

The Court of Final Appeal's decision on void disposition



Hsin Chong Construction Company Limited (in liquidation) v Build King Construction Limited [2021] HKCFA 14 (judgment dated 13 May 2021)

Introduction

When a company is presented with a winding up petition, its contracting parties may be asked to make payments to a different entity in the same group as the company. Section 182 of Cap 32 voids such payments unless they are validated by the Court. In this case, the Court of Final Appeal considered the application of section 182 on payments arising from a joint venture construction project.

Background

In 2013, Hsin Chong Construction Company Limited ("Hsin Chong") and Build King Construction Limited ("Build King") entered into a joint venture agreement (the "JVA"). There is a mechanism under the JVA whereby one party may exclude the other from the management of the joint venture by reason of that other's insolvency and take over the benefit of the excluded party in the joint venture (the "Exclusion Option"). If the option is invoked, there will be a final accounting exercise at the end of the project. The excluded party will be entitled to a share of the profit up to the date of exclusion, less expenditure and losses caused by the excluded party.

In August 2018, a creditor presented a winding-up petition against Hsin Chong. Upon taking the view that Hsin Chong was insolvent, Build King exercised the Exclusion Option in December 2018. The parties then entered into a Supplemental Agreement (the "SA") whereby Build King agreed to acquire Hsin Chong's residual rights and interests under the JVA at a consideration of HK\$ 53 million in two instalments to one of Hsin Chong's sister company in the Hsin Chong Group.

Only the first instalment (the "Proceeds") was paid by Build King. The Proceeds were dissipated through various payroll and MPF payments owed by Hsin Chong, as well as legal costs and other expenses of other entities in the Hsin Chong Group.

Build King applied to seek retrospective validation of the SA pursuant to section 182 of Cap 32.¹

Decisions in the Court of First Instance and the Court of Appeal

Deputy High Court Judge Le Pichon found that Hsin Chong had requested payment to be made to the sister company as Hsin Chong's bank accounts were frozen because of the winding up petition and outstanding MPF contributions as well as employees' wages could not be paid.

Her Ladyship also found that (i) Build King had "an inkling" that part of the proceeds would be applied by Hsin Chong in settling outstanding MPF contributions and employees' wages which would contravene section

¹ Build King also sought to validate the Exclusion Option under the JVA in the same application, but this was no longer in issue before the CFA. The first instance Judge confirmed the validity of Exclusion Option and the decision was upheld by the Court of Appeal. Click [here](#) to read our previous article on the first instance decision.

182 (absent any prior validation order) and (ii) Build King could be said to be facilitating a possible contravention by making payment to the sister company instead of Hsin Chong directly.

Nevertheless, her Ladyship granted a validation order because:

- (1) She considered the Proceeds as a payment to Hsin Chong for discharging Build King's obligations as purchaser under the SA, hence not a disposition of Hsin Chong's property. Subsequent misapplication of the Proceeds was internal to Hsin Chong and its directors which did not involve Build King.
- (2) Build King had not breached any duty to the unsecured creditors or otherwise.
- (3) Hsin Chong would have to repay the Proceeds to Build King if validation is refused.

Decision of the Court of Final Appeal²

Section 182 explained

The Court of Final Appeal explained that:

- (1) Section 182 is concerned with the disposition of a company's property made after the commencement of the winding up. If a transaction amounts to such a disposition, it is void unless the Court orders otherwise.
- (2) If entry into and performance of the SA were held to constitute a disposition of Hsin Chong's property, the transaction would be presumptively void and the burden would fall on Build King to show why the Court ought to make a validating order.
- (3) The interests of the general body of creditors are determinative in deciding whether a disposition of a company's property after commencement of the winding up should be validated.³

Overtaking the decision of the lower Courts

The Court of Final Appeal considered that the lower Courts had focused on the wrong property and the wrong disposition. Instead of Build King's payment under the SA, the relevant property should be the right to payment (including the first instalment) as the consideration for sale of Hsin Chong's residual and incidental rights in the JVA.

The question of whether a disposition has taken place is one of substance and not form. It was therefore irrelevant that the parties have contractually agreed that the Proceeds were to be paid to Hsin Chong's sister company. By paying the sister company instead of Hsin Chong, the transaction under the SA has dissipated Hsin Chong's property.

The lower Courts had erroneously decided the fact that Build King had no ulterior motive and breached no duty were matters favouring the making of a validation order. Section 182 is concerned with the preservation of a company's property for proper distribution to the general body of creditors. That section does not concern with the parties to the transaction nor require it to be shown that such parties were in breach of any duty. Build King's knowledge that the use of the Proceeds would be in contravention of section 182 does not militate in favour of a validation order.

² Unanimous decision of the Court of Final Appeal with Mr Justice Ribeiro PJ and Mr Justice Fok PJ giving the joint judgment

³ Citing, among others, the English Court of Appeal case of *In re Gray's Inn Construction Co Ltd* [1980] 1 All ER 814

Hsin Chong has never received any Proceeds, nor any part of the Proceeds have been made available for distribution to its creditors. Hence there was no question of any repayment by Hsin Chong to Build King even if validation is refused.

The Court of Final Appeal therefore held that the SA and the dispositions were void by reason of section 182 and set aside the validation order. The effect of holding the SA void was that Hsin Chong could revert to a claim against Build King for the value of its residual rights under the JVA as determined by the final accounting exercise.

Takeaway points

- (1) Section 182 is concerned with the preservation of a company's property for proper distribution to the general body of creditors.
- (2) The question of whether a disposition has taken place is one of substance and not form.
- (3) A validation order is likely to be refused unless the disposition actually has been or is likely to be for the benefit of the unsecured creditors.

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