

ONC Lawyers
柯伍陳律師事務所



Trust and Insolvency

Seminar for Hong Kong Academy of Law

by Ludwig Ng, partner, ONC Lawyers

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Topics covered

1. Basic concepts of trust
2. Why is trust important in the context of insolvency?
3. Proprietary claim by/against the estate
 - a) Trust
 - i. Expressly created trusts: “Twilight trusts”, “Quistclose trusts”
 - ii. Resulting/Constructive trust claims based on ‘property rights’, ‘unjust enrichment’, ‘restitution for wrongs’
 - b) Specific performance
 - c) Subrogation claims
4. Liabilities of parties assisting breach of trust or receiving trust property
5. Asset tracing rules
6. Conclusion



Basic Concepts of Trust

- A trust arises when there is a separation of ownerships of property into legal and beneficial. The separation of ownerships could arise in two broad situations.
- 1. Express Creation – e.g., Settlor transfers her property to Trustee subject to a trust deed which provides that Trustee holds the property on trust for Beneficiary
- 2. Implied Creation
- 2.1 X provides the purchase money to buy a house in the name of Y (resulting trust – Y is the trustee, X is the beneficiary)
- 2.2 Agent sold a property for Principal and received the sale proceeds on behalf of the Principal (constructive trust – Agent holds the money on trust for Principal)



Why is trust important in the context of insolvency?

- Apart from what is clearly registered in the name of the estate, the estate may comprise of property held by (registered in the names of) other persons to which the estate has beneficial ownership. Those properties can be recovered for the benefit of the estate (i.e., creditors).
- Some properties held by the estate (as legal owner) may actually belong to other persons beneficially who may have a **proprietary** claim against those properties in priority to other creditors, i.e., the estate is just a trustee. Those properties cannot be distributed to general creditors.

Important Procedural Advantages of Trust Claims

- Trust claims have the important procedural advantages of:-
 - Being a proprietary claim, it gives priority in the defendant's insolvency
 - Allow tracing (important when the property has changed hands or even changed forms)
 - Expand the scope of potential defendants (for dishonest assistance/unconscionable receipt)
 - Overcome limitation periods (but note the equitable defence of *laches*)



Expressly Created Trust

- If the Bankrupt is holding property expressly under a trust deed (such as in the case of a professional trust company), the property would not be available for distribution to general creditors
- Less clear where the Bankrupt entered into “arrangements” with parties during the ‘twilight’ period in an attempt to afford extra protection to them
 - “Twilight period” – the period when directors know that insolvent liquidation is unlikely to be avoided but continue to trade in the interests of creditors.

Barclays Bank Ltd v Quistclose Investments Ltd [1970] AC 567

Facts:-

- Quistclose lent a company, Rolls Razor Ltd, some £210,000 to allow Rolls Razor to pay a dividend it had already declared.
- Rolls Razor sent the money to its bank, asking it to pay into a separate dividend account and stating that the money was to be used only to pay the dividend.
- But before the dividend could be paid, Rolls Razor went into voluntary liquidation, leaving Quistclose and the bank to dispute the ownership of the £210,000. The bank claimed a right to set off the £210,000 credit against a debit balance in another account.

***Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567**

Held:-

- In *Toovey v Milne* (1819) 2 B. & Ald. 683, A advanced money to his brother-in-law, B, for the purpose of B settling with his creditors. That purpose failed and B was declared bankrupt. What was left of the money was repaid to A by the bankrupt. The Court held that this repayment was protected and that the assignees in bankruptcy could not recover the money so repaid.

***Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567**

Applying *Toovey v Milne*, Lord Wilberforce held that the money lent by Quistclose to Rolls Razor was impressed with a trust in favor of Quistclose:-

- The mutual intention of Quistclose and Rolls Razor, and the essence of the bargain, was that the sum advanced should not become part of the assets of Rolls Razor but should be used exclusively for payment of a particular class of its creditors, namely, those entitled to the dividend.
- This entailed the necessary consequence that if, for any reason, the dividend could not be paid, the money was to be returned to Quistclose.

Even if the word ‘trust’ is not used in the ‘arrangement’, a trust may nevertheless arise so long as the intention of the parties is clear.

Re Kayford Ltd (in liquidation) [1975] 1 WLR 279

- Kayford Ltd (the “**Company**”) conducted a mail-order business. Customers would either pay in full or provide a deposit for the goods when they placed their orders before receiving the goods.



***Re Kayford Ltd (in liquidation)* [1975] 1 WLR 279**

- The Company's chief supplier went into liquidation. Fearing that the Company would also get into financial difficulties, the Company's accountants open a separate bank account (to be called "**Customers' Trust Deposit Account**") and pay into it moneys received from customers for goods not delivered to them, withdrawing the moneys only if the goods were later delivered.
- However, the company initially paid money into a dormant deposit account in the company's name, only later altering the name of the account.
- Company subsequently went into liquidation. The liquidator argued that the money in the separate account – which totaled nearly £38,000 – belonged to the Company and so, on liquidation, to the Company's general creditors.
- The customers argued that a trust had been created by the Company of the money in the account in their favor.

***Re Kayford Ltd (in liquidation)* [1975] 1 WLR 279**

Megarry J held that a trust had been created:-

- A trust can be created without using the words “trust” or “confidence” or the like. The question is whether in substance a sufficient intention to create a trust has been manifested.
- The Company had sufficiently shown an intention to create a trust by its words and actions. It had:-
 - (i) considered very carefully how to protect its customers’ pre-payments in the event of its insolvency;
 - (ii) instructed its bank to use a separate account; and
 - (iii) asked that the name of that account reflect that the company was a trustee of the money for the customers

Implied trusts: Resulting/Constructive

Aravanis v Studwell Pty Ltd [2015] FCCA 2012

- Mr. Studwell was the sole director of Studwell Pty Ltd, which conducted an earthmoving business.
- He became bankrupt on his own petition.
- There were four pieces of equipment, which were purchased in the name of and for use in the company's business.
- The TIB claimed that the equipment vested in the estate by reason of resulting trust.
 - The equipment was purchased with money provided by Mr. Studwell.
 - Mr. Studwell provided the purchase monies from loans under which Mr. Studwell was the borrower

***Aravanis v Studwell Pty Ltd* [2015] FCCA 2012**

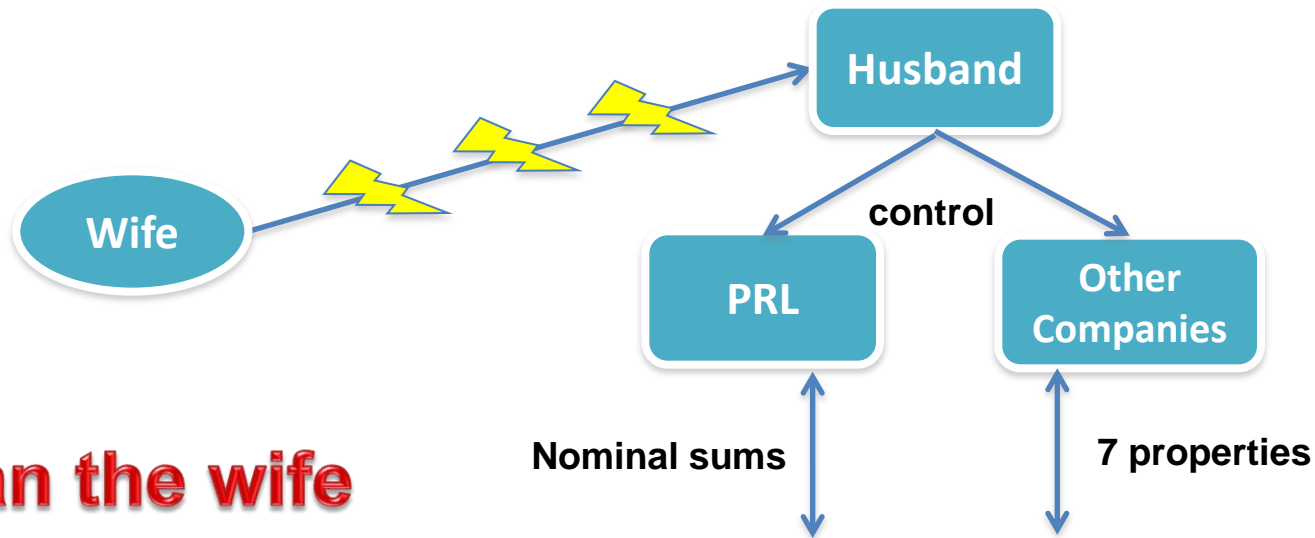
Findings:-

- Presumption that Mr. Studwell did not intend to make a gift of the equipment to his company
- The presumption was not rebutted:
 - Mr. Studwell at all times had remained the debtor of the loans used to purchase the equipment. There was no evidence he and the lender had agreed to novate the loan so as to make the company the debtor under the loan agreement.
 - The equipment may have a value of at least \$25,000, but in a declaration prepared by Mr. Studwell, the assets of the company were stated to be valued at less than \$1,000 → Mr. Studwell did not intend to include in the assets of the company the equipment.

Conclusion:-

- The company held the equipment on resulting trust for Mr. Studwell.
- It was open to the TIB to take possession of the equipment.

Prest v Petrodel Resources Ltd [2013] 2 AC 415



Can the wife claim the 7 properties?



***Prest v Petrodel Resources Ltd* [2013] 2 AC 415**

Facts :-

- In a case arising from a divorce, Mrs. Prest claimed against a number of offshore companies, including Petrodel Resources Ltd (“**PRL**”), for transfer of various properties to her.
- The wife’s claim was in respect of the ownership of seven residential properties acquired by the husband. The properties were later transferred to PRL for nominal sums at a time before the company commenced trading.

***Prest v Petrodel Resources Ltd* [2013] 2 AC 415**

Findings :-

- The court could not order the companies to transfer the properties to the wife in the divorce proceedings as they were **separate legal entities** from the husband.
- However, the companies could be ordered to convey the seven properties to the wife if the properties belonged **beneficially** to the husband.
- It was found that the most plausible inference from the little-known facts was that each of the properties was held on a **resulting trust** by the companies for the husband.
- Accordingly, the seven disputed properties were required to be transferred to the wife.

Implied trusts: Resulting/Constructive

- Constructive trust is a useful tool to recover assets to which the estate has beneficial ownership:
 - ***Carl Zeiss Stiftung v Herbert Smith & Co*** [1962] CH 425: “No clear and all-embracing definition of a constructive trust.”
 - However, there are some well established classifications of when a constructive trust may arise, including where a **fiduciary** has received money or property as a result of his or her position.

Circumstances that give rise to fiduciary duties

- ***Chirnside v Fay* [2007] 1 NZLR 433** recognized two kinds of circumstances that give rise to fiduciary duties :-
 - 1) Where the relationship is ***inherently fiduciary***. These include the relationships of solicitor and client, trustee and beneficiary, principal and agent, the doctor and patient, director and company.
 - 2) Where the particular aspects of the relationship justify it being so classified. (***ad hoc*** fiduciary relationship)

Fiduciary Obligations

Bristol & West Building Society v Mothew [1997] 2 WLR 436, per Millet LJ at 18 :-

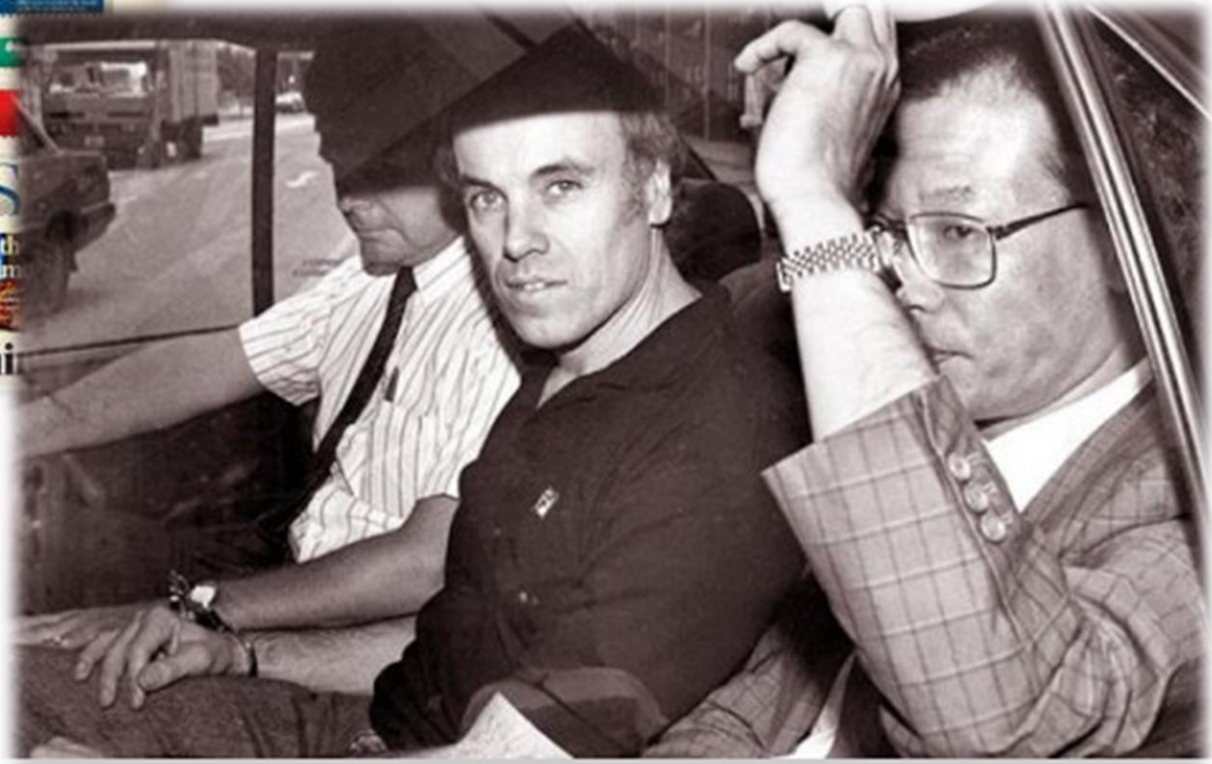
- A relationship of trust and confidence.
- A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal.

Unauthorized gains made by a fiduciary

Unauthorized gains include *secret profits, bribes or the use of confidential information to make an unauthorized profit.*

AG for Hong Kong v Reid [1994] 1 AC 324

- Mr. Charles Warwick Reid was the Hong Kong Deputy Crown Prosecutor and then Acting Director of Public Prosecutions.
- Therefore, he was in a fiduciary relationship with the Hong Kong government.
- He took bribes, totaling NZ\$540,000, to obstruct prosecution of some criminals, and used the money to buy land in New Zealand. The value of the land increased in value to NZ\$2.4 million.
- The Hong Kong government argued that the land was held on trust for it.



Warwick Reid flanked by police after a court hearing in 1990. Photo: Robert Ng



***AG for Hong Kong v Reid* [1994] 1 AC 324**

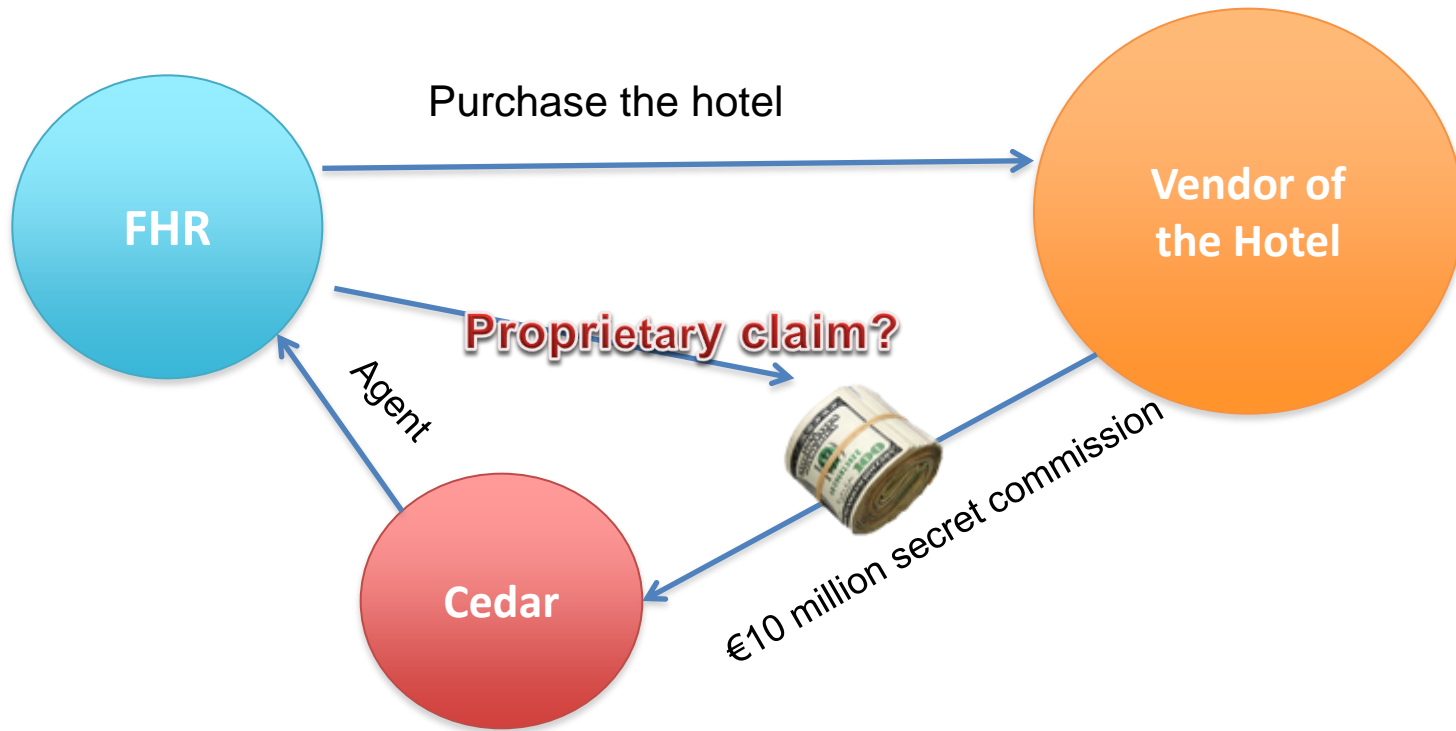
Held :-

- In equity, the fiduciary held the bribe and any property acquired therewith on constructive trust for the person to whom the fiduciary duty was owed.
- Therefore, to the extent that they represented bribes received by Reid, the New Zealand properties were held on trust for the Crown, and the Crown had an equitable interest therein.

Unauthorized gains made by a fiduciary

- There have been conflicting authorities as to whether the principal has **proprietary** right to the bribe proceeds or just a right to require the agent to give an account. For example, the English Court of Appeal in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347 disagreed with *Reid*. However, the question is now definitively answered by the **FHR** case.

FHR European Ventures LLP and others v Cedar Capital Partners [2014] UKSC 45



FHR European Ventures LLP and others v Cedar Capital Partners [2014] UKSC 45

Facts :-

- FHR European Ventures LLP (“FHR”), along with other companies in the same investment group, purchased the Monte Carlo Grand Hotel.
- Cedar Capital Partners (“Cedar”) acted as FHR’s agent in negotiating the purchase price of €211.5 million for the sale.
- But unknown to FHR, Cedar received a €10 million secret commission from the vendor of the Hotel, pursuant to an exclusive brokerage agreement, whereby Cedar had agreed to act as a facilitator in respect of the sale of the Hotel.
- FHR brought proceedings against Cedar to recover the secret commission.

FHR European Ventures LLP and others v Cedar Capital Partners [2014] UKSC 45

Findings (first instance):-

- At first instance, Simon J agreed that Cedar was in breach of the fiduciary duties it owed, as an agent to FHR, by failing to obtain FHR's informed consent to the commission fee.
- Accordingly, Cedar was liable to FHR in the sum of €10 million.
- The judge, however, declined to make the declaration sought by FHR that Cedar received the sum of €10 million on constructive trust for FHR absolutely.
- The question of whether FHR had acquired a proprietary interest in the commission fee mattered because it would allow FHR to better discover what had happened to the fee and who had benefited from it.
- On appeal, the Court of Appeal allowed the appeal and granted FHR the declaration sought.
- Cedar then appealed to the Supreme Court.

***FHR European Ventures LLP and others v Cedar Capital Partners* [2014] UKSC 45**



Supreme Court held in favor of FHR that Cedar held the commission on constructive trust for FHR:-

1. It is consistent with the fundamental principles of the law of agency.
2. It had the merit of certainty and simplicity, which were highly desirable qualities in the law.
3. It also aligned the circumstances in which an agent is obliged to account for any benefit received in breach of his fiduciary duty and those in which his principal can claim beneficial ownership of the benefit.
4. There is always a strong possibility that the bribe had caused loss to the principal.
5. Bribery and secret commissions are evil practice and it is appropriate that the law be particularly stringent when it comes to bribes and/or secret commissions, which tend to undermine trust in the commercial world.

Implied trusts: Resulting/Constructive

- Property (money) transferred as a result of mistake, misrepresentation, undue influence and duress
- Closely related to the law of unjust enrichment
- Issue: Whether a claim for unjust enrichment could give rise to a proprietary remedy? – If so, under what circumstances?
- The issue is important: If the Bankrupt is holding property that is subject to a claim for unjust enrichment, does he need to hand over the property?

Chase Manhattan Bank NA v Israel-British Bank (London) Ltd [1981] Ch 105

Facts:-

- The Plaintiff bank, Chase Manhattan had been instructed to pay just over \$2 million to the defendant, Israel-British Bank. However, by mistake it paid this sum twice.
- Shortly after, Israel-British Bank went into liquidation. Chase Manhattan could not recover the whole sum without claiming a declaration that the defendant received the moneys as trustee for the plaintiff, thus entitling it to trace and recover the mistaken payment.

***Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105**

Goulding J held:-

- A person who pays money to another under a factual mistake retains an equitable property in it and the conscience of that other is subject to a fiduciary duty to respect his proprietary right.
- Hence, Israel-British Bank held the second payment on trust from the moment it was received.
- Chase Manhattan is entitled to trace and recover the mistaken payment.
- But the authority of this decision has been weakened by the criticism made by Lord Browne-Wilkinson in *Westdeutsche Bank v Islington LBC* [1996] AC 669.

***Westdeutsche Bank v Islington LBC* [1996] AC 669**

Background:-

- Islington London Borough Council, a local authority, entered into a 10-year interest rate swap agreement with the Westdeutsche Bank. The agreement was in fact ultra vires local authorities and therefore void. The Bank sought to recover the money and compound interest thereon.
- The defendant conceded that it was liable to repay the money to the claimant, so the only question before the House of Lords was whether the claimant could claim compound interest.
- Compound interest was (at that time, as a matter of law) available only in respect of equitable claims, so the claimant needed to establish that it had an equitable proprietary interest in the money which the defendant had received.

***Westdeutsche Bank v Islington LBC* [1996] AC 669**

- The reasoning of Goulding J in *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* was criticized by Lord Browne-Wilkinson.
- Lord Browne-Wilkinson said a trust only arises if the “conscience” of the recipient was affected. But the recipient’s “conscience” could not be affected at a time when he was not aware of any mistake.
- However, his Lordship thought that the Chase case was rightly decided. Within two days of the mistaken payment having been made, the defendant bank learned of the situation and either knew that it was a mistake, or was put fully on inquiry by facts that should have indicated it might be a mistake.
- The mere receipt of the moneys, in ignorance of the mistake, gave rise to no trust. But the retention of the moneys after the recipient bank learned of the mistake gave rise to a constructive trust.

***Westdeutsche Bank v Islington LBC* [1996] AC 669**

- His Lordship took the view that a claimant for restitution of moneys paid under an *ultra vires*, and therefore void, contract only has a personal action at law to recover the moneys paid as on a total failure of consideration.
- The claimant does not have an equitable proprietary claim which gives him either rights against third parties or priority in an insolvency; nor will he have a personal claim in equity (to be secured by a lien), since the recipient is not a trustee.
- To date, there is still much academic debate regarding whether proprietary remedies are available for unjust enrichment claims
- (note: compound interest is now allowed even if the claim is not equitable proprietary claim – see Sempra Metals v IRD [2007] UKHL 34)

Trust Claims against Third Parties

- Trust can also be useful weapons to claim against third parties.
- A third party may incur liability as a constructive trustee if he assist a trustee (or other fiduciary) in a breach of duty, or where he receives trust property in breach of trust.
 - Dishonest assistance
 - Unconscionable receipt



Dishonest Assistance

- Where a third party assists, in a dishonest manner, in the misapplication of trust property, he may be held personally liable for the loss to the trust fund, even though the third party might never have received the property: ***Agip (Africa) Ltd v Jackson*** [1990] Ch 265
- ***Abou-Rahmah v Abacha*** [2006] 1 All ER (Comm) 247 stated the essential elements of dishonest assistance as follows:-
 - (a) that a third party has the requisite knowledge of breach of trust;
 - (b) that, given that knowledge, the third party acts in a way which is contrary to normally acceptable standards of honest conduct

Royal Brunei Airlines Sdn Bhd v Tan [1995] 2 AC 378



BLT is travel agent



Tan, Managing Director

Sell tickets



***Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378**

Facts :-

- The plaintiff airline company appointed Borneo Leisure Travel (“**BLT**”), to act as its travel agent for the sale of airline tickets.
- BLT was required to account to the plaintiff for all amounts received from such sales. As such, BLT was a trustee for the plaintiff.
- However, the trust sums received were not paid into a separate account, but were paid into BLT’s current account and used for its own purposes.
- The defendant, Tan, was BLT’s managing director and principal shareholder. He was effectively in charge and in control of BLT.
- BLT’s payments fell into arrears.
- BLT became insolvent.
- The plaintiff commenced an action against the defendant claiming an account in respect of the unpaid money.

***Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378**

- 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....”*

***Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378**

Held:-

- The defendant had caused or permitted the company to commit a breach of trust by using in the conduct of its business money held on trust for the airline when he knew that the company was not authorized to do so by the terms of the trust.
- The defendant had acted dishonestly, and was, therefore, liable to the airline for the amount owed to it by the company.
- THIS CASE HAS LOTS OF PRACTICAL IMPLICATIONS FOR LITIGATION AND COMMERCIAL PRACTITIONERS.

***Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd* [2005] UKPC 37**

Facts :-

- Mr. Peter Clowes through the company called Barlow Clowes International Ltd operated a fraudulent offshore investment scheme purporting to offer high returns from the skilled investment of funds in UK gilt-edged securities.
- He attracted about £140m, mainly from small UK investors.
- Most of the money was dissipated in the personal business ventures and extravagant living of Mr. Clowes and his associates.
- Some of the investors' funds were paid away through bank accounts administered by a company called Eurotrust.
- The scheme later collapsed.
- The liquidator of Barlow Clowes brought proceedings against Eurotrust and its two directors, Mr. Henwood and Mr. Sebastian, alleging dishonest assistance in the misappropriation of investors' funds.

Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd [2005] UKPC 37

Held :-

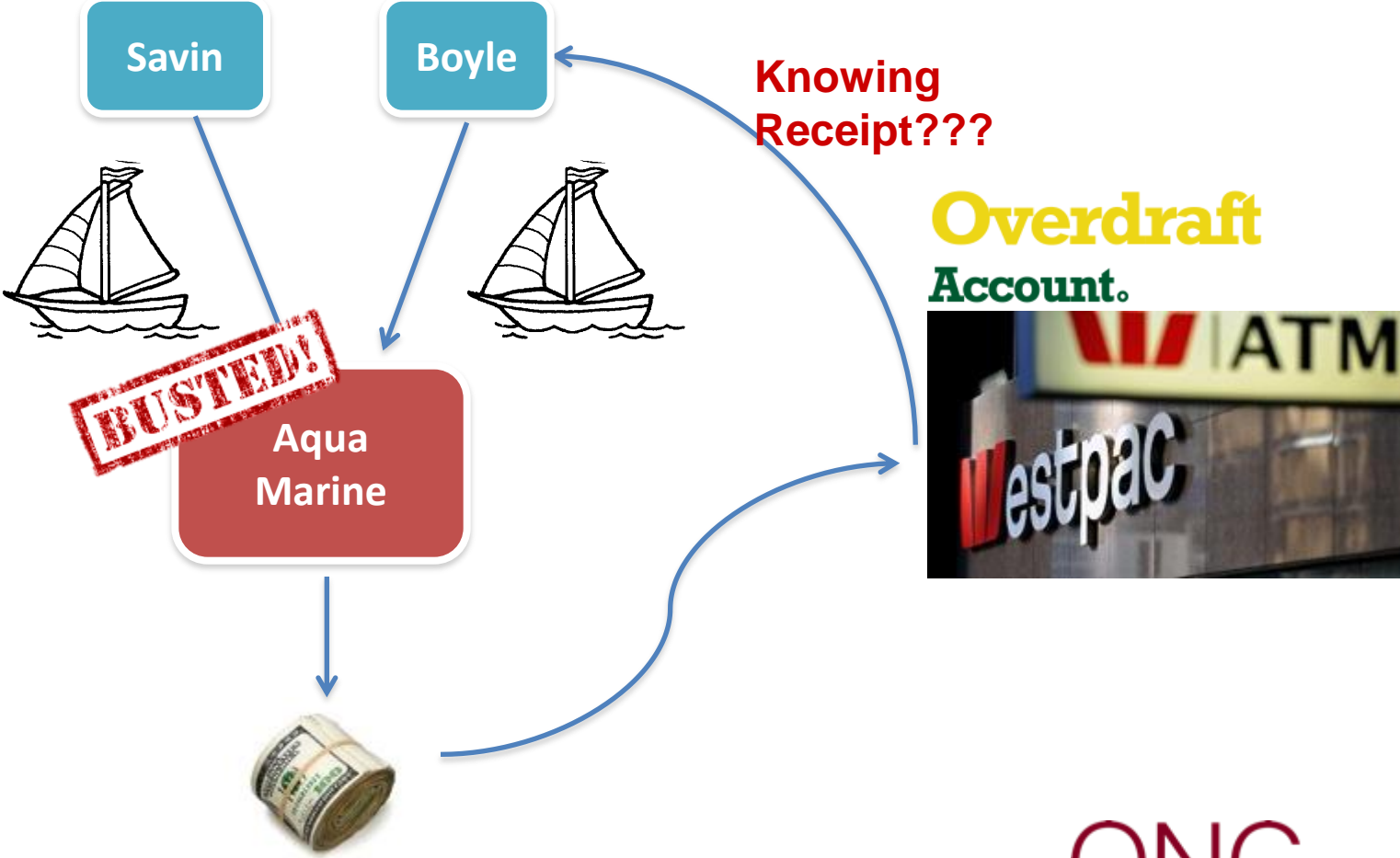
- Eurotrust is liable for dishonestly assisting in the misappropriation of a number of sums.
- Further, one of its director, Mr. Henwood, had had a dishonest state of mind because he had strongly suspected that the funds passing through his hands were monies which the company had received from members of the public who thought that they were investing in gilt-edged securities.
- If those suspicions were correct, no honest person could have assisted Mr. Clowes to dispose of the funds for their personal use.
- However, Mr. Henwood consciously decided not to make inquiries so as to avoid the risk of discovering the truth → liable for dishonest assistance

Knowing Receipt*

Snell's Principles of Equity (27th ed, 1973) at pp. 186-187:

- **Knowing Receipt:** a person receiving property which is subject to a trust becomes a constructive trustee if he falls within either of two heads, namely –
 - (i) that he received trust property with actual or constructive notice that it was trust property and that the transfer to him was breach of trust; or
 - (ii) that although he received it without notice of the trust, he was not a bona fide purchaser for value without notice of the trust, and yet, after he had subsequently acquired notice of the trust, he dealt with the property in a manner inconsistent with the trust.
- * it is now more commonly called “Unconscionable Receipt” – Principles of Equity and Trust (Virgo 2016)

Westpac Banking Corporation v Savin [1985] 2 NZLR 41



***Westpac Banking Corporation v Savin* [1985] 2 NZLR 41**

Facts :-

- Two boat owners, Savin and Boyle, authorized Aqua Marine to sell their boats on their behalf.
- It was agreed that the money would be remitted to Savin and Boyle, after Aqua Marine deducted its commission therefrom.
- Aqua Marine, however, deposited the money received from the purchaser into its trading account at Westpac which was overdrawn.
- Neither vendor was paid. Subsequently, Aqua Marine went into liquidation and there was no funds available on the liquidation to meet ordinary creditors.
- The boat owners sued Aqua Marine and Westpac.

Westpac Banking Corporation v Savin [1985] 2 NZLR 41

Findings in respect of Aqua Marine :-

- The relationships between Aqua Marine and its principals, Savin and Boyle, are agent and principal -> fiduciary relationship
- The principal's beneficial ownership of the property sold gives him prima facie an equitable interest in its proceeds: ***Foley v Hill*** (1848) 2 HK Cas 28, 35-36
- Aqua Marine held the proceeds on trust for Savin and Boyle.

Westpac Banking Corporation v Savin [1985] 2 NZLR 41

Findings in respect of Westpac :-

- The relationship between a bank and a customer is one of debtor and creditor.
- **Ordinarily**, a banker is not concerned to inquire into the sources whence his customer derived the money he pays into his private account at the bank, or to pay heed to the claims of third parties seeking to reach it in his hands as being by rights theirs.
- But there are certain circumstances under which a bank incurs a liability for participation in a breach of fiduciary duty on the part of the customer.

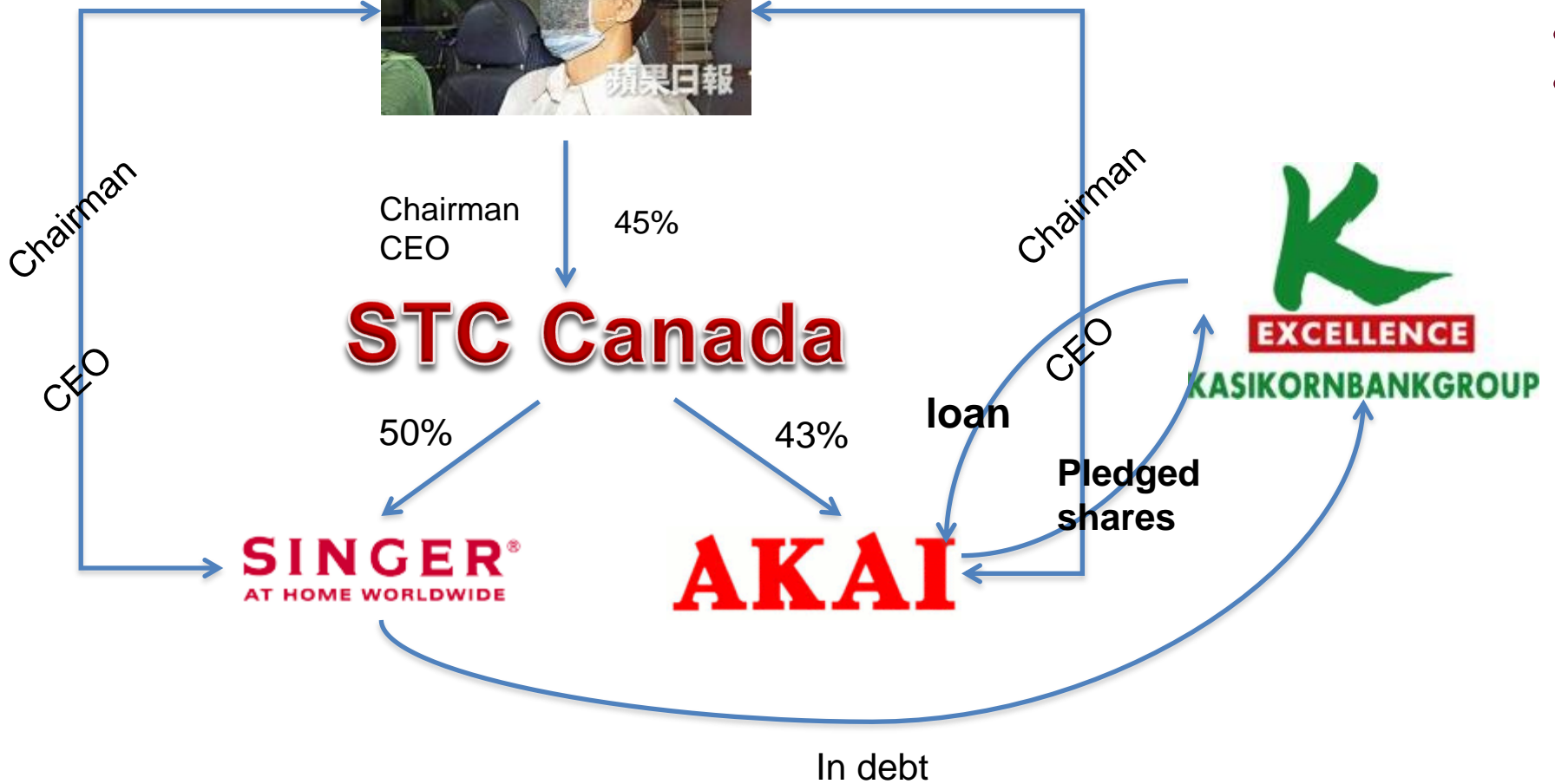
***Westpac Banking Corporation v Savin* [1985] 2 NZLR 41**

Findings :-

- The bank knew that Aqua Marine's receipts came from dealing in boats.
- The bank was aware that Aqua Marine "endeavors to maintain a ratio of 3 'on behalf of' boats to every 1 stock unit". (i.e. most likely sales proceeds are from "on behalf of" boats)
- The bank manager's diary entries noted the financial difficulties Aqua Marine was facing in the intervening months.
- The facts demonstrate a clear suspicion of, if not awareness, on the part of Westpac that Aqua Marine was not entitled to pay the proceeds into its own overdrawn trading account with the bank.
 - it willfully shut its eyes to the obvious or, at least, that it willfully and recklessly failed to ascertain and satisfy itself that the receipts were not in respect of "on behalf" sales.
 - Westpac had constructive notice of the continuing breach of fiduciary duty on the part of Aqua Marine

Akai Case

James Henry Ting



Akai Holdings Ltd (in liq) v Thanakharn Kasikorn Thai Chamkat (Mahachon) (2010) 13 HKCFAR 479

Facts :-

- Ting was the chairman and CEO of Akai, which was a Bermudan company listed on the Hong Kong Stock Exchange.
- Ting caused Akai to obtain a loan from the Thanakharn Kasikorn Thai Chamkat (the “Bank”).
- The loan was to be used to pay off the liability to the Bank of another company, Singer Company NV.
- Ting also caused Akai to grant a charge in favor of the Bank over certain shares owned by Akai as security for the loan.
- Akai did not have any equity interests in Singer but the two companies had a common majority shareholder, STC Canada.
- Ting owned 45% of STC and was the chairman and CEO of that company, and was also a chairman and director of Singer.
- Akai failed to repay the loan to the Bank, and the Bank sold the pledged shares.

***Akai Holdings Ltd (in liq) v Thanakharn Kasikorn
Thai Chamkat (Mahachon) (2010) 13 HKCFAR 479***

- The liquidators of Akai brought proceedings against the Bank to set aside the loan and the security agreements.
- The liquidators contended that the Bank realized, must have realized, or ought to have realized, that Ting had no power to commit Akai to the switch transaction, and that the Bank was accordingly liable to pay compensation to Akai.

***Akai Holdings Ltd (in liq) v Thanakharn Kasikorn
Thai Chamkat (Mahachon) (2010) 13 HKCFAR 479***

Held :-

- Ting was in breach of duty by failing to act in the interests of Akai in respect of the loan and security transactions.
- Those transactions placed a considerable debt burden of another company upon Akai, in which Akai had no equity interests.
- This was plainly to the financial detriment of Akai.
- Ting did not have apparent authority to commit Akai to the switch transaction and even if Ting had otherwise been clothed with such authority, the bank was simply **irrational** in its belief when it relied on that authority under the circumstances.

***Akai Holdings Ltd (in liq) v Thanakharn Kasikorn
Thai Chamkat (Mahachon) (2010) 13 HKCFAR 479***

Held :-

- The bank's reliance on Ting's alleged authority, when accepting the pledged shares of Akai, was irrational.
- Therefore, it would be unconscionable for the bank to retain the benefit of any assets received from the company under the impugned transaction.

Other Proprietary Claims: Specific Performance

- Specifically enforceable contracts against the estate
 - Subject matter of the contract is so unique that damages would not be adequate
 - E.g. contract for sale of landed properties; article of special value; where replacement is very difficult for the buyer
- Specific performance confers priority on the purchaser over other unsecured creditors. Swiss Bank Corporation v Lloyds Bank Ltd [1979] Ch 548, 566 per Browne-Wilkinson J:

“the court can and should order specific performance of an obligation of an insolvent company if that obligation was contracted before any insolvency, even if such specific relief will adversely affect third parties, the unsecured creditors of the company. In this regard I can see no relevant distinction between the position of an insolvent company and a bankrupt individual.”

Disclaimer of onerous property

- IP could bring unprofitable contracts to an end / give up company's interest in onerous property: s.59, Bankruptcy Ordinance (Cap 6) and s.268, Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap 32)
- Disclaimer, however, can be difficult:
 - In *Patel v Ali* [1984] Ch 283 at 288; 1 All ER 978 at 982, Goulding J held that “only in extraordinary and persuasive circumstances can hardship supply an excuse for resisting performance of a contract for the sale of immovable property.”

Other Proprietary Claims: Subrogation Claims

- Subrogation is a remedy which is designed to ensure ‘a transfer of rights from one person to another...by operation of law’ .
- Essentially, it allows the claimant to rely on the rights of a third party against a defendant (“stand in the shoes” of the third party).
- Typical example: the claimant’s money is used by the defendant to discharge a debt which the defendant owed to a **secured** creditor. The claimant can be subrogated to the secured creditor’s charge and gain the benefit of that security as against other creditors of the defendant.

Subrogation

- Section 15(1) of the Law Amendment and Reform (Consolidation) Ordinance (Cap 23):
 - “Every person who, being surety for the debt or duty of another or being liable with another for any debt or duty, pays such debt or performs such duty, shall be entitled to have assigned to him, or to a trustee for him, every judgment, specialty, or other security which is held by the creditor in respect of such debt or duty, whether such judgment, specialty, or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty.”

***Butler v Rice* [1910] 2 Ch 277**

Facts:-

- Mr. Rice asked Butler to lend him £450 to pay off a bank mortgage over a house in Bristol.
- The money was lent on the express understanding that Mr. Rice would give Butler a charge over the house to secure the repayment of the £450 .
- The bank's mortgage was thereby discharged.
- However, Mr. Rice did not inform Butler that the house was in fact in his wife's sole name. And Mrs. Rice refused to create a charge in favor of Butler.

***Butler v Rice* [1910] 2 Ch 277**

Held:-

- Mr. Rice was enriched by discharging of his debt to the bank and Mrs. Rice was enriched by having had the bank's charge over her house paid off.
- Those enrichments were directly and indirectly at Butler's expense.
- It was unjust as Butler was not repaid the money.

- Butler was entitled to be subrogated to the bank's mortgage over the property to secure his right to repayment of the £450.

Important Procedural Advantages - Tracing


- Trust claims have many important procedural advantages, including tracing.
- The beneficiary under a trust can trace the trust property into substitute assets, to expand his claim both in terms of **people** and **property**.




Asset Tracing Rule (greatly simplified)

Proprietary claims pre-suppose that the relevant asset, or its substitute could be identified. The law has developed a number of rules for identifying the substituted assets. They are summarized as follows:-

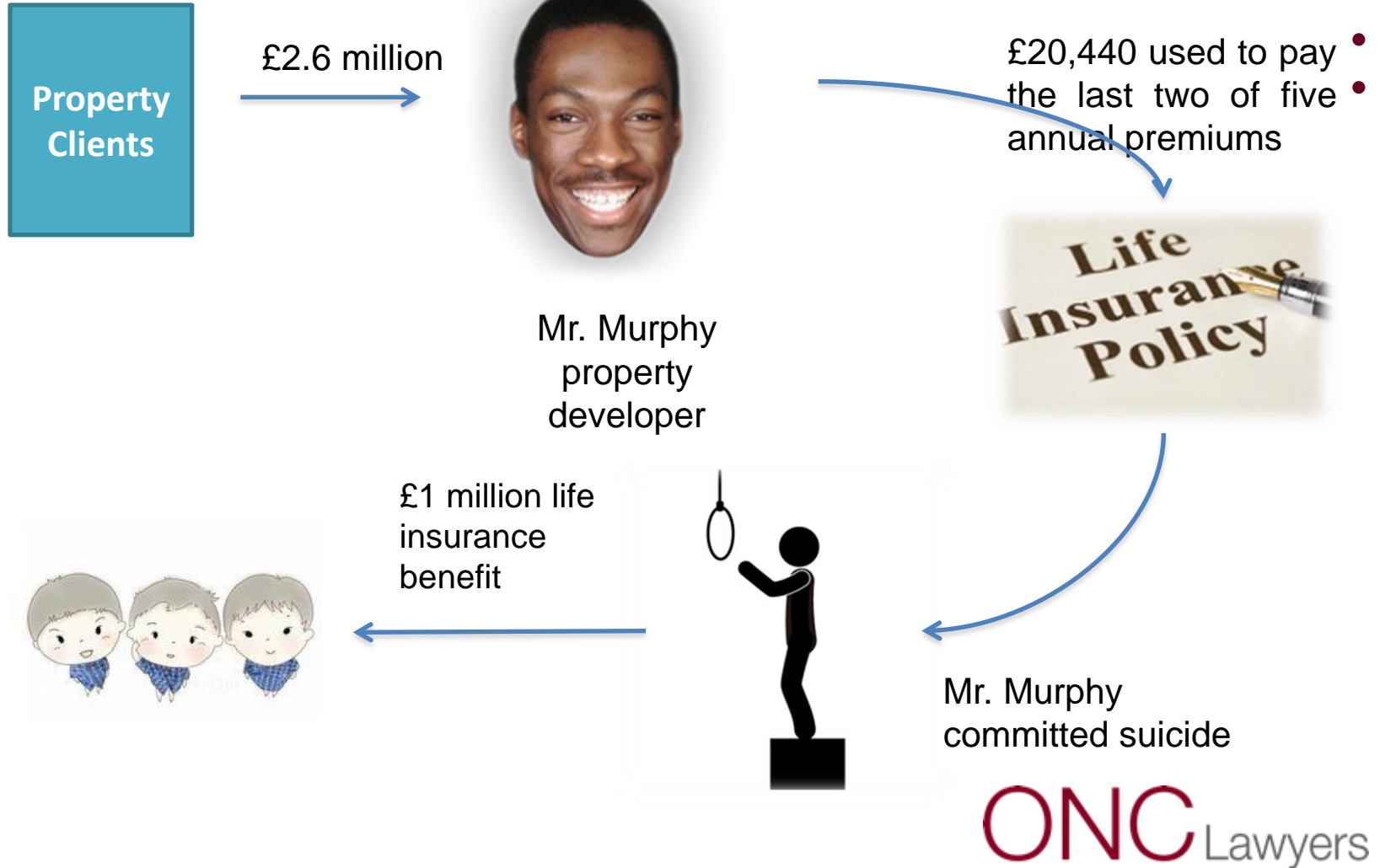
1. If the original asset has been exchanged for another asset, the tracing claimant may adopt the exchange and claim the fresh article as his own. In Taylor v Plumer (1815) 3 M&S 562 Plumer gave Walsh a bank draft with instructions to purchase Exchequer Bills. Instead Walsh purchased bullions and American shares and tried to abscond. Plumer intercepted him and took the bullions and shares. Walsh's TIB sued Plumer for conversion. Court held that Plumer got the title in the bullions and shares.
2. Alternatively, the person mounting the tracing action may lay claim to a lien on the new article. For example, when a fraudster purchased assets partly with money from victim and partly from other sources.

- 
3. If misdirected funds are mixed with the fiduciary's own funds in a bank account and then drawings are made from the account the presumption is that the fiduciary intended to spend his own funds first and that the funds which remain in the account belong to the tracing claimant: Re Hallett's Estate (1880) 13 Ch D 696
 4. If a mixed fund has been used in the acquisition of property that has increased in value the claimant may claim a proportionate part of the added value: Foskett v McKeown [2001] 1 AC 102
 5. Where the funds of two "innocent parties" have been mixed by a fiduciary in a bank or other running account, the "first in, first out" rule in Clayton's Case (Devaynes v Nobel (1816) 35 ER 781) would apply as a default rule. However, this would be subject to contrary intention. In Vaughan v Barlow Clowes International Ltd [1992] 4 All ER 22, the Court held that the investors in a failed investment management company could not have intended that withdrawals from the account, and investments then purchased, could be allocated by reference to the order the contributions were made. So the first in first out rule does not apply. The pari passu rule applies instead.

- 
6. Backward tracing is now confirmed by *Federal Republic of Brazil and another v Durant International Corpn and another* [2015] UKPC 35.

 7. A tracing claim will fail if assets that form the subject matter of the claim have ceased to exist. A corollary of this principle is the lowest immediate balance rule. E.g., if \$100 was paid into the fraudster's account, but the account subsequently fell to \$60 at some point of time, then in general the maximum proprietary claim of the victim would be \$60 even if the account later went back up to \$100.

Foskett v McKeown and Others [2001] 1 AC 102



***Foskett v McKeown and Others* [2001] 1 AC 102**

Facts:-

- Murphy claimed to be a property developer in Portugal. Foskett and 219 other clients paid over £2.6 million, with the agreement that building plots would be developed for them.
- This money was held on trust, but Murphy never carried out the development.
- He used £20,440 of this money to pay the last **two of five** annual premiums of a life insurance policy.
- In 1991, Murphy committed suicide and the life insurance death benefit paid out £1 million to Murphy's three children.
- The property clients claimed that they were entitled to trace their £20,440 into the death benefit.

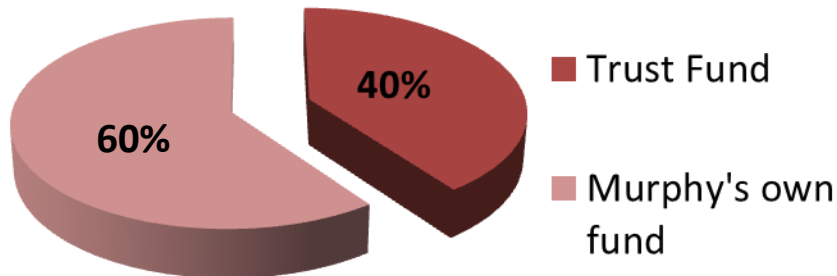
***Foskett v McKeown and Others* [2001] 1 AC 102**

Held :-

- The death benefit paid on Mr. Murphy's death was paid in consideration of the receipt of all the premiums payable under the policy. Part of that sum, therefore, represented the traceable proceeds of the plaintiff's money. (note: the policy will not lapse even if the last two installments were not paid)
- The parties' respective entitlement to the proceeds of the policy depend on the shares in which they contributed to the premiums.

Conclusion :-

- The money should be divided between the parties **in proportions** in which they contributed to the premiums.



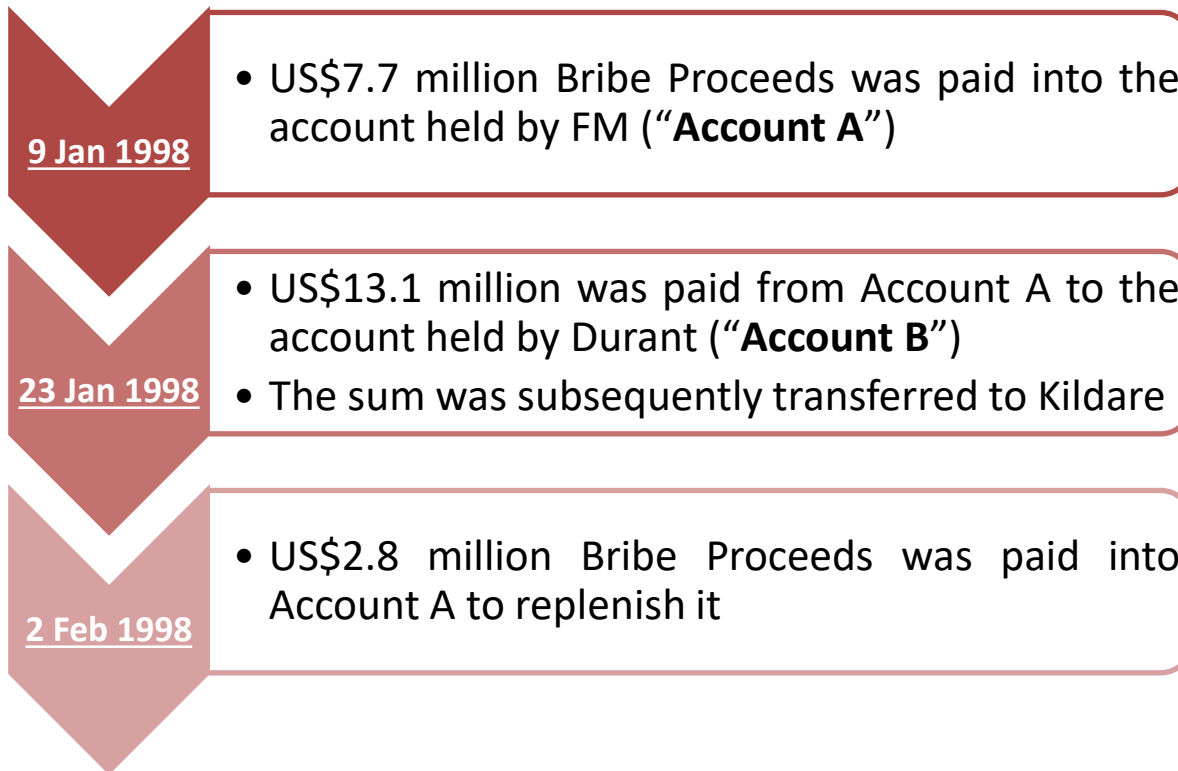
1 million insurance benefit

Backward Tracing

Federal Republic of Brazil and another v Durant International Corpn and another [2015] UKPC 35

Facts :-

- The Municipality of Sao Paulo brought proceedings in Jersey against two BVI companies, which were controlled by the former mayor of the municipality (“**PM**”) and his son (“**FM**”).
- It was alleged that bribes totaling US\$10.5 million was paid to PM and then laundered through bank accounts belonging to FM and the two companies.
- The Jersey courts found the defendants liable to the Municipality as constructive trustees of US\$10.5 million.
- The defendants appealed to the Privy Council.



- Before the Privy Council, The BVI companies argued that their liability as constructive trustees should be limited to US\$7.7m.
- The remaining US\$2.8m bribe proceeds was paid into Account A **after** the US\$13.1m was paid from Account A to Account B.
- The US\$2.8m was then used to replenish Account A.
- Durant and Kidare argued that there is no doctrinal basis for “**backward tracing**”.

Backward Tracing

- “Backward tracing” describes where the claimant’s property is traced into an asset the defendant already has.
- *Example:-*
The trustee acquired an asset and thereby incurred a debt. Later the trustee used the trust fund to pay off the debt. By the “no backward tracing” principle, it is impossible to trace the trust funds into the asset that the trustee had already acquired.

Federal Republic of Brazil and another v Durant International Corpn and another [2015] UKPC 35

Held :-

- Backward tracing is a point unclear in English law.
- Public policy informs the Board's judgment.
- The methods of money laundering are increasingly sophisticated and elaborate and often involve a web of credit and debits between intermediaries.
- A court should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect.
- The court should **look at the transaction overall**, rather than divide minutely the connected steps.
- If the court is satisfied that the various steps are part of a coordinated scheme, the strict order in which associated events occur should not matter.

Federal Republic of Brazil and another v Durant International Corpn and another [2015] UKPC 35

Held :-

- The Privy Council therefore rejects the argument that there can never be backward tracing.
- But the claimant has to establish a **co-ordination between the depletion of the trust fund and the acquisition of the asset** which is the subject of the tracing claim, looking at the whole transaction, such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund.
- Held in favor of the Plaintiff.

Important Procedural Advantages - Limitation

- Under s.49 of the Bankruptcy Ordinance, the trustee in bankruptcy can apply to the court to set aside transactions at an undervalue.
- Such actions, however, may be time-barred:-
 - For actions to recover the payment of money, the limitation period is 6 years: s.4(1)(d) of the Limitation Ordinance (Cap 347)
 - For an action upon a specialty, the limitation period is 12 years: s.4(3) of the Limitation Ordinance (Cap 347)

N.B. limitation defence is not available in a trust claim

Re Lee Siu Fung, Siegfried HCB 345/2001

破產令失效後 再遭狀告隱瞞資產 李兆峰指公司業務受影響

文章日期：2016年10月3日

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事件簿

1993年	兆峰陶瓷於聯交所主板上市，帶挈李兆峰身家暴漲至35億元
2001年5月8日	兆峰陶瓷因無法償還債務清盤，李兆峰因擔保公司2億元債務，同告破產
2005年5月5日	鄧忠華提出8項理由，要求延長李兆峰的破產令
2012年10月10日	高等法院頒令指，李兆峰的破產令已於2005年5月8日失效
2015年4月30日	李兆峰擔任行政總裁的ROY Ceramics於德國法蘭克福交易所上市
2016年9月28日	鄧忠華入稟法院，要求就李兆峰與ROY Ceramics的關係作出訊問，並獲高等法院批准，日期待定



李兆峰小檔案

姓名	李兆峰 (Siegfried)
出生地	泰國曼谷
年齡	58
學歷	華南工大學陶瓷工業碩士
簡介	兆峰陶瓷(已清盤)創辦人、現為德國上市公司ROY Ceramics董事總經理兼行政總裁

Re Lee Siu Fung, Siegfried HCB 345/2001

- The Bankrupt was adjudged bankrupt on 8th May 2001 and was discharged from bankruptcy in May 2005.
- It was alleged that the Bankrupt concealed or not disclosed his assets held in nominee accounts or through offshore companies. Further, it was also alleged that since 1996, the Bankrupt had taken steps to squirrel away his assets and put them beyond the reach of the creditors.
- Can the TIB claim for the concealed properties after 15 years?
 - Yes! Because it is a trust claim, therefore not subject to limitation.

***Re Lee Siu Fung, Siegfried* HCB 345/2001**

Held:-

- Upon a bankruptcy, the property of the bankrupt vests in the Official Receiver and subsequently in the trustee in bankruptcy: s 58(1) & (2) of the Bankruptcy Ordinance (Cap 6).
- This generally includes all property belonging to or vested in the Bankrupt at the commencement of the bankruptcy: s 43(1).
- Any property of the Bankrupt so vested in the trustee does not re-vest in the bankrupt upon discharge: *Cheung Wing Kwan Tommy v Hong Kong Export Credit Insurance Corp* [2012] 2 HKLRD 1255.
- Thus, any assets concealed by a Bankrupt prior to his bankruptcy are vested in the trustee and continue to be so vested after and despite discharge.

Equitable defence of *laches*

- Although the limitation defence is not available in an action by beneficiary to recover trust property or its traceable product against the trustee or a third party to the trust, the defendants in such an action can still raise an equitable defence of *laches*: ***Nelson v Rye*** [1996] 2 All ER 186
 - (a) that there has been **unreasonable delay** by the plaintiff; and
 - (b) that there has been **consequent substantial prejudice** or detriment to the defendant which justifies the refusal or the equitable relief sought.
- Mere delay *per se* is not sufficient. There must be established a **causal link** between the delay and the prejudice / detriment.

Concluding Words

- Trust claims may widen the recovery of assets in insolvency
- Trust claims arise from:-
 - Resulting trust – where the bankrupt dispose of his property in a gratuitous manner
 - Constructive trust – where a fiduciary (director/agent of the company) mis-appropriated company assets (including opportunity/bribe)
- Trust claims have the important procedural advantages of:-
 - Being a proprietary claim (giving it priority in the defendant's insolvency)
 - Allow tracing
 - Expand the scope of potential defendants (for dishonest assistance/unconscionable receipt)
 - Overcome limitation periods



- At the same time, some properties held by the estate (as legal owner) may actually belong to other persons beneficially who may have a proprietary claim against those properties in priority to other creditors.

- Circumstances giving rise to proprietary claims include:
 - Where the contract can be specifically enforced
 - Assets impressed with trust (express, resulting and constructive)
 - Subrogation

- Those assets, or their substitutes, as identified by the tracing rules, are not available for distribution to general creditors



Thank you! 

ONC Lawyers

柯伍陳律師事務所

19th Floor, Three Exchange Square
8 Connaught Place, Central, Hong Kong

Tel: (852) 2810 1212

Fax: (852) 2804 6311

Email: ludwig.ng@onc.hk

Website: www.onc.hk



Primerus
Member



Important: The law and procedure on this subject are very specialised and complicated. This seminar 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.

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