Insolvency & Restructuring

Liquidators of Moulin Global Eyecare Holdings Limited (in Liquidation) Succeeded in Reinstating Struck Out Claims Against Former Director

Introduction
The litigation between Moulin Global Eyecare Holdings Limited (in liquidation) (the “Plaintiff”) and a former non-executive director (the “Defendant”) look to be continuing after the Court of Final Appeal has set aside the Court of Appeal’s order striking out the claims of the Plaintiff. In our “Quantifying Director’s Liability for Loss Suffered by a Company for Prolonged Trading after it became Insolvent” from March 2013, we discussed the Court of First Instance decisions in Moulin Global Eyecare Holdings Limited (In liquidation) v Olivia Lee Sin Mei (HCA 167/2008) in respect of quantifying loss suffered by the Plaintiff for prolonged trading after it became insolvent. The rulings of the Court of First Instance striking out claims of the Plaintiff were subsequently re-affirmed by the Court of Appeal (in CACV 155/2012 and CACV 161/2012), as discussed in our further newsletter “Discharging a Genuine Liability is No Loss to the Company”. The Plaintiff then took the matter to the Court of Final Appeal (“CFA”) and this article discusses certain aspects of the CFA’s judgment.

Background
Liquidators of the Plaintiff have pursued litigation against various parties since they discovered the falsified accounting records of the Plaintiff. Action was brought against the Defendant for breach of fiduciary duties and/or breaches of duty of care and skill owed by the Defendant acting as a director and legal adviser of the Plaintiff. It was alleged that Plaintiff was insolvent at various stages from about 2011 and that the Defendant had the necessary knowledge of the fraudulent accounting practices concealing the insolvency of the Plaintiff but yet she failed to “blow the whistle” by alerting the board and shareholders of the Plaintiff. As a consequence, the Plaintiff suffered losses for which the Liquidators claimed against the Defendant (collectively the “Claims”):

1. The “Convertible Notes Loss” – where amounts totalling US$15 million and more than HK$98 million were paid out for early redemption of convertible notes;

2. The “Share Repurchases Loss” – where more than HK$37 million was paid for share repurchases out of capital when the Plaintiff was not in a position to make such repurchase; and
3. The “IND Loss” – for increase in net deficiency of the Plaintiff in the period between the time when the Plaintiff should have been placed into liquidation and the time when it actually went into liquidation.

Decisions of the Court of First Instance and the Court of Appeal
The Convertible Notes Loss claim was struck out by both the Court of First Instance and the Court of Appeal on the basis that the payment for early redemption of the convertible notes discharged genuine liabilities of the Plaintiff and as such the Plaintiff had not suffered any loss.

Further, both the Convertible Notes Loss claim and the Share Repurchases Loss claim were added to the existing claims in the Amended Statement of Claim, when the claims were already statute barred. Both the Court of First Instance and the Court of Appeal struck out the Convertible Notes Loss claim and the Share Repurchases Loss claim on the basis that they were new causes of action which were statute barred from the current action since those claims did not “arise out of the same facts or substantially the same facts” within the meaning of section 35(6) of the Limitation Ordinance (Cap. 347).

In respect of the IND Loss claim, the Court of First Instance allowed the IND Loss claim to be retained but the same was struck out by the Court of Appeal on the basis that the IND Loss claim was also a new cause of action and was statute barred.

CFA Issue 1: striking out the statute barred Claims
The CFA reconsidered the lower courts’ decisions to strike out the Claims by reason that the Claims were statute barred. The CFA overruled the decisions of the lower courts and held that the issue of writ will satisfy the statute of limitations with respect to all claims falling fairly within purview of the writ indorsement. The Claims were within the purview of the indorsement on the writ, which was issued before the Claims became statute barred. It is irrelevant that the Claims were added to the Amended Statement of Claim after the limitation period. Hence, the CFA reinstated all of the Claims that were struck out by the lower courts.

CFA Issue 2: striking out the Convertible Notes Loss claim
In considering the striking out of the Convertible Note Loss claim by reason that the Plaintiff suffered no loss, the CFA was referred to an English case, Hellard v Carvalho¹, where the Deputy High Court Judge regarded that “loss” to the company should be assessed at the time

¹ [2013] EWHC 2876 (Ch)
of the insolvent administration by the liquidators and not by reference to the state of the balance sheet at the time of making payment to certain creditors.

Having regard to Hellard, the Plaintiff submitted that in an insolvency context, the director owes a duty to take into account the interests of creditors and the duty may extend to not prejudicing the interests of creditors and to preserving the assets of the company so that those assets may be distributed amongst all creditors. Therefore, the company may pursue equitable remedies against the director if he was in breach of the duty, so that assets are restored to the company for pro-rata distribution amongst all creditors (the “Plaintiff’s Propositions”).

In the overwhelming majority of cases, the Plaintiff’s Propositions will fail if the Defendant can prove that her decisions to pay particular creditors were not unreasonable and the payments were believed to be in the best interests of the company. However, the CFA accepted that the Plaintiff’s Propositions were reasonably arguable and that the Convertible Notes Loss claim should not be struck out such that the issue may be determined at trial. But, the CFA further held that the pleading of the Convertible Notes Loss claim was not sufficiently consistent with the Plaintiff’s Propositions, and as such, the CFA declared that the Convertible Notes Loss claim as presently pleaded did not plead a triable cause, leaving it for the Plaintiff to seek leave to replead, if so advised.

**Implications**

The CFA’s rulings are significant in two aspects. First, it confirms that issue of writ will prevent the expiry of limitation period for claims within the nature and scope of the writ indorsement. This would allow plaintiffs to introduce additional claims in an amended statement of claim (subject to the discretion of the court to grant leave to amend) which fall within a widely drafted scope of the indorsement.

Second, outside the well established unfair preference regime, the CFA judgment indicates that a case framed consistently with the Plaintiff’s Propositions is reasonably arguable. However, in the majority of cases cited before the CFA, the chance for liquidators to succeed in this type of claim is rather slim, especially when such payments were made bona fide by the director to discharge a genuine liability of the company. We shall wait and see whether the Plaintiff in this case will seek leave to further amend its pleading such that the Convertible Notes Loss claim will be tested at trial.