How to assess whether a series of complicated transactions entered into by a bankrupt were at an undervalue or with intent to defraud creditors?

Introduction

In the recent case of *Yeung Lui Ming and Lai Kar Yan v Tang Mo Lin, Irene and Cheong Tai International Holdings Limited* [2019] HKCFI 1848, the Court scrutinized a series of complex transactions that disposed of the assets of a bankrupt and a company controlled by him. The transactions involved transfer of shares held by the bankrupt and sale of cemetery sites held by a company controlled by the bankrupt. The case is a good illustration of how such transactions would be assessed by the Court in the context of s.49 of the Bankruptcy Ordinance (Cap. 6) ("BO") (transactions at an undervalue) and s.60 of the Conveyancing and Property Ordinance (Cap. 219) ("CPO") (Voidability of dispositions to defraud creditors).

The Facts

A Sales and Purchase Agreement purportedly dated 23 January 2007 (the “Share Transfer Agreement”) was made between Wong Yuk Tung (the “Bankrupt”) and Tang Mo Lin ("Tang"), for the Bankrupt to sell 20% of Class B shares in Cheong Tai International Holdings Limited ("Cheong Tai") for a consideration of HK$60 million to Tang, shareholder of the remaining 80% of shares.

One of the pre-conditions of executing the Share Transfer Agreement was that the Bankrupt should, at no consideration, procure Bright Success Management Company Limited (“Bright Success”) to transfer the legal and beneficial ownerships of 38 cemetery sites to Wintop Inc Ltd. Bright Success was majorly owned and controlled by the Bankrupt, whereas Wintop Inc was Tang’s nominee company. On 7 June 2007, a deed was executed to effect the transfer of the cemetery sites (the “Cemetery Sites Transfer”). An average price of around HK$47,000 each was paid as consideration whereas the market price at that time was up to HK$100,000.

On 6 February 2009, a bankruptcy petition was presented and a bankruptcy order was subsequently made against the Bankrupt due to his failure to indemnify for the huge debts owed by his companies.

The Plaintiffs were trustees of the Bankrupt’s estate (the “Trustees”). They sought an order under s.49 of the BO to remedy the losses based on the fact that the transactions were at an undervalue. They also argued that such dispositions were made with intent to defraud creditors, therefore should be void according to s.60 of the CPO.
Ascertaining the date of the transactions

The Agreement was purportedly dated 23 January 2007, just about two weeks before the filing of the bankruptcy petition against the Bankrupt. If the transactions were regarded as having entered into on that date, then, under s.51 of the BO, it would be outside the two-year period of bankruptcy and in order to invoke s.49 of the BO, the Trustees would have to prove the insolvency of the Bankrupt at that time.

However, the Trustees contended that circumstantial evidence such as the date of the actual payments and the date of the Cemetery Sites Transfer showed that the Agreement was actually entered into in May 2007. The solicitor who prepared and witnessed the Share Transfer Agreement was not called by Tang to give evidence. The Court held that it was entitled to rely on the doctrine of contra spoliatorem to hold against Tang on this issue. In any event, the Court held that as the actual transfer of the shares and the cemetery sites took place in May 2007, these transactions could be regarded as having entered into in May instead of the purported date of the agreement.

How to assess whether a series of composite transactions was at undervalue

In the transactions between the Bankrupt and Tang, the Bankrupt transferred his shares in Cheong Tai to Tang, and also undertook to procure Bright Success to transfer 38 cemetery sites to Tang. First, the Court applied the English case of Phillips v Brewin Dolphin Bell Lawrie Ltd [2001] 1 WLR 143 and held that both the value of the shares and the cemetery sites have to be taken into account in assessing the value of the consideration moving from the Bankrupt, even though the cemetery sites were not directly owned by the Bankrupt but by a company controlled by him.

As for the consideration moving from Tang, firstly, the price of the Bankrupt's shares in Cheong Tai was agreed at HK$60 million. In the absence of expert evidence from the Trustees on the value of such shares, the Court accepted that this figure itself was not an undervalue. However, the Share Transfer Agreement provided that about HK$14 million of the consideration was to be paid by cash (and the Court found that Tang did make such payment), and the balance of about HK$46 million was to be paid by Cheong Tai transferring the debts totalling in such amount owed by companies controlled by the Bankrupt and his son (the “Perfecta Group”) to the Bankrupt.

The Court found that the Perfecta Group was in fact insolvent at the time of the Share Transfer Agreement. Hence, the value of such debts was merely illusory. On such ground, the Court held that the transfer of shares by the Bankrupt was at an undervalue.
Further, regarding the Cemetery Sites Transfer by Bright Success to Tang’s nominee, the Court also found that it was at a total undervalue of HK$1,595,455.84. Although it was not a transfer directly made by the Bankrupt, he suffered a diminution in value of his shares in Bright Success. The Court held that this should be taken into account in assessing the amount of undervalue.

**What is meant by “significantly less”?**

S.49(3) of the BO defines “undervalue” as “a consideration the value of which, in money or money’s worth, is significantly less than the value, in money or money’s worth, of the consideration provided by the debtor”. The Court confirmed that there is no hard and fast formula for determining what amounts to “significantly less”. It is a question of fact to be determined by the Court by comparing the absolute and relative values of the shortfall to see whether the consideration paid was significantly less than “what a reasonably well-informed purchaser was prepared to pay in arm’s length negotiations”. The market price at time of the transaction would be a reasonable indicator for comparison.

In this case, the Court also considered the nature of transaction when doing the comparison. It stated that when the transaction value is at the lower end, the absolute difference should carry more weight; whereas at the higher end, the relative value should be more important to the Court’s determination. According to previous cases and authorities cited, a 2.6% difference in a $700,000 transaction was not regarded as “significantly undervalue”, while a 15.5% shortfall was.

**Disposition with intent to defraud creditors**

The Trustees’ claim was also based on s.60 of the CPO, claiming that the Share Transfer Agreement shall be voidable for being dispositions made with intent to defraud creditors. In this case, since Tang had provided consideration for the Share Transfer, the Court applied the dictum of Ribeiro PJ in *Tradepower (Holdings) Ltd v Tradepower (HK) Ltd* FACV 5/2009 that:

“…in cases where the disposition is made for valuable consideration, or where the disponor is not insolvent or where the disposition does not deplete the fund potentially available to the creditors, an actual intent to defraud creditors must be shown as an inference properly to be drawn on the available evidence before s.60 is engaged.”

Hence, the Court held that the Trustees had the burden to show actual intent to defraud.

The Trustees argued, and the Court agreed, that the Bankrupt and Tang had a close and tight business relationship of being co-investors and co-directors of several companies over three decades. Tang had also heavily lent up to HK$530 million to help the Bankrupt with his
finances. After his bankruptcy, Tang continuously supported the Bankrupt and his son by employing them and providing them a roof at one of her luxurious apartments.

In view of these, the Court was convinced that both of them must have had prior knowledge of the failing financial conditions of the Bankrupt and his companies at time of the Agreement. The Court also inferred that the Bankrupt must be morally urged to reciprocate Tang’s support by making the Share Transfer Agreement, so that Tang could recover a substantial amount of debts and become the sole owner of Cheong Tai. Whereas for Tang, she showed an uncooperative attitude towards the Trustees’ investigation and repeatedly refused to provide information until threatened by two court summonses. Moreover, she consolidated the two classes of shares in Cheong Tai, diluting the Bankrupt’s Class B shares so that they became no longer identifiable. The Court therefore believed she felt entitled to the Bankrupt’s gratitude and was attempting to hide the unwarranted benefits she obtained.

The Court’s Decision

The Court concluded that the transactions were made at a significant undervalue of some 79.37% (factoring in the illusory consideration) and also dispositions with intent to defraud creditors. As it was impossible to recover the diluted Class B shares in specie after the consolidation, to remedy the loss, Tang was ordered to repay the shortfall in consideration to the Bankrupt’s estate. The total shortfall was adjudged to be HK$47,622,868.84, which included (i) the illusory set-off portion of consideration amounting to HK$46,027,413 and (ii) the unreceived consideration consisted of the loss in value of the Bankrupt’s Bright Success shares amounting to HK$1,595,455.84.

For enquiries, please contact our Litigation & Dispute Resolution Department:

E: insolvency@onc.hk  T: (852) 2810 1212
W: www.onc.hk       F: (852) 2804 6311

Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

Published by ONC Lawyers © 2019