks including identifying data for deletion once key criteria are met, changing read-write permissions where necessary, and giving notice to the Commissioner if a breach occurs. Control over the way data is collected and processed likely means the administrator falls under section 2(12) of the Ordinance.

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121 Roderick Woo, *Data Protection Principles in the Personal Data (Privacy) Ordinance – From the Privacy Commissioner's Perspective* (Hong Kong Office of the Privacy Commissioner for Personal Data, 2010) 27. <www.pcpd.org.hk/english/resources_centre/publications/books/files/Perspective_2nd.pdf > accessed 5 October 2020.

122 ibid.

123 Deloitte Consulting (n 4) 74.

CONCLUSION

Unpermissioned DLTs present numerous opportunities and challenges. Certainly, the normal running of unpermissioned DLTs challenge the approaches encapsulated in the PDPO. Organizations that look to implement distributed ledger technology would find it difficult to operate in a manner consistent with the six data protection principles. As a result, permissioned platforms appear to be the natural response given issues with distributed consensus, immutability, and decentralization.

Permissioned DLTs may represent a more direct approach under the PDPO. Yet this would be a step backwards. Permissioned DLTs that remove disruptive characteristics would simply be hardened versions of traditional databases. They do not make use of the technology's full potential. Encouraging development of permissioned DLTs because of perceived regulatory ease would mean that DLT technology would not be developed meaningfully.

The dual chain solution is the more sensible approach. This arrangement retains some of the disruptive characteristics of unpermissioned DLTs such as its auditability and security. Yet it also enables organisations to implement policies and establish safeguards that are compliant with the PDPO. Achieving a workable tradeoff is important because it encourages adoption by industry players. It also provides a point of accountability for data issues that the Office of the Privacy Commissioner desires. Such a tradeoff is necessary if DLTs are to develop technologically and commercially for the benefit of consumers.

THE EU SUSTAINABLE FINANCE TAXONOMY REGULATION: IMPLICATIONS FOR ESG INFORMATION AND HONG KONG FINANCIAL INDUSTRY

Grégoire Lunven*

The Taxonomy Regulation adopted in 2020 by the European Parliament establishes a list of 'green' economic activities. This list is a tool for determining investments' degrees of environmental sustainability. This comment argues that the significant progress in ESG information enabled by the Regulation will have implications for Hong Kong's financial actors. The Regulation decisively complements EU's existing legal framework on sustainable finance by improving the scope, precision, and comparability of ESG disclosures. The Regulation may have indirect effects on Hong Kong's financial actors due to the EU's ability to regulate the global marketplace. In addition, the Regulation will likely lead Hong Kong's financial regulators to enact an EU-inspired sustainable finance taxonomy.

INTRODUCTION

In a recent article, international law scholar Jorge Viñuales identifies the dichotomy between 'transaction' and 'externality' as one of the legal patterns responsible for current environmental issues. According to Viñuales, the laws that supported the industrial revolution were first concerned with organising transactions – ie the definition of powers over the objects exchanged, such as natural resources, capital or intellectual property rights – while other laws, such as those dedicated to the reduction of environmental degradation, were designed to mitigate

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negative externalities without interfering with transactions. In this perspective, environmental law is, according to Viñuales, 'not only a latecomer but an epiphenomenon', while the legal processes organising transactions are 'at the root of the geological impact of humans'.[1]

The Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment (the Taxonomy Regulation) adopted by the European Parliament on 18 June 2020[2] illustrates the overcoming of the transaction/externality dichotomy. Indeed, this Regulation is an essential milestone towards the integration of environmental concerns in financial transactions. Its political objective is to stimulate green private investment – in other words, transactions that integrate from the start their environmental externalities. The Regulation fulfils this objective by defining a list of economic activities that can be qualified as environmentally sustainable (or 'green'), for the purpose of determining the degree of environmental sustainability of an investment. As a matter of precision, the list (or 'technical criteria of the taxonomy') itself is not in the Regulation but is to be enacted by the Commission through delegated acts.[3] From 2022 onwards, the Regulation mandates financial market participants and large public-interest entities to make statements about how their financial products and activities align with this list of 'green' economic activities defined in the delegated acts of the Regulation.

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1 Jorge Viñuales, 'Two layers of self-regulation' (2020) 11(1-2) Transnational Legal Theory 16.

2 Regulation (EU) 2020/852 of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 [2020] OJ L 198/13.

3 A provisional version of the delegated acts regarding climate change mitigation and adaptation has been adopted on 21 April 2021 by the Commission. See Commission, 'Commission Delegated Regulation (EU) supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives' COM (2021) 2800 final.

This obligation may be a game-changer in the field of Environmental, Social and Governance (ESG) information. Actors of the financial sector increasingly recognise that they incur mounting environmental risks, and notably climate change-related risks.[4] To assess these risks, many financial players have long been advocating for a common standard to compare companies and assets according to their degree of alignment with global environmental objectives. The Taxonomy Regulation is currently the most complex piece of legislation addressing this need. Adding to the significance of this legislation, its requirements will be enforced over one of the largest economic zones in the world. This comment argues that the significant progress in ESG information enabled by the Regulation Taxonomy (1) will certainly have implications for Hong Kong's financial actors (2).

I. THE TAXONOMY REGULATION AS A SIGNIFICANT PROGRESS FOR ESG INFORMATION

To understand the implications of the Taxonomy Regulation for Hong Kong's financial actors, this section first provides some background information about the Taxonomy Regulation (Section I(A)) before explaining the obligations set by the Regulation (Section I(B)).

A. Background on the Taxonomy Regulation

The Taxonomy Regulation appeared in the context of a normative race to define which economic activities qualify as green or sustainable finance. Over the last 20 years, the Organisation for

[4] See Andrew Ross Sorkin, 'BlackRock C.E.O. Larry Fink: Climate Crisis Will Reshape Finance' *New York Times* (New York, 14 January 2020) <www.nytimes.com/2020/01/14/business/dealbook/larry-fink-blackrock-climate-change.html> accessed 5 June 2021; Patrick Bolton, Morgan Depres, Luiz Awazu Pereira Da Silva, Frédéric Samana, Romain Swartsman, 'The Green Swan: Central Banking and Financial Stability in the Age of Climate Change' (*Bank of Internal Settlement – Banque de France*, January 2020) <www.bis.org/publ/othp31.pdf> accessed 3 August 2021.

Economic Cooperation and Development (OECD),[5] the International Organization for Standardization (ISO),[6] the International Platform on Sustainable Finance (IPSF),[7] a group of Multilateral Development Banks (MDBs),[8] a private standard-setter called the Climate Bonds Initiative (CBI),[9] the People's Bank of China[10] and France[11] have been developing classifications of sustainable finance activities.

All these classification schemes ultimately boil down to lists of economic activities. In general, each of these economic activities is associated with a criterion determining whether the activity can be qualified as 'climate-compliant', 'green' or 'sustainable'. For instance, in the Climate Bonds Taxonomy, geothermal electricity generation facilities (economic activity) shall have direct emissions of less than 100gCO2/kWha

5 Organisation of Economic Co-operation and Development – Development Assistance Committee Working Party on Development Finance Statistics, 'Converged Statistical Reporting Directives for the Creditor Reporting System' (2018) DCD/DAC/STAT(2018)9/ADD2/FINAL, 51.

6 International Organization for Standardization, 'BS ISO 14030-3 Environmental Performance Evaluation – Green Debt Instruments – Part 3: Taxonomy' (2020). Regarding the current state of development of the standard, see ISO, 'ISO/DIS 14030-3.2 Environmental Performance Evaluation – Green Debt Instruments – Part 3: Taxonomy' (2021) <www.iso.org/standard/75559.html> accessed 3 August 2021.

7 International Platform on Sustainable Finance, 'Statement: 1st year anniversary meeting of 16 October 2020' (2020) <http://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/201016-international-platform-sustainable-finance-statement_en_0.pdf> accessed 5 June 2021 (IPSF Statement).

8 World Bank, 'Common Principles for Climate Mitigation Finance Tracking' (2011) <www.worldbank.org/content/dam/Worldbank/document/Climate/common-principles-for-climate-mitigation-finance-tracking.pdf> accessed 5 June 2021.

9 Climate Bonds Initiative, 'Climate Bonds Taxonomy' (2021) <www.climatebonds.net/files/files/CBI_Taxonomy_Jan2021.pdf> accessed 5 June 2021 (Climate Bonds Taxonomy).

10 People's Bank of China, 'Announcement of the People's Bank of China (2015) No. 39' (12 December 2015) <www.gov.cn/xinwen/2015-12/22/content_5026636.htm> accessed 5 June 2021.

11 Décret n° 2015-1615 du 10 décembre 2015 relatif au label « Transition énergétique et écologique pour le climat » <www.legifrance.gouv.fr/jorf/id/JORFTEXT000031593158/> accessed 5 June 2021 (Décret Label TEEC).

(criterion).[12] On the one hand, the criteria are often extremely simplistic, selecting only one of the many dimensions regulated by existing environmental and social laws. On the other hand, these criteria are often more ambitious than existing environmental and social laws. They draw on laws enacted in developed countries,[13] or on objectives enshrined in international law.[14]

The Taxonomy Regulation is based on the work of the Technical Expert Group on Sustainable Finance set by the Commission in 2018.[15] The Commission introduced the legislative proposal for the Taxonomy Regulation in May 2018 under the ordinary legislative procedure. The Council reached a political agreement on the text of the Regulation on 18 December 2019, and the European Parliament adopted it on 18 June 2020. In EU law, a regulation 'shall have general application [and] shall be binding in its entirety and directly applicable in all Member States.'[16]

The Taxonomy Regulation is the central element of the 2018 Commission's Action Plan on sustainable finance (see Figure 1). The other substantive parts include: Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR) and Regulation (EU) 2019/2089 on EU climate transition benchmarks, EU Paris-aligned benchmarks and sustainability-related disclosures for benchmarks (Low Carbon Benchmark Regulation). The Taxonomy Regulation amends the SFDR.

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12 Climate Bonds Taxonomy (n 9).

13 For instance, Climate Bonds Initiative's expert group for its 'solar criteria' referred to the feed-in tariff legislation developed in Spain. See Padraig Oliver, 'Solar Energy and the Climate Bond Standard – Background Paper to eligibility criteria: Solar Technical Working Group' (*Climate Bonds Initiative*, 2013) <www.climatebonds.net/files/files/standards/Solar/Solar%20Criteria%20Background%20Paper.pdf> accessed 5 June 2021.

14 For instance, the 2°C temperature objective, often referenced among sustainable finance taxonomies and originating from the international law on climate change.

15 Commission, 'Technical expert group on sustainable finance (TEG)' (13 June 2018) <http://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en> accessed 5 June 2021.

16 Article 288 of the Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C 326/49.

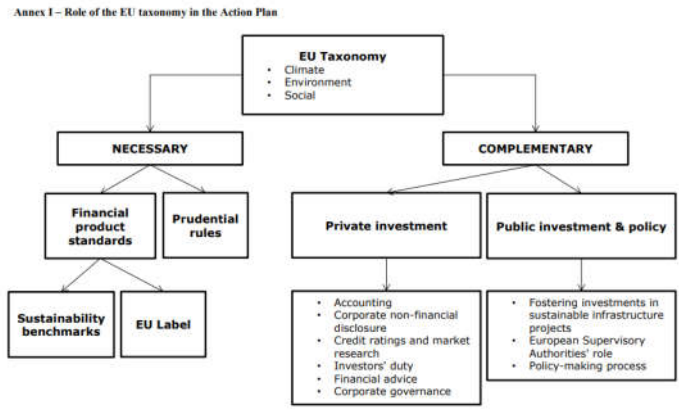

Figure 1: Role of the EU taxonomy in the Action Plan[17]

B. Obligations set by the Taxonomy Regulation

This sub-section deals with the scope of the obligations set by the Regulation, the substance of these obligations and enforcement details. It finally explains how the most technical part of the Taxonomy Regulation works: the mechanism for the classification of environmentally sustainable activities.

1. Scope of Application

As a matter of scope of application, the obligations set by the Taxonomy Regulation apply to:

1. measures adopted by Member States or by the European Union relating to financial products or corporate bonds that are made available as green;

17 Commission, 'Action Plan: Financing Sustainable Growth' COM (2018) 97 final 14.

2. financial market participants[18] who make financial products[19] available;
3. companies[20] subject to the obligation to publish a non-financial statement in accordance with Directive 2013/34/EU (the Accounting Directive).

2. SUBSTANCE OF OBLIGATIONS

Regarding the substance of the obligations set by the Regulation, distinctions must be made between EU Member States, financial market participants and the large companies defined by the Accounting Directive.

EU Member States must refer to the taxonomy in any measures relating to green finance. This obligation does not apply to certification-based tax incentive schemes which existed before the entry into force of this Regulation and which set out requirements for financial products intended to finance sustainable projects (article 4).

Financial market participants, when making available financial products promoting environmental characteristics, must

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18 As defined in article 2 of the SFDR, the term 'financial market participants' covers, among others, investment firms that provide portfolio management services, alternative investment fund managers and management companies of undertakings for collective investment in transferable securities (UCITS management companies): Regulation (EU) 2019/2088 of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector [2019] OJ L 317/1 (SFDR), art 2.

19 As defined in article 2 of the SFDR, the term 'financial products' means a portfolio managed according to Directive 2014/65/EU, an alternative investment fund (AIF), an insurance-based investment product (IBIP), a pension product, a pension scheme, an undertaking for collective investment in transferable securities (UCITS), or a pan-European personal pension product (PEPP): SFDR, art 2.

20 As defined by articles 19a and 29a of Directive 2013/34/EU, these companies are listed companies, credit institutions and insurance companies with more than 500 employees: Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC [2013] OJ L 182/19 (Accounting Directive), arts 19a, 29a.

communicate in the pre-contractual disclosures a description of how and to what extent the investments underlying the financial product are directed towards environmentally sustainable activities as defined by the taxonomy, specifying the percentage of investments made in these green activities (articles 5 and 6). Non-green financial products must include in their pre-contractual documentation a statement indicating that 'the investments underlying this financial product do not take into account the European Union's criteria for environmentally sustainable economic activities' (article 7).

The relevant companies must include in their non-financial statements a description of how and to what extent the activities of the company are associated with economic activities that qualify as environmentally sustainable. In particular, non-financial companies must publish the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable, as well as the proportion of their investment and operating expenses related to assets or processes associated with these same green activities defined by the taxonomy (article 8).[21]

3. Enforcement of Obligations

Regarding the enforcement of the obligations, the Regulation leaves it to the Member States to set the applicable penalties. These penalties must be effective, proportionate and dissuasive. The Regulation entered into force on 12 July 2020, but the articles relating to the obligations mentioned above only apply from 1 January 2022 with regard to the climate change-related section of the taxonomy and from 1 January 2023 with regard to the rest of the environmental objectives covered.

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21 For further details on the requirements under article 8, see Commission, Draft Commission Delegated Regulation (EU) supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation (2021) <http://ec.europa.eu/finance/docs/level-2-measures/taxonomy-regulation-delegated-act-2021-article-8-draft_en.pdf> accessed 5 June 2021.

4. CLASSIFICATION OF ENVIRONMENTALLY SUSTAINABLE ACTIVITIES

The most technical part of the Taxonomy Regulation relates to the mechanism for the classification of environmentally sustainable activities. According to article 3 of the Regulation, an activity can be considered as environmentally sustainable if it meets four conditions:

1. it contributes substantially to one or more of the six environmental objectives set by the Regulation. The six objectives are: climate change mitigation; adaptation to climate change; sustainable use and protection of aquatic and marine resources; the transition to a circular economy; prevention and reduction of pollution; protection and restoration of biodiversity and ecosystems (article 9);
2. it does not cause significant harm to any of the six environmental objectives. For instance, an economic activity shall be considered to significantly harm climate change mitigation where that activity leads to significant greenhouse gas emissions (article 17);
3. it is carried out in compliance with the minimum safeguards set by the Regulation. These minimum safeguards correspond to the procedures that the entity carrying out the economic activity implements to align itself with the OECD Guidelines for Multinational Enterprises and the United Nations Guidelines on Business and Human Rights (article 18);
4. it complies with the technical screening criteria established by the Commission. These technical screening criteria set the detailed requirement, activities by activities, about the three previous conditions (substantial contribution, no significant harm, respect of minimum safeguards).

To conclude this section, the Taxonomy Regulation is a progress for ESG information with regard to two dimensions. First, the Taxonomy Regulation has an expanded scope compared

to the SFDR, since its scope include not only financial market participants but also large companies. Second, the Taxonomy Regulation improves the precision and comparability of disclosures. The SFDR imposes procedural recommendations on financial actors and products but lacks substantial environmental criteria to abide by. By setting a classification of sustainable activities, the Taxonomy Regulation decisively complements the SFDR.

II. IMPLICATIONS FOR HONG KONG FINANCE INDUSTRY

EU's Taxonomy Regulation may have two types of implications for the finance industry in Hong Kong. First, the EU taxonomy may have indirect effects on Hong Kong's financial actors because of EU's ability to regulate the global marketplace – what has been called 'the Brussel Effect' (Section II(A)). Second, the EU's taxonomy could lead Hong Kong's financial regulators to enact an EU-inspired sustainable finance taxonomy (Section II(B)).

A. The Taxonomy as a New Instance of the 'Brussel Effect'

Theorised by Anu Bradford, the term the 'Brussels Effect' refers 'to the EU's unilateral ability to regulate the global marketplace [as] the markets are transmitting the EU's regulations to both market participants and regulators outside the EU. […] In essence, the Brussels Effect emerges from market forces and multinational companies' self-interest to adopt relatively stringent EU standards globally.[22] The adoption beyond EU borders of the General Data Protection Regulation – which, for instance, requires websites to ask for the users' privacy preferences – is a recent example of such a Brussel Effect.[23] The Brussel Effect is relevant to the EU taxonomy because the actors targeted by the Taxonomy

22 Anu Bradford, *The Brussels Effect: How the European Union Rules the World* (OUP 2019) 1-2.

23 Ioanna Hadjiyianni, 'The European Union as a Global Regulatory Power' (2021) 41(1) OJLS 243.

Regulation – financial market participants and large companies – generally operate on a worldwide scale. Regarding the Taxonomy Regulation, there are three transmission channels of the Brussel Effect: EU public authorities (EU Member States and the European Union itself), EU listed companies and EU financial market participants.

Under article 4 of the Taxonomy Regulation, Member States and the European Union shall apply the taxonomy 'to determine whether an economic activity qualifies as environmentally sustainable for the purposes of *any measure* setting out requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable.'[24] Such an obligation means that the 27 states of the EU will harmonise their green finance measures, standards and labels around the taxonomy. For instance, France's GreenFin label[25] – a state supported label defining green funds – will have to be based in the future on the EU taxonomy. Such a simultaneous move in 27 countries will induce a pressure for green finance labels anywhere in the world to define what is green in relation with the EU taxonomy. Hong Kong's Green and Sustainable Finance Certification Scheme already references several international standards, such as the Green Bond Principles.[26] It is likely that the Certification Scheme will have to be updated in order to reference the EU taxonomy and other taxonomies that integrate some elements of the EU taxonomy, such as the 2021 update of PBoC's Green Project Catalogue[27] and the incoming IPSF Common Ground Taxonomy.

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24 Emphasis added.

25 Décret Label TEEC (n 11).

26 Hong Kong Quality Assurance Agency, 'Green and Sustainable Finance Certification Scheme' <www.hkqaa.org/en_certservice.php?catid=26> accessed 5 June 2021.

27 A sign of that the Brussel Effect is already at play: the 2021 update of PBoC's Green Project Catalogue borrows on the Do No Significant Harm Principle from the EU taxonomy. Climate Bonds Initiative, 'Twin announcements presage new stage in green revolution' <www.climatebonds.net/2021/04/big-day-brussels-releases-eu-taxonomy-prelude-biden-summit-chinas-pboc-releases-updated> accessed 5 June 2021.

The European Union itself is subject to article 4 of the Taxonomy Regulation, and as such will integrate the taxonomy in all its measures relating to the definition of environmentally sustainable financial products and corporate bonds. These measures include the incoming EU Ecolabel for Retail Financial Products and EU standards for green bonds as well as green mortgages. But the EU also plans to use the taxonomy beyond what is required by article 4. The Recovery and Resilience Facility (RRF)[28] and some of EU's budget expenditure for the period of 2021-2027 will have to respect the 'do no significant harm' principle within the meaning of article 17 of the Taxonomy Regulation.[29] Such pervasive use of the taxonomy by in EU's finances increases the relevance of the taxonomy for a global financial place such as Hong Kong.

According to article 8 of the Taxonomy Regulation, financial and non-financial large companies must publish information on how and to what extent their activities are associated with the taxonomy's environmentally sustainable activities. This obligation is applicable from 1 January 2022 regarding climate mitigation and adaptation objectives, and from 1 January 2023 regarding the four remaining environmental objectives. As a result, a Hong Kong subsidiary of large company domiciled in the EU will need to assist the parent company with information relating to the Taxonomy Regulation, as the Regulation apply to all the activities of those companies regardless

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28 'The Recovery and Resilience Facility (the Facility) makes €672.5 billion (in 2018 prices) in loans and grants available to support reforms and investments undertaken by Member States [and] to mitigate the economic and social impact of the coronavirus pandemic […]': Commission, 'Recovery and Resilience Facility' <http://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en#the-recovery-and-resilience-facility> accessed 3 August 2021. In addition, 'the Facility is to contribute to the mainstreaming of climate action and environmental sustainability and to the achievement of an overall target of 30 % of Union budget expenditure supporting climate objectives.': Regulation (EU) 2021/241 of the European Parliament and of the Council establishing the Recovery and Resilience Facility [2021] OJ L 57/17 (Facility Regulation), recital 23.

29 Commission, 'FAQ: What is the EU Taxonomy and how will it work in practice?' (2021) <http://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-faq_en.pdf> accessed 5 June 2021.

of their location.[30] Many Hong Kong entities are concerned: 'as of June 2019, there were 507 regional headquarters, 746 regional offices and 1,063 local offices in Hong Kong with parent companies located in the EU.'[31] Another channel of transmission could be the desire of companies domiciled in Hong Kong to voluntarily comply with article 8 in order to provide a level of ESG information comparable to their European counterparts. Such voluntary compliance could also attract or retain European investors, who are themselves subject to disclosure obligations under the Taxonomy Regulation. European investors are not negligible to Hong Kong financial institutions: in 2019, 31 out of the 164 licensed banks in Hong Kong were owned by EU interests.[32]

Articles 5, 6 and 7 of the Taxonomy Regulation require financial market participants to include information based on the taxonomy in the precontractual and periodic reports of their financial products. These provisions will impact Hong Kong financial actors who manage collective investment schemes that are domiciled in the European Union. For instance, Undertakings for Collective Investment in Transferable Securities (UCITS) – a type of fund under European law – represent 'most [of the] collective investment schemes' authorised by Hong Kong's SFC.[33] UCITS funds managed in Hong Kong will have to comply with the Taxonomy Regulation in the same way that they had to comply with the SFDR (whose main provisions entered into application on 10 March 2021).[34]

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30 Commission, 'Frequently Asked Questions about the work of the European Commission and the Technical Expert Group on Sustainable Finance on EU taxonomy & EU Green Bond Standard' (19 June 2020) <http://ec.europa.eu/info/files/200610-sustainable-finance-teg-taxonomy-green-bond-standard-faq_en> accessed 5 June 2021.

31 Hong Kong Trade and Industry Department, 'Hong Kong – European Union Trade Relations' <www.tid.gov.hk/english/aboutus/publications/factsheet/eu.html> accessed 5 June 2021.

32 ibid.

33 Rolfe Hayden, Eva Chan and Ivy Yam, 'Retail Investment Funds in Hong Kong: Regulatory Overview' (*Thomson Reuters Practical Law,* 1 May 2021) <http://uk.practicallaw.thomsonreuters.com/6-501-3339?transitionType=Default&contextData=(sc.Default)&firstPage=true> accessed 3 August 2021.

34 Jeremy Lam, 'Impact of the EU's SFDR on Hong Kong Fund Managers' (*Deacons*, 25 March 2021) <www.deacons.com/news-and-

B. Prospects for a Hong Kong Sustainable Finance Taxonomy

A sustainable finance legal regime is currently emerging in Hong Kong and this regime will likely include a taxonomy in the near future. In May 2021, the HKMA released a guideline setting the details of the Green and Sustainable Finance Grant Scheme.[35] This scheme aims at providing 'subsidy for eligible bond issuers and loan borrowers to cover their expenses on bond issuance and external review services.'[36] The Government also issued several green bonds[37] and set a Green & Sustainable Finance Cross-Agency Steering Group (hereafter, the Steering Group).[38] The HKMA issued two circulars relating to green and sustainable finance: one inviting banks to join efforts for developing a common framework to assess the 'Greenness Baseline' of individual banks,'[39] and another circular for inviting banks to join climate stress tests to be conducted in 2021.[40] The SFC has developed circulars relating to Green and ESG Funds,[41] and a

insights/publications/impact-of-the-eu%E2%80%99s-sfdr-on-hong-kong-fund-managers.html> accessed 3 August 2021.

35 Hong Kong Monetary Authority, 'Guideline on the Green and Sustainable Finance Grant Scheme' (4 May 2021) <www.hkma.gov.hk/media/eng/doc/key-information/press-release/2021/20210504e4a1.pdf> accessed 3 August 2021.

36 ibid.

37 Government of the HKSAR, 'Government Green Bond Programme' <www.hkgb.gov.hk/en/greenbond/greenbondintroduction.html> accessed 3 August 2021.

38 Hong Kong Monetary Authority, 'Cross-Agency Steering Group Launches its Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future' (17 December 2020) <www.hkma.gov.hk/eng/news-and-media/press-releases/2020/12/20201217-4/> accessed 5 June 2021.

39 Hong Kong Monetary Authority, 'Common Assessment Framework on Green and Sustainable Banking' (13 May 2020) <www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200513e1.pdf> accessed 5 June 2021.

40 Hong Kong Monetary Authority, 'Climate Risk Stress Test' (4 December 2020) <www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20201204e1.pdf> accessed 5 June 2021.

41 Securities and Futures Commission of Hong Kong, 'Circular to management companies of SFC-authorized unit trusts and mutual funds – Green or ESG Funds' (11 April 2019)

circular requesting corporations licensed for asset management to join in a Survey on Integrating Environmental, Social and Governance Factors in Asset Management.[42] The SFC also maintains a list of registered Green and ESG funds.[43]

Plans published by Hong Kong authorities indicate that a sustainable finance taxonomy will complement this emerging regulatory regime. The Steering Group has disclosed a strategic plan in December 2020, in which it aims 'to adopt'[44] the Common Ground Taxonomy developed by mid-2021 by the International Platform on Sustainable Finance (IPSF) Working Group on Taxonomies co-led by China and the EU.[45] What 'adopting' means from a legal standpoint is not clear. It nonetheless reveals an additional channel through which the Taxonomy Regulation could produce normative effects in Hong Kong, since the Regulation will be one of the taxonomies which inform the Common Ground Taxonomy.

To guide Hong Kong's public policy as regards the Taxonomy Regulation, the example set by the United Kingdom (UK) is interesting. The Taxonomy Regulation came into force during the Brexit transition period. Consequently, the Taxonomy Regulation became part of UK law as of 31 December 2020. However, the technical criteria designed by the EU Commission to operationalise the taxonomy had not been enacted at the time of the Brexit, and therefore did not become part of UK law. Therefore, the UK has in its own legal order the framework for the

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<http://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=19EC18> accessed 5 June 2021.

42 Securities and Futures Commission of Hong Kong, 'Circular to Licensed Corporations Engaged in Asset Management: Survey on Integrating Environmental, Social and Governance Factors in Asset Management' (29 March 2019) <http://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=19EC20> accessed 5 June 2021.

43 Securities and Futures Commission of Hong Kong, 'List of Green and ESG Funds' <www.sfc.hk/en/Regulatory-functions/Products/List-of-green-and-ESG-funds> accessed 5 June 2021.

44 The Green and Sustainable Finance Cross-Agency Steering Group, 'Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future' (17 December 2020) <www.hkma.gov.hk/media/eng/doc/key-information/press-release/2020/20201217e4a1.pdf> accessed 5 June 2021.

45 IPSF Statement (n 7).

taxonomy (the Taxonomy Regulation) without the detailed criteria (the delegated acts). On 9 November 2020, the Chancellor of the Exchequer announced that the UK will design its own technical criteria.[46] This taxonomy will be subject to review by the 'UK Green Technical Advisory Group', 'who will assess the metrics' suitability for the UK market.'[47]

This hybrid solution – shared structure with the EU taxonomy but nationally set technical criteria – may be an option for Hong Kong's sustainable finance policy. This solution enables adopting a global standard – the principles and structure of the taxonomy – while retaining local agency on the definition of what is green/sustainable. When 'adopting' IPSF's Common Ground Taxonomy, Hong Kong's financial regulators could choose to implement IPSF's principles and structure only while determining locally the technical criteria suitable for Hong Kong's situation.

CONCLUSION

This comment has shown that the Taxonomy Regulation will probably increase the precision and comparability of ESG information, and as such, represent a progress. Given the applicability of the Taxonomy Regulation to the European financial market – one the largest capital markets in the world – it is likely that the Taxonomy Regulation will trigger some form of compliance from Hong Kong's financial actors. The problem of such 'legal export' is the imposition of norms in a jurisdiction that did not chose them. Hong Kong's Steering Committee on Sustainable Finance reacted by announcing the adoption of the future Common Ground Taxonomy drafted by a working group of the International Platform on Sustainable Finance (IPSF) co-chaired by China and the EU. The content of this Common Ground Taxonomy may not reflect local choices, but at least its EU-China co-drafting process suits well Hong Kong's role as a gateway between East and West.

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46 HM Treasury, 'Chancellor sets out ambition for future of UK financial services' (2020) <www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services> accessed 5 June 2021.

47 HM Treasury, 'New independent group to help tackle greenwashing' (2021) <www.gov.uk/government/news/new-independent-group-to-help-tackle-greenwashing> accessed 5 June 2021.

CODIFYING CEFC: FROM PRAGMATICS TO PRACTICALS IN RECOGNISING PRC ENTERPRISE BANKRUPTCY IN HONG KONG

Alex Chan*

This article analyses the development building upon Re CEFC to regularise the recognition and assistance of PRC administrators in Hong Kong in enterprise bankruptcies. Through tracing the historical development of the law, it is observed that there are unresolved issues regarding the recognition regime between the PRC and Hong Kong on corporate insolvencies, specifically on the applicability of Article 5 of the Enterprise Bankruptcy Law 2005 towards properties situated in Hong Kong; while it is also observed that the flexibility in the development of the common law meant that Re CEFC should not be taken as sufficient groundwork to the proposed regularisation. The current effort in reaching an Arrangement between the PRC and Hong Kong is therefore encouraging in settling the long-standing legal lacuna, entrenching the universal collection mechanisms as between the two legal jurisdictions.

INTRODUCTION

An important aspect of the law in cross-border commercial activity is the facilitation of the recovery of debts when companies go insolvent, as a legal regime that enables the realisation of properties across jurisdictions is crucial to the confidence of creditors in extending loans to businesses with a dispersed profile of assets. The challenge, though, is that the laws across

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jurisdictions are bound to be different, from declarations of winding up to the eventual distributive orders; and indeed, the mutual recognition and enforcement of corporate insolvencies between Hong Kong and the PRC was until recently a gap that lacked the necessary certainty, owing to the vast differences in the two legal cultures. It is in this respect that the judgment in *Re CEFC*[1] proved to be a much-needed landmark, not only because the common law courts in Hong Kong have yet again recognised and assisted administrators appointed from a civil law jurisdiction,[2] but also due to the practical reality of the increasing integration between the two economies, that development in the laws of recognition is long called for and, perhaps, long overdue.

In this respect, the impact of the *CEFC* decision is profound. Not only has the Hong Kong companies court considered and approved another application in quick succession to recognise the enterprise bankruptcy declared in the Mainland; the judicial framework laid down is in the meantime supplemented by two major administrative developments. On 22 June 2020, the Department of Justice (DOJ) submitted to the Legislative Council a 'Proposed Framework for Co-operation with the Mainland in Corporate Insolvency Matters' (June 22 Paper),[3] after years of indications of pushing for the same;[4] and more significantly, on 14 May 2021 the Supreme People's Court (SPC) and the DOJ signed the 'Record of Meeting on Mutual Recognition of and

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1 *Re CEFC Shanghai International Group Ltd (Mainland Liquidation)* [2020] HKCFI 167, [2020] 1 HKLRD 676.

2 The Hong Kong courts have previously granted recognition to a Japanese trustee in bankruptcy appointed by a Japanese court over a company incorporated in Japan, which is a civil law jurisdiction: *Re Takamatsu* [2019] HKCFI 802, [2019] 5 HKC 505.

3 Legislative Council Panel on Administration of Justice and Legal Services, 'Proposed Framework for Co-operation with the Mainland in Corporate Insolvency Matters' LC Paper No CB(4)715/19-20(04) (22 June 2020).

4 As early as in December 2018, the Department of Justice has indicated its plan to 'issue a consultation paper by the first quarter of 2019 on the proposed mechanism for mutual legal assistance with the Mainland on corporate insolvency matters': Legislative Council Panel on Administration of Justice and Legal Services, 'Proposed Creation of one Permanent Post of Principal Government Counsel, one Permanent Post of Deputy Principal Government Counsel, one Supernumerary Post of Deputy Principal Government Counsel and Upgrading of one Assistant Principal Government Counsel Post to Deputy Principal Government Counsel in the Department of Justice' LC Paper No CB(4)323/18-19(03) (19 December 2018) para 94. This was postponed until the publication of the June 22 Paper.

Assistance to Bankruptcy (Insolvency) Proceedings' (Record of Meeting),[5] establishing a pilot framework for cooperation between the Hong Kong courts and three selected People's Court in corporate insolvency and debt restructuring matters. Indeed, while *CEFC* and *Shenzhen Everich*[6] were both cited in the June 22 Paper,[7] the DOJ has made explicit its view on the lack of 'certainty and stability' in the existing machineries, deeming unsatisfactory that 'the relevant common law principles might evolve over time'.[8] This view is also recorded in the Preamble to the Record of Meeting, as the three main motives for such development were stated to be to 'further improve the mechanism for judicial assistance' between the PRC and Hong Kong, to 'facilitate economic integration and development', and to 'optimise business environment underpinned by the rule of law'.[9]

From the legal perspective, it is the choice of the word 'improve' (完善) which deserves attention, as that alludes to a prevailing problem in the existing regime, where the DOJ has rightly acknowledged that recognition and assistance has long been provided for by (and solely by) the common law in Hong Kong.[10] The query, in gist, is the utility of a new regime, as if the proposed reform does no more than to codify the common law solution as provided by *CEFC*, what more would a new regime add to the advantages of the flexibility of the common law such as to justify the administrative effort. To put the matter another way, the question that must be explored is that if, indeed, *CEFC* is sufficient in resolving the legal lacuna that has existed for two decades since the handover, what more is there for a new Mainland-Hong Kong arrangement on cross-border insolvency to contribute, so as to justify the new pilot framework?

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5 Supreme People's Court and the Government of the Hong Kong SAR, 最高人民法院与香港特别行政区政府关于内地与香港特别行政区法院相互认可和协助破产程序的会谈纪要 [Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region], 14 May 2021.

6 *Re The Liquidator of Shenzhen Everich Supply Chain Co, Ltd* [2020] HKCFI 965.

7 DOJ (n 3) paras 13-14.

8 DOJ (n 3) para 34.

9 Record of Meeting (n 5) Preamble.

10 DOJ (n 4) para 93.

This paper aims, therefore, to explore the answers provided by *CEFC*, and more importantly the unresolved issues thereof – to illuminate the areas that must be addressed in the exercise towards a new arrangement with the PRC. Section I traces the development in the cross-border insolvency issues between the PRC and Hong Kong before *CEFC*, exploring the lacuna that is ever present with the EBL regime in the PRC, as well as the arrangements that the two jurisdictions have entered into since the Handover. Section II analyses the judgment in *CEFC*, its impact and the corresponding responses on the Mainland-Hong Kong recognition and enforcement regime. Section III scrutinises the June 22 Paper and the Record of Meeting, so as to envisage the intended developments of the Hong Kong government and to critique thereupon, exploring how an upcoming Arrangement may improve upon the present state of the law. Section IV concludes.

I. THE LAW BEFORE CEFC

A. Persisting Problems with The EBL Regimes

While the differences in legal culture between the two jurisdictions have certainly been a barrier in achieving a formal regime of mutual recognition and assistance in corporate insolvencies, much of this inaction can be traced to the historical absence of insolvency legislations in Mainland China. Johnston and Harris presented the issue as an 'acute problem',[11] as the lack of prescription of the extraterritorial effects of corporate bankruptcy orders issued by PRC courts before the enactment of the Enterprise Bankruptcy Law 2006 (EBL 2006) had proved to be testing to Hong Kong courts, a situation exacerbated by a lack of executive arrangement on the resolution of the same.

The 2001 decision in *CCIC Finance v GITIC*[12] illustrated the persisting difficulties with the PRC insolvency regime before the enactment of the EBL 2006, insofar as the ambit of a PRC

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11 Graeme Johnston and Paul Harris, *The Conflict of Laws in Hong Kong* (3rd edn, Sweet & Maxwell 2017) para 8.080.

12 *CCIC Finance Ltd v Guangdong International Trust & Investment Corporation* [2001] HKCFI 920, [2005] 2 HKC 589.

corporate bankruptcy order is concerned. Then, the PRC corporate laws were governed by the Enterprise Bankruptcy Law (for Trial Implementation) 1986 (Trial EBL);[13] and whereas Article 5 of the EBL 2006 made clear that the bankruptcy procedures commenced under that Law shall bind the debtor's property 'outside the territory of the PRC', no equivalent provisions to that effect were present in the Trial EBL. *CCIC Finance* concerned a creditor applying for a garnishee order against GITIC, a company incorporated and declared bankrupt in the PRC; and while it was not explicitly fallen to be considered the extraterritorial effects of the PRC bankruptcy order, GITIC opposed to the making absolute of the garnishee order *nisi*, on the ground that bankruptcy proceedings had already commenced in the PRC, and that the making absolute of the order in Hong Kong would favour the plaintiff creditor at the expense of the distributive scheme in the Mainland.[14] The question before the court, therefore, was incidentally on the nature of the PRC bankruptcy scheme in binding the company's assets out of its jurisdiction;[15] and indeed, in the course of DHCJ Gill's examination of the conflicting expert evidence adduced on PRC law, the difficulty identified by Professor Jingxia Shi was the 'deliberate intention' of the drafters of the Trial EBL in leaving blank the issue of extraterritorial effects of bankruptcies, since 'the legislators could not make up their mind (*sic*) as to whether to adopt the principle of universal application or the principle of territorial application and so they considered the best solution was not to make any enactments'.[16] The lack of bilateral arrangement on corporate insolvency between the Mainland and Hong Kong then had certainly not helped in resolving the issue. What is made clear, though, is the major reason for inaction in the early days of the Handover to arrange for the Mainland-Hong Kong cross-border insolvency regimes – that without legislators in the Mainland being

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13 Law of the People's Republic of China on Enterprise Bankruptcy (For Trial Implementation) 1986.

14 *CCIC Finance* (n 12) [48].

15 *CCIC Finance* (n 12) [56]-[85].

16 *CCIC Finance* (n 12) [63]. The garnishee order was eventually not made absolute, because the judge accepted, on the basis of expert evidence, that the PRC bankruptcy regime under the Trial EBL is a universal collection and distribution of assets and creditors worldwide were to be paid pari passu subject to ranking, see [84]. To make absolute the garnishee order would therefore prejudice other creditors to GITIC. The exact extraterritorial effect of a PRC bankruptcy under the predecessor regime was, therefore, not decided in this case.

intelligible as to the extraterritorial effects of their enterprise bankruptcy, any discussion would be clouded by a string of uncertainty in the default position under PRC law.

That Article 5 of the EBL 2006[17] represented major progress in Mainland's insolvency regime is therefore apparent, as PRC company law can then be said to have adopted a certain form of universalism in corporate bankruptcies, filling the void that was left from the Trial EBL regime. The persisting difficulty, nonetheless, is the proper interpretation of the Article's ambit in covering the Hong Kong SAR. In exact terms, the universal effects of Article 5(1) go so far as to bind assets 'outside the territory' of the PRC;[18] and a query remains as to whether property within the jurisdiction of Hong Kong is 'outside the territory' of the PRC. While the limits of Article 5(1) have yet to be tested before the PRC judiciary, an analogous inquiry had arisen in relation to the applicability of Article 5(2), which empowers PRC courts to recognise and enforce a bankruptcy case 'by a court of another country';[19] and in *Re Norstar Automobile*, the SPC declared in 2011 that the sub-article is inapt in covering winding up orders issued by the Hong Kong judiciary.[20] It must be noted that Article 5 is the only provision in EBL 2006 governing the extraterritorial effects of PRC enterprise bankruptcies; while Articles 5(1) and 5(2) are, in substance, reciprocal in nature. Given this view pronounced by the apex court of the PRC, it is unclear whether the present Mainland insolvency regime is apt in supplying the legal basis for developing recognition and assistance between the two legal jurisdictions.

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17 Enterprise Bankruptcy Law of the People's Republic of China 2006, art 5(1) states: 'Once the procedure for bankruptcy are initiated according to this Law, it shall come into effect in respect of the debtor's property outside of the territory of the People's Republic of China.'

18 In Chinese, the effects of art 5(1) extend to '中华人民共和国领域外的财产'.

19 In Chinese, art 5(2) enables PRC courts to '对外国法院作出的发生法律效力的破产案件…裁定承认和执行'.

20 Supreme People's Court of the People's Republic of China, 最高人民法院关于北泰汽车工业控股有限公司申请认可香港特别行政区法院命令案的请示的复函 [Reply of the Supreme People's Court on the Application for the Recognition of the order of the Hong Kong SAR re Norstar Automobile Industrial Holding Ltd], s 5.

B. Arrangements between the PRC and Hong Kong

In other areas of civil and commercial law, nevertheless, there has been considerable development since the Handover, where 'Arrangements'[21] have been entered into between the two jurisdictions to facilitate reciprocal recognition and enforcement. To date, six Arrangements have been finalised,[22] including the first Arrangement on mutual enforcement of arbitral awards (1999)[23] and the Arrangement on reciprocal recognition of civil judgments in matrimonial and family cases (2017).[24] But the most significant arrangement thus far has been the Arrangement on the reciprocal recognition and enforcement of judgments in civil and commercial matters signed in 2006 (2006 Arrangement),[25] as that was the first Arrangement that provided the basis for mutual enforcement of monetary judgments across the border, provided that the agreement in dispute was one that contained a choice of court agreement.[26] Most recently, the 2006 Arrangement was

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21 It should be noted that the documents of which the cooperation details between the PRC and Hong Kong SAR are set out are, and will be, referred to as 'arrangements' rather than 'agreements'. That is due to the linguistic differences of the two words in Chinese, of which the latter is used in preferential agreements among states. Cooperation between the Mainland and Hong Kong, on the other hand, is done under the principle of One Country, Two Systems. For details, see Wei Wang, 'CEPA: A Lawful Free Trade Agreement Under "One Country, Two Customs Territories?"' (2004) 10 Law & Business Review Americas 647, 654.

22 Department of Justice, 'Reciprocal Recognition and Enforcement of Civil and Commercial Judgments between Hong Kong and the Mainland' (*Department of Justice*, 2 December 2020) <www.doj.gov.hk/en/mainland_and_macao/RRECCJ.html> accessed 5 December 2020.

23 Supreme People's Court of the People's Republic of China and the Government of the HKSAR, Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region, June 1999.

24 Supreme People's Court of the People's Republic of China and the Government of the HKSAR, Arrangement on Reciprocal Recognition and Enforcement of Civil Judgments in Matrimonial and Family Cases by the Courts of the Mainland and of the Hong Kong Special Administrative Region, 20 June 2017.

25 Supreme People's Court of the People's Republic of China and the Government of the HKSAR, Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned, July 2006.

26 ibid art 1.

superseded in 2019 by the arrangement on reciprocal enforcement of judgments in civil and commercial matters (**2019 Arrangement**),[27] with the effects of the 2006 Arrangement being expanded to the wider private law regime, beyond commercial agreements with a choice of court clause.

However, none of the six arrangements dealt with issues of cross-border insolvency between the Mainland and Hong Kong. Indeed, while the 2019 Arrangement has an ambit of reciprocal recognition that is so wide as to have covered most of the judgements on private agreements, the issue on corporate insolvency and debt restructuring (as well as personal bankruptcy) is expressly left out,[28] alongside other exemptions such as matrimonial and arbitration matters.[29] This should not come as any surprise: the legal basis upon which a PRC bankruptcy order may bind assets in Hong Kong is itself unclear; but more fundamentally, Mainland courts have rarely recognised and assisted foreign liquidation proceedings, and have in fact granted only three such recognitions historically.[30] Emily Lee, when evaluating in 2015 the deadlock in cross-border recognition of insolvencies between the two jurisdictions, suggested the removal of three restrictions embedded in the 2006 Arrangement as necessary to extend such to apply in cross-border insolvency issues, ie the requirements of a monetary judgment, a choice of court clause, and the absence of disputes in employment contracts;[31] but the comment probably missed a crucial

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27 Supreme People's Court and the Government of the HKSAR, Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region, 18 January 2019.

28 ibid art 3(1)(2).

29 ibid arts 3(1)(5) and 31. For a summary of the exclusions in the 2019 Arrangement, see Department of Justice, 'Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Regions' (*Department of Justice*, 18 January 2019) <www.doj.gov.hk/en/mainland_and_macao/pdf/Doc6_481354e.pdf> accessed 20 November 2020. Note, also, that matrimonial matters and arbitration matters have already been specifically dealt with in the Arrangements in 1999 and 2017 respectively.

30 Jingxia Shi, '香港法院对内地破产程序的承认与协助' [Hong Kong Court's Recognition and Assistance in Mainland Bankruptcy Procedures] (2020) 国际法研究 [International Law Studies] 162, 173.

31 Emily Lee, 'Problems of Judicial Recognition and Enforcement in Cross-Border Insolvency Matters Between Hong Kong and Mainland

complication, as insolvency proceedings by nature involve a universal scheme of asset collection and the ranking of creditors, which is not a one-off determination that could be easily enforced.[32] That insolvencies would require an open and public process for the submission of debts and the recovery of assets means that any reciprocal arrangement must be capable of requiring the submission of the ***entire process*** to a certain jurisdiction[33] – and the lack of experience of such in PRC courts in dealing with companies beyond that incorporated within its jurisdiction explains the current impasse which the decades-long development has reached. This, indeed, was forthrightly illustrated by the express exclusion of cross-border insolvency matters in the 2019 Arrangement.

How the PRC insolvency regime will develop so as to accommodate Hong Kong winding up orders will be a debate for another day, as this article focuses on the development of Hong Kong's recognition and assistance mechanism in light of the opportunity for a further arrangement.[34] The brief survey on the post-Handover evolution of Mainland-Hong Kong mutual recognition nonetheless highlights the challenges that the Hong Kong system faces as it takes a step further in formalising the process of cross-border realisation of insolvent assets. Indeed, what the detailed scrutiny of legal texts and case laws sought to reveal was the difficulty with maintaining a doctrinal approach in light of the fast-developing cross-border businesses. Where the rules and procedures on the PRC side had been demonstrably strict, the solution to the lacuna had to be sourced from the inherently flexible common law practiced in Hong Kong.

China' (2015) 63(2) American Journal of Comparative Law 439, 451-55.

32 Ian Fletcher, *The Law of Insolvency* (5th edn, Sweet & Maxwell 2017) para 1-003.

33 That is given that Hong Kong is practising modified universalism in cross border insolvencies.

34 Note that the scope of the Record of Meeting (to be discussed below) covers the Mainland recognition regime. For a good overview of the latest development, see Look Chan Ho, 'Blackoak workshop series - Blog 6: Look Chan Ho Explains the New HK/Mainland China Cross-Border Insolvency Arrangement' (*BlackOak*, May 2021) <www.blackoak-llc.com/blog/blackoakworkshopseries-blog6> accessed 1 June 2021.

II. CEFC AND ITS IMPACT

A. Revisiting CEFC and subsequent decisions

CEFC, therefore, is in all respects a pragmatic solution to an unresolved lacuna. In giving effect to the Mainland's request for assistance for its appointed administrators, the Hong Kong court must have necessarily left unresolved the admittedly difficult issue of the exact ambit of Article 5(1) of the EBL 2006. The facts of the case deserve a re-examination: in remarkably close resemblance with *CCIC Finance*, the application was initiated by a garnishee order *nisi*; but the administrators of the bankrupt PRC company went one step further to seek recognition from the Hong Kong companies court, and the henceforth assistance in protecting all other assets of the company situated in the jurisdiction.[35] In granting the application, Harris J considered the scope of powers which the common law could afford to a foreign liquidator seeking assistance, as the judge placed strong emphases on the Privy Council advice in *Singularis Holdings Ltd v PricewaterhouseCoopers*[36] to conclude that (a) no powers of assistance would be granted which the administrators could not have so acted under the laws by which they were appointed; (b) the powers sought would only be available where necessary, and (c) the orders sought must be consistent with the substantive law and public policy of the assisting court.[37] Such were held to have been satisfied on the facts, and hence the famous order of recognition and assistance was granted to the PRC administrators.

While Harris J did not specifically discuss how each of the three *Singularis* elements was satisfied, it would be apparent that the main challenge to the application lied with the first element, namely, whether the company's properties in Hong Kong were to be regarded as outside the territory of the PRC, such that the Mainland administrators had power to lay hands into such properties situated in Hong Kong. The special feature of the case that distinguishes it from *CCIC Finance*, though, is that it is a recognition application backed by a letter of request from the

35 *CEFC* (n 1) [4]-[6].
36 [2014] UKPC 36, [2015] 1 AC 1675 [25] (Lord Sumption).
37 *CEFC* (n 1) [11].

Shanghai court where the bankruptcy order is made.[38] Such, it is submitted, is crucial to the eventual orders of the case, not less because it conclusively determines for the Hong Kong judge on any potential non-compliance of Mainland laws in the proceedings. Hence, as doubtful the legal basis of the application may be, the judge in *CEFC* cannot be said to have wrongly decided the case, because there can be no better evidence of Mainland law compliance adduced to the court than an endorsement by a PRC court in its official proceedings.

Another notable feature of the *CEFC* judgment is the common law basis upon which the recognition was supported, as the judge, though mildly, alluded to the principle of 'modified universalism'. Indeed, Lord Hoffmann's advice in *Cambridge Gas v Navigator Holdings*[39] was quoted to the effect that the common law may extend recognition to foreign liquidators so as to facilitate the consolidation into one process of the distribution of insolvency properties;[40] and on this basis, Harris J ordered a stay of the ongoing garnishee proceedings in Hong Kong, recognising it as a form of specific assistance.[41] That, of course, is consistent with the court's approach in recent years, as the same judge in *A Co v B*[42] spoke of a 'trend' in the common law of applying modified universalism in issues on cross-border insolvencies.[43] However, this reliance on modified universalism may lead to consequences that would operate as a double-edged sword. On the one hand, the current popularity of modified universalism in the common law means that the primary focus of courts would be to consolidate the insolvency proceedings into one forum. That the main forum would be in a drastically different legal culture, hence, would not in itself be a barrier for such assistance, as all that is required to be shown is that the foreign insolvency proceedings is 'similar' to that of Hong Kong's, ie being a collective insolvency proceedings, and that the

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38 ibid [7].

39 *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings* [2006] UKPC 26, [2007] 1 AC 508.

40 *CEFC* (n 1) [16], quoting *Cambridge Gas* (n 39) [16]. See also *CEFC* (n 1) [25].

41 *CEFC* (n 1) [15]-[16].

42 *Joint Official Liquidators of A Co v B* [2014] HKCFI 1294, [2014] 4 HKLRD 374.

43 ibid [10].

distribution will be conducted on a *pari passu* basis.[44] So far as precedents can tell, Hong Kong courts have had no difficulty in accepting that the PRC enterprise bankruptcy regime satisfied these requirements. On the other hand, insofar as the judge takes the view that modified universalism 'has been the law … for nearly 250 years',[45] caution must be exercised. Whereas ancient cases such as *Solomons v Ross*[46] have been cited in support of the proposition, the purported conclusion that the judge seeks to rely on is not immediately apparent. Indeed, Look-Chan Ho pointed out that, just over 40 years ago, English courts had been slow in granting recognitions:[47] Lord Denning, for example, has (in *obiter*) revealed a remarkably territorialist attitude in *Levy v International Resources Ltd*,[48] as the judge was unconvinced in granting recognition to US liquidators over an insolvent English company, asserting that an English company should be subject to the insolvency regime of the English, but not that of the US. While Ho is certainly correct in stating that the law has since developed,[49] following a series of Lord Hoffmann's opinions[50] that were most recently affirmed in *Singularis*,[51] the critical point to note is that the law ***can*** develop, that precedents laid down in and since *CEFC* can be overturned if and when the common law develops in another direction. There is, after all, nothing to prevent territorialism in once again gaining attraction.

B. The Reception

The impact of the *CEFC* decision, nonetheless, has been far-reaching. While Harris J remarked in conclusion that future applications for recognising Mainland administrators will be decided on a case-by-case basis,[52] within a year since the handing down of the judgment the case has already been cited in 9 first

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44 *CEFC* (n 1) [23], [25].
45 ibid [16].
46 (1764) 1 H Bl 131n.
47 Look Chan Ho, *Cross-Border Insolvency: Principles and Practice, First Edition* (Sweet & Maxwell 2016) para 3-120.
48 CA, 8 March 1973.
49 Ho (n 47) para 3-121.
50 See, for example, *Cambridge Gas* (n 39) and *In re HIH Casualty and General Insurance Ltd* [2008] UKHL 21, [2008] 1 WLR 852.
51 *Singularis* (n 36) [11]-[23] (Lord Sumption).
52 *CEFC* (n 1) [33].

instance decisions,[53] with *Re Shenzhen Everich*[54] witnessing PRC administrators taking full advantages of the post-*CEFC* convenience in making a recognition and assistance application to Hong Kong. What is notable from the facts in *Shenzhen Everich* is that, unlike the scenario in *CCIC Finance* and *CEFC*, there were not any prior adverse proceedings motivating the application, as the Shenzhen court directly issued a letter of request to Hong Kong seeking recognition and assistance of the PRC-appointed administrators.[55] The judgment was thus straightforward, not less because much of the principles discussed in *CEFC* were applied with approval by the same Harris J.[56] This meant that the focus in that judgment went into the administrative side of affairs, ie the framing of the letter and the form of the orders to be sought by these administrators.[57] The utilisation of the *CEFC* judgment in other cases were also evidence of the noteworthiness of the case: in *Re Moody Technology*,[58] for example, DHCJ William Wong SC utilised the 'universalism rationale' in *CEFC* to extend assistance to the Bermuda-appointed liquidators in facilitating their restructuring proposal;[59] while more strikingly in *Re Ando Credit*,[60] the petitioners in Hong Kong went so far as to apply before Harris J for an appointment of provisional liquidators, expressly for the purpose of seeking recognition in the Mainland, with a view to recovering receivables owed to the company in the PRC.[61] This rapid development, on the one hand, illustrates that the *CEFC* breakthrough was indeed long overdue; while on the other hand, the evidence suggests that the decision has been well received, not only in the domestic judiciary, but also as amongst insolvency practitioners across the border.

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53 Other cases cited *CEFC* in the discussion of providing assistance on liquidators' right to pursue a restructuring. See, for example, *Re China Oil Gangran* [2020] HKCFI 825.

54 *Shenzhen Everich* (n 6).

55 ibid [2].

56 ibid [3].

57 ibid [4]-[8].

58 *Re Moody Technology Holdings Ltd* [2020] HKCFI 416, [2020] 2 HKLRD 187. Note, however, that the recognition and assistance of foreign 'soft-touch' provisional liquidators has since been discouraged, following Harris J's scepticism over the lack of protection of Hong Kong creditors in granting recognition. See Part C below.

59 ibid [29]-[37].

60 *Re Ando Credit Limited* [2020] HKCFI 2775.

61 ibid [1].

Unsurprisingly, the demonstrated willingness of Hong Kong courts to recognise Mainland administrators has also been met with positive reception from the PRC. In terms of literature that has emerged from *CEFC*, Shuo Zhang, commenting as a judicial assistant at the Beijing Haiding People's Court, celebrated the 'regularisation' and 'standardisation' of the recognition mechanisms in Hong Kong courts towards Mainland administrators,[62] as he envisages the milestone that is achieved with *CEFC* to be the cornerstone in the closer cooperation between the two jurisdictions in corporate insolvency matters, the issues thereof being the 'most difficult barrier' in the Belt and Road and Greater Bay initiatives.[63] A more reserved welcoming, in the meantime, was offered by Professor Jingxia Shi, as she recognised that the historic conservatism of Mainland China over reciprocal recognitions in cross-border insolvencies had necessarily inhibited the potentials that *CEFC* opened up, in terms of the volume of cases that would have been successfully arranged for a universal collection of assets;[64] but she nonetheless applauded Harris J's decision as an instance where the Hong Kong common law indicated its receptibility over cultures with drastically different economic and legal fundamentals, and that systemic controls can be built by remarking that cases thereafter have to be considered on a case-by-case basis.[65]

The most noteworthy opinion, though, came from the extrajudicial comments of PRC judges. In a blog post by Yanni Yue, Shan Tang and Fang Wang, all being members of the Shenzhen Intermediate People's Court, the approach of the Hong Kong court was celebrated to have pioneered insolvency cooperation in Bay Areas as amongst jurisdictions with 'fundamental differences in the legal systems',[66] that the

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62 Shuo Zhang, '从"广信案"到"华信案":香港对内地公司跨境破产清算承认与协助的新发展' [From Guangxin to Huaxin: New Developments in Cross Border Recognition and Assistance of Insolvency Proceedings of Mainland Companies in Hong Kong] (2020) 14 法律適用司法案例 [National Judges College Journal] 41, 48-49.

63 ibid 49.

64 Shi (n 30) 173-74.

65 ibid 174-75.

66 Yanni Yue, Shan Tang and Fang Wang, '内地與香港跨境破產得實踐探索' [Exploring the Practice of Cross-border Insolvency between Mainland China and Hong Kong] (*WeMP*, 11 September 2020) <http://wemp.app/posts/c4ee81da-dfc9-45e3-b440-fcf9d88d47c1> accessed 1 December 2020, s 4(1).

'exchange of legal culture and judicial practice' enabled by *CEFC* and *Shenzhen Everich* laid 'solid foundations' for the breaking of cross-border insolvency barriers in the Greater Bay Area.[67] Similarly, in a column authored by Yanli Shi and Kun Liu,[68] both being officers at the Supreme People's Court, a 'Manual' for future applications for recognition in Hong Kong was drafted on the basis of the experiences in *CEFC* and the *Shenzhen Everich*, as the column concluded with the optimism that there would be further entrenchment of 'judicial cooperation' in corporate insolvencies and rescues between the two legal systems.[69]

One must nonetheless approach with caution the unanimity in the positive reception of *CEFC*, as a common thread running through these comments is the socio-political significance of the decision. That a good policy is being pursued, however, does not necessarily render the laws so applied as immune from defects; and the legalistic dissection that is conducted above has illustrated that there are remaining issues to be resolved. Modified universalism, while being a malleable principle capable of adapting novel scenarios, has a fatal weakness of being a thin basis for a long-term recognition regime; and insofar as the administration intends a form of permanence in Hong Kong courts recognising and assisting Mainland enterprise bankruptcies, domestic legislation backed by bilateral arrangement is necessary in entrenching the current practice. Further, without a clear enactment or pronouncement to the effect that the inferred interpretation from *Norstar Automobile* on Article 5(1) of the EBL 2006 does not hold true, a long-term reliance on the Hong Kong common law in resolving this difficult area of 'regional conflict of laws' in corporate insolvency[70] runs the risk of the regime

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67 ibid s 4(1). The piece is also translated and appended by Harris J in *Re Ando Credit* (n 60) at [3], as a support to his seeking of assistance from the PRC courts of recognising Hong Kong appointed provisional liquidators.

68 Yanli Si and Kun Liu, '香港法院认可与协助域外破产程序简介' [Introduction to Hong Kong Courts' Approval and Assistance in Extraterritorial Bankruptcy Procedures] 人民法院报 [People's Court Mail] (Beijing, 11 June 2020) <www.chinacourt.org/article/detail/2020/06/id/5294599.shtml> accessed 21 November 2020.

69 ibid s 5.

70 As skilfully termed by Emily Lee, see Emily Lee, 'Legal Pluralism, Institutionalism, and Judicial Recognition of Hong Kong-China Cross-Border Insolvency Judgments' (2015) 45 HKLJ 331, 338-41.

suffering from a sustained void in the legal basis of the practising reciprocal recognition.

III. THE UPCOMING ADMINISTRATIVE EXERCISE

The PRC and Hong Kong authorities must therefore be applauded for working on a new arrangement, opening up the opportunity to supplement the impermanence of the current *CEFC* framework and the potential inadequacies of the current Article 5 regime under the EBL 2006. What the foregoing analysis illustrates is that the pertaining legal issues that underlie the current regime, which is heavily reliant on the Hong Kong common law, are inherently complex, as the issues entangle the laws of two jurisdictions which may not be resolved purely by a domestic approach to both jurisdictions. The development towards a new arrangement, thus, provides the prime opportunity for these pertaining issues to be resolved. The following sets out the key takeaways from the June 22 Paper and the Record of Meeting respectively to pinpoint the considerations that the administrations must take into account in finalising the arrangement in the near future.

A. The June 22 Paper: Evaluation

Being the first official document on the initiation of the cooperation, the June 22 Paper is understandably brief, as the 15-page document sets out the legal and policy background of the initiative, while highlighting the 'key features' of the suggested framework. Part A of the Background section lays out the present conflict of laws principles applied in Hong Kong in cross-border insolvency proceedings, as paragraph 7 recites the basis of 'modified universalism' which guided the development of the insolvency regime in the jurisdiction, while paragraph 8 repeats the *Singularis* factors that were applied in *CEFC*, ie that the assistance powers conferred on the foreign liquidator must be necessary and must not exceed the powers they would have had in their appointment jurisdiction. The paper then referred to the established procedures in making the application,[71] followed by

[71] DOJ (n 3) paras 11-12.

an approving discussion of the two landmark judgments, *CEFC* and *Shanghai Everich*.[72]

Material to the present discussion are Parts B and C, as the paper moves on to detail the insufficiencies of the present legal regime. The problems persisting in Article 5 were discussed with reference to *Norstar Automobile*,[73] but the implications of that to the legal effect of Article 5(1) were not discussed. Insofar as the domestic regime is concerned, the government advertised for a 'modernised, effective and efficient insolvency regime',[74] as the current 'lack of a co-operation mechanism' is 'unconducive to the ***promotion of an orderly and efficient insolvency regime*** and the ***facilitation of the rescue of financially troubled businesses***'.[75] The later paragraphs further stated the objectives of the proposed framework as to provide an 'additional tool' for the protection of assets, to 'minimise the need for parallel proceedings', to 'enhance the recovery rate', and to 'facilitate the successful restructuring or rescue of the debtor company'.[76] In concluding the section, policy objectives of the government were also alluded to, as paragraph 23 speaks of the new regime enhancing the city's competitiveness as a regional insolvency and debt restructuring hub; while at the same time projecting a vision for 'new opportunities and synergy for cross-fertilisation' between stakeholders in the two jurisdictions.[77]

The final two parts of the June 22 Paper discusses the substantial proposals that the government has in mind at the time. But whereas the detailed discussions were recorded in Part D on the proposed reforms in the Mainland's recognition regime vis-à-vis Hong Kong requests,[78] Part E on Hong Kong's future position contained only 1 paragraph.[79] The paragraph nonetheless fleshed out two crucial propositions: that firstly, the existing common law mechanism of recognition should be continued; and secondly, the

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72 ibid paras 13-14.
73 Though the specific problems in relation to Article 5(1) was not considered.
74 DOJ (n 3) para 17.
75 ibid para 19, original emphasis.
76 ibid para 22.
77 ibid para 23.
78 ibid paras 25-33.
79 ibid para 34.

existing framework 'offers less certainty and stability' given the evolving nature of the common law.[80]

The effect of the proposal, it appears, is that there would be a parallel common law and statutory regime in operation at the same time, upon the domestic rectification of the arrangement. That, indeed, is a proposal to be welcomed, because the preservation of the common law route of recognition enables the desirable flexibility for future litigants and judges alike in coping with unforeseeable future developments. This is much like the preservation of the common law derivative action by virtue of section 168BC(4) of the predecessor Companies Ordinance (Cap 32), which subsequently enabled the landmark *Waddington v Thomas Chan* decision,[81] as the Court of Final Appeal marked itself as the first common law court to recognise a multiple derivative action in company disputes.[82] In fact, it is not uncommon for common law jurisdictions to have multiple recognition and assistance regimes operating in parallel: liquidators seeking recognition or assistance in England and Wales, for example, had historically four possible routes in pursuing the same.[83]

Besides, insofar as the codification exercise (without replacing the current *CEFC* machinery) aims for a long-term entrenchment of the recognition regime with Mainland China, such a development is rightly undertaken by the executive and legislative branches of the Hong Kong government. The merits (and demerits) of reciprocal recognition of Hong Kong

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80 ibid.

81 *Waddington Ltd v Chan Chun Hoo Thomas* [2008] HKCFA 63, (2008) 11 HKCFAR 370 [55] (Lord Millett NPJ).

82 The abolishment of the common law derivative action in other common law jurisdictions such as the UK, on the other hand, meant that a statutory amendment must be enacted in permitting a multiple derivative action. For the UK, see Part 11 of the Companies Act 2016.

83 Respectively, through (1) the EU Regulation on Insolvency Proceedings (Insolvency Regulation), (2) the Cross-Border Insolvency Regulations 2006, implementing the UNCITRAL Model Law on Cross-Border Insolvency, (3) under section 426 of the Insolvency Act 1986, and (4) under the common law. Since 31 January 2021 (when the UK formally withdrew from the European Union), the EU Insolvency Regulation no longer applied to the UK, but the regime is supplemented by the Insolvency (Amendment) (EU Exit) Regulations 2019 (as amended by the Insolvency (Amendment) (EU Exit) Regulations 2020) which laid down tests broadly consistent with the EU Insolvency Regulation.

insolvencies and Mainland bankruptcies are, after all, public policy; and whereupon the administration saw fit for the current developments to transcend the changes in common law trends, such is best achieved by legislation. Indeed, it is the intended closer integration between the two legal and economic jurisdictions that called for the present consultation exercise. As Professor Shi accurately warns, a recognition order should never be approached by Mainland administrators 'as of right', at least when common law principles are to be applied,[84] because the applicant PRC administrators must show 'necessity' of the powers sought, which thereupon tasks the judge with an examination of the proximity between the extraterritorial proceedings and the assisting jurisdiction, ie Hong Kong.[85] The administration is certainly entitled to take the view that more robust assistance mechanism should be made available – but if that is intended, the progression of the law is best left to legislation, which in turn requires close consultation between the Mainland and Hong Kong authorities.

A problem with the June 22 Paper, though, lies with the ostensible intention of the administrations to secure an arrangement that is apt in covering rescue proceedings. In paragraph 19, for example, the Paper referred to the 'facilitation of the rescue of financially troubled businesses'; while in paragraph 22, the Paper manifested the wish of the government to 'where appropriate, facilitate the successful restructuring or rescue of the debtor company'. Owing to the brief nature of the document, it is unclear the extent to which the Hong Kong government intended the courts to grant powers to PRC administrators in facilitation of their rescue procedures. So far as PRC law is concerned, Chapter 8 of the EBL 2006 provides for a mechanism for which a reorganisation procedure may be initiated for a company incorporated in the Mainland, as under Article 101 the administrator can submit draft reorganisation plans, while they may also exercise managerial powers without having to report to the court. The bankruptcy committee also has little powers in sanctioning these acts of the state-appointed administrators.[86]

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84 Shi (n 30) 174.

85 Yue, Tang and Wang (n 66).

86 For a detailed analysis of the PRC corporate reorganisation scheme, see Rebecca Parry and Haizheng Zhang, 'China's New Corporate Rescue

To require Hong Kong courts to sanction these rescue powers is quite a different matter. Not only that the current Hong Kong insolvency regime has little to offer in enabling rescue proceedings,[87] recent development has indicated Hong Kong court's scepticism in even recognising or assisting soft-touch foreign provisional liquidators in 'facilitating' the insolvent foreign company's restructuring of debts, with Harris J placing paramount emphasis on the interests of Hong Kong creditors.[88] The legislature is most certainly entitled to so empower the judges in sanctioning reorganisation schemes and granting according assistance powers to the Mainland administrators, but the consequence of a drastic step as such at this stage, without a corresponding Hong Kong experience in working on the same, is that judges will henceforth be tasked with an unfamiliar duty. The Privy Council advice in *Singularis* offered a lively debate on the position of the common law in this respect, as the Board found only on a 3-2 majority that assistance powers under the principle of modified universalism enabled judges to go so far as to provide assistance to foreign liquidators so long as there is ***some*** legal basis in the assisting forum, whether by statutory basis, or by an 'inherent power' that the court possessed. Lord Mance and Lord Neuberger, on the other hand, gave powerful dissents in this regard, as the opening up of the 'inherent power' route were to allow common law courts to 'introduce' new principles and procedures, of which judges are inapt in assessing the wider implications of their actions.[89] This rationale, it is submitted, applies equally to a statutory regime that enables judicial inventions; and if indeed rescue proceedings are to be included in the later arrangement, the proposal would be opening up judicial powers in a much broader scale than that allowed by Lord Sumption's more generous approach. The upshot is that the

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Laws Perspectives and Principles' (2008) 8(1) Journal of Corporate Law Studies 113, 34.

87 Note, however, that the Hong Kong government has recently announced its intention to relaunch the Companies (Corporate Rescue) Bill into the Legislative Council in 2021. See Legislative Council Panel on Financial Affairs, 'Legislative Proposals of the Companies (Corporate Rescue) Bill', LC Paper No. CB(1)48/20-21(03) (2 November 2020) para 13.

88 See, as a recent test case, *Re China Bozza Development Holdings Ltd* [2021] HKCFI 1235, [2021] 4 HKC 560. See also Ho (n 34).

89 *Singularis* (n 36) [156]-[162] (Lord Neuberger).

companies court of Hong Kong lacked the experience in sanctioning rescue proceedings, and to bestow upon the judges the right to umpire such a procedure at this stage, ie before Hong Kong adopts a similar regime, is either to enable judicial rubber-chopping of applications from the Mainland, or to place them in uncharted waters. Neither of which appearing to be desirable, it is submitted that rescues are best left for another opportunity.

Another problem, of course, is the lack of address towards the Article 5(1) issue in the June 22 Paper. As shall be seen, the same is not tackled as well in the pilot scheme under the Record of Meeting; and it is submitted that such is an issue that must be dealt with when a PRC-wide framework is established, and when the new Arrangement is confirmed in the near future.

B. The Pilot Scheme under the Record of Meeting

While containing only five paragraphs, the Record of Meeting represented the latest breakthrough in the Mainland-Hong Kong cross-border insolvency regime. The Preamble sets out the background of the development, as the four objectives of the scheme were stated to be (1) to thoroughly implement Article 95 of the Basic Law, which refers to the maintenance of juridical relations between PRC and Hong Kong courts, (2) to 'further improve the mechanism for judicial assistance' between the two jurisdictions, (3) to 'facilitate economic integration and development', and (4) to 'optimise business environment underpinned by the rule of law'.[90] Most importantly to the present discussion, paragraph 1 empowers designated Intermediate People's Courts, the second-tier court under the PRC system, in the 'pilot areas' to initiate cooperation with Hong Kong courts; while paragraph 3 further empowers administrators in Mainland bankruptcy proceedings to apply for recognition of and assistance for 'bankruptcy liquidation, reorganisation and compromise proceedings under [EBL 2006]' in the High Court. It is also clear that Hong Kong would retain control over the recognition and assistance process, as paragraph 4 specifies that the relevant procedures will be governed by Hong Kong law, while paragraph 5 referred to a 'practical guide' issued by the DOJ in the relevant

[90] Record of Meeting (n 5), Preamble.

proceedings, with the SPC issuing a 'guiding opinion' (SPC Opinion) on the parallel proceedings in the Mainland.

And in marked contrast with the DOJ's Practical Guide, which contained little other than procedural guides and templates on court documents, the SPC Opinion is in all respects revolutionary in Mainland's cross-border enterprise bankruptcy regime.[91] Focusing again on the relevant aspects on Hong Kong's recognition of Mainland bankruptcies, paragraph 2 defines 'Hong Kong Insolvency Proceedings' as the collective insolvency proceedings commenced under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) and the Companies Ordinance (Cap 622), while paragraph 4(1) makes explicit that the SPC Opinion applies to Hong Kong Insolvency Proceedings. Most significantly, paragraphs 4(3) and 5(1) provide that if the debtor's principal assets in the Mainland are in a pilot area, or it has a place of business or a representative office in a pilot area, the Hong Kong liquidator may apply for recognition of and assistance to the Hong Kong Insolvency Proceedings under the SPC Opinion, provided that the debtor has Hong Kong as its 'centre of main interests'. One would immediately recognise that this supplied for the legal lacuna manifested under Article 5(2) of the EBL 2006, as made apparent in *Norstar Automobile*.

What of the Article 5(1) issue, which remained as the most significant gap in the Mainland-Hong Kong insolvency regime? In this regard, the SPC Opinion has understandably given away little, as the Opinion was targeted mainly towards addressing the recognition regime in the Mainland pilot courts. Indirectly relevant there is paragraph 19, which required the insolvency practitioners in the two jurisdictions to 'strengthen their communication and cooperation' where separate insolvency proceedings have been commenced across the border; while paragraph 24 required the pilot courts to 'actively communicate and take forward cooperation' with the Hong Kong courts'. But neither was sufficient in suppling explicit certainty to that end; and

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91 The scope of this article meant that the wider implications of the Record of Meeting over the Mainland's cross-border bankruptcy regime were not fully explored. For example, the adoption of 'centre of main interests' as the basis for determination of primary jurisdiction of the insolvency proceedings is an unprecedented move in the PRC. See Ho (n 34).

while one may argue that paragraphs 4(3) and 5(1) supplied the necessary assurance to the Article 5(1) controversy, interests of legal and business certainty meant that an express confirmation would be very much welcomed. The aim, of course, is to ensure that subsequent recognitions and assistances sanctioned by the companies court are solid in their fundamental legal basis, and hence it is hoped that the upcoming Arrangement would either obtain an official declaration from the PRC, to the effect that a PRC enterprise bankruptcy is apt to cover properties situated in Hong Kong; or that the necessary amendments to the PRC legislations could be effected, so as to fill the historical lacuna that is lingering upon the EBL regime.

CONCLUSION

While the pragmatism of the Hong Kong companies court has triggered momentous development in the Mainland-Hong Kong cross-border insolvency regime, it will perhaps be a consensus that pragmatism alone is insufficient in laying the groundwork for this very important area of law which overlays business transactions amongst the two legal jurisdictions. Therefore, while the reactions to *CEFC* have been predominantly positive, the PRC and Hong Kong authorities should be commended in responding to the decades-long challenge and to finally work towards an Arrangement for the recognition and assistance of insolvency proceedings between the two judiciaries. The June 22 Paper and the Record of Meeting were thus good foundations for the further negotiations towards the ultimate Arrangement. The upcoming negotiations, nevertheless, is high time for the practical implications of the unresolved legal issues to be explored, so as to achieve the government's stated objectives of providing certainty and predictability to cross-border businesses and insolvency practitioners. To be practical means as well to be realistic. Hence, given the complicated nature of the very issues that are in consideration, it is submitted that the first Arrangement on cross-border insolvency is best to be kept modest. To incorporate into the new statutory regime recognition powers of PRC rescues is to potentially inject too much uncertainty into the present insolvency regime in Hong Kong. That risk compromises the ability of Hong

Kong judges in discharging their duties in the excellent fashion as they have demonstrated throughout the years.

THE COMPATIBILITY OF HONG KONG PRIVACY LAWS WITH CONCEPTS OF ARTIFICIAL INTELLIGENCE

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This article investigates whether the present privacy laws, as contained in the Personal Data (Privacy) Ordinance (Cap 486) in Hong Kong are compatible with the development of AI. Further, it seeks to explore the legal struggle between protection of data privacy and the need for Big Data in the development of AI. This struggle is embodied across different aspects of AI: First, it will be shown how the present legal framework presents a Jenga conundrum to the development of AI, in that the removal of small data packets may jeapardise entire AI systems. Secondly, it will be argued that present privacy laws are not sufficient in regulating methods of data anonymization for AI systems. Thirdly, AI's latent defects will be exposed when discussing its applications to algorithmic surveillance. This article also proposes changes to the PDPO to allow room for AI to thrive. The importance of future AI-specific legislation will be highlighted as issues such as anonymity rules, strict liability with regards to AI products, and principles of control have yet to be entrenched as law.

INTRODUCTION

When the first wave of the Industrial Revolution hit the world, many relished in this new form of civilisation as it presented limitless opportunities. The steam engine and mass assembly lines

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became synonymous with progress to a utopian society. Now, we are amidst a technological revolution where there is an upheaval of societal norms raising unforeseen ethical quandaries. The notion of machines rising to power and forging a digital civilisation no longer seems like a castle in the air: would we be able to govern artificial intelligence (AI) or would AI govern us?

This article will investigate whether the present privacy laws, as contained in the Personal Data (Privacy) Ordinance (Cap 486) (PDPO) in Hong Kong are compatible with the development of AI. Part II of this article aims to explore the legal struggle between protection of data privacy and the need for Big Data in the development of AI. This struggle is embodied across different aspects of AI, and these will be examined in turn: First, it will be shown how the present legal framework presents a *Jenga* conundrum to the development of AI, in that the removal of small data packets may jeopardise entire AI systems. Secondly, it will be argued that present privacy laws are not sufficient in regulating methods of data anonymisation for AI systems. Thirdly, AI's latent defects will be exposed when discussing its applications to algorithmic surveillance.

Part III of this article will propose changes to the PDPO to allow room for AI to thrive. The importance of future AI-specific legislation will be highlighted as issues such as anonymity rules, strict liability with regards to AI products, and principles of control have yet to be entrenched as law.

I. Scope of AI

As AI becomes the new buzzword in spearheading the technological revolution, what it actually entails seems to be muddled with ideas of a mass upheaval of the status quo as popularised by science fiction. To put it simply, AI refers to 'a system that can learn how to learn'.[1] Learning is achieved through one of two ways: machine learning and pattern learning; the former functions by utilising algorithms to collect, process and

[1] Francesco Corea, *Artificial Intelligence and Exponential Technologies: Business Models Evolution and New Investment Opportunities* (Springer International Publishing 2017) 2.

adapt to data from the real world.[2] Pattern learning identifies regularities in data and automates the process of recognising trends for statistical analysis. Evidently, the effectiveness of both hinge on the collection of big data, a process that generates 'high-volume, high-velocity and high-variety information assets'.[3] This posits a strong positive correlation between the amount of big data available and the quality of machine learning. It would then be the expectation that AI could generate new models to accurately map out data inputs and transform them into meaningful outputs. As the growth rate of data available becomes exponential, so would the improvement in AI's sophistication.

With such an automated pathway, it sets a difficult conundrum for legal professionals to identify the various gears in the machine and pinpoint regulatory risks.

Optimists would point to AI's harmlessness in its applications in gaming, translation, retail advertising and more through 'deep learning', a term coined by Igor Aizenberg in 2000, as a subsect of machine learning.[4] Deep learning delves into the mechanism that governs AI, and often entails 'an agent, action and reward.'[5] The agent, usually in the form of a robot or machine, interacts with its environment to observe a specific activity to respond to, with the hope of producing a beneficial reward. Through adhering to what was inputted, it engages in a series of trials and errors to maximise a cumulative reward. This bodes well with gaming, as was the case with DeepMind's AlphaGo, where it utilised deep learning to play Go (a form of chess) and was able to beat the incumbent world champion in 2016.[6] OpenAI furthered this by engineering a robot arm (the aforementioned 'agent') that

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2 Jordan Novet, 'Everyone Keeps Talking about AI - Here's What It Really Is and Why It's so Hot Now' (*CNBC*, 23 June 2017) <www.cnbc.com/2017/06/17/what-is-artificial-intelligence.html> accessed 10 May 2020.

3 Gartner Corporation, 'Big Data' (*Gartner Glossary*) <www.gartner.com/en/information-technology/glossary/big-data> accessed 9 June 2020.

4 Iman Vanani and Morteza Amirhosseini, *Deep Learning for Opinion Mining* (IGI Global 2019) 40.

5 Tom Taulli, 'Reinforcement Learning: The Next Big Thing For AI (Artificial Intelligence)?' (*Forbes,* 5 June 2020) <www.forbes.com/sites/tomtaulli/2020/06/05/reinforcement-learning-the-next-big-thing-for-ai-artificial-intelligence/#2dd4460662ba> accessed 15 May 2020.

6 ibid.

could untangle a Rubik's cube.[7] Intuitively, one would ponder about more intrusive AI uses, one akin to a machine so powerful that its decisions could jeopardise a person's livelihood. AtomNet, a deep learning system for structured-based rational drug designs[8], exemplifies this worry since it is used to predict novel candidate biomolecules to target diseases such as Ebola and multiple sclerosis.[9]

II. Discord

This part relates to the tension and incompatibility between privacy laws and the development of AI. Stemming from the process of data collection, this part will further expose the problems with data anonymisation and fallacies in AI with its role in surveillance.

A. Prohibitive Privacy Laws and AI: The *Jenga* Conundrum

A key element in AI is the usage of massive amounts of data, within a neural network. This means that where personal data is involved, it may be used over and over again in successive processes of the AI's algorithm. An example of this is the game Pokémon Go that was launched in 2016. It was aimed at providing players with an augmented reality to engage with the platform's virtual characters. Data such as where the players are going, their surrounding environment and their movements, are tracked and processed under the guise of enhancing the game's interactivity. At the same time, business corporations flocked to grasp the

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7 ibid.

8 Izhar Wallach, Michael Dzamba Heifets and Abraham Heifets, 'AtomNet: A Deep Convolutional Neural Network for Bioactivity Prediction in Structure-based Drug Discovery' (2015) arXiv: 1510.02855.

9 Caleb Garling, 'Startup Harnesses Supercomputers to Seek Cures' (*KQED,* 27 May 2015) <www.kqed.org/futureofyou/3461/startup-harnesses-supercomputers-to-seek-cures accessed> accessed 15 May 2020.

opportunity to gather a plethora of new consumer data, transforming performative data into a business goldmine.[10]

This presents two key issues. First, where a data subject revokes his consent for the AI system to use his data, there is potential for a substantial proportion of an AI system to be paralysed. This is so because, by nature of neural networks in deep learning, stopping the usage of small datasets will necessitate the halting of a large proportion of the entire system. Secondly, as an AI system continues to learn, the purpose of successive processing of one's personal data may become different from the original purpose of data collection. Again, if no consent was sought for the new purpose, the successive processes of the AI may be rendered unusable and illegal.

These two issues expose a *Jenga* conundrum. It shows that where the law prohibits an AI system to continue to use a small packet of information, the whole system could be in danger of collapsing.

1. The Law On Consent

Under Data Protection Principles (DPPs) 1 and 3 of the PDPO, consent is not a pre-requisite for collecting personal data, unless it is for a new purpose. DPP 1 requires the collection of personal data to be adequate and not excessive, and the taking of practicable steps to inform a data subject to the collection of data. In gist, it ensures that there is a right to exercise consent and to opt out from having one's personal data being processed.

This contrasts with the position of the General Data Protection Regulation of the EU (GDPR), where art 4(11) provides that consent of the data means 'any…informed and unambiguous indication of the data subject's wishes by which he or she … signifies agreement to the processing of personal'.[11] This is symbolic of an opt-in approach.

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10 Aphra Kerr, Marguerite Barry and John Kelleher, 'Expectations of Artificial Intelligence and the Performativity of Ethics: Implications for Communication Governance' (2020) Big Data & Society 1.

11 General Data Protection Regulation 2016 (GDPR), art 4(11).

For these provisions, the right to withdraw consent can be exercised at any time.[12]

2. THE LAW ON 'NEW PURPOSE'

DPP 3 of the PDPO requires prescribed consent if personal data collected was to be used for a new purpose. Under s 3(4) of Schedule 1:

> 'a new purpose, in relation to the use of personal data, means any purpose other than—
> (a) the purpose for which the data was to be used at the time of the collection of the data; or
> (b) a purpose directly related to the purpose referred to in paragraph (a)'

In furtherance to these generalities, the HKCFI has held obiter that it is legitimate to have regard to the '*reasonable expectations of the data subject*' when assessing original purposes of data collection and new purposes.[13] In *Ng Shek Wai v Medical Council of Hong Kong*, the same court ruled that the data subject should reasonably expect that names of counsel in a public hearing (eg the Medical Council in the present case) will be released, should the public enquire about it.[14] No new purpose was found. This *'reasonableness'* test was further applied in *David M Webb v Privacy Commissioner for Personal Data*[15] to state that DPP 3 is also applicable to personal data published in the public domain, which in this case referred to hyperlinks leading to judgments in the Legal Reference Systems. The PCPD, in their submissions, reinforced that the legislative intention behind DPP 3 was not to exempt public domain data but to direct against the misuse of personal data.[16]

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12 GDPR, art 7. See also the Personal Data (Privacy) Ordinance 1995 (PDPO), s 2(3) where consent does not include any consent which has been withdrawn by notice in writing served on the person to whom the consent has been given.

13 *Ng Shek Wai v Medical Council of Hong Kong* [2015] HKCFI 244, [2015] 2 HKLRD 121 [52] (G Lam J).

14 ibid.

15 [2014] AAB 54 [7], [38].

16 Cindy Chan, 'Learning from the Administrative Board's Decisions' (*Data Protection Officers' Club under PCPD*, 7 December 2016)

In *Wing Lung Bank Ltd v Privacy Commissioner for Personal Data*,[17] a data subject consented to the Bank using her personal data for promotional materials to be sent to her.[18] On the basis of this consent, the Bank allowed a third-party insurance company to call the data subject to promote insurance products.[19] The insurance company called under the disguise of representing the Bank, but notwithstanding this, the Commissioner found that promotion by a different service provider was in fact a new purpose (ie 'not the original purpose').[20] Evidently, the PDPO merely sets out a general rule insofar as the new purpose would highly depend on the circumstances and parties involved. It could be seen to have a paternalistic attitude towards data subjects as they are often lay people who lack the foresight of data exploitation.

3. THE JENGA CONUNDRUM

The legal parameters of consent and 'new purposes' will become prohibitive to the development of AI, due to the nature of machine learning from neural networks. Assume that a data user, for example a creator of an AI system, collects personal data to build a model that predicts changes in artistic styles between a community of artists. This AI system collects the images of an artist's creation and collates it with personality traits, psychological behaviours, and choices of aesthetics. Through deep learning, it continuously builds on every artists' collated data to develop its algorithm. Suppose that this AI system can now predict what potential creations would look like from each artist, what would happen if one or more data subjects withdraw consent for the use of their personal data?

It has been argued that while the efforts of machine learning prior to the withdrawal of consent will still be valid, any subsequent learning would need to be halted. This is due to the

<www.pcpd.org.hk/misc/dpoc/files/Learning_from_AABs_Decisions.pdf> accessed 10 October 2021

17 [2010] 6 HKC 266.

18 ibid [4].

19 ibid [10]-[11].

20 ibid [38].

fact that the matrix of information has become so intertwined within the neural network of the AI, that a very substantial amount of computing will invariably have 'processed' the data set that is now non-consensual.[21]

This is detrimental to any further meaningful developments of AI, as machine learning cannot be facilitated without re-computing the AI system again with the non-consensual dataset removed. Furthermore, it has been noted that in some circumstances, a deletion of particular datasets may cause damage to the AI system's integrity.[22] There is an immense risk of a *Jenga*-esque collapse to the entire system.

Going back to the aforementioned AI artist-prediction system, it creates a risk that its future predictions will be impaired, and no future refinements can be done. Another example that was raised by the Centre for Data Innovation (US) was how AI systems used for evaluating credit risks may be undermined by partial removal of personal datasets, with real world ramifications such as customers having unfair credit ratings assigned to them by AI.[23] This materialised in the Chinese social credit system where although there are 'limited legal restraints on the government's collection and use … of data',[24] Chinese data protection laws on consent largely conflicts with the functions of the nationwide state-held financial credit information system.[25] This is due to the conflict between the possibility of withdrawing consent and the purpose of a public credit registry, which is to reduce risks to financial institutions. Thus, a phenomenon of 'over-reliance on consent'[26] occurs as countries and companies deem consent as the

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21 Matthew Humerick, 'Taking AI Personally: How The E.U. Must Learn to Balance The Interests Of Personal Data Privacy & Artificial Intelligence' (2018) 34 Santa Clara High Technology Law Journal 393, 407.

22 ibid 408.

23 Nick Wallace and Daniel Castro, 'The Impact of the EU's New Data Protection Regulation on AI' (*Centre for Data Innovation*, 27 March 2018) 13 <www2.datainnovation.org/2018-impact-gdpr-ai.pdf> accessed 10 October 2021

24 Yujie Chen, Chingfu Lin and Hanwei Liu, 'Rule of Trust: The Power and Perils of China's Social Credit Megaproject' (2018) 32 Columbia Journal of Asia Law 1, 27.

25 Lu Yu and Bjorn Ahl, 'China's Evolving Data Protection Law and The Financial Credit Information System: Court Practice and Suggestions for Legislative Reform' 51 HKLJ 287, 297.

26 ibid 5.

ideal legal basis in collecting data. In reality, scholars have criticised consent rules in the status quo for 'lacking clarity' and 'using … standard terms to acquire consent, which ultimately renders consent an empty shell'.[27]

On a similar vein, the 'new purpose' formulation in the PDPO poses a significant threat to automation of existing services with the aid of AI.

The present parameters of a 'new purposes' create a large barrier against the innovation of AI as new consent will be needed for any uses that differ from the original purpose. This means that companies cannot find serendipitous uses for data, *even when there are no privacy implications in doing so*. As a corollary, the cost and efficiency of developing AI systems will be significantly heightened if an organisation has to implement new systems of AI for data with existing consent – as new consent will need to be sought for the sole purpose of automation.

It is difficult to see or predict whether the Commissioner, under the PDPO, will allow 'automation of data' or 'input of data into a novel AI system' to be within the *Ng Shek Wai* formulation of 'reasonable expectation' of data use. It is also unclear whether automation of data for the same purpose will fall under 'reasonable expectations'. The formulation of a 'new purpose' under the PDPO may therefore lead to the risk of entire AI automated systems being in breach of the ordinance.

The Royal Free Hospital (the Hospital) example[28] from the UK shows how a prohibition on non-consensual repurposing of data may lead to a *Jenga*-esque collapse of an AI system. In 2017, the Hospital used personal data from 1.6 million patient records for a medical AI system (ran by Google's DeepMind) used for the advanced prediction of kidney injuries. The legal purpose for the initial collection of data was for the purpose of *inter alia*

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27 ibid citing Qing Lu, 'Research on the Normative Construction of 'Consent' Rules in Personal Information Protection' (2019) 5 Wuhan daxue xuebao (Journal of Wuhan University) 119, 128.

28 See generally, Elizabeth Denham, 'RFA0627721 – provisions of patient data to DeepMind' *(Information Commissioner's Office (UK)*, 3 July 2017) <ico.org.uk/media/2014353/undertaking-cover-letter-revised-04072017-to-first-person.pdf> accessed 10 October 2021.

'direct care'. However, the Information Commissioner's Office (UK) found that the input of data into the AI for automation purposes did not satisfy data protection principle one of the Act as it 'significantly differ[ed] from what data subjects might reasonably have expected to happen to their data'.[29] New consent was required to be sought from the 1.6 million patients, which led to a *de facto* collapse of the entire system, as high costs and substantial time delays were incurred.

As Hong Kong organisations move towards data automation in different sectors, not least in medicine,[30] this is a significant challenge that may prejudice imprudent data users. The present laws must require further facilitation.

These examples of AI systems running the risk of substantial failure in the face of repurposing or consent withdrawals show that the law leaves room for a *Jenga* conundrum vis-à-vis AI where small obstacles may lead to a catastrophic collapse of the entire system.

B. REGULATING DATA ANONYMISATION

At present, the PDPO only extends to govern the use of personal data. As the data that are used to feed into AI's algorithms are often highly personal, AI developers have curated data anonymisation methods to protect users' privacy and to prevent a significant loss in data due to restrictions.

This article argues that current methods of data anonymisation are inadequate in rendering information as impersonal, as the identity of a person could still largely be *indirectly* ascertained. Tension thus arises between the law and

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29 ibid para 5.

30 The University of Hong Kong (HKU), 'HKU Medical AI Laboratory Programme employs AI as new testing ground for more optimal and efficient clinical practice of eye diseases' (*HKU*, June 10 2019) <www.hku.hk/press/news_detail_19593.html> accessed 14 March 2021. It is also interesting to note the exemption on health related data as provided under PDPO s 59, and whether such a case of automation akin to the Royal Free Hospital case in Hong Kong would be an 'application of … [data protection] provisions [that] would be likely to cause serious harm to the physical or mental health of the data subject' to merit exemption.

anonymisation methods which will materialise into another barrier in creating a symbiotic legal environment for AI development to thrive.

1. THE LAW

Personal data, as defined in s 2(1) PDPO, means any data

> '(a) relating directly or indirectly to a living individual;(b) from which it is practicable for the identity of the individual to be directly or indirectly ascertained; and (c) in a form in which access to or processing of the data is practicable'.

The provisions set out under s 2(1) are incredibly vague, as the parameters to which an individual could be identified from a dataset are not set out. The term 'personal' is thrown as a blanket label without regard to different degrees of personal data such as 'sensitive' personal data being regulated differently, which was the line taken by the GDPR.[31] Further, there is no indication as to the form personal data could take, creating ambiguity as to whether s 2(1) extends to non-verbal utterances or CCTV recordings.

This was somewhat improved by consolidations in various Hong Kong judgments, such as in *Eastweek Publisher Ltd v Privacy Commissioner for Personal Data* [32] where the Court of Appeal held that a photograph of a person is personal data as it 'contains some of the most accurate information of the person'.[33] In the Court's view, as the photograph depicts a data subject and 'satisfies the three requirements under s 2(1)', it is deemed as 'personal data'.[34] In another case before the Privacy Commissioner, internet cookies (ie data package containing web-browsing data) were found to be personal data as, inferring from

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31 GDPR OJ L119/1, where it separates 7 categories which are identified as 'sensitive' personal data.

32 [2000] HKCA 442, [2000] 2 HKLRD 83, 25-26.

33 ibid 99J (Wong JA).

34 ibid 100B (Wong JA).

the facts of the case, it could be used to uniquely identify the individual as it contained the complainant's English name.[35]

Conversely, in the case of *Shi Tao v Privacy Commissioner for Personal Data*,[36] the Administrative Appeals Board held that an IP address in the circumstances did not constitute as personal data. From the facts, the IP address only 'disclosed that the email was sent from a computer located at the address of a business entity, and the data and time of the transaction'.[37] As a result, the decision was based on the IP address's inability to uniquely identify the actual person who sent the email from the IP address.

It is argued that even with the consolidated test of whether an individual could be *directly* identified, s 2(1) is still insufficient in clearly outlining the legal restraints of data collection. The mentioned cases show that the PDPO functions on a case-by-case basis rather than serving as a definitive guide to the categories of data deemed as 'personal'. This is exacerbated by the lack of statutory and criminal investigation power of the PCPD, as noted by the present Commissioner, Chung, in requesting the removal of materials infringing on individuals' privacy online.[38] Thus, the goal of maximising data protection of individuals may be undermined without further facilitations.

Another aspect where the provisions in s 2(1) are argued to be vague is the lack of guidance in how ordinary meaning of the words should be interpreted in context. This was articulated by the Privacy Commission that relying on the 'ordinary' [39] meaning of

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35 Office of the Privacy Commissioner for Personal Data (PCPD), 'Employee complained her employer logged in her computer collecting cookies without notifying her' (*PCPD Case Notes*, September 2010) 2 <www.pcpd.org.hk/english/enforcement/case_notes/casenotes_2.php?id=2006C14>.

36 [2008] 3 HKLRD 332.

37 ibid [67].

38 Thomson Reuters, 'Face to Face with Ada Chung Lai-ling' (2021) 3 Hong Kong Lawyer 12, 16, where Chung noted that '[t]he handling of the complaints also highlighted the lack of criminal investigation power and lack of prosecution power the PCPD holds, which meant that over 1,400 cases were referred to the police for their investigation and consideration for prosecution'.

39 Office of the Privacy Commissioner for Personal Data (Hong Kong), 'Data Protection Principles in the Personal Data (Privacy) Ordinance – from the Privacy Commissioner's perspective (2nd edn) (2010) [2.7]

the words provided may 'give rise to difficulty in application of paragraph (a) such as the word *relatedness* being capable of having a range of definitions varying by different degrees'.[40]

This question of *relatedness* has been considered in UK courts. In *Durant v Financial Services Authority*[41] it was held that information which was significantly biographical and focused on the individual constituted as personal data. Whilst this has been adopted in interpreting the Data Protection Act 1998 by the UK privacy authority, Hong Kong judges have moved away from relying on principles used in English courts. In *Wu Kit Ping v Administrative Appeals Board*,[42] it was conceded further that even when data would be related directly to an individual, concerns may arise as such a relationship could be so 'trivial that it would appear strange'[43] to attribute liability under the PDPO. Consequently, both fundamental interpretation and practical issues arise from the lack of clarity of s 2(1).

2. Problems With Data Anonymisation

Data anonymisation refers to 'personal data being rendered anonymous in such a manner that the data subject is not or no longer identifiable',[44] and may be done through de-identification and pseudonymisation. AI complicates this as all its datasets are high-dimensional, increasing the interconnectedness of each data point.

Two questions arise regarding the process of data anonymisation: whether it succeeds in protecting user privacy and if not, how the PDPO could be improved to regulate data collection.

De-identification is the process of separating personally identifiable information and the user's identity. One example is

<www.pcpd.org.hk/english/publications/files/Perspective_2nd.pdf> accessed 18 June 2021.

40 ibid.

41 [2003] EWCA Civ 1746, [2004] FSR 28.

42 [2007] HKCFI 1104, [2007] 4 HKLRD 849.

43 *Data Protection Principles* (n 38) [2.12].

44 GDPR, Recital 26.

the k-anonymity model, where a dataset is said to be k-anonymous if no combination of user attributes is shared by fewer than *k* individuals.[45] It follows a general principle of generalising data then deleting raw and identifiable bits, ostensibly solving the issue of being able to link the data to a single living individual. An issue with k-anonymity is in instances where data is incredibly high dimensional, there are few points that could be easily isolated. Consequently, it becomes difficult to anonymise the data without an unacceptably high amount of information loss.[46] The concept of uniqueness was also raised as a risk metric for measuring the re-identifiability of high-dimensional anonymous data. In a study based in the US, it showed that just 3 data points (ie gender, date of birth, and a 5-digit zip code) are sufficient to uniquely identify 87% of the population in the US.[47] This is alarming as it merely takes 4 batches of information regarding where and when a user was to reveal their entire location history.

Pseudonymisation replaces personally identifiable information fields (also known as "direct identifiers") within a database with artificial identifiers, or pseudonyms.[48] This process transforms personal data and these are aggregated to support AI machine learning. Latanya Sweeney's involvement with the US Supreme Court reviewing of the case of *IMS Health v Sorrell*[49] showed that 'widespread aggregation of medical information threatens individual patient privacy', where there was no independent review system for IMS' de-identification process nor

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45 Ashwin Machanavajjhala and others, 'L-Diversity: Privacy Beyond k-Anonymity' (2007) 1(1) ACM Transactions on Knowledge Discovery from Data, citing Pierangela Samarati, 'Protecting Respondents' Identities in Microdata Release' (2001) 13(6) IEEE Transactions on Knowledge Data Engineering.

46 Khaled Emam and Fida Dankar, 'Protecting Privacy Using k-Anonymity' (2008) 15(5) Journal of the American Medical Informatics Association, 627-637; Charu Aggarwal, 'On k-anonymity and the curse of dimensionality' (*IBMTJ Watson Research Centre*, 2 September 2005) <www.researchgate.net/publication/221311488_On_k-Anonymity_and_the_Curse_of_Dimensionality> accessed 20 May 2020, 901–909.

47 Machanavajjhala (n 47) citing Latanya Sweeney, 'k-anonymity: A model for protecting privacy' (2002) 10(5) International Journal of Uncertainty, Fuzziness, and Knowledge-Based Systems 557.

48 Wolfgang Kuchinke et al., 'A standardized graphic method for describing data privacy frameworks in primary care research using a flexible zone model' (2014) 83 International Journal of Medical Informatics, 941-957 at 945

49 564 US 552 (USSC 2011).

were there checks for vulnerabilities in data protection.[50] These factors combine to enable unauthorised re-identification of individuals via the Mosaic Effect. The Mosaic Effect occurs when a person is indirectly identifiable because information can be combined with other pieces of information, enabling the individual to be distinguished from others.

These offer disheartening examples of data anonymisation failing to protect user privacy that leaves it to be constituted as *personal data* under the PDPO. Present anonymisation methods are plainly insufficient to properly de-identify a person from his personal data. As such, many organisations which are contemplating the use of anonymisation methods for their AI systems may need to widen their collection of consent and detail clearly the potential purposes that the AI system may be used for.

Without the requisite consent, use of such personal data could be vulnerable to restrictions that would be highly detrimental to the development of AI machine learning, a facet of the *Jenga* conundrum outlined earlier in the essay.

C. PITFALLS IN AI'S ROLE IN ALGORITHMIC SURVEILLANCE

Algorithmic surveillance is 'in literal terms surveillance that makes use of automatic step-by-step instructions'.[51] In many instances, AI systems are used in algorithmic surveillance to engage masses of data in identifying threats to society. This ranges from the Hubble deep-space telescope (for incoming planets and deep-space exploration)[52] to the Primsmatica/Cromatica movement-recognition system for the London Underground (for monitoring flow of people and suicide rates near the platforms).[53]

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50 Adam Tanner, *Our Bodies, Our Data: How Companies Make Billions Selling Our Medical Records* (Beacon 2018), 91

51 Lucas D Introna and David Wood, 'Picturing Algorithmic Surveillance: The Politics of Facial Recognition Systems' (2004) 2 Surveillance & Society 177, 181.

52 ibid.

53 ibid.

AI's role in algorithmic surveillance is to effectively use machine learning to identify patterns in large data sets to predict activity. An example of this in a law enforcement context is a pilot project at Berlin-Südkreuz, which was launched by the German Government to detect acts of violence and individuals in distress.[54] It aimed to use facial recognition technologies on volunteers. By the end of the pilot project, the Government deemed the project to be a success, with an 80% accuracy of identifying participants, as well as general competency with detecting various criminal scenarios.[55]

This article argues that if AI and algorithmic surveillance technologies were to be applied in a criminal setting in Hong Kong, the present legal rules will be overtly prohibitive against any meaningful local development or application. In any event, the latent defects in AI and algorithmic surveillance makes it an unideal technology to be applied locally on a large scale.

1. THE LAW

Under the PDPO, ss 57 and 58 exempt the use of personal data by the Government for purposes of *inter alia* security, international relations, and the prevention of crime from applications of DPP 3, 6 and s 18(1)(b) respectively. s 58A exempts the use of personal data from the entire PDPO when such data is contained in protected product or relevant records under the Interception of Communications and Surveillance Ordinance (Cap 589) (ICSO).

It is at this juncture that we evaluate whether the law of covert surveillance in Hong Kong would allow the application of a system that is akin to the AI and algorithmic surveillance examples given above (ie in a criminal context).

Under the ICSO, it is likely that AI and algorithmic surveillance fall within the category of Type 1 surveillance.[56]

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54 Anna Verena Eireiner, 'Imminent dystopia? Media coverage of algorithmic surveillance at Berlin-Sudkreuz' (2020) 9(1) Internet Policy Review.

55 ibid.

56 It is likely that AI and algorithmic surveillances will come under 'data surveillance devices' hence not falling within the purview of Type 2

Where law enforcement agencies desire to conduct Type 1 surveillance, permission before a panel judge would be required.[57] In granting permission for Type 1 surveillances to be conducted, it has to be proved that there is a circumstance in which the same objective cannot be achieved by a Type 2 surveillance (less intrusive surveillance techniques using optical or listening devices), or search warrants and court orders.[58] The rationale behind this is to minimise intrusions to personal privacy.

Further and in addition to the above, ICSO s 3 provides that covert surveillance would only be allowed for preventing or detecting *serious* crime[59] or protecting public security. Moreover, there needs to be a reasonable suspicion that any person under surveillance has been involved in that particular serious crime. Lastly, the considerations of necessity and proportionality have to be taken into account vis-à-vis the intrusiveness of the covert surveillance (eg people who will be affected by said surveillance).

2. AI AND ALGORITHMIC SURVEILLANCE AND THE ICSO REGIME

It would be certainly surprising if any large scale AI and algorithmic surveillance for purposes of preventing serious crimes will be permitted under the aforementioned ICSO regime.

An AI and algorithmic surveillance system, by nature, would only be meaningful if applied to a very broad data sample. As alluded to by the former Director of the US National Security Agency, 'you need the haystack to find the needle'.[60] It is difficult

surveillance, which governs listening devices or optical surveillance devices. In any event, persons under large scale of algorithmic surveillances are unlikely to reasonably expect their words or activity to be heard or seen, thus outside of the provisions of Type 2 surveillance under ICSO s 2.

57 Interception of Communications and Surveillance Ordinance (Cap 589) 2006 (ICSO), s 8.

58 ICSO, s 3(c)(ii).

59 ICSO, s 2(1) defines serious crime to be an offence punishable by a maximum sentence of not less than 7 years' imprisonment.

60 Barton Gellman and Ashkan Soltani, 'NSA Collects Millions of E-mail Address Books Globally' *Washington Post* (Washington DC, 14 October 2013) <www.washingtonpost.com/world/national-security/nsa-collects-millions-of-e-mail-address-books-

to see how a substantial collection of data, which may very much contain a 'haystack' of people beyond suspicion, can be necessary and proportionate. This is especially so given the broad range of alternative options that law enforcement agencies already have for crime prevention (such as applications for warrants, search orders, and general police powers). Coupled with the immense level of intrusion for our citizen's privacy, and the potentially vast amount of people that do not attract reasonable suspicion, it would be unlikely that such surveillance would be proportionate.

The effects of unrestrained surveillance could be exacerbated with the recent 2019-20 social unrest as well as the application of the National Security Law (NSL), whereby the police is granted sweeping powers in the collection and usage of personal data.[61]

In the Code of Practice (CoP) pursuant to ICSO, it is said that 'advocacy, protest or dissent … unless likely to be carried on by violent means, is *not* of itself regarded as a threat to public security'.[62] Furthermore, it explicitly says that applications for authorisation *must* comply with the statement made by the Secretary for Security in 2006: that '*the powers under this [law] will not be used for investigation of criminal offences that are yet to be created under Art 23 of the Basic Law*'.[63]

With the NSL coming into play, it overrides the PDPO with reference to its Article 62 that mandated it shall prevail over the local laws where the provisions are inconsistent.[64] It becomes clear that the Government interpreted the statement made by the Secretary in 2006 to be cast aside for the prevailing of the NSL.

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globally/2013/10/14/8e58b5be-34f9-11e3-80c6-7e6dd8d22d8f_story.html> accessed 27 June 2021.

61 Yew Lun Tian, 'China law requires Hong Kong to enact national security rules as soon as possible' (*Reuters*, *22* May 2020) <www.reuters.com/article/us-china-parliament-hongkong-legislation-idUSKBN22Y0CG> accessed 16 July 2021.

62 Code of Practice Issued Pursuant to Section 63 of the Interception of Communications and Surveillance Ordinance (Cap 589) 2016, para 37.

63 ibid.

64 Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region 2020, art 65.

An example of this materialising can be found in the common workplace. Whilst it is standard practice for employers to collect data from their employees regarding their personal particulars, it is usually the case whereby the data would not be disclosed unless a warrant is presented under the effects of section 58 of the PDPO.[65] Under the Implementation Rules for Article 34 of the NSL, enforcement officers could make a request for the collection of a subject's data and employers are expected to cooperate even in the absence of a warrant.[66] This could include highly sensitive data such as one's bank details or home addresses which are usually deemed as personal data. Further, the lack of detail regarding whether the employee will be kept in the dark when employers have been requested to disclose their data raises concern as highly personal data could be given to a third party without the individual knowing. This suggests a lack of consent when employees aren't given the opportunity to object or seek independent legal advice. The balance between preserving one's privacy and aiding in the protection of national security becomes more tipped in favour of the latter as the Government is granted more powers in the surveillance of individuals or lobby groups.

As mentioned previously, AI and algorithmic surveillance fall within the category of Type 1 surveillances, which would typically require panel approval before its usage. Under the enactment of the NSL, it could potentially lead to a fall in scrutiny of the use of surveillance mechanisms the Government uses. As the Government approves of broader surveillance measures, the algorithms AI operates on would change accordingly to the level desired. As AI's knowledge and sophistication grows exponentially over time, a slippery slope could emerge with the privacy of people's lives being overly encroached.

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65 PDPO, s 58.

66 'National Security Law and employers' obligations to safeguard employee data' (*Dentons*, September 9 2020) <http://hongkong.dentons.com/en/insights/articles/2020/september/9/national-security-law-and-employers-obligations-to-safeguard-employee-data> accessed 26 August 2021.

3. PITFALLS OF AI AND ALGORITHMIC SURVEILLANCE IN GENERAL

In any event, there is a swathe of opinions that argue against the general application of AI and algorithmic surveillance. Most saliently, the technology doesn't seem to be ripe for vast application in a way that can ensure foreseeability and reliability. It has been shown that 'an inherent problem … is the base rate fallacy and the high likelihood of "false positives"'.[67] These may, in a criminal setting, lead to overtly unnecessary surveillance on the innocent and further exacerbates the disproportionality of this measure.

By the inherent nature of machine learning, the internalised surveillance algorithmic processes can even be 'opaque … to those who designed it'.[68] This alone caused academics to say that there is an 'unconquerable obstacle to the provision of foreseeability'.[69] When the creators themselves could hardly map out the mechanism or pathway of algorithmic processes, it is difficult to expect policy makers to understand the intricacies of AI's potential.

In sum, it is argued that the present laws in Hong Kong would prohibit any meaningful application of AI and algorithmic surveillance in a crime-prevention context.

III. PROPOSALS FOR THE PDPO TO ENHANCE INCLUSIVITY FOR AI

In view of the multifaceted discord between the present privacy laws in Hong Kong and the development of AI, this article

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67 Douwe Korff, 'Technologies for the Use of Images: Automated Processes of Identification, Behavioural Analysis and Risk Detection Control at the Airports' (seminar presentation at Spanish Data Protection Agency Seminar, Madrid, 9-11 June 2010). See also Bruce Schneier, 'Terrorists, Data Mining, and the Base Rate Fallacy' (*Schneier on Security,* July 10 2006) <www.schneier.com/blog/archives/2006/07/terrorists_data.html> accessed 5 September 2021.

68 ibid citing Maria Helen Murphy, 'Algorithmic surveillance: the collection conundrum' (2017) 31(2) International Review of Law, Computers & Technology 225, 230.

69 ibid.

contends that a symbiotic environment between the law and AI could be achieved if AI-specific provisions can be added to the PDPO.

The PDPO was often branded as a 'technology-neutral' and 'principle-based' creature[70] inspired by the somewhat antiquated 1980 OECD Privacy Guidelines and a 1994 Law Reform Commission Report titled 'Reform of the Law Relating to the Protection of Personal Data'.[71]

What is apparent from an examination of these documents is that no consideration was given to novel ideas such as 'big data' and 'artificial intelligence' – for the simple reason that such ideas were not prominent in the 90s. In a similar vein, the experts representing the European Commission[72] described that regimes 'designed with traditional … business models in mind' may be an 'inadequate match' for 'emerging digital technologies'.[73] In other words, the 'technology-neutral' element of the PDPO may, when applied to AI technologies, be analogous to '[fitting] a square archaic peg into the hexagonal hole of modernity'.[74]

This article proposes the following additions to the PDPO to facilitate a symbiotic legal landscape to the development of AI:

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70 Information Accountability Foundation and Privacy Commissioner for Personal Data, 'Ethical Accountability Framework for Hong Kong, China – A Report prepared for the Office of the Privacy Commissioner for Personal Data' (2018) <www.pcpd.org.hk/misc/files/Ethical_Accountability_Framework.pdf > 1.

71 ibid 18 n 63, which states that the 'PDPO [had] enacted six of the eight OECD fair information principles … in 1995'. See also Law Reform Commission of Hong Kong, 'Reform of the Law Relating to the Protection of Personal Data (Topic 27)' (1994).

72 These experts refer to the New Technologies Formation of the Expert Group on Liability and New Technologies, set up by the European Commission and convened in June 2018.

73 Expert Group on Liability and New Technologies – New Technologies Formation, 'Liability for Artificial Intelligence and other emerging digital technologies' (*European Commission*, 2019) <http://op.europa.eu/en/publication-detail/-/publication/1c5e30be-1197-11ea-8c1f-01aa75ed71a1/language-en> accessed 7 July 2021, 27-28.

74 *Crookes v Newton* [2011] SCC 47, [2011] 3 SCR 269 [38] (Supreme Court of Canada).

A. Attribution of Liability

Under the PDPO, a data user is a 'person' who 'controls the collection, holding, processing or use of the data'.[75] At present, algorithms and AI have not been given legal personality under Hong Kong laws. Therefore, when amending the PDPO to facilitate AI development, clear parameters have to be set to identify to whom liability is attributed to.

As laid down in the landmark Singaporean decision of *B2C2*,[76] common law is chiefly concerned with two strands of automated data processing insofar as liability is concerned. First, deterministic automation, ie where the automation produces 'the exact same output when provided with the same input; and secondly, autonomous artificial intelligence, which could 'be said to have a mind of its own'.[77]

Case law has shown that where automation is deterministic, liability is attributed to the programmer of the system. Deterministic automation, as said by the Singaporean Court, is like a kitchen blender – the output is the always same when provided with the same input. It has no mind of its own. In so suggesting, it held that where deterministic systems enter into automated contracts, it is the state of mind of the programmer which will be under scrutiny when evaluating liability.

Similarly, in *Yeung Sau Shing v Google*,[78] Deputy Judge Marlene Ng held that there is a good arguable case that Google will be liable, as a publisher, for AutoComplete results generated by an automated algorithmic process that collects data 'precisely as [the programmers] intended'.[79] The lack of human input in the collection process of data did not affect the fact that the system performed as intended by the programmers.

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75 PDPO, s 2.
76 *B2C2 Ltd v Quoine Pte Ltd* [2019] SGHC(I) 3.
77 ibid [185].
78 *Dr Yeung Sau Shing Albert v Google Inc* [2014] HKCFI 1404, [2014] 4 HKLRD 493.
79 ibid [98].

Privacy legislation in Hong Kong, therefore, should follow established case law to state clearly that where there is deterministic automation (be it 'AI' or not), programmers should be liable for the system's breach of the PDPO if the system had acted in a way that was intended by the programmers.

On the other hand, for an autonomous AI system that 'has a mind of its own', the attribution of liability may be inherently difficult, as some algorithmic processes can even be 'opaque … to those who designed it'.[80] This presents problems in ascertaining the causal nexus between a mistake generated by the autonomous system, and the fault of the programmer, issues of allocation of liability may thus arise.

Experts from the European Commission have argued that the prudent measure would be to impose strict liability on programmers for liabilities incurred by their autonomous AI creations.[81] They have argued that, amongst other things, it allows for a clear statutory solution to be publicised and thus AI systems can then be more easily insurable.[82]

Verging nearer the realms of public policy, scholars have argued in support of strict liability as it incentivises further development of AI technologies, since it engages developers to make their AI products safer.[83] It can be foreseen that given the unlimited potential of the machine learning facet of AI, safeguards are very much needed to rein in data absorption and automated learning.

On the other hand, some have also argued that the peculiar and novel nature of AI makes it unfit to be a creature ruled by strict liability. The EU Expert Group on Liability and New Technologies, have questioned whether strict liability is adequate to govern AI as the existing notions of strict liability under EU is based on 'Anthropocentric and monocausal model of inflicting

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80 n 45.

81 Expert Group on Liability and New Technologies (n 75) 39.

82 ibid 27.

83 Herbert Zech, 'Liability for AI: public policy considerations' (2021) 22 ERA Forum 147, 152.

harm'[84] Delving deeper into the theoretical side of the argument, it has also been argued that holding programmers accountable on a strict liability basis would cast an unduly wide net that exposes programmers to 'unpredictable and potentially unlimited claims for civil liability'.[85]

An interesting case study of note of emerging legal systems experimenting with liability and AI is that of the PRC. Though academic commentaries on the topic is scarce vis-à-vis Chinese law and strict liability of AI programmers, a recent case involving Baidu shed light on how the PRC courts may impose liabilities on AI programmers.[86] In *Ren Jiayu v Beijing Baidu Technology & Science Co*[87] it was held that the algorithm-caused appearance of a name in a search engine's keyword search cannot be attributed to that of the programmer. In other words, the programmer was not liable for an algorithmic which automated the process of showing search results from a search engine.[88] This gives insight on how it is unlikely that all programmers will be strictly liable for the fault of automated algorithms in China.

This article wholly agrees insofar as liabilities under the PDPO is concerned. Not only would this increase awareness and due diligence by programmers, this would guarantee that victims of the breach of privacy would be entitled redress.

In short, it is proposed that the PDPO include provisions which attribute liability incurred by deterministic and autonomous systems under the PDPO to programmers. For the former, the intention of the programmer would have to be ascertained, for the latter, strict liability should be imposed.

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84 Emiliano Marchisio, 'In support of "no-fault" civil liability rules for artificial intelligence' (2021) 54 Springer Nature Social Sciences 1, 8 citing Expert Group on Liability and New Technologies (n 75).

85 ibid 9.

86 Marta Infantino and Weiwei Wang, 'Algorithmic Torts: A Prospective Comparative Overview' (2018) 29(1) Transnational Law & Contemporary Problems 307, 335.

87 (2015) Beijing First Intermediate Court 09558.

88 Infantino and Wang (n 88) 335 n 113.

B. Anonymisation

Understanding the pitfalls of previous anonymisation efforts would enable the PDPO to effectively target stakeholders and uphold data privacy protection. Whilst stakeholders could take the form of AI algorithms, control mechanisms could be put in place to ensure no single individual can be identified.

Mechanisms could be added as an extension to DPP 6 PDPO regarding access to personal data. The ICO has criticised how the patients were not informed of their patient records getting processed by DeepMind, academics such as Montjoye has suggested tightening access control through privacy-enhancing technologies (PET) that allow datasets to be 'used in a privacy conscientious way'.[89] Taking a step further from listing what the data subject is entitled to doing, it could create an audit system to ensure that any interaction with the data is recorded and accessible, hopefully mitigating the risk of exploitation of personal data.

A successful example of access control coupled with an audit system is Google's DeepMind, which trained machine learning algorithms on individual-level health data records from the NHS.[90] Their 'Verifiable Data Audit' increases accountability on all levels for whoever has access to the dataset.[91]

Through implementing a tailored version of the right to be forgotten from the GDPR to the PDPO by focusing on anonymisation efforts rather than outright erasure, it could minimise the risk of large data loss. This removes the need for data removal and allows for abundant neural network circulation in AI to aid its machine learning. As AI thrives from being able to access large amounts of data, the quality of AI would not be sacrificed as a result.

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89 Yves-Alexandre de Montjoye and others, 'Solving Artificial Intelligence's Privacy Problem' (2017) (17) Field Actions Science Reports 80, 83.

90 ibid citing Mustafa Suleyman and Ben Laurie, 'Trust, Confidence and Verifiable Data Audit' (*DeepMind*, 9 March 2017) <http://deepmind.com/blong/trust-confidence-verifiable-data-audit> accessed 27 July 2021.

91 ibid.

In staying aligned with the rapid pace of data growth, the PDPO could prevent future breaches of privacy instead of passively waiting for the next data collapse.

C. Additional exemptions and regimes for automated systems

Part II of this article saw an exposure of a *Jenga* conundrum under the present formulation of a 'new purpose' for the use of data under the PDPO.

To remedy this lacuna, it is proposed that an additional exemption is provided under Part 8 (Exemptions) for AI systems. This exemption should clearly provide that where there is consent for an existing purpose in using personal data, the automation of such existing purpose should be exempt from the provisions under DPP 3.

This will create an immensely symbiotic environment for organisations to structure their datasets in an automated way (often done by AI as seen from examples above) and allow the development of such systems to flourish.

Furthermore, an additional regime can be provided under the ICSO for potential applications for AI and algorithmic surveillance systems in the future. At present, the ordinance is mainly aimed at regulating authorisation for surveillance on persons who have already attracted reasonable suspicion.[92]

This is different from the main aims of algorithmic surveillance, which seeks to find out who law enforcement agencies should be suspicious about in the first place. In other words, algorithmic surveillance should be a treated as a separate type of surveillance compared to the regimes under the ICSO. Hence, legislation should aim to regulate algorithmic surveillance with separate safeguards to ensure that the right of privacy as guaranteed under the Basic Law and the Bill of Rights Ordinance.

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92 ICSO, s 3(1)(b).

CONCLUSION

Societal improvement is buttressed in staunch belief of a legal system. As AI continues to strengthen its neural networks and ability to learn, likewise, we must strive to enhance our adaptability through the PDPO.

Whilst discord may arise between PDPO's prohibitive parameters and the development of AI, where tightened regulations may cause AI to crumble under the *Jenga* conundrum, hope is not lost. There is room for the law to be changed with regards to progressions in AI advancements, this article has proved that in engaging headfirst with AI's intricacies, the law could be improved to provide an environment for AI to thrive in Hong Kong. Some AI technologies may require alterations in terms of its use in algorithmic surveillances and anonymisation methods, but this should not hinder the PDPO as it could improve alongside AI with proposals outlined in Part III. Enabling the PDPO to be on the forefront in this race to maximising AI's utility would render what was once a discordant environment into one that is appropriately synergetic.

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