Cross-border assets recovery:

battlefield Hong Kong
A typical scenario
Company A (SG, with business in HK)

Director X (HK)

A suffered loss from X’s breach of trust and fiduciary duty and was wound up in SG.

Money payable to A

A’s customers

Bank C (A1’s accounts)

Money maintained in A1’s accounts has been depleted.

Company A1 (HK)

2 Secret commission to X through A1 for discounted sale of A’s products.

3

Question: What can the Singaporean liquidators do?

Through nominee service by Com Sec Ltd.

4

Y
The facts

- Company A is incorporated and headquartered in Singapore with business across Asia.
- Director X was based in HK and looked after business in HK and China.
- Director X set up Company A1 in HK (using nominee service by Com Sec Limited) and channelled money payable to A into the accounts of A1 maintained with Bank C.
- Director X accepted secret commission from Y through A1 and sold A’s products to Y at a discount.
- The acts of X have caused Company A great loss and it was wound up. Liquidators were appointed in Singapore.
- Money in accounts of Company A1 has been depleted.

What could the liquidator do?
Focus

- Can foreign liquidators exercise their powers in Hong Kong?
- How to identify the defendants and claims?
- How to trace the value of the assets?
- How to recover from third parties?
Can foreign liquidators exercise their powers in Hong Kong?
Recognition of foreign liquidation

• As Godfrey JA said in Chen Lei Hung v Ting Lei Miao [1998] 3 HKC119:-

“It has been settled for centuries, in England and Wales, that the court may recognise and give effect to, foreign bankruptcy proceedings where no question has arisen as to the jurisdiction of the foreign court over the bankrupt…notwithstanding that the foreign insolvency proceedings may be of a very different nature from ours and that a decree in such proceedings pronounced by a foreign court cannot be equated with a foreign judgment...."
Recognition of foreign liquidators

- A liquidator or similar officer (such as receiver, Official Examiner, administrator, etc.) who has been appointed by a foreign court in a manner which the Hong Kong court recognises as valid will be recognised in Hong Kong as being entitled to:
  
  - control the assets in question; and
  - sue in the Hong Kong court.

- Despite the recognised foreign liquidator’s power to control the assets in question, the scope for the outcome of the foreign winding-up may be different from what it would be in Hong Kong (e.g. a foreign law may not provide for a vesting of assets in the foreign liquidators).

- To protect himself, a person in control of the assets in Hong Kong may seek a Hong Kong court order to authorise the paying over of assets to such a person.
What are the requirements for recognition?
Validity of foreign court’s jurisdiction

- The Hong Kong court will generally regard a foreign court’s jurisdiction over a company as valid based on any of the followings:-

  1. its domicile in the relevant foreign place;
  2. its having submitted to the jurisdiction; and
  3. the place of incorporation recognises the order as having a worldwide effect.

By applying a broader principle, where the matter has a reasonable connection with the foreign place, it may suffice for recognition of the foreign jurisdiction (Re Russo-Asiatic Bank (1930) 24 HKLR 16; BCCI (Overseas) Ltd. v BCCI (Overseas) Ltd. (Macau Branch) [1997] HKLRD 304, CA (Hong Kong).
Judicial cooperation
Insolvency protocols

- An insolvency protocol is a document that seeks to promote cooperation between the courts and parties with an interest in the insolvency.
- In practice, an insolvency protocol usually consists of a set of guidelines and statements of intention on agreement among liquidators appointed to run insolvency proceedings in respect of a company or a group of companies opened in different jurisdictions.
- An insolvency protocol is not legally binding or legally enforceable – however, in HK, if anyone is aggrieved by the HK liquidator not abiding the protocol, an application to court for directions could be made under s.200(5) Companies Ordinance.
Insolvency protocols in Hong Kong

- Insolvency protocol was first adopted by the US and English courts in 1991 during the large-scale bankruptcy of Maxwell Communication Corp.
- In recent years, the Hong Kong courts have adopted cross-border protocols by the liquidators in a number of reported cases. (e.g. *Re Jinro (HK) Int’l Ltd* (unrep., HCCW 1352/2001, 9 July 2003))
Hong Kong court’s approach to approving protocols

- In Hong Kong, there is no legislation dealing with matters affecting cross-border insolvency.
- Unlike the United Kingdom, there is no legislative provision equivalent to section 426 of the Insolvency Act 1986 providing for co-operation between courts exercising jurisdiction in relation to insolvency.
- Given the above situation, a Hong Kong court may adopt a limited supervisory role as a general approach to an application for approval of an insolvency protocol.
- In ordinary situation, the court is ready to accept the professional judgment of insolvency practitioners appointed to act as liquidators who have put together the protocols as a pragmatic solution to harmonise and co-ordinate concurrent liquidations (Re Kong Wah Holdings Ltd & Another [2004] 1 HKLRD C9, C11 ).
Identifying principal/ancillary proceedings

• The general rule for identifying the principal jurisdiction is by reference to the domicile of the debtor company.

  Place of incorporation
  • The starting point for identifying the domicile is to refer to the place of incorporation of the debtor company.

  Place of substantial business, liabilities and assets
  • Where there is no substantial business in the place of incorporation, the HK court may defer to the forum in the place of the company’s substantial business.
    • Where a BVI company’s assets and liabilities are virtually all located in HK, or closely connected with HK, HK court could assume jurisdiction. However, see: Kam Kwan Sing v. Kam Kwan Lai [2012] HKCFI 1672, and Re Gottinghen Trading Limited HCCW 740 & 741 of 2009
Identifying principal/ancillary proceedings (cont’d)

- Where the company is subject to an appropriate insolvency proceeding in foreign jurisdiction, there is no real benefit to be obtained from the Hong Kong court’s involvement which would indeed add costs, the court may refuse to appoint liquidators even on an ancillary basis. (*Re Legend International Resorts Ltd* [2005] 3 HKLRD 16)
How to identify the defendants and claims?
Liquidator’s statutory power of investigation
Private examination – s.221 Companies Ordinance
- a very powerful investigative tool (applicable to non-HK companies)

(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 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 any person whom the court deems capable of giving information concerning the promotion, formation, trade, dealings, affairs, or property of the company.

(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.

(3) The court may require him to produce any books and papers in his custody or power relating to the company, but, where he claims any lien on books or papers produced by him, the production shall be without prejudice to that lien, and the court shall have jurisdiction in the winding up to determine all questions relating to that lien.

(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.
**Re Information Security One Ltd [2007] 3 HKLRD 780**

- A Cayman Islands company registered in Hong Kong as an oversea company.

- The Company was ordered to be wound up by the Court in the Cayman Islands and liquidators were appointed.

- The liquidators initiated new liquidation in Hong Kong under s. 327 CO to seek the assistance of the Hong Kong court to recover assets within its jurisdiction and to invoke the procedure under s.221 CO for the examination of various directors.

- The court ordered the Company be wound up. S. 221 CO could be invoked accordingly.
“Norwich Pharmacal” discovery
“Norwich Pharmacal” discovery

• Purpose
  • To enable a person to ascertain the identity of a wrongdoer so that the appropriate remedies can be pursued against him.

• Who may be ordered to disclose?
  • Any person who was directly or indirectly involved in the wrongdoing that he/she might have knowledge of the relevant information.
“Norwich Pharmacal” discovery

• What may be ordered for disclosure?
  • Identity of the wrongdoers; or
  • Information showing that a person committed the wrong: *A Co v B Co* [2002] 3 HKLRD 111 and *Kensington International Ltd v ICS Secretaries Ltd* [2007] 3 HKLRD 29 (see next slide).

• Safeguard
  • The information ordered to be disclosed must be specific and restricted to those or those classes of documents that are necessary to enable the applicant to preserve or discover assets.
A Co v B Co [2002] 3 HKLRD 111

P (US) (Plaintiff)

P's Employee (Intended defendant)

"Norwich Pharmacal" relief

Bank

SHL (BVI)

ALIL (Macau)

Secret profits to P

XS (PRC)
A Co v B Co [2002] 3 HKLRD 111

• P’s employee was in charge of P’s operation in the PRC and contacted many PRC companies.

• P utilised XS (a PRC company) to develop its sourcing operations in Asia

• P’s employee received secret profits from XS.

• The money was apparently deposited into ALIL (a Macau company), then into the account of a SHL (BVI company) held at the defendant’s bank.
A Co v B Co [2002] 3 HKLRD 111

• Scope

  • The jurisdiction to grant Norwich Pharmacal relief is wide and not restricted to discovery of names of wrongdoers.

  • The subject of discovery can be extended to bank books and documents to assist the plaintiff to investigate the passage of money in tracing a claim.
Kensington International Ltd v ICS Secretaries Ltd
[2007] 3 HKLRD 297

P (judgment creditor)

Seek “Norwich Pharmacal” relief

ICS

Company secretary

The Congo (judgment debtor)

The Companies (alleged emanations of the Congo)
**Kensington International Ltd v ICS Secretaries Ltd**

- After obtaining information under the first Norwich Pharmacal order, P found gaps in the previous disclosure and the need to identify additional wrongdoers.

- Further application based on the information supplied after the first Norwich Pharmacal relief to seek additional information must be both **reasonable and necessary**.
  - The information sought must serve a legitimate purpose.
  - E.g. information as to the flow of funds and location of the assets which may be attached by way of enforcement of the judgments in order to assist the applicant to identify additional parties who had assisted the defendant in evading enforcement of the judgments.
Asset tracing
Identifying claimable assets by tracing

- An insolvent company may pursue personal action against someone who “knowingly received” the company’s assets but who no longer has the property or its proceeds.

- The liquidators have to show that the property that has been received by the defendant is property which the company has an equitable interest.

- This can be established by tracing the value of the property from the original property in which the company had an equitable proprietary interest into the substitute property that was received by the defendant.
Example:
in breach of fiduciary duty, Director X misappropriated Company A’s funds and transferred them to A1’s bank account and then used the money to buy a house.

1. The company has an equitable interest in the misappropriated funds.
2. The company’s proprietary interest in the money transferred to and deposited in A1’s accounts is established.
3. The company’s proprietary interest in the house is established.

Diagram:
- Director X
- Company A
- Misappropriated funds
- Tracing
- Money in A1’s accounts maintained with Bank C
- Tracing
- House
Tracing rules

- **Unmixed funds**
  - Where money owned in equity by the company has not been mixed and has been used to buy substitute property (clean substitution), the company can trace through to the substitute property (*Re Hallet’s Estate* (1880) 13 Ch D 696, 709 (Jessel MR)).

- **Mixed funds with the money of the person in breach (e.g. director)**
  - The person is presumed to exhaust his own money first, irrespective of the order in which money was paid into the account, unless the fiduciary can distinguish the separate assets (*Re Hallet’s Estate* (1880) 13 Ch D 696, 709 (Jessel MR)).
Unauthorized profits – personal or proprietary?
Example:
in breach of fiduciary duty, Director X used his position in Company A to make unauthorized secret commission.

Director X — Company A

? Is there any proprietary claim?


Does the company have equitable interests in the secret commission?

Can the company establish an equitable interest in A1’s accounts and the house?
Is the claim against the ex-director for the unauthorized profits a personal claim or a proprietary claim?
The significance

• If proprietary, the liquidators could trace into the unauthorized profits and are protected in the event of the ex-director’s bankruptcy.

• A proprietary claim would also make it easier for the liquidators to obtain necessary Mareva injunction to protect their claims.

• If personal, the liquidators could only prove in the ex-director’s bankruptcy and could not lay a tracing claim.
Is the claim against the ex-director for the unauthorized profits a proprietary claim?

Lister v Stubbs
(1890) 45 Ch D 1
(CA)

No

AG for HK v Reid
[1994] 1 AC 324
(Privy Council; on appeal from NZ)

Yes

Which route will HK follow?
Sinclair Investments (UK) Ltd v Versailles Trade Finance
[2011] EWCA 347

CA decision:-
• Reid is wrong. Lister is right – no proprietary claim.
• The issue is now settled in England.

Which route will HK follow?
Sinclair Investments (UK) Ltd v Versailles Trade Finance

TPL (proprietary claim against ex-directors’ unauthorised profits) vs Bank (security)
**Sinclair Investments (UK) Ltd v Versailles Trade Finance**

- C (crook) set up a company TPL to solicit investors.
- C set up another company VGP (the holding company of VTF) purportedly investing money (collected by TPL) in trade financing transactions.
- In fact no trade financing transactions had ever been conducted.
- Somehow VGP got listed in London Stock Exchange (!) and its share price soared as a result of fictitious accounting showing increasing profits.
- C sold some of VGP’s shares and made a handsome profit.
- C used part of the money to buy a house.
- VGP or VTF had no money to repay TPL.
**Sinclair Investments (UK) Ltd v Versailles Trade Finance**

Claims:-

- TPL claimed that the profits C made from sale of VGP’s shares were obtained by C as a result of breach of fiduciary duties to TPL.
- TPL should have a proprietary claim over the profits in accordance with Reid.
- Hence it could trace the money into the house, which was taken over by the banks which had a security interest over the house.
- This is a fight between TPL and the banks.
- The court rejected TPL’s proprietary claim to the proceeds of sale of VGP’s shares, and held that a claimant could not claim proprietary ownership of an asset purchased by the defaulting fiduciary with funds which, although they could not have been obtained if he had not enjoyed his fiduciary status, were not beneficially owned by the claimant or derived from opportunities beneficially owned by the claimant.
How to recover from third parties?
Company A (SG, with business in HK)

Director X (HK)

Depending on knowledge/fault, Bank C may be liable for knowing receipt.

Money payable to A

A’s customers

Bank C (A1’s accounts)

Company A1 (HK)

Secret commission to X through A1 for discounted sale of A’s products.

Money maintained in A1’s accounts has been depleted.

Y

A suffered loss from X’s breach of trust and fiduciary duty and was wound up in SG.

Through nominee service by Com Sec Ltd.
Claims against recipients

- Where a third party has received property of the insolvent company in breach of trust or fiduciary duty, but has subsequently transferred the property to the others without obtaining an identifiable substitute, such third party can still be personally liable for the value of the property received.
Claims against recipients (cont’d)

- Common law personal claims
  - Action for money had and received
  - Action for debt
    - *Lipkin Gorman (a firm) v Karpnale Ltd* [1991] 2 AC 548
- Equitable personal claims
  - Action for unconscionable receipt
    - *BCCI v Akindele* [2001] Ch 437
    - *Akai Holdings Ltd (in Liquidation) v Thanakharn Kasikorn Thai Chamkat (Mahachon)* [2010] HKCFA 63
Unconscionable receipt (cont’d)

• The liquidator must show the followings:-
  • Receipt of property by third parties;
  • The company’s equitable proprietary interest in the property;
  • Breach of trust or fiduciary duty;
  • Beneficial receipt; and
  • Fault (or unconscionability).
Applicable level of fault

  - Employees of a company entered into an artificial investment agreement under which the defendant can receive US$17m from the company by investing US$10m for a short while.
  - The liquidators of the company sued the defendant for receipt of the money knowing the above breach of fiduciary duty.
  - The defendant was held not liable.
  - The liquidator failed to prove the recipient’s actual knowledge of the circumstances relating to the breach of trust or fiduciary duty.
  - Thus it could not be established that it was unconscionable for him to retain the benefit of the property that had been received.
What constitutes unconscionability?

- Suspicion
  - Any suspicion must relate to the particular transaction rather than the general reputation of the company. (*BCCI v Akindele*)
  - General suspicion about the nature of the fiduciary’s conduct is not sufficient to constitute unconscionability; it must relate to the particular transaction involving the transfer of property. (*Abou-Rahman v Abacha*)
- Dishonesty
  - This is not a necessary element for receipt-based claim, as receipt might be passive and dishonesty was considered only to relate to actions. (*BCCI v Akindele*)
  - However, while Lord Millet in *Dubai Aluminium Co Ltd v Salaami* [2002] UKHL 48 confirmed that the liability for receipt claim is fault-based, he concluded that it was founded on allegations of dishonesty and described it as dishonest receipt.
Depending on knowledge/fault, Bank C may also be liable for fraudulent trading.

Money payable to A

Money maintained in A1’s accounts

Secret commission to X through A1 for discounted sale of A’s products.

Through nominee service by Com Sec Ltd.
Relfo Ltd v Jadvavarsani [2012] EWHC 2168 (Ch) (27 July 2012) - application of tracing claim

- Mirren (BVI)
  - £500K
- Relfo (U.K.)
- Director of Relfo
- Intertrade (U.S.)
  - US$890K
- D (Singapore)
  - US$100K
Relfo Ltd v Jadvavarsani [2012] EWHC 2168 (Ch) (27 July 2012) - application of tracing claim

- 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 [2012] EWHC 2168 (Ch) (27 July 2012) - application of tracing claim

• 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’s unjust
Relfo Ltd v Jadvavarsani [2012] EWHC 2168 (Ch) (27 July 2012) - application of tracing claim

- **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).
Fraudulent trading

• s.275 of the Companies Ordinance of Hong Kong:

"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 [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 Khalil.
  - BCCI deposited sums of money with BOI, while BOI lend the same amount of money to Khalil at a slightly higher rate.
  - BOI benefited from the higher interest rate by lending to Khalil.
  - The loans from BOI were used to credit the heavily overdrawn accounts of Khalil to give the false impression that the indebtedness was being repaid by Kahlil.
The liquidators of BCCI claimed against BOI for being knowingly a party to fraudulent trading by BCCI.
Bank of India v Morris

- Held:-
  - BOI was dishonest as it knew the transactions were dishonest and chose to turn a blind eye on this when entering into the transactions.
Company A (SG, with business in HK)

Director X (HK)

Through nominee service by Com Sec Ltd.

Bank C (A1’s accounts)

Company A1 (HK)

A’s customers

Y may be liable for dishonest assistance.

Money payable to A

Money maintained in A1’s accounts has been depleted.

Secret commission to X through A1 for discounted sale of A’s products.

③ A suffered loss from X’s breach of trust and fiduciary duty and was wound up in SG.
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.
Dishonest assistance

- The liquidator must show the following elements:-
  - 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.
Royal Brunei Airlines v Tan

- Tan (Defendant) (Third party)
- B.L.T. (insolvent) (Trustee)
- B.L.T.’s creditors
  - Proceeds of ticket sale
  - Royal Brunei Airlines (Plaintiff) (Beneficiary)

Breach of trust

Principal director and shareholder

Agent
Royal Brunei Airlines v Tan (cont’d)

- The plaintiff appointed B.L.T. as its travel agent to sell air tickets.
- B.L.T. was expected to account to the plaintiff for the proceeds of tickets sale, but it used the money to pay off its own debts and then became insolvent.
- The plaintiff sought a remedy from Tan, the principal shareholder and controlling director of B.L.T., on the ground that Tan had assisted B.L.T. to breach the trust.
The test of dishonesty

- 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 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.
- The defendant caused B.L.T. to apply the money in a way that he knew was not authorised. This constitutes a dishonest act.
- Held (Privy Council): Tan was liable as an accessory.
The test of dishonesty (cont’d)

• Dishonesty – How to define? Subjective? Objective? Hybrid?

• After Royal Brunei Air, some English HL and PC and CA authorities contain conflicting descriptions of the test.
  • Twinsectra Ltd v Yardley [2002] UKHL 12
  • Barlow Clowes v Eurotrust International [2005] UKPC 37
  • Abou-Rahmah v Abacha [2006] EWCA Civ 1492

• The position in HK appears to be settled in favour of the objective test.
Hong Kong court’s position as to the test of dishonesty

- *Peconic Industrial Development Ltd v Chio Ho Cheong & Others* HCA 16255/1999, 3083/2002

*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...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.
Thank you!
solutions • not complications