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Basic Insolvency Law and Practice and Company Restructuring for Managers and Directors

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Part 1: Director/manager’s concern

1. How to avoid incurring personal liabilities when the company is wound-up
2. Duties upon winding-up of the company
3. Restructuring and rescue options
How to avoid incurring personal liabilities when the company is wound-up?

- Breach of fiduciary duty
- Negligence
Breach of fiduciary duties

- *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134
  - Regal owned a cinema.
  - A subsidiary, Hastings, was set up to buy long leases of two other cinemas so that all three could be sold as a going concern.
  - The owner of the two cinemas was only willing to grant the leases if Hastings’ fully paid-up capital was £5,000 or if the directors would give personal guarantees for the rent.
Regal (Hastings) Ltd v Gulliver (cont’d)

- The directors of Regal were not prepared to give personal guarantees and Regal could not contribute capital of more than £2,000 for the shares in Hastings.
- In the end it was decided that four directors, Bobby, Griffiths, Bassett and Bentley, would themselves subscribe for 2,000 shares.
- The chairman, Gulliver, found outside subscribers for 500 shares, and the company’s solicitor, Garton, took the remaining 500 shares. The deal went through. Hastings acquired the leases.
Regal (Hastings) Ltd v Gulliver (cont’d)

• All the shares in Regal and the individually held shares in Hastings were then sold and the four directors made a profit on selling those shares.
• The new controllers caused Regal to bring an action and successfully required the directors to account for their profit to Regal.
Regal (Hastings) Ltd v Gulliver (cont’d)

- Lord Russell of Killowen:-
  “The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action…”
Regal (Hastings) Ltd v Gulliver (cont’d)

• The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.

• Question: What could the directors have done to save them?
Negligence

• The test:-
  • the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in relation to that company (an objective test); and
  • the general knowledge, skill and experience that the director actually has (a subjective test).

• Re D’Jan of London Ltd [1994] 1 BCLC 561
• Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors [1992] 2 HKC 637
• Codification of directors’ duty of care, skill and diligence under the new Companies Ordinance (“CO”)
Duties upon winding-up

2 broad categories of duties

1. Statutory duties
   - Submission of verified statement of company’s affairs – s.190 CO
   - Delivery of property to liquidator – ss. 211 CO
   - Private examination – s.221 CO
   - Public examination – s.222 CO

2. Common law duties
   - Fiduciary duties
   - Duty of care and skill
Duties upon winding-up

Submission of verified statement of company’s affairs – s.190 CO

- If required by the provisional liquidator or liquidator, directors or officers must within 28 days of the appointment of the provisional liquidator or the date of the winding-up order submit to the provisional liquidator or liquidator a verified statement of company’s affairs (s.190(1), (2), (3) CO)

- Matters to be included (s.190(1) CO)
  - Particulars of the company’s assets, debts and liabilities
  - Names, addresses and occupations of its creditors, securities held by them, dates when the securities were respectively given
  - Any other information as the provisional liquidator or liquidator may require
Duties upon winding-up

Submission of verified statement of company’s affairs – s.190 CO

- Duty to attend personal interviews and provide information when required by the Official Receiver or provisional liquidator or liquidator (CWUR r39(2))

- After the submission of the statement of affairs, the directors or officers who have made the statement have the duty to attend before the Official Receiver, provisional liquidator or liquidator to answer any questions and give further information relating to the statement of affairs if so required (CWUR r41)

- Any director or former director, without reasonable excuse, defaults in complying with s.190 shall be liable to a fine and, for continued default, to a daily default fine (s.190(5) CO)
Duties upon winding-up

**Delivery of property to liquidator – s.211 CO**

- After a winding-up order is made, the court may order officers of the company to deliver, convey, surrender or transfer any money, property or books and papers in their hands, to which the company is prima facie entitled (s.211 CO)

- The power is delegated to the liquidator (s.226(c) CO and CWUR r67)
Duties upon winding-up

Private examination – s.221 CO

- S.221 CO is a powerful investigative tool for liquidators of a company for them to summon any officer of the company for examination.

- Although the examination is called “private examination”, the answers to the “private examination” could be made public, as discussed below.
Duties upon winding-up

Private examination – s.221 CO

Who can be questioned?

- S.221(1)

“The court may, at any time after the appointment of a provisional liquidator or the making of a winding-up order, summon before it:
1. any officer of the company or person known or suspected to have in his possession any property of the company or supposed to be indebted to the company; or
2. any person whom the court deems capable of giving information concerning the promotion, formation, trade, dealings, affairs, or property of the company.”
Duties upon winding-up

Private examination – s.221 CO

What can be asked and how are the answers given?

- S.221(2)
  “The court may examine him on oath concerning the matters aforesaid, either by word of mouth or on written interrogatories, and may reduce his answers to writing and require him to sign them.”

- S.221(3)
  “The court may require him to produce any books and papers in his custody or power relating to the company…”
Duties upon winding-up

Private examination – s.221 CO

What if the person summoned does not cooperate?

- **S.221(4)**
  “If any person so summoned, after being tendered a reasonable sum for his expenses, refuses to come before the court at the time appointed, not having a lawful impediment (made known to the court at the time of its sitting, and allowed by it), the court may cause him to be apprehended and brought before the court for examination.”

- **CWUR rule 61**
  “If the summoned person refuses to answer the questions put to him or produces documents/property requested under the order, he may be held in contempt of court.”
Duties upon winding-up

Private examination – s.221 CO

What about the “right against self-incrimination”?

• “No one could be obliged to jeopardize his life or liberty by answering questions on oath came to be applied to all witnesses in all proceedings.” per Murphy J in Pyneboard Pty Ltd v Trade Practices Commission (1983) 152 CLR 328

• There is a common law right that a person could not be compelled to answer questions that may tend to incriminate himself; i.e. no forced confession.

• However, the court held that this has been impliedly abrogated by s.221. (See Kwan J’s judgment in Re Weihong Petroleum Company Limited [2002] 1 HKLRD 541)
Duties upon winding-up

Private examination – s.221 CO

What about the “right against self-incrimination”?  

- Art. 11(2)(g) of the Bill of Rights Ordinance (Cap. 383)  
  “In the determination of any criminal charge against him, everyone shall be entitled to the following minimum guarantees, in full equality –  
  …  
  (g) not to be compelled to testify against himself or to confess guilt.”

- Art. 11(2)(g) is restricted to the rights of a person charged or convicted of a criminal charge. (Kwan J in *Re Weihong Petroleum Company Limited*)
Duties upon winding-up

Private examination – s.221 CO

What about the “right against self-incrimination”?

- What if answers or documents are likely to expose the examinee to criminal prosecution? Is he still required to answer?

- Hon Kwan J, citing Mann LJ’s judgment in Bishopgate Investment Management Limited v Maxwell [1993] Ch 1

  “The first duties of an office-holder who is provisional liquidator are to trace and then to secure the assets of the company for the benefit of the creditors and (occasionally) the contributories. His ability to trace in a liquidation where assets are missing and the documentation does not explain their whereabouts, must be heavily dependent upon his ability to use section [ s.221 CO]. Those sections could be useless for their purpose if the privilege against self-incrimination is not abrogated.”
Duties upon winding-up

Private examination – s.221 CO

What about the “right against self-incrimination”?

- Can the liquidators release the examination transcript to the police?

- CWUR rule 62(2) – leave of the court required
- *Re Kong Wah Holdings Ltd & Another* (HCCW 49 and 50/2000)
  - Release of private examination transcript to CCB held not to infringe human right
  - No prohibition against derivative use
- *Kennedy v Cheng & Another* [2009] 6 HKC 454
  - No leave is required for a liquidator who reported wrongdoing to the police to supply them with examination transcripts
  - CWUR rule 62 does not offer protection of the examinee, but of the liquidation.
  - Where an examinee is prosecuted and the prosecution seeks to make direct use of his or her examination transcripts supplied to the authorities, it would be for the criminal court to rule whether that is to be permitted.
Duties upon winding-up

Private examination – s.221 CO

What about the “right against self-incrimination”?

- Can the examination transcript be used as evidence against the examinee?

- S.296(2A) CO
  “any answer given by a person to a question put to him in exercise of powers conferred by rules made under this section may be used in evidence against him.”

- Re Wing Fai Construction Co Ltd [2006] 4 HKLRD 58
  - CA has interpreted s.296(2A) to mean that answers given in a private examination can be used against the examinee in civil and criminal proceedings.
Duties upon winding-up

Duty not to use trade secrets or confidential information

*Measures Brothers Ltd v Measures* [1910] 1 Ch. 336

- At a time when winding-up of P company was imminent, D director had made copies of lists of the customers of P company for later use in his own business after the winding-up order was made.
- P company sought an order upon D director to deliver up such lists in his possession or under his control.

- Held:
  - D director’s actions in taking the lists amounted to a breach of duty to the company.
  - “No man who is in the employment of another is entitled to use or even take a copy, for his own private purposes, of any document of his employer which comes to his hands or to which he has access in the course of his employment.”
  - D director ordered to deliver up the lists of customers.
Duties upon winding-up

Compulsory winding-up

• No duty to act in good faith in the best interests of the company or to act with care and skill as directors can no longer exercise powers on behalf of the company.

• However, duty not to use trade secrets or confidential information and duty not to divert corporate opportunities will continue.
Duties upon winding-up

Duty not to divert corporate opportunities

*McAusland v Deputy Commissioner of Taxation* (1994) 12 ACLC 78

- The legislative scheme (in relevant respects comparable to the HK legislation) requires *nothing more than a cessation of the powers* of the directors on a winding-up.

- The legislation, in allowing for a stay or termination of the winding-up, would be consistent with a mere suspension of powers of directors rather than an automatic vacation of office.
Duties upon winding-up

Duty not to divert corporate opportunities

- As the directors’ powers are merely suspended, they would, in principle, still be subject to the duty not to divert corporate opportunities which belong to the company.

- However, as a director is no longer under a duty to act in good faith in the best interests of the company upon winding-up, he would not be precluded from exploiting a business opportunity which came to him in a “private” capacity following commencement of winding-up or from otherwise competing with the company during the winding-up.
Restructuring and rescue options

• Currently, there is no statutory provision for corporate rescue in Hong Kong.
• Nevertheless, corporate rescue may be carried out indirectly through:-
  1. Voluntary restructure;
  2. Formal scheme of arrangement; or
  3. Appointment of provisional liquidator.
Voluntary restructure

• Informal and non-statutory arrangements between the company, all shareholders, creditors on a voluntary basis.
• The parties may adopt the Hong Kong Approach to Corporate Difficulties published jointly by the Hong Kong Association of Banks (HKAB) and the Hong Kong Monetary Authority as the guiding principals for the conduct of corporate restructuring.
• Limitation: the voluntary nature of this route requires the consent and cooperation of all parties involved.
• The lack of moratorium and the law about unfair preference make it difficult to accomplish voluntary restructuring.
Formal scheme of arrangement

- Companies and creditors may reach compromise agreements and apply for the court’s sanction under section 166 of the Companies Ordinance (“CO”).
- Limitation:
  - this method requires intensive court involvement and is generally expensive and time-consuming; and
  - A pending application for statutory scheme of arrangement under section 166 CO does not confer a creditor moratorium.
    - Before the proposed scheme is sanctioned by the court, creditors can still commence legal proceedings against the company or seek to wind-up the company.
    - This often hinders the parties from reaching a compromise.
Appointment of provisional liquidator

- In some situations, a provisional liquidator may be appointed under section 193 CO for the purpose of corporate restructuring.
- Appointment of PL has the effect of a moratorium because of s.186 of the CO.
- This is often used in conjunction with s.166 of CO to achieve corporate restructuring.
Part 2: When your customer is experiencing financing difficulties...

A. how to protect your company against customers' insolvency
B. how to recover assets from wound-up companies
C. how to pursue personal liabilities of directors/managers of wound-up companies
D. how to recover payment without being challenged when the customer is eventually wound-up
A. How to protect your company against customers' insolvency?

• Investigation as to client’s financial situation before entering into a transaction.
  • Conduct company search to check for any existing mortgage or charge, appointment of receiver, etc.

• Security
• Guarantee
B. How to recover assets from wound-up companies?
Some legal actions for recovery of assets

1. Unfair preferences
   • Section 50, Bankruptcy Ordinance (extended application to companies by Section 266B, Companies Ordinance)

2. Fraudulent conveyance
   • Section 60, Conveyancing and Property Ordinance

3. Avoidance of Floating Charge
   • Section 267, Companies Ordinance

4. Fraudulent Trading
   • Section 275, Companies Ordinance

5. Accessorial Liability – Dishonest Assistance

6. Transfer of Business (Protection of Creditors) Ordinance

7. Transactions after commencement of winding up
   • Section 182, Companies Ordinance
1. Unfair Transactions
1. Unfair Transactions

**Essential Requirements**

- A creditor (or guarantor) was put in a better position (than other creditors) by the transaction (s.50(3)(a) BO)
- The transaction was influenced by the debtor’s “desire to prefer” the recipient (s.50(4) BO)
- Relevant time
  - 6 months for non-associates
  - 2 years for associates
- Must the debtor be insolvent at transaction time?
  - Yes
- Remarks
  - The “desire to prefer” is presumed in the case of associate.
  - Serious gaps appear when concept of “associates” in BO applied to corporate debtor by s.266B, CO.
1. Unfair Transactions

**Hau Po Man Stanley [2005] 2 HKC 227**

- Debtor (a dentist) borrowed $1.5 million from sister.
- Within two years, he repaid the loan and then petitioned for his own bankruptcy.
- Three repayments were made by debtor to sister at different time.
- High Court held no unfair preferences
- Creditor appealed.
- Court of Appeal held (2:1):-
  - No unfair preference for the first two repayments, because:-
    - Sister and husband chased hard (sent letters, quarrels, went to his clinics, threatened to cut off relationship) caused considerable pressure on debtor.
    - hence, the payment was not made with “desire to prefer”. The presumption of preference was rebutted.
  - the third payment, made a few months later, and after another creditor started legal action, was an unfair preference.
2. Fraudulent conveyance
2. Fraudulent conveyance

**Essential Requirements**

- s.60, Conveyancing and Property Ordinance provides:-

  ...every disposition of property made, ..., with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced.
2. Fraudulent conveyance

Tradepower (Holdings) Ltd (In Liquidation) v Tradepower (Hong Kong) Ltd and others
FACV 5/2009

- One of the most important recent decisions in insolvency
- Judgment handed down on 30th November 2009
Facts:-

Same Directors/Shareholders

Girvan Ltd.

Deferred Share Scheme

Tradepower Hong Kong

Deferred Share Scheme effected in Sep 1999

Tradepower (Holdings) wound-up in Apr 2000

Elimor

Summary Judgment obtained in Jan 1999 with damages to be assessed.

Deferred Share Scheme effected in Sep 1999

Tradepower (Holdings) wound-up in Apr 2000
2. Fraudulent conveyance

Tradepower (Holdings) Ltd (In Liquidation) v Tradepower (Hong Kong) Ltd and others
FACV 5/2009
• The liquidators brought claim against the Girvan and the former directors under s.60 of the Conveyancing and Property Ordinance (Cap.219) and for breach of fiduciary duties.
2. Fraudulent conveyance

Tradepower (Holdings) Ltd (In Liquidation) v Tradepower (Hong Kong) Ltd and others
FACV 5/2009

• The material part of S.60 of CPA provides as follows:-

“(1) …, every disposition of property made… with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced….

(3) This section does not extend to any estate or interest in property disposed of for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the disposition, notice of the intent to defraud creditors.”
2. Fraudulent conveyance

Tradepower (Holdings) Ltd (In Liquidation) v Tradepower (Hong Kong) Ltd and others
FACV 5/2009

- The trial judge dismissed the liquidators’ action:-
  - following the authority of Lloyds Bank v Marcan, ‘intent to defraud’ in s.60 means actual subjective intent to defraud creditors;
  - it could be negated if the directors were motivated by other legitimate concerns;
  - in this case the directors were primarily motivated by their concerns over Girvan’s position, which having financed the mortgage payments, had not obtained any interest in the property;
2. Fraudulent conveyance

**Tradepower (Holdings) Ltd (In Liquidation) v Tradepower (Hong Kong) Ltd and others**

FACV 5/2009

- the lack of intent to defraud was further shown by:
  - the time lag of 7 months between the summary judgment and the scheme;
  - the belief (which he found to be genuine) that Elimor’s claim was exaggerated and that the company had sufficient fund to meet the claim
- the breach of fiduciary duty claims fell with the s.60 claim
2. Fraudulent conveyance

Tradepower (Holdings) Ltd (In Liquidation) v Tradepower (Hong Kong) Ltd and others
FACV 5/2009

• CA reversed the trial judge’s decision. The directors appealed. The CFA affirmed the CA decision.
• The CFA stated the principle as follows:-

“Where it is objectively shown that a disposition of property unsupported by consideration is made by a disponor when insolvent (or who thereby renders himself insolvent) with the result that his creditors (including his future creditors) are clearly subjected at least to a significant risk of being unable to recover their debts in full, such facts ought in virtually every case to be sufficient to justify the inference of an intent to defraud creditors on the disponor’s part.”Para 88, per Ribeiro PJ
3. Avoidance of floating charge
3. Avoidance of floating charge

**Essential Requirements**

- Any floating charge created within 12 months from the commencement of winding up shall be void:
  - unless it is proved that the company immediately after the creation of the charge was solvent; and
  - except to the amount of cash paid to the company at the time of the charge at interest rate of not more than 12%
- “Cash paid to the company” is strictly interpreted.
3. Avoidance of floating charge

*Re Dream Asia Limited HCMP 4394/2002*

- Lenders paid to the creditors of the Company directly in consideration of a floating charge.
  
  Held:-
  
  - Not ‘cash paid to the company’
  - Floating Charge created within 12 months avoided.
4. Fraudulent trading
4. Fraudulent trading

C. fraudulent trading

- s.275 of the Companies Ordinance:

"If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court, on the application of the Official Receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct."
4. Fraudulent trading

“Intent to defraud creditors” and “fraudulent purpose”

  - The directors of Wheelock Maritime International ("WMI"), procured a loan from ADS for WMI.
  - WMI was subsequently wound-up and could not repay the loan.
4. Fraudulent trading

**ADS v Brothers (cont’d)**

- Unsecured creditors ADS claimed that the directors of WMI had been guilty of fraudulent trading, contrary to s. 275 of the Companies Ordinance.
- But the directors of WMI were found to be NOT liable because they were found to honestly (but erroneously) believe that the parent of WMI would provide financial support to WMI.
4. Fraudulent trading

**ADS v Brothers (cont’d)**

- “Intent to defraud creditors” and “fraudulent purpose”
- "Fraudulent intent must be established subjectively after a careful examination of all the evidence. Even in what appear to be water-tight cases, fraud may not be found - simply an unjustified albeit honest 'chasing of the rainbow'."
4. Fraudulent trading

Bank of India v Morris [2005] 2 BCLC 328

The facts:-

- BCCI, a banking group, entered into a series of circular transactions with BOI, an India bank, in order to conceal the losses incurred from the heavily withdrawn accounts of Maram.
- BCCI deposited sums of money with BOI, while BOI lend the same amount of money to Maram at a slightly higher rate.
- BOI benefited from the higher interest rate by lending to Maram.
- The loans from BOI were used to credit the heavily overdrawn accounts of Maram to give the false impression that the indebtedness was being repaid by Maram.
4. Fraudulent trading

1. Lender/Borrower
2. Deposit
3. Loan
4. Guarantee
5. Repayment
6. Repayment deposit
7. Repayment for Maram

BCCI

BOI

Maram
4. Fraudulent trading

Bank of India v Morris (cont’d)

Fraudulent trading:-
• The court found that the businesses of BCCI “has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose”.
• The liquidators of BCCI claimed against BOI for being knowingly a party to fraudulent trading by BCCI.
4. Fraudulent trading

Bank of India v Morris (cont’d)

“Knowingly a party to fraudulent trading”:-
- BOI acted through S, its senior manager.
- S’s knowledge that the transactions were dishonest sufficed for the purpose of the fraudulent trading provision. It is not necessary to prove that S had a direct intent to defraud BCCI’s creditors or he was aware of BCCI’s insolvency.
- The judge reached a conclusion as to S’s “blind-eye knowledge” at the time of most of the transactions, and upheld the judge’s finding of S’s dishonesty in the lower court.
4. Fraudulent trading

Bank of India v Morris (cont’d)

Attribution of individual to corporate knowledge:-

- It was accepted that “outsider” companies could be made liable under the fraudulent trading provision provided that it was shown they were “knowingly” parties to the fraudulent trading.
- The application of the fraudulent trading provision required a special rule of attribution in order to make its self-evident policy effective (para. 95).
Bank of India v Morris (cont’d)

Attribution of individual to corporate knowledge:-

• It could be appropriate to attribute knowledge of fraud to a company, even though:
  • S had acted dishonestly, in breach of his duty to his principal and employer and in circumstances in which he would not have passed on his knowledge to his employer.
  • the members of the board of BOI personally had no knowledge of the fraud, but they were content to leave the conduct and completion of the negotiations in the hands of S.
  • S was acting in breach of his duty to BOI in respect of the transactions with BCCI or that BOI was somewhat a “secondary victim” of his wrongdoing and that of BCCI.
Bank of India v Morris (cont’d)

Attribution of S’s knowledge to BOI:-
• S's knowledge of the fraud of BCCI was sufficient to make BOI a party to the fraudulent trading of BCCI.
• S was in substance the relevant decision maker for BOI in respect of the relevant transactions:-
  • He was a senior manager of BOI whose board relied on his judgment in relation to the transactions.
  • He was given “blanket permission” to deal with BCCI by negotiating the terms of the transactions.
  • He was allowed by the board to supervise the relevant transactions with BCCI and ultimately to decide to proceed with them on terms negotiated by him.
4. Fraudulent trading

**Bank of India v Morris (cont’d)**

- BOI was held “personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct.”
- The loss that BOI has to contribute was loss of BCCI that could be attributed to the fraudulent transactions. The fraudulent transactions helped kept BCCI afloat for longer than it naturally could and suffered more losses than it would otherwise have.
- Taking into account the “contribution” of other parties (e.g. some Swiss banks) and other fraudulent activities of BCCI not related to BOI, the court ordered BOI to contribute $43.231m plus interest.
5. Accessorial Liability – Dishonest Assistance
Accessorial Liability – Dishonest Assistance

Where the third party has encouraged or assisted a breach of fiduciary duty, he may be personally liable to the insolvent company for the loss arising from the breach.

The requisite elements for establishing dishonest assistance are:

- Breach of trust or fiduciary duty.
- Procuring, inducing, or assisting the breach of duty.
  - The accessory must have contributed to the breach of trust or fiduciary duty.
- Fault: knowledge of the circumstances
5. Accessorial Liability – Dishonest Assistance

Fault

- **Royal Brunei Airlines v Tan [1995] 2 AC 378**
  - The claimant airline appointed Borneo as its travel agent to sell tickets.
  - Borneo was in breach of trust and was expected to account to the claimant for the net proceeds of tickets sales, but Borneo became insolvent.
  - The claimant sought a remedy from the principal shareholder and controlling director of Borneo on the ground that the defendant had assisted Borneo to breach the trust.
5. Accessorial Liability – Dishonest Assistance

Fault

• *Royal Brunei Airlines v Tan* [1995] 2 AC 378
• Held: The defendant was liable as an accessory.
• The appropriate test of fault was dishonesty with the following considerations:-
  • the defendant’s knowledge of the circumstances at the time relating to the proposed transaction and his participation in it; and
  • objectively, whether a reasonable person would have considered the defendant’s conduct as dishonest taking into account his relevant knowledge.
5. Accessorial Liability – Dishonest Assistance

Fault

• *Royal Brunei Airlines v Tan* [1995] 2 AC 378
• Application
  • The defendant caused Borneo to apply the money in a way that he knew was not authorised. This constitutes a dishonest act.
  • The defendant was liable to the claimant airline for the amount owed to it by Borneo.
• This case established that the defendant is not the arbiter as to whether his conduct was honest; he might consider in the light of his knowledge of the circumstances whether his conduct would be viewed as honest in the eye of a reasonable person.
6. Transfer of Business (Protection of Creditors) Ordinance
Transfer of Business (Protection of Creditors) Ordinance

Transfer of Business (Protection of Creditors) Ord., Cap.49

- Transferee becomes liable for all debts and obligations of the transferor: S.3
- NOT liable if:
  - Only part of business is transferred; or
  - Notice of transfer been given (not > 4 months & not < 1 month before the date of transfer)
6. Transfer of Business (Protection of Creditors) Ordinance

Proper Notice s4(1) TBO

- Notice of transfer: 1 April 10
- Last day to commence proceedings vs transferor: 30 April 10
- Date of transfer: 1 July 10

1 month before transfer
4 months before transfer
1 May 10 Notice complete
1 month before transfer
6. Transfer of Business (Protection of Creditors) Ordinance

Late Notice s4(2) TBO

- 4 months before transfer
- 1 month before transfer
- Date of transfer
- Last date to commence proceedings vs transferee
- 15 June 10: Notice of transfer
- 15 July 10: Notice complete
- 14 July 10
- 1 July 10
6. Transfer of Business (Protection of Creditors) Ordinance

Subsequent Notice s4(3) TBO

- **4 months before transfer**
- **1 month before transfer**
- **Date of transfer**: 14 September 10
- **Last date to commence proceedings vs transferee**: 15 September 10
- **Notice of transfer**: 15 August 10
- **Notice complete**: 15 September 10
6. Transfer of Business (Protection of Creditors) Ordinance

Transfer of Business (Protection of Creditors) Ord., Cap.49 (cont’)

• A transferee’s liability under TBO is limited to the value of the business acquired
• A creditor is not entitled to institute any action against a transferee for liabilities under TBO more than 1 year after the date of transfer: S. 9
• The transferee is entitled to be indemnified by the transferor
7. Transactions after commencement of winding up
7. Transactions after commencement of winding up

**Section 182, CO**

**Transactions after Commencement of Winding Up**

- Only applies where winding up is by the Court;
- Wide interpretation of ‘disposition’ and ‘property’.
- Liquidators should seek to recover all property disposed in contravention of this section.
- Commencement of winding up = date of petition (except where there was a prior resolution to the same effect – see. S.184)
- Cease to apply once liquidators or PLs appointed
7. Transactions after commencement of winding up

CHEVALIER (HK) LIMITED v
RIGHT TIME CONSTRUCTION COMPANY LIMITED
CACV 120/1989

- Main Con made direct payment to sub-sub-con after Sub-Con commenced winding up.
7. Transactions after commencement of winding up

CHEVALIER (HK) LIMITED v RIGHT TIME CONSTRUCTION COMPANY LIMITED CACV 120/1989

• Held:-
  • s.182 infringed
  • Sub-sub con has to refund.
C. How to pursue personal liabilities of directors or managers of wound-up companies?
Halt Garage (1964) Limited [1982] 3 ALL ER 1016

- Mr. and Mrs. C were the only directors and shareholders
- Initially both worked in the Company and drew directors’ remuneration.
- Since 1967 Mrs. C became ill and draw remuneration at a reduced rate.
- From 1968, Company became unprofitable and went into liquidation in 1971.
- Liquidators sought to recover sums paid to Mr and Mrs. C on the ground that they were disguised return of capital.
Halt Garage (1964) Limited (cont’d)

Held:-

- sums paid to Mr. C, even though may be high, could not be challenged in absence of fraud or dishonesty;
- sums paid to Mrs. C, only one-third represented reasonable remuneration. She had to refund the rest.
Aveling Barford v Perion [1989] BCLC 626

- P's entire issued share capital was owned or controlled by L.
- P owned a property which it sold to D for GBP 350,000.
- D was a Jersey trustee company controlled by L for the benefit of his family.
- The property was valued at GBP 1,150,000. D resold the property for a profit.
- P claimed against D on the basis that D was liable to account for the profit.
Aveling Barford v Perion (cont’d)

Held:-

- The terms on which the property was sold amounted to a breach of L's fiduciary duty owed to P as a director.
- D knew all the facts surrounding that breach of duty through L and the solicitors and was therefore accountable as a constructive trustee.
- The transaction could not be ratified by P's shareholders. The transaction was not a genuine exercise by P of its powers to sell its own assets but was a dressed-up distribution by P of capital to its shareholders.
Aveling Barford v Perion (cont’d)

• As P had no distributable reserves the transaction was ultra vires and incapable of ratification.
• The transaction was capable of being a fraud on the creditors of P notwithstanding the fact that P was solvent at the relevant time.
Shareholders’ vs creditors’ interests

• *Kinsela v Russell Kinsela* (1986) 4 ACLC 215
• The company in financial difficulties entered into a leasing agreement with its directors at a substantially undervalued rent. The company went into liquidation subsequently.
• A question arose as to whether (1) such transaction involved a breach of duty and (2) the transaction could be avoided even though it had been approved of by all the shareholders.
  Held:–
• The interests of creditors intervene on insolvency, so that directors have to have regard to them in exercising their powers in relation to a company's assets.
Kinsela v Russell Kinsela (cont’d)

• Street CJ at 730A-C:
  “In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration.”
**Kinsela v Russell Kinsela (cont’d)**

- The company was plainly insolvent at the date of the lease and its collapse on that ground was imminent.
- The prejudice to the creditors was the direct and calculated result of the lease; its purpose was to place the company's assets beyond the reach of the creditors.
- Based on the above, the court held that the company's challenge was made good.
West Mercia Safetywear Ltd v Dodd [1988]
BCLC 250

• A director caused the company to transfer a sum of money to its holding company, of which he was also a director, and whose overdraft he had guaranteed, in partial repayment of amounts which it owed to the holding company at a time when both companies were on the verge of liquidation.

• The company subsequently went into liquidation and its liquidator claimed that the director was guilty of misfeasance and breach of duty and applied for an order that the director repay for the amount paid to the holding company.
II. Negligence

• The test:-
  • the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in relation to that company (an objective test); and
  • the general knowledge, skill and experience that the director actually has (a subjective test).
Re D’Jan of London Ltd [1994] 1 BCLC 561

• A director signed an insurance proposal for his company.
• The form asked:-
  • Have you or any director or partner ... been director of any company which went into liquidation ...?
• The answer was 'No'.
• The director admits that this was wrong. He had been director of wound up companies.
• The proposal gave inaccurate information and enabled insurers to repudiate the policy. The liquidator brought an action against the director in negligence.
Re D’Jan of London Ltd (cont’d)

• The form was filled in by his insurance broker, who had been handling his personal and corporate insurance affairs for about five years.
  • The director says that the insurance broker had demonstrated his competence by obtaining good rates and recommending him to loss adjusters who had obtained satisfactory settlements on his claims.
  • So he trusted the insurance broker to fill in the form correctly.
Re D’Jan of London Ltd (cont’d)

Held:-

• The director was negligent and liable to compensate the company.
• However, the judge held he was not guilty of gross negligence and had acted honestly.
• He was 99% shareholder of the company and the form was signed at a time when the company was solvent.
• Liability limited to his own claim against the company as creditor.
Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors [1992] 2 HKC 637

- The plaintiff company, in compulsory liquidation was a broker on the Futures Exchange.
- The 1st defendant was the chairman of the plaintiff and its beneficial owner, and the account executive for the company’s account which was opened in 9 May 1986 and which traded exclusively in Hang Seng Index futures contracts.
- Following the October 1987 stock market collapse, the customer defaulted on the account.
- The account was liquidated on 2 November 1987 with a deficit of $83.97m.
Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors (cont’d)

• The plaintiff became responsible and claim for damages against the 1st defendant for breach of his duty of care owed to the plaintiff by permitting the account to be operated unsecured, inadequately margined or overexposed.
• The 1st defendant argued that his ‘breach’ was ratified impliedly by the company.
Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors (cont’d)

- The defendant owed to the plaintiff duty to take reasonable steps to safeguards against customer default.
- He should have appreciated the risks of futures trading account and taken proper steps to protect the company. He breached his duty by failing to do so.
Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors (cont’d)

• Validity of ratification in the context of liquidation

Held (by Bokhary J):-
• Where a director so fails to take reasonable care to protect a company as to expose it to a risk of insolvency, and the company becomes insolvent as a result and goes into liquidation, then if any creditor of the company suffers loss and is driven to proving in the liquidation for redress, the company’s claim against the negligent director cannot be defeated, to the ultimate detriment of any creditor, by any ratification which such director may be able to procure of their own negligent acts or omissions.
Codification of directors’ duty of care, skill and diligence under the new Companies Ordinance (“CO”)

- Directors’ duties to exercise reasonable care, skill and diligence have been codified in the new CO (section 465).
- The civil consequences for breach (or threatened breach) of the above duties remain to be governed by the common law and equity (section 266).
- Nevertheless, directors’ fiduciary duties remain defined by case law and uncodified.
- The new CO will commence on a date to be appointed and published in the Gazette, which is expected to be in 2014.
D. How to recover payment without being challenged when the customer is eventually wound-up?
Avoiding challenge of unfair preference

• Pressure on debtors for payment to eliminate any “desire to prefer” which may render payment void for unfair preference.
Hau Po Man Stanley [2005] 2 HKC 227

- [discussed above]

- The Company went into compulsory liquidation on a creditor’s petition.
- A little over a month prior to the presentation of the petition, the Company granted a mortgage over a yacht in favour of HSG Nordbank AG, a non-associate of the Company.
- The loan was drawn down three days later and used to repay an existing overdraft of the Company with the Bank.
- Following presentation of petition, the Bank exercised its right under the mortgage and took possession of the yacht. The vessel was sold and a sum was realized after the deduction of sale expenses.
- The liquidators sought a declaration that the mortgage constituted an unfair preference in favour of the Bank.
Re Sweetmart Garment Works Limited (In Liquidation) (cont’d)

Held:-

• There was a desire to prefer the Bank.
• There is no need for there to be direct evidence of the requisite desire. Its existence may be inferred from the circumstances of the case.
• The requisite desire must be one of the factors which operated on the minds of those who made the decision. It needed not be the only factors or even the decisive one.
Re Sweetmart Garment Works Limited (In Liquidation) (cont’d)

• Having reviewed the contemporaneous correspondence between the Bank and the Company and the evidence of the steps being taken by other creditors of the Company, the judge found that the steps taken by the Bank were too mild and unspecific, which could not sensibly be regarded as constituting pressure on the Company in any real form.

• In stark contrast, the steps taken by the other creditors were “more concrete, more serious, and instituted much more promptly” than those threatened by the Bank.
Re Sweetmart Garment Works Limited (In Liquidation) (cont’d)

• Also, given it did not appear that there could have been any real prospect of the Company trading through its difficulties, it could not be said that the mortgage was granted to preserve the ongoing commercial relationship with the Bank.

• Furthermore, even though personal bankruptcy proceedings were threatened against the Company's directors by other creditors consequent on the service of statutory demands against them, on the very day the vessel was offered to the Bank as security. The judge took this as strong evidence of a desire to prefer the Bank.
solutions • not complications