How Common Law and Equity Assist the Liquidator in Assets Recovery

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Foreword

• This seminar discusses several causes of action based on common law and equity available to the liquidator in their assets recovery work. Where relevant their relationship with the traditional statutory powers will be discussed. Some important points about limitation periods for these causes of action will also be discussed.
Negligence

Examples of action against directors for negligence:

1. **Chingtung Futures Ltd (In Liquidation) v Lai Cheuk Kwan Arthur & Ors** [1992] 2 HKC 637
   - Director failed to monitor credit risk of a futures trading account. Customer defaulted causing substantial loss to the company.

   - Director negligently filled in insurance proposal form resulting in insurance policy being avoided, company failed to get compensation for a factory destroyed by fire.

   • In both cases, both directors were in effective control and ownership of the company. Could they have ratified and forgiven his own negligence?
Codification of directors’ duty of care, skill and diligence under the new CO

- The test is well-established and will be codified in the new Companies Ordinance in 2014 (tentatively):

- Section 465:
  
  “(1) A director of a company must exercise reasonable care, skill and diligence.
  
  (2) Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with –
  
  (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
  
  (b) the general knowledge, skill and experience that the director has.”
Negligence claims against directors and employees...

- Note that this is a hybrid test comprising both “objective” and “subjective” standards. This is a strong disincentive for occupying position outside one’s competence.
- The claim is not confined to the director whose acts cause direct loss to the company. Directors failing to prevent such acts from happening could be held liable.
- Similar duties apply to employees.

- These are aptly illustrated by the case of *Weavering Capital (UK) Ltd. v. Peterson* [2012] EWHC 1480 (Ch).
Weavering Capital (UK) Ltd. v. Peterson (cont’d)

Fraud, breach of fiduciary duty
Negligence

Liquidators

WCUK (in liq)
Manager and Adviser of Macro

WCF
D1
Director
Couple
Control (father and brother nominees)

D2
Director

D9
Director

D10
Senior employee

CE/MD
Advice and Manage

$ Investors

Macro (in liq)
Public fund

OTC transactions

WCF transactions

Swaps
FRAs
Weavering Capital (UK) Ltd. v. Peterson (cont’d)

• WCUK set up and managed a public fund called “Macro”.
• Macro’s Offering Memorandum set out its objectives and strategy which include:

  • To effect capital appreciation by producing long-term risk adjusted returns by a portfolio of “a balanced and diversified risk profile”.
  • No more than 20% of the value of the Gross Assets of the Company is exposed to the creditworthiness or solvency of any one counterparty.
  • Instruments for investment would be predominantly exchange-traded (as opposed to OTC).
Weavering Capital (UK) Ltd. v. Peterson (cont’d)

- Facts:
  - D1 Mr. Magnus Peterson – CE and MD of WCUK
  - D2 Mrs. Amanda Peterson – Director, D1’s wife, herself an experienced trader
  - D9 Mr. Dabhia – a 27-year-old director with duties including marketing and customer relationship
  - D10 Mr. Platt – a senior employee responsible for compliance and administration
Weavering Capital (UK) Ltd. v. Peterson (cont’d)

• From the beginning, D1 caused Macro to enter into OTC transactions with another (non-public) fund called WCF (set up by D1 with father and brother being nominees) to cover up losses of Macro incurred in exchange-traded transactions.

• In fact, many such transactions were simply shams to make the books of Macro look good.

• In any event, Macro’s risk was pre-dominantly skewed to the creditworthiness of WCF (which had little assets).

• Macro appeared to be making steady positive return until it failed to meet redemption requests in the fall of 2008.
**Weavering Capital (UK) Ltd. v. Peterson (cont’d)**

- Macro went into liquidation and its liquidators sued WCUK for breaches of the Investment Advisory Agreement, breaches of fiduciary duty, negligence etc.
- The Investment Agreement provided that:
  - WCUK would indemnify Macro in respect of all losses and liabilities suffered or sustained by Macro resulting or arising in any way from the fraud, negligence or wilful default of WCUK.
- Liquidators of WCUK admitted the claim and then sought reimbursement from the defendants on various grounds including: tort of deceit, breach of fiduciary duties, negligence and dishonest assistance.
Weavering Capital (UK) Ltd. v. Peterson (cont’d)

- D1 held liable for breach of fiduciary duties, negligence, deceit.

- D2 defended that her role in WCUK was confined to exchange traded transactions. The OTC transactions were not carried out by her. And that she was justified in delegating the compliance duties to outside professionals (including auditors EY and the custodian of Macro, PNC Global), other directors and senior employees.
Director (D2)

- The court took the following factors into account to hold her liable in negligence:
  - she herself was an experienced trader;
  - she was highly paid;
  - the company was relatively small so that everyone knew what everyone else was doing;
  - she knew of and approved at least some irregular OTC transactions;
  - she is to be judged against what a reasonable director should have done in her situation, not what she could have done, i.e. subjective factor such as D1 being her husband is irrelevant.
- **the test** is “whether D2’s conduct was that of a reasonable director of a hedge fund management company in her position who had her experience, actual knowledge and intelligence, and whether she had acquired sufficient knowledge of WCUK’s business to discharge her duties”.

Director (D9)

• The 27-year-old director.
• His duties include attending meetings with investors and prospective investors to discuss Macro's strategy, holdings and performance, sending out marketing materials and due diligence questionnaires of Macro and dealing with queries from investors.
• Many of his communications with investors concerning the OTC transactions were found to be false and misleading.
• The defence that he was merely passing on the messages of D1 was not sustainable.
  • As director, he failed in his duties by not acquiring sufficient knowledge and understanding of WCUK’s business and the details and propriety of the OTC transactions; and taking care in his communications with investors.
Senior employee (D10)

- D10 was regarded as D1’s right-hand man and always followed D1’s instructions.
- He sent the trade tickets for the OTC transactions to Macro’s Administrator for valuation, and circulated untrue NAV estimates to the investors.
- His bookkeeping for the OTC transactions was flawed and involved backdating, forging of documents and irregularities in documentation for the OTC transactions.
Senior employee (D10) (cont’d)

Held:

- Even though D10 was not a director and regarded his role as confined to options and futures trading, his duties to WCUK were held to be fiduciary in nature.
- He was highly paid and was entrusted to safeguard the cash and investments under WCUK’s management.
  - Therefore, he owed a duty to conduct WCUK’s business with due care, skill and diligence.
  - His compliance duty was also incorporated in his employment contract.
- In blindly following D1’s instructions in operating the OTC transactions without questions, D10 was held to be negligent.
Some food for thought…

- The cases clearly show that duties of directors and employees are owed to the company, not its controlling director or even sole shareholder, especially when the company is insolvent – this is a counter-intuitive principle overlooked by most employees every day – following the instructions of the controlling director/sole shareholder is NOT a defence to a claim for breach of duties to the company.

- Can the net be cast even wider?
  - What about the Macro’s custodian (PNC Global Investment Servicing) who was supposed to provide independent valuation of Marco’s investments?
  - What about D1’s father and brother who were (nominee) directors and shareholders of WCF? What’s the cause of action against them?
The Equitable Claim of Dishonest Assistance

- A doctrine developed in equity and trusts to hold liable those assisting a trustee to breach his duties to the beneficiaries.
- Now mainly applied in the corporate and commercial context (as directors are deemed trustee of the company’s assets).
- Formerly called “knowing assistance”, later changed name and received a boost in application since the landmark case of *Royal Brunei Airlines v Tan* [1995] 2 AC 378.
Statement of the doctrine

“A stranger* will be personally liable to account as a constructive trustee** to the beneficiaries of a trust for any loss caused to the trust by a breach of trust if the stranger assisted that breach of trust and if the stranger did so dishonestly.”

--- Alastair Hudson, Equity and Trusts (7th ed)

* “stranger” means someone not directly related to the trust.

** “account as a constructive trustee” is merely a fiction for holding the stranger liable. It does not really mean he’s a trustee. It’s not necessary for him to hold any assets of the trust in order to be liable to account.
Another formulation

“…First, a trust or, as here, other fiduciary relationship; Secondly, a breach of the fiduciary duty on the part of the fiduciary; Thirdly, a causal link between the breach and a loss to the beneficiaries (or between the breach and a gain to the defendant, as the case may be); Fourthly, assistance by the defendant in the breach; and Fifthly a dishonest state of mind on the part of the defendant.”

(Weavering Capital (UK) Ltd. v. Peterson at para. 200.)

- RBA appointed Borneo Travel Limited ("BTL") as its travel agent to sell tickets.
- BTL was supposed to keep the sale proceeds separate and remit them to RBA within 30 days. Hence, BTL was trustee of the proceeds for RBA.
- BTL used the money to pay its own expenses and debts and then became insolvent.
- RBA sued the principal shareholder and controlling director of BTL, Tan, on the ground that Tan had assisted BTL to breach the trust.
Royal Brunei Airlines v Tan (cont’d)

- The trial judge (Denys Roberts, our old CJ) held that Tan had not been fraudulent. He was merely sloppy in running his business.
- Yet, he was liable to RBA for assisting BTL to breach its duty as trustee.
- Tan’s knowledge of the trust (and the prohibition to use trust money) made him “dishonest” and rendered him liable as constructive trustee to RBA.
- CA overruled Roberts J.
- Privy Council (led by Lord Nicholls) restored Roberts J’s judgment.
Royal Brunei Airlines v Tan (cont’d)

Held (Privy Council):

- 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.
- The defendant caused BTL to apply the money in a way that he knew was not authorised. This constitutes a dishonest act.
The Equitable Claim of Dishonest Assistance (cont’d)

- Lord Nicholls emphasized that the test of honesty is an objective one i.e. what an honest person in the defendant’s circumstances and with his knowledge should have done.
- Some later cases (particularly the HL case of Twinsectra Ltd v Yardley [2002] UKHL 12) introduced some uncertainty and seem to suggest that D should be aware that what he did would be regarded as dishonest by ordinary honest people.
- Now authorities seem to be settled, especially in Hong Kong since the Peconic case (discussed below), that the test is an objective one.
The Equitable Claim of Dishonest Assistance (cont’d)

- It’s important to note that P does not need to prove that D knew the details of the trust or its breach by the trustee.
- The test is whether his own conduct in providing assistance to the trustee, in light of what he knew, would be objectively regarded as dishonest (*Barlow Clowes v Eurotrust International* [2005] UKPC 37).
The Equitable Claim of Dishonest Assistance (cont’d)

In Weavering, D10 was also sued for dishonest assistance (assisting D1 to breach his fiduciary duties) but he was acquitted of this charge. Why?

“Having heard Mr Platt over a number of days, my conclusion is that he was simply over-promoted and that he swallowed everything that Mr Peterson told him as to trade customs, compensation, authorisation and the like. He thought, indeed still thinks, that Mr Peterson's explanations made sense, especially as they were not apparently queried by Ernst & Young or by PNC. I do not think he believed that the swaps were not genuine instruments or that his statements to PNC were false. He was given too much to do and did it unquestioningly.

However, although not fraudulent within the Twinsectra test, Mr Platt was in my judgment plainly negligent. It was an implied term of his contract with WCUK that he would perform his duties with proper care: see e.g. Lister v. Romford Ice and Cold Storage Co Ltd [1957] AC 555 at 572.”
The Equitable Claim of Dishonest Assistance (cont’d)

• In *Weavering*, D1’s father and brother, who were directors of WCF, which was used to carried out OTC transactions to defraud the investors of Macro, could be sued for dishonest assistance.
• Their liability would depend on their state of mind – to what extent they were aware of D1’s fraudulent scheme.
• Note that “blind eye knowledge” could constitute dishonesty:

  “… an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless….” Per Lord Nicholls, *Royal Brunei Air v. Tan* [1995] 2 AC 378.
And don’t forget s.275, CO – fraudulent trading and the case of *Bank of India v Morris* [2005] 2 BCLC 328

- s.275 provides:

  “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.”
Bank of India v Morris

- The Bank of India was held liable under the English equivalent of s.275 of the CO because it participated, through a senior manager, in a fraudulent scheme orchestrated by the directors of BCCI (a banking group) to boost its book. Thus it was “… knowingly party to the carrying on of the business … [with an intent to defraud or for a fraudulent purpose]…”

- Note that Bank of India was liable even though:
  - It participated through a senior manager, not directors.
  - It did not know of the solvency situation of BCCI.
  - It did not know of the exact purpose of the fraudulent scheme.
  - But it did know that the scheme was commercially pointless and to the detriment of BCCI.
Assistance

- The “assistance” in dishonest assistance can take many forms:

  “Nor is [liability] limited to those who assist [the trustee] in the original breach. It extends to everyone who consciously assists in the continuing diversion of the money. Most of the cases have been concerned, not with assisting in the original breach, but in covering it up afterwards by helping to launder the money”

  per Lord Millett, Twinsectra Ltd v Yardley [2002] UKHL 12.
Solicitors as dishonest assistants...

- Solicitors involved in the fraudulent transactions involving breaches of fiduciary duties seem to be common targets:

- *Twinsectra Ltd v Yardley*: solicitors paid over loan proceeds to borrower disregarding restrictions imposed by lender.

- *Dubai Aluminium Co Ltd v Salaam*: solicitors helped prepare documentation for a sham consultancy agreement used by fraudster to defraud company.

- And the Hong Kong case of *Peconic Industrial Development Ltd v Chio Ho Cheong & Others*. 
Hong Kong: *Peconic Industrial Development Ltd v Chio Ho Cheong & Others* FACV 17/2008

The main cast:

**Agricultural Bank of China:** the victim of fraud and majority shareholder of Peconic (the Plaintiff)

**Peconic:** a JV between ABC and Chio formed for real estate investment in HK

**Chio:** a Macau businessman and legislative council member, director of Peconic, as well as controller of Asiagreat

**Elsie:** Chio’s girlfriend, a celebrity.

**Asiagreat:** purchaser of some agricultural land in Mai Po and sub-seller to Peconic

**Danny Lau:** solicitor for Chio/Elsie handling all the transactions
Mai Po Landowners

Danny Lau
Handing the acquisition transactions

Asiagreat
Sub-sale of the properties at overvalue with secret profits for Chio

$515m

$151m

Elsie Chan
Elsie Chan’s mother

Leung

... Secret profits channeled back to Chio

Chio
(director of Peconic)
Peconic Industrial Development Ltd (cont’d)

- Peconic made claims of dishonest assistance against the following parties:

1. Elsie Chan, the Chio’s girlfriend who was alleged to have played a central role in Asiagreat for conducting fraud.
2. Elsie Chan’s mother, who handled part of the proceeds of sale under fraudulent scheme so as to conceal the money trail for Chio. Also, she took up appointment of director of the Asiagreat.
3. Leung, common law wife of Chio’s brother, who was involved in setting up Asiagreat, being a nominee shareholder of Asiagreat, signed the legal documents as its director to effect the transactions under the scheme, and was involved in the transfer of proceeds of sale from Asiagreat to the director.
Peconic Industrial Development Ltd (cont’d)

4. Danny Lau, the solicitor who handled the transactions (and his solicitors’ firms (through vicarious liability)), for assisting Chio in misrepresenting the beneficial ownership of the corporate vehicle to JSM (Peconic's conveyancing solicitors), concealing Chio’s interest in Asiagreat and facilitating the Chio’s obtaining massive secret profits in the conveyancing transactions.
The test of dishonesty

*Per* Andrew Cheung J at 184:-

“It is true that strictly speaking these authorities are not binding in Hong Kong. However, I see no reason for not following the latest development of the law by the Privy Council [i.e. *Royal Brunei Airlines*]...For my part, I prefer the views of *Lord Millett* expressed in *Twinsectra* for the reasons that his Lordship explained in some detail in that case.”

- Effectively, the court adopted the **objective** test of dishonesty.
Elsie Chan

- Drove Peconic’s PRC investors to the properties for site visit.
- Accompanied Chio to meetings with Peconic’s investors.
- Gave instructions to the solicitor in the acquisition transaction.
- Negotiated with landowners for acquisition.
- Entered into commission agreement with the paper owner of Asiagreat.
- Channeled all the proceeds of sale to Chio and his nominees.
- Knew Chio was making the relevant false representations to Peconic’s PRC investors as to the development and resale potential of the properties, and the reasonableness of the unit prices of the acquisition.
- On the evidence and application of the objective test of dishonesty, the court found that Elsie Chan was a knowing and willing assistant to Chio’s breach of fiduciary duty.
Elsie Chan’s mother

- She knew (1) she was assisting Chio in earning money from a dishonest scheme involving Elsie Chan and Chio, and channelling the money so earned to himself or his nominees and (2) the money in question was not at the free disposal of Chio.
- The Court considered the following:
  - her close relationship with Elsie that she must have known the huge sum of money in question could not have been Elsie’s money but her boyfriend’s money.
  - the huge price difference between the sale and resale transaction that she was involved in as director of Asiagreat.
  - The secretive manner in which the control and ownership of Asiagreat was being concealed.
  - The manner in which money was being channelled out from Asiagreat.
  - She had obtained benefits from her involvement.
  - By applying the objective test, the court found that she was dishonest in rendering assistance to Chio’s breach of fiduciary duty.
- It was not necessary that she was actually aware of the fact that Chio was a director in Peconic and he was earning a secret profit in breach of his fiduciary duty. The court adopted what Lord Millett said in Twinsectra that it may be sufficient that the defendant knew she was assisting in a dishonest scheme.
Leung

- By applying the objective test of dishonesty, the court found that:
  - She knew she was helping Chio to receive and channel money to himself that did not belong to him and that he had no right to receive or keep.
  - She knew sufficiently about the transaction to constitute a dishonest state of mind on her part.
  - She must have suspected his so-called commission was unlawful but she shut her eyes and unduly failed to make enquiry.
  - It was unnecessary to find that she knew precisely the role of Chio in Peconic.
  - Accordingly, Leung was held to be liable for dishonest assistance of Chio’s breach of fiduciary duty.
Danny Lau

- As Elsie Chan’s solicitor, he assisted in setting up Asiagreat, the fraudulent vehicle for concealing Chio’s ultimate ownership and control of the company.
- Lau also took an active role seeking to use Macau cheques for paying deposits to the landowners in order to buy time to wait for the arrival of the huge initial deposit from Peconic’s lawyers.
- Lau also caused the paper owner of Asiagreat to give a personal guarantee in relation to the title of the land to conceal the ultimate ownership of Asiagreat.
- Significantly, Lau prepared the legal documents for releasing the sale proceeds to Chio and his nominees, where Lau must have known that Chio was Elsie Chan’s boyfriend and Peconic’s director, and the huge price difference in the sub-sale that Asiagreat and thus Choi and Elsie Chan were earning.
Danny Lau (cont’d)

• Lau chose to shut his eyes and unduly failed to make enquiry as to his suspicion.
• The CFI held that he was dishonest based on the above and given his assistance in the conveyancing transactions, he was held liable for dishonest assistance.
• However, on appeal to the CA which was affirmed by the CFA, Danny Lau succeeded in his limitation defence under section 20 and 26 of the Limitation Ordinance.
• The fraud was committed in 1991/1992
• Actions were commenced against a number of people including Chio, Elsie, her mother and other ‘assistants’ in 1999.
• However, action was somehow not commenced against Danny Lau until 2002.
Limitation period of a dishonest assistance action

Peconic’s attempt to overcome the limitation defence:-

1. Pursuant to section 20 of the Limitation Ordinance, Peconic argued that there was no limitation period to the dishonest assistance claim against Danny Lau.

2. Pursuant to section 26 of the Limitation Ordinance, the limitation period was postponed until the date of discovery which was after the six-year period before the second action in 2002, thus the action was not time-barred due to fraud and late discovery of the wrongdoing.
S. 20 Limitation Ordinance

• “(1) **No** period of limitation...shall apply to an action by a beneficiary under a trust, being an action...(a) in respect of any **fraud or fraudulent breach of trust** to which the trustee was a party or privy...”
S. 26 Limitation Ordinance

• “...where in the case of any action for which a period of limitation is prescribed...(a) the action is based upon the fraud of the defendant...the period of limitation shall not begin to run until the plaintiff has discovered the fraud, …or could with reasonable diligence have discovered it.”
Limitation period of a dishonest assistance action

- The CFA held that first, the six-year limitation period applies, as section 20 of the Limitation Ordinance did not apply to Danny Lau who was a non-fiduciary. “Trustee” in section 20 does not include a constructive trustee who is a non-fiduciary.

- Second, the beginning of the limitation period was not postponed until less than six years (see section 29(2), LO) before the action was commenced under section 26, as Peconic could with reasonable diligence have discovered the fraud before the six-year period prior to the commencement of the action against Danny Lau, given all the apparent signs known to Peconic previously.

**Held**: fraud could have been discovered in 1994 or 1995

**Claimed**: fraud was discovered in 1998

**Action commenced in 2002**

6 years

**Held**: limitation period ended in 2000 or 2001

(Accrual of cause of action)
Limitation defence: *New China Hong Kong Group Ltd v Ernst & Young* HCCL 41/2004, 2/2005

- This is an action against former auditors and director which was struck out on the ground of limitation period.

- The companies claimed against EY and Anthony Wu for **breach of common law duties** in failing to report various problems to the Companies’ management/ the Executive Committee or warn them of the same.

- EY applied to Court to strike out the claims on the ground that the actions were time-barred.
New China Hong Kong Group Ltd v Ernst & Young

Limitation periods applicable to negligence claim:
S. 31 of Limitation Ordinance:

• 6 years from the date of *accrual* of cause of action; or
• 3 years from the date of *knowledge*, if that period expires later.
Limitation defence: *New China Hong Kong Group Ltd v Ernst & Young*

- The companies relied on section 31 LO and contended the causes of action were not **accrued** until the companies’ liquidation which is within the time limit.
- The companies argued that the relevant facts were **unknown** to them so as to postpone the running of time until a moment within 3 years of the commencement of the respective actions.
- The above arguments were rejected by the CFI.

**Held:** actions accrued in around 1995-1997

**6 years**

Plaintiff’s board members had knowledge of the essential facts by then

**Held:** limitation periods ended in 2001-2003

**3 years**

**Action commenced in 2004 and 2005**

Plaintiff claimed knowledge at late stage (but failed to prove)
New China Hong Kong Group Ltd v Ernst & Young

Held:

- The independent members of the boards of the Companies (e.g. finance director of the executive committee and common director of the companies) had knowledge of the essential facts of the claims.

- By operation of the general rules of attribution, the knowledge acquired by those specifically charged with monitoring the credit positions of the clients should be imputed to the company.

- The causes of action have accrued more than 6 years before the commencement of the respective actions against the Defendants.

- The claims were time-barred.
For **breach of fiduciary duty**: although equitable relief was sought for the claims for breach of fiduciary duty, the limitation period of 6 years under s. 4(7) shall apply, as the factual basis and nature of this action is the same as the claims in negligence. Even if such claims were framed as breach of trust, the 6 years limitation period still apply in the absence of fraud in this case.

The companies were held to have knowledge of all essential facts, and the court held there had been no concealment of facts relevant to their right of action. Therefore, the **postponement** under s. 26 of the Limitation Ordinance did not assist the companies.
Unconscionable receipt

- Another important equitable cause of action.
- Often used together with unjust enrichment.

- Statement of the Doctrine:

  “Where a person knowingly receives trust property which has been transferred away from the trust or otherwise misapplied, and where that person has acted unconscionably, then that person will incur a personal liability to account as a constructive trustee to the beneficiaries of that trust for the amount of their loss.”

--- Equity and Trusts, Alistair Hudson (7th ed)
Unconscionable receipt

• It was formerly called “Knowing Receipt”. Again, name changed and given a boost by the case of BCCI v Akindele [2001] Ch 437.
• However, Lord Nicholls in Criterion Properties Plc v Stratford UK Properties LLC [2004] UKHL 28 opined that Akindele was wrongly decided in the context of its facts*.
• Nevertheless, the principles regarding unconscionable receipt propounded in Akindele are still widely accepted as authoritative and applied.

* Lord Nicholls was of the view that Akindele should be decided on ordinary principles of company and contract law – ie, whether the contract with Akindele was binding on BCCI and that in turn depends on Akindele’s knowledge of the impropriety of the transaction. The same approach was applied by Lord Nicholls in the HK CFA case of Thai Farmer Bank v Akai FACV 9/2010
A recent application: *Relfo Ltd v Jadvavarsani* [2012] EWHC 2168 (Ch)

- **Mirren (BVI)**
  - 4 May 2004: £500K (converted to **US$890K**)
- **Relfo (U.K.)**
  - 13 May 2004: **US$100K**
- **Intertrade (U.S.)**
  - Paid on 5 May 2004: **US$878K**
  - Credited on 10 May 2004 (1.3% less)
- **Director of Relfo**
Relfo Ltd v Jadvavarsani (cont’d)

• Relfo was wound up shortly after the remittance, owing HMRC over $1.4million
• Liquidator of Relfo sued D in Singapore
• Action dismissed as that tantamount to enforcing revenue claim ([2008] SGHC 105])
• Liquidator sued in UK
• The timing and amount of the Relfo/Mirren remittance matched that of the Intertrade/D payment, but the liquidator was not able to establish direct link.
• D gave completely incredible explanations of the remittances.
• Court found that, on balance, what D had received represented proceeds from Relfo.
*Relfo Ltd v Jadvavarsani* (cont’d)

- What claims could be made by the liquidator?
  
  (a) Tracing/property claim – what’s left in the account of D represented Relfo’s property.

  (b) Knowing receipt – D knew or had reason to suspect the impropriety of the payment and is liable to account to Relfo.

  (c) Unjust enrichment – D benefited at the expense of Relfo, and that is unjust.
Relfo Ltd v Jadvavarsani (cont’d)

- Held:
  
  (a) Failed – D is not a fiduciary of Relfo. Hence court would not make the assumption that money in the account (which mixed D’s own money with the Intertrade payment and there had been in and out transactions since receipt of the Intertrade payment) represented Relfo’s money. Note that if L was quick enough to get an injunction, this claim could probably succeed.

  (b) Succeeded – the evidence showed that D was most likely aware of the impropriety of the payment – the breach of duty by Relfo’s director. Hence D is liable to account to Relfo.

  (c) Succeeded – D was clearly enriched. The unjust factor is the lack of consent of Relfo, as the payment was made in breach of its director’s duty. This claim has the advantage that D’s mind set was irrelevant. But he could raise the change of position defence (which failed in this case).
Fiduciary duty at Insolvency and Unfair Preference

- Action for breaches of fiduciary duties can be used to expand the scope of “unfair preference” claims, as explained in the *Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei CACV 155/2012 AND CACV 161/2012.*
- At present, the statutory unfair preference provisions suffer from the following limitations:-
  - Many related persons do not fall within the definition of “associates” – holding companies, spouse and relatives of directors.
  - The need to prove ‘desire to prefer’.
  - The relatively short claw-back periods – 6 months (for non-associates) and 2 years (for associates).
Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei (cont’d)

- One of the claims by the liquidators against the director (Lee) was that she advised on and procured the repayment of certain commercial notes to HSBC at a time when the company was insolvent, thus causing loss to the general body of creditors.
- Liquidators relied on the principles in West Marcia and Kinsela that at a time when the company is insolvent, the interests of creditors override that of the shareholders and directors’ fiduciary duties are owed to the creditors rather than the shareholders.
- Liquidators argued that the company should have stopped trading so that more assets would be available for distribution to general body of creditors.
“Outside the regime of unfair preference, for a company to seek redress against a director for breach of duty in failing to take account of the interests of creditors, the company would need to bring itself within one of three situations: (a) it has suffered loss; (b) that the director has profited (so that the “no profit” rule operates); or (c) that the transaction in question is not binding on the company …” (per Kwan JA, at para. 27).

Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei (cont’d)
Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei (cont’d)

- The early repayments of contract notes were to extinguish genuine liabilities of the company and in discharge of trading liabilities of the company.
- However, there was no resultant depletion of the company’s net assets or increase in its net deficiency as a result of the repayments.
- In the absence of loss to the company, or profit or benefit to the director, a director is not liable to make good an early repayment of contract notes.
- The trial judge’s decision was affirmed by the Court of Appeal.
**Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei (cont’d)**

- Note that it was argued by counsel for the liquidator at the hearing that the purpose of the early repayment was to conceal the fact from the Exchange and public that the company had breached its financial covenants under the loan, and that if not for such concealment, the company would have entered into provisional liquidation much earlier. Hence the director (Lee) was breaching her fiduciary duties in not procuring the early repayment.

- However, Kwan JA did not consider this argument in details as she found that it had not been properly pleaded in the pleadings. It is submitted that there could be some force in the liquidators’ argument on this point.
West Mercia Safetywear Ltd v Dodd [1988] BCLC 250

- D was the director of the company and its holding company. D had guaranteed the overdraft of the holding company.
- D caused the company to transfer a sum of money to its holding company in partial repayment of amounts it owed to the holding company.
- At the time of the repayment, 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.
West Mercia Safetywear Ltd v Dodd (cont’d)

Held:-

• Once a company was insolvent, the interests of the creditors overrode those of the shareholders.
• The director knew the company was insolvent when he caused the money to be transferred to its holding company.
• The transfer was a fraudulent preference made solely to relieve the director of personal liability under his guarantee in disregard of the interests of the company’s creditors.
• The director was guilty of a breach of duty and should be ordered to repay the amount transferred with interest.

• **Note** that this case was decided NOT on the basis of statutory unfair/fraudulent preference, but on general fiduciary duties of directors.
Fiduciary duty at Insolvency and Unfair Preference (cont’d)

• The position seems to be that:-
  • If a payment at the time of insolvency is not caught by the unfair preference provisions, it could still be set aside as an act in breach of fiduciary duty (to the creditors) on the *West Mercia* and *Kinsela* principle.
  • However, unless the directors or their associates somehow benefit from such payment, **normal payment in the ordinary course of business for a legitimate loan** will not be regarded as breach even if it reduces assets available for distribution.
Final words

- This seminar is not an exhaustive discussion of all actions available to liquidators. (There’re many others.)
- The claim for negligence is potentially useful and could be used against not just the directors in direct charge, but other ‘independent’ directors and senior employees who failed to prevent the breach of duties to the company.
- The claim in dishonest assistance can much widen the net to cover many more targets (including solicitors!)
- If an unfair preference payment is not caught by the statutory provision, check if a claim in breach of fiduciary duty could catch it.
- Be mindful of limitation periods – be diligent, otherwise liquidators could become the target of negligence claims!

- So, back to work now.
solutions • not complications