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Review and Update on Insolvency Recovery Actions

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22 October 2018

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Scope of Talk

- Major amendments to the Companies (Winding Up and Miscellaneous Provisions) Ordinance **("CWUMPO")** in 2017 relevant to recovery actions
- Unfair Preference
- Transaction at an Undervalue
- Post-Petition Disposition
- Transaction to Defraud Creditors

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Major Amendments to CWUMPO in 2017

Effective on 13 February 2017

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Transactions at an Undervalue

- In the past, transactions at an undervalue are voidable in personal bankruptcy (s.49, Bankruptcy Ordinance ("**BO**")) but not in winding-up of companies. Now s.265D CWUMPO give the courts have power to set aside transactions at an undervalue entered into by a company

Unfair Preferences

- In the past, liquidator of company needed to make cross-reference to the BO to set aside an unfair preference; Now, we have an independent s.266 CWUMPO to deal with an unfair preference made by the winding-up company

Associates and Connected Persons

- CWUMPO now has its own definition of "associate" and "person connected with a company" (ss.265A, 265B and 265C CWUMPO)

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Floating Charge (s.267, 267A, CWUMPO)

- In the past, liquidators may challenge a floating charge created within 12 months prior to the commencement of the winding up if insolvency immediately after the creation of the charge can be proved and unless new money was provided in return of the creation of the charge

- Now, the clawback period is extended to 2 years if the floating charge is created in favour of persons connected with the company

Unfair Preference

Section 266 CWUMPO

Section 50 BO

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Unfair Preference

- Unfair preference is a most commonly used instrument in the Insolvency Practitioners' toolkit. Yet its application is wrought with difficulties and uncertainties, as is illustrated by some recent cases in which the Insolvency Practitioners' claims were dismissed with costs.

- The difficulty arises from a fundamental policy choice between:-
  - Ensuring "fair" treatment of all creditors and *pari passu* distribution
  - Protecting legitimate commercial transactions from being upset (which may create uncertainties over validity of completed transactions)
  - Promoting a rescue culture

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- The policy choice was made by a rather elaborate set of rules contained in the BO and CWUMPO, which is centered around the concept of “desire to prefer”

- Transactions undertaken within the twilight period (6 months for all and 2 years for associates, when the company is insolvent) putting a creditor in a preferred position will be set aside if it’s entered into by the debtor with a “desire to prefer” that creditor

Note:

1. In some jurisdictions (US and Australia), all transactions within the twilight period will be set aside irrespective of the debtor's mental state.

2. It's arguable if the policy choice has been rightly made. Since case law suggests that any inference of 'desire to prefer' could be negated by positive pressure applied by the creditor on the debtor, the law as it stands now encourages creditors to apply pressure and get paid at the first sight of trouble, which is not conducive to debt restructuring and rescue.

3. The mental state of the preferred creditor is entirely irrelevant – see *Re Stealth Construction Ltd* [2011] EWHC 1305 – completely innocent creditor could be found liable to clawback.

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Re Stealth Construction Ltd [2011] EWHC 1305

Facts:

- Mrs. Ireland lent money to her sister's company on a second mortgage at a time when the company was not insolvent. However, the sister forgot to register it until about one year prior to winding-up, when the company had become insolvent.

Held:

1. The desire to prefer was to be assessed at the time when the debtor decided to enter into transaction, NOT the time of actual transaction.
2. However, if there was a long time lag, the debtor would be taken to have made a second decision at the time of the actual transaction.
3. The time when the mortgage was entered into was not a relevant time (because company not insolvent), but the time when it was registered was relevant (because the company was insolvent).
4. Mrs. Ireland was completely innocent. Yet she was not able to rebut the presumption and found liable for unfair preference.

The last para of the judgment :

I wish only to add this. Mrs. Ireland is an entirely innocent participant in all this, as no doubt are other creditors of the company. Section 239 focuses not on the conduct or state of mind of the creditor concerned, but on that of the directors or others acting for the company. In many cases, the preferred creditor will share the desire to be preferred but this need not be so. It is not the case with Mrs. Ireland who reasonably believed that she already had the benefit of a charge until October 2008 [time of discovery of non-registration] and that she received no more than her due. The result in this case implies no criticism of her at all.

- Subjective mental state is notoriously difficult to define, not to say prove.

- Since the IP, in order to invoke the unfair preference provisions, need to establish the debtor's 'desire to prefer', which is a subjective mental state, the claim is often uncertain.

- What exactly is meant by 'desire' and how's it different from 'intention'?

- This is purportedly explained in a most oft-cited passage by Lord Millet in *Re MC Bacon Limited* [1990] BCLC 324

Lord Millet's main points are that:-

1. In 1986, the law was changed. The old test (for fraudulent preference) of 'dominant intention' was changed to 'desire to prefer" (for unfair preference).
2. 'Intention' is different from 'desire'.
3. A man usually intends the (foreseeable) consequences of his action, but doesn't necessarily desire such consequences.
4. A debtor who gave a preference to a creditor of course had the intention to do so, but he didn't necessarily desire that creditor to be preferred.

5. To establish voidable preference, it's sufficient that the desire was one of the factors influencing the debtor's mind, not the sole, or even balance-tipping factor.
6. "Desire" in this section means the desire to put the preferred creditor in a better position in the event of an insolvent liquidation.

UK Insolvency Act 1986 v. Hong Kong Cap 32

Before proceeding further in our discussion, it's necessary to first clarify some terminology issues. Note the following difference in the wording of the UK and HK statues:-

UK Insolvency Act 1986		Hong Kong Cap 32	
Section 239(2)	Where the company has at a relevant time (defined in the next section) given a preference to any person, the office-holder may apply to the court for an order under this section.	Section 266(2)	If the company has at a relevant time (within the meaning of section 266B) given an *unfair preference* to a person, the liquidator may apply to the court for an order under subsection (3).
Section 239(3)	Subject as follows, the court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if the company had not given that preference.	Section 266(3)	Subject to section 266C, on an application under subsection (2), the court may make an order that it thinks fit for restoring the position to what it would have been if the company had not given that unfair preference

See the difference? Any significant implications on the law?

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UK Insolvency Act 1986 v. Hong Kong Cap 32

Probably no. See:

UK Insolvency Act 1986		Hong Kong Cap 32	
Section 239(5)	The court shall not make an order under this section in respect of a *preference* given to any person unless the company which gave the *preference* was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (4)(b).	Section 266(4)	The court must not make an order under subsection (3) unless the company was influenced, in deciding to give that *unfair preference*, by a desire to produce in relation to that person the effect mentioned in section 266A(1)(b).

- The title of s.239 IA is: Preferences (England and Wales)
- The title of s.266, Cap 32 is: Unfair preferences voidable in certain circumstances

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Notes:

1. The HK wording, it is submitted, actually causes confusion. Under the HK wording, “unfair preference” simply means “preference” and is not automatically voidable. Other elements need to be proved.
2. The technical meanings of the words “desire” and “intention” in the sections are to be obtained in the context (particularly having regard to the old law). One may fall into confusion if one analyses these words purely from a language/psychological point of view.

Proving a subjective mental state is always not easy. The law assists the IP by:-

1. presuming such desire against associates of the debtor,

2. allowing the IP to prove the desire by inference from factual circumstances surrounding the impugned payment.

Application of the Presumption

- s.266(5): A company which has given an unfair preference to **a person connected with the company** (otherwise than by reason only of being its employee) at the time the unfair preference was given is **presumed**, unless the contrary is shown, to have been influenced, in deciding to give it, by the desire mentioned in subsection (4).

- It should first be noted that the presumption is only in respect of desire, NOT the insolvency of the debtor. The presumption of insolvency only applies against associates in undervalue transactions (s.266B(3)). Hence, the IP still need to establish that the debtor was insolvent at the time of the impugned preference.

‘Insolvent’ is defined in s.266B(2)*:-

(2) The time mentioned in subsection (1)(a), (b) or (c) is not a relevant time for the purposes of sections 265D(2) and 266(2) unless either of the following conditions is satisfied—

(a) the company is unable to pay its debts (within the meaning of section 178) at that time;

(b) the company becomes unable to pay its debts (within the meaning of section 178) in consequence of the transaction or unfair preference.

* Note: in the past, we rely on s.51(3) BO, which expressly stipulate the ‘balance sheet’ test. But s.178 CWUMPO does not expressly stipulate a balance sheet test.

S.51 BO

(3) For the purposes of subsection (2), a debtor is insolvent if—

(a) he is unable to pay his debts as they fall due; or

(b) the value of his assets is less than the amount of his liabilities, taking into account his contingent and prospective liabilities.

S.178 CWMUPO – Definition of inability to pay debts

(1) A company shall be deemed to be unable to pay its debts—

….

(c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company.

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The importance, and difficulty, in proving insolvency is highlighted in the cases of:-

- *Re Ng Shiu Kwan*, HCA 311/2014
- *Re Cheung Siu Kin*, HCMP 1431/2012

Re Ng Shiu Kwan, HCA 311/2014

Facts:

- TIB challenged transfer of 55% shares in a property holding company by husband (bankrupt) to his wife.
- Husband executed declaration of trust in favour of wife for the shares in Nov 2009 (unstamped) purportedly as repayment of loans from wife to husband.
- The actual transfer was made in Oct 2012.
- Husband was petitioned bankrupt in May 2013.

Held:

- Although, for purpose of s.49 BO, insolvency of the bankrupt (husband) is presumed against the wife, the court found that in Nov 2009, the husband was not actually insolvent. Action failed.

Re Cheung Siu Kin, HCMP 1431/2012

Facts:

- There're large numbers of to and fro transfers between B and his brother five years prior to bankruptcy.

- TIB claimed that (i) the transfers from brother to B were gifts, when B gave back the money to brother, they were caught by s.49, or (ii) the transfers from brother to B were loans or money entrusted to B for investment, when B gave back the money to brother, they were unfair preferences.

- Brother defended that (i) the transfers to B were money for investment and brother was entitled in trust to a proprietary claim, or (ii) the transfers to B were loan, when B gave back they were repayments – they were made mostly when B was not insolvent and there's no desire to prefer.

Re Cheung Siu Kin, HCMP 1431/2012

Held:-

- The TIB's claim of mutual gifts was unrealistic*.
- The money transferred from brother to B was mostly for investment, but there's no proprietary claim.
- Transfers back to brother were made mostly when B was not insolvent. Those made after B became insolvent was not influenced by desire – presumption rebutted. [One main factor in rebutting the presumption was that brother continued to give money to B to help him out financially after the alleged unfair preference.]

*However, see the case of *Re Lam Ying Ho*, HCA 653/2011 – A gift of property had been given by father to son. When the son, at verge of bankruptcy, gave it back to the father, it was held to be in breach of s.49, BO.

- We’ve seen that the presumption was rebutted even between husband and wife (*Re Ng Shiu Kwan*), and brothers (*Re Cheung Siu Kin*).

- There’s also the famous case of *Dr. Stanley Hau* (CACV 234/2004) where threats to cut off blood relationship by a sister and disturbances at his clinic were held sufficient to rebut the presumption of the debtor’s desire to prefer his sister.

Phantom Records Limited, HCMP 2770/2003

- Yet sometimes the presumption is so strong that a director who had advanced huge sum to the company could be held liable for unfair preference when a relatively small sum was repaid to himself.

Facts:

- In late 1998, Phantom had largely ceased business and laid off most employees.
- In Jan 1999, Hang Seng Life refunded some HK$350k to Phantom from its retirement scheme.
- Mr. Louey by that time had advanced HK$5.7m to Phantom but it was left with little assets.
- Mr. Louey and another director signed a cheque to transfer the refund from Hang Seng to himself.

Phantom Records Limited, HCMP 2770/2003

- In Dec 1998, some employees had filed claim against Phantom with Labour Tribunal for around HK$150k.
- Mr. Louey claimed that he thought the claim was without merits/exaggerated and the company should have enough fund to meet it.
- The company was later sold at nominal value and the employee's claim was not satisfied.

Held:

- The court did not accept Mr. Louey's explanation. He was found guilty of unfair preference and disqualified as director for 3 years (although he already paid up the employees' claim subsequently).

Hau Po Man Stanley [2005] 2 HKC 227

Facts:

- Debtor (a dentist) borrowed HK$1.5 million from sister
- Within 2 years, he repaid the loan and then petitioned for his own bankruptcy
- Three repayments were made by debtor to sister at different time

Hau Po Man Stanley [2005] 2 HKC 227

CFI: No unfair preference

CA (2:1): No unfair preference for the first two repayments

- Sister and husband chased hard (sent letters, quarrels, went to his clinics, threatened to cut off relationship) which caused considerable pressure on debtor
- Hence, the payment was not made with “desire to prefer”. The presumption of desire was rebutted
- The third payment, made a few months later, when the pressure had abated, and after another creditor started legal action, was a voidable unfair preference.

***Sweetmart Garment Works Limited*, HCCW 755/2005**

And, where the right circumstances existed, an inference of 'desire' could be drawn even against a non-associate:-

Facts:

- A case concerned with non-associate being preferred.
- Company granted a mortgage over a ship in favour of one creditor - HSH Nordbank AG
- Nordbank had been sending reminders for repayment to company, but other creditors had taken much more concrete actions – demand letters by solicitors, statutory demands, petition for bankruptcy against guarantors/directors.
- The security to Nordbank was not for new money and the relationship with Nordbank would not help the company to escape insolvency.

Sweetmart Garment Works Limited, HCCW 755/2005

Held:

- The court held that the circumstances were sufficient to infer the desire to prefer Nordbank even without other evidence as to the mental state of the directors.

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- The issue of ‘desire’ becomes particularly tricky in a three party situation (guaranteed debt), which in fact is quite common, but not much addressed in case law.
- A director provided personal guarantee to a lender for a loan to the debtor company. When he caused the company to repay the lender, he’s presumed to be influenced by the desire to prefer himself.
- s.266A(1) has made clear that the guarantor could be liable for unfair preference:

(1) A company gives an unfair preference to a person if—

(a) that person is—

(i) one of the company’s creditors; or

(ii) a surety or guarantor for any of the company’s debts or other liabilities…

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The issue is:

- What about the lender who got repaid?

Q1. Does the liquidator need to show that there's a desire to prefer the lender if he wants to recover from the lender?

Q2. If the answer to Q1 is yes, can the desire to prefer the lender be inferred from the desire to prefer the director?

Re Agriplant Services Ltd (in liq) [1997] 2 BCLC

This case suggested that the answers to both questions are in the affirmative.

Facts:

- The company leased plant and equipment from an asset financier, CAF.
- S, a director who was also the company's majority shareholder, guaranteed rental payments under the lease.
- The company got into financial difficulties and S suspended the rental payments. CAF pressed for payment and threatened to repossess the plant.
- Three weeks before the company went into liquidation a payment of £20,000 was made to CAF.
- The liquidators brought proceedings for unfair preference claims against both CAF and S.

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Re Agriplant Services Ltd (in liq) [1997] 2 BCLC

Held:

- The case against S was relatively straight forward as he was a connected person and desire was presumed. (His evidence that he acted solely under pressure from CAF and wanted to keep the business was rejected.)

- In relation to CAF, judge found that the company was influenced by the requisite desire because it was only by improving CAF's position that S's own position under the guarantee could itself be improved.

A finding that the company was influenced by a desire to prefer the guarantor can apparently therefore ground an inference that it was also influenced by a desire to prefer the principal creditor.

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Re Agriplant Services Ltd (in liq) [1997] 2 BCLC

Here's what the Jonathan Parker J. said:

- *The evidence in the instant case establishes, and I find, that in making the payment to CAF the company, that is to say Mr. Sagar, was influenced by a desire to improve the position both of himself and of CAF on an insolvent liquidation of the company….*

- *Given the inevitability and the imminence of an insolvent liquidation of the company, it was only by improving the position of CAF on an insolvent liquidation of the company that Mr. Sagar's own position under his guarantee could itself be improved. Mr. Sagar wanted (desired) to reduce the company's debt to CAF; that is to say, to produce in relation to CAF the effect described in s. 239(4)(b) for just that reason. I accordingly find that the requirements of s. 239(5) are also satisfied in relation to CAF.* [exact wording of judge]

- He rejected CAF's submission that the director was purely motivated by the desire to protect himself from the liability under the guarantee and that payment to CAF was but a necessary step and he had no intention/desire to prefer CAF.

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Re Agriplant Services Ltd [1997] B.C.C. 842

- The HK Court of Appeal in the case of *Re Kam Toys & Novelty Manufacturing Ltd*, CACV 67/2017, also a three party case in which a director had given personal guarantee, referred to *Agriplant* but did not apply it against the lender, mainly on the ground that the repayment in question was made from money stakeheld by solicitors (as required by the lender/respondent) hence it could not be said to be influenced by any desire on the part of the director. [The loan in question was a short term loan to enable the company to be released a large deposit from the sale of a property.]

- Counsel for both sides didn't really argue the applicability of *Agriplant*. Hence it could not be said whether the CA approved it or not.

Re Agriplant Services Ltd [1997] B.C.C. 842

- However, academics such as Adrian Walters*, Goode** doubted *Agriplant*'s answers to both questions.

- AW and Goode are of the view that the court has power to order lender to clawback without separately proving desire to prefer the lender, once the desire is proved against the guarantor. This is based on the wording of s.266C, Cap 32, in particular (1)(a) and (d) and (2):-

(1) Without limiting sections 265D(3) and 266(3), an order under either of those sections with respect to … an unfair preference given by a company, may do one or more of the following—

(a) require any property transferred as part of the transaction, or in connection with the giving of the unfair preference, to be vested in the company;

….

- *Vulnerable Transactions in Corporate Insolvency (2002 ed)
- **Principles of Corporate Insolvency Law (2011 ed)

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Re Agriplant Services Ltd [1997] B.C.C. 842

(d) require a person to pay, in respect of benefits received by that person from the company, any sums to the liquidator that the court may direct;

….

(2) An order under section 265D(3) or 266(3) may affect the property of, or impose an obligation on, any person **whether or not that person is the person with whom the company entered into the transaction or, as the case may be, the person to whom the unfair preference was given.**

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Re Agriplant Services Ltd [1997] B.C.C. 842

Section 266C(3) seems to provide some protection to innocent third party, but not the lender who received the payment:

(3) Despite subsection (2)—

(a) the order must not prejudice—

(i) any interest in property which was acquired **from a person other than the company** and was acquired in good faith and for value; or

(ii) any interest deriving from such an interest; and

(b) the order must not require a person who received a benefit from the transaction or unfair preference in good faith and for value to pay a sum to the liquidator, **except where that person was a party to the transaction or the payment is to be in respect of an unfair preference given to that person at a time when that person was a creditor of the company.**

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- In fact, it is submitted (by me) that the wording of s.266C(3)(a) and (b) made it highly arguable that the good faith of the lender is NOT a relevant consideration in whether the court should make the clawback order and the court should make such a clawback order irrespective of the lender's good faith.

- The judge and counsel in *Agriplant* seems to have overlooked these provisions.

- No other HK cases, so far, have discussed these provisions.

Moulin Global Eyecare Holdings Ltd (in liquidation) & Ors v Olivia Lee Sin Mei [2011] HKCFI 82; [2012] HKCA 144; [2014] HKCFA 22

Facts:

- The liquidator of MGEH brought action against its former director and legal adviser for breach of contractual, common law and fiduciary duties in certain transactions including a payment of more than HK$98m for an early redemption of convertible notes

Moulin Global Eyecare Holdings Ltd (in liquidation) & Ors v Olivia Lee Sin Mei [2011] HKCFI 82; [2012] HKCA 144; [2014] HKCFA 22

First Instance:

- The claim was struck out because the payment discharged genuine liabilities and as such the company had not suffered any loss

Court of Appeal:

- Directors owed a duty to consider the creditor's interests when the company is insolvent
- The duty is not owed to the creditors but to the company
- The early redemption was the payment of a genuine liability of the company
- The appropriate cause would be unfair preference

Moulin Global Eyecare Holdings Ltd (in liquidation) & Ors v Olivia Lee Sin Mei [2011] HKCFI 82; [2012] HKCA 144; [2014] HKCFA 22

Court of Final Appeal:

- Even though in one sense the company suffered no loss, the claim was maintainable if framed as a claim for breach of the prescriptive fiduciary duty
- The director owes a duty to act *bona fide* in the best interests of the company
- In an insolvency context the duty requires the directors to take into account the interest of creditors
- The duty may extend to not prejudicing the interests of creditors and preserving the assets of the company so that those assets may be dealt with in accordance with ordinary principles of insolvency law, including the *pari passu* distribution of the company's assets amongst all creditors

Moulin Global Eyecare Holdings Ltd (in liquidation) & Ors v Olivia Lee Sin Mei [2011] HKCFI 82; [2012] HKCA 144; [2014] HKCFA 22

- A director who knowingly causes a company to pay away company assets to a creditor when he does not subjectively believe that the payment is in the best interest of the company may act in breach of duty
- The company may pursue equitable remedies (such as equitable compensation) against the director to restore the company to the position that it was in prior to the breach of duty
- The assets restored to the company are then available for *pari passu* distribution amongst all creditors

Transaction at Undervalue

Section 265D CWUMPO (new)

Section 49 BO

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Section 265D CWUMPO

(1) This section applies in relation to a company if the company goes into liquidation.

(2) If the company has at a relevant time (within the meaning of section 266B) entered into a transaction with a person at an undervalue, the liquidator may apply to the court for an order under subsection (3).

(3) Subject to section 266C, on an application under subsection (2), the court may make an order that it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.

(4) The court must not make an order under subsection (3) if it is satisfied that—

  (a) the company entered into the transaction in good faith and for the purpose of carrying on its business; and

  (b) at the time the company did so, there were reasonable grounds for believing that the transaction would benefit the company.

Transaction at Undervalue

It must be proved that:

- the company/debtor made a gift/entered into a transaction for a consideration, the value of which, in money or money's worth, is significantly less than the value of the consideration provided by the company/debtor
- at the time of the transaction took place, the company/debtor was insolvent or became insolvent as a result thereof
- the transaction was made at a time in the period of 5 years ending with the day of the presentation of the winding-up petition / bankruptcy petition

*Note: There is a presumption that the company/ debtor was insolvent at the time of the transaction if the transaction took place with a connected person with the company or an associate. (s.266B(3) CWUMPO/ s.51(2) BO)

Corporate v Individual

	Corporate (s265D CWUMPO)	Individual (s49 BO)
Undervalue	• Gift • Consideration provided is significantly less than the value	• Gift • Consideration provided is significantly less than the value • Marriage
Clawback Period	5 years	5 years
The proof of (resulting) insolvency	Required in every cases	Only when the transaction was entered into at any time more than 2 years before the day the petition was presented, but not more than 5 years
Possible Defences	• Entered into the transaction in good faith and for the purpose of carrying on its business; and • Reasonable grounds for believing that the transaction would benefit the company	No defence

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Phillips and Another v. Brewin Dolphin Bell Lawrie Ltd and Another [2001] 1 W.L.R. 143

Facts:

- A company ("**AJB**") negotiated with another company ("**BD**") for sale of its stockbroking business for £1.25m
- AJB sold its business to its solely owned subsidiary for £1
- AJB then sold its business to BD by transferring the shares to BD under a share transfer agreement on 10 November 1989
- On the same day, AJB entered into an agreement with BD's parent company, which was expressed to be a computer equipment leasing agreement in which BD's parent company agreed to pay AJB £312,500 per annum for four years

Phillips and Another v. Brewin Dolphin Bell Lawrie Ltd and Another [2001] 1 W.L.R. 143

- However, the leasing agreement was actually a sublease which would breach the covenant of the lease
- In fact BD's parent company had already decided not to use the relevant computer equipment
- Two months later and before the first payment under the sublease became due, the owners of the computer equipment terminated the company's lease for non-payment of rent
- BD's parent company was discharged from paying the rent under the sublease

Phillips and Another v. Brewin Dolphin Bell Lawrie Ltd and Another [2001] 1 W.L.R. 143

- Later, AJB was wound up
- The liquidator of AJB applied to declare the share sale agreement be a transaction at an undervalue

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Phillips and Another v. Brewin Dolphin Bell Lawrie Ltd and Another [2001] 1 W.L.R. 143

Held:-

- It does not matter who provides the consideration
- The value of a collateral agreement entered into by the company with a third party could be the consideration
- Therefore, the value of the sublease could be the consideration of the transfer of shares
- However, …

Phillips and Another v. Brewin Dolphin Bell Lawrie Ltd and Another [2001] 1 W.L.R. 143

- In assessing the value in money's worth of sublease, the court could not turn a blind eye to the events which had occurred after the transaction
- Having regard to the circumstances, the sublease was precarious and speculative from the outset
- The value of the sublease was nil and added nothing to the consideration for the share transfer
- Thus, the share sale agreement had been a transaction at an undervalue

Re Lam Ying Ho, HCB 1873/2010

Facts:

- Oct 1996 – residential property purchased in name of B by his father who paid for the purchase price and mortgage instalments (mortgage was taken out in name of B)
- May 2009 – B made a Declaration of Trust that B held the property as a trustee for the father
- Dec 2009 – B executed a Vesting Assignment assigning all the legal and beneficial interest in the property to the father
- Mar 2010 – HSBC filed a bankruptcy petition against B
- May 2010 – Bankruptcy order made against B

Re Lam Ying Ho, HCB 1873/2010

TIBs' case

- At time of the acquisition of the property, it was the intention of the father that B should be the true owner of the property
- The father purchased the property as a gift for B (Presumption of advancement)
- The Declaration of Trust and the Vesting Assignment should be avoided because they were either:
  - transactions at an undervalue pursuant to s.49 BO; or
  - an unfair preference pursuant to s.50 BO; or
  - transactions to defraud creditors under s.60 CPO

The Father's case

- At all material times, the father intended that the property was acquired by the Bankrupt as a trustee for the father
- The father was at all times the true beneficial owner of the property

Re Lam Ying Ho, HCB 1873/2010

- Held: Judgment for Trustees against the father's personal representative, *inter alia*, … (the property) be vested in (the Trustees) as part of the estate of the Bankrupt pursuant to ss 49(2) and 50(2)

*Note: the judge made a finding in favour of the Trustees under either section 49 or 50 of the BO and held there was no need to have recourse to section 60 of the CPO

Guaranteed Debt

Would a parent company giving a guarantee to secure advances already made or intended to be made to its subsidiary company be considered as a transaction at an undervalue?

Professor Goode*:

- Not a transaction at an undervalue *per se*

- The issue is whether the benefit conferred on the creditor by the issue of the guarantee is significantly greater than the value to the surety of the advance to the principal debtor

*Principles of Corporate Insolvency Law (2011 ed)

Guaranteed Debt

Professor Goode:

- Benefit conferred on the creditor depends on the risks of the guarantee being called

- Value to the surety depends on the how the guaranteed debt would be used by the principal debtor (the subsidiary)

- The time for measuring the respective values is the date the guarantee is given, not the date when the principal debtor defaults in repayment

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Guaranteed Debt

Practical Difficulties:

- The weighing exercise is not an easy one to undertake
- This may introduce uncertainty to validity of guarantees given by parent companies
- Note: good faith of the counter-party is basically irrelevant though the court retain an overall discretion as to the proper remedies

Post-Petition Disposition of Assets

Section 182 CWUMPO

Section 42 BO

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Section 182 CWUMPO

In a winding up by the court, any disposition of the property of the company, including things in action, and any transfer of shares, or alteration in the status of the members of the company, made after the commencement of the winding up, shall, unless the court otherwise orders, be void.

*Note: Section 184(2) provides that the winding up of a company by the court shall be deemed to commence at the time of presentation of the petition for the winding up

Section 42 BO

Where a person is adjudged bankrupt, any disposition of property made by that person in the period beginning with the day of the presentation of the petition for the bankruptcy order and ending with the vesting of the bankrupt's estate in a trustee is void unless it is or was consented or ratified by the court.

Note: Bankruptcy commences when the bankruptcy order is made, not when the petition is presented (s.30 BO)

No remedy against (a) any person in good faith, for value and without notice that the petition had been presented; or (b) any person who derives from an interest in property referred to in (a). (s.42(4) BO)

Osman Mohammed Arab & Anor v Commissioner of Inland Revenue, CACV 201/2015

Facts:

- AGI Logistics (HK) Ltd ("the Company") presented its winding-up petition on 8 December 2009
- The Company failed to file a tax return of assessment and the Company sought reassessment later
- the Inland Revenue Department ("IRD") decided to refund the tax after reassessment
- IRD was informed of the winding-up proceeding of the Company on 14 January 2010
- The Company requested the IRD to pay the refund to a third party ("Careship")
- IRD complied with the request on 27 January 2010 and the cheque was issued to Careship on the same day

Osman Mohammed Arab & Anor v Commissioner of Inland Revenue, CACV 201/2015

Held:-

- The English authorities suggested that an intermediary lacks the characteristics of a disponor necessary to justify treating its action as constituting a disposition
- However, CA held that transaction through intermediary involves two dispositions:

  (i) Payment by the intermediary to the payee; and

  (ii) Extinguishment of the company's liability to the payee

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Osman Mohammed Arab & Anor v Commissioner of Inland Revenue, CACV 201/2015

- Departed from the English position
- It is the practical position in Hong Kong that after a petition is presented local banks freeze accounts and will only debit them after a validation order has been obtained
- After a company is presented with a winding-up petition, all dispositions whether it serves only an ‘intermediary function’ will be caught by s182 CWUMPO

Three-Party Situation

When the asset is held on trust for the company which only has equitable interest in the asset, the issue is:-

- Whether the transfer of the legal interest of the asset is regarded as “disposition of the asset”?

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Akers and Others (Respondents) v. Samba Financial Group (Appellant) [2017] UKSC 6

Facts:

- SICL, a company incorporated in Cayman Islands, went into liquidation in Cayman Islands in 2009
- Mr. S, a Saudi Arabian alleged that he owned shares in five Saudi Arabian banks valued at around US$318m on trust for the beneficial interest of SICL
- Six weeks into the liquidation, Mr. S transferred all the shares to Samba for discharging his personal liabilities

Akers and Others (Respondents) v. Samba Financial Group (Appellant) [2017] UKSC 6

Held:-

- "Property" is plainly wide enough to embrace both legal and equitable proprietary interests
- Where an asset is held on trust, the legal title may be transferred to a third party as long as the trust agreement allows so but the trust rights are not disposed of
- The beneficiary of the trust is still capable of enforcing the trust until the disposition of the legal title has the effect of overriding the protected trust rights e.g. where a legal estate is sold to a *bona fide* third party purchaser for value without notice, the equitable interest is not transferred to the purchaser

Further Discussion on Three-Party Situations

- The Supreme Court's decision significantly settled that section 127 (equivalent to section 182 CWUMPO) does not cover transfer of legal title where the company only owns equitable interests

- However, when the third party has notice of the breach of trust, it could be held liable to return the trust assets on the basis of knowing receipt

Transaction to Defraud Creditors

Section 60, Conveyancing and Property Ordinance (Cap. 219) ("CPO")

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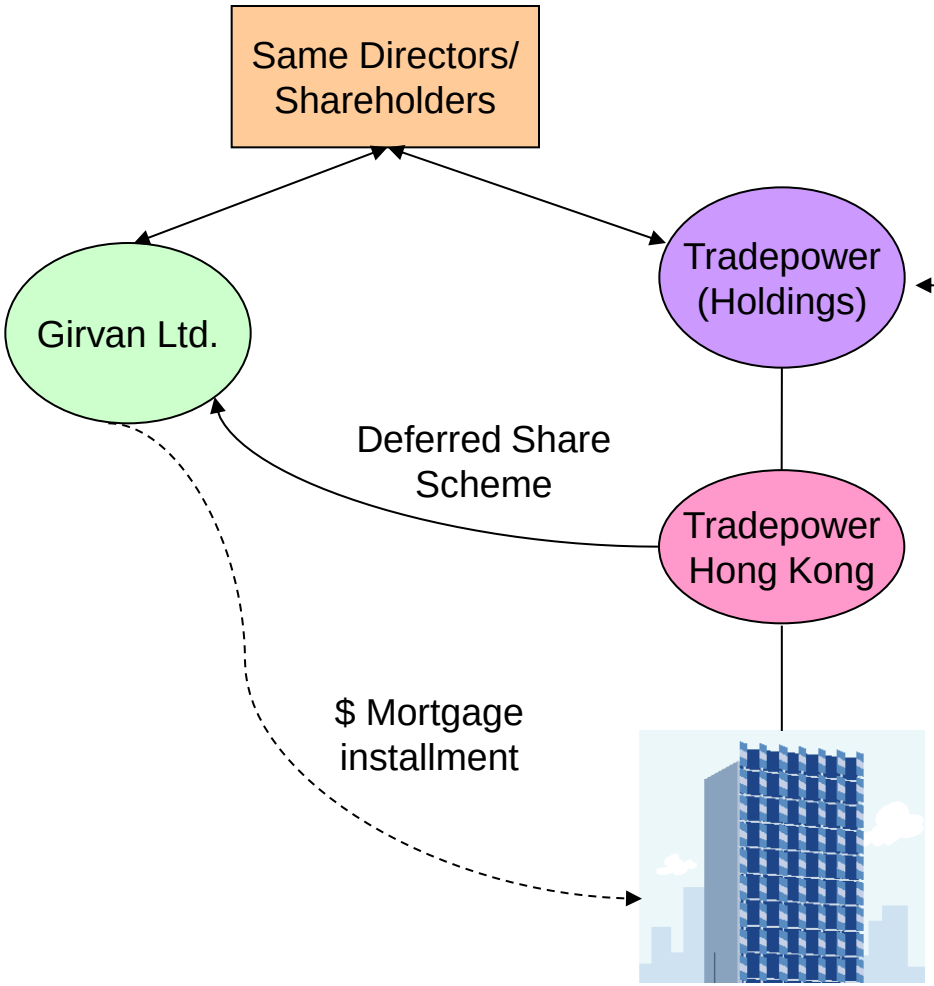
Section 60 CPO

(1) Subject to subsections (2) and (3), every disposition of property made, whether before or after the commencement of this section, with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced.

(2) This section does not affect the law of bankruptcy for the time being in force.

(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.

Tradepower (Holdings) Ltd (In Liquidation) v. Tradepower (Hong Kong) Ltd and Others [2009] HKCFA 103



- 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

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Tradepower (Holdings) Ltd (In Liquidation) v. Tradepower (Hong Kong) Ltd and Others [2009] HKCFA 103

- The Liquidators brought claims against Girvan and the former directors under s.60 CPO and for breach of fiduciary duties
  - High Court action commenced in the name of the Company
  - Instructed by Liquidators of the Company
  - Funding provided by Petitioning Creditor (Elimor)

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Tradepower (Holdings) Ltd (In Liquidation) v. Tradepower (Hong Kong) Ltd and Others [2009] HKCFA 103

- The trial judge dismissed the liquidators' action and held:
  - following the authority of *Lloyds Bank v Marcan* [1973] 1 WLR 1387, *'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
  - 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 of the directors (which the trial judge 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

Tradepower (Holdings) Ltd (In Liquidation) v. Tradepower (Hong Kong) Ltd and Others [2009] HKCFA 103

- CA reversed the trial judge's decision and the directors appealed

- CFA affirmed the CA decision and 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

Tradepower (Holdings) Ltd (In Liquidation) v. Tradepower (Hong Kong) Ltd and Others [2009] HKCFA 103

- The word ‘virtually’ is used only because “Never say never is a wise judicial precept” [para 90]
  - Hence, for all practical purposes, we could ignore the word
- The “actual subjective intent” need only be considered if:
  - the company is not insolvent (burden of proof of solvency on the debtor if he was bankrupted shortly afterwards, say, one year); and/or
  - the disposition is supported by good consideration

Thank You!

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