March 2025

GOING CONCERNS

RESTRUCTURING AND INSOLVENCY

As we approach the 5th anniversary of Singapore's modernisation of its restructuring and insolvency regime by way of the Singapore Insolvency, Restructuring and Dissolution Act 2018 (which was passed in 2018 but only came into effect on 30 July 2020), we cover the latest restructuring and insolvency developments in Singapore and Hong Kong, including a recent creative approach as regards classification in a scheme of arrangement; clarification on the arsenal of tools available to a Singapore liquidator to restrain its creditors; the sanctity of the *pari passu* regime; and the first reported Hong Kong judgment on fraudulent trading.

We hope you enjoyed this edition of the Going concerns and we look forward to your continued support in the coming editions of the same. As usual, please feel free to contact us should you like to learn more on any topic.

CONTENT

DECLASSIFYING CLASSIFICATION

The liquidators in *Re Hin Leong Trading (Pte) Ltd (in compulsory liquidation) and another matter* [2024] SGHC 256 sought to classify its creditors as "potential secured creditors" in a potential scheme of arrangement. The main question before the Court was whether this was permissible or if this was the liquidators seeking to shirk their duties to determine the security rights between the potential secured creditors.

The Court agreed with the liquidators that there was no need to determine the security rights of every creditor claiming to have security and how the secured creditors ranked as between themselves. The matter is subject to an appeal to the Court of Appeal and we will also cover this decision when it is published in our next edition of the Going Concerns.

BACKGROUND

Hin Leong Trading (Pte) Ltd (in compulsory liquidation) ("**HLT**") was in the business of oil trading. When HLT was placed in interim judicial management on 27 April 2020, some oil purportedly belonging to HLT was stored in the oil storage terminals maintained and operated by UT Singapore Services Pte Ltd ("**UTSS**").

After HLT was placed in liquidation, the liquidators sold some of the oil purportedly belonging to HLT and proposed a scheme for the *pari passu* distribution of US$80 million of the sale proceeds ("**Uninjuncted Proceeds**") to HLT's "Potential Secured Creditors" (those who had asserted security interests (but which had not been determined) over the Uninjuncted Proceeds) and "Unsecured Creditors" (those who had *not* asserted security interests over the Uninjuncted Proceeds) ("**Scheme**"). The Potential Secured Creditors (which included UTSS) would release and waive any security they may have in the Uninjuncted Proceeds.

The liquidators of HLT explained that the Scheme would be in the best interests of the creditors as it would allow for a fair, commercial and expeditious distribution of HLT's assets because there is significant uncertainty in:

(a) the recoveries the creditors will be able to obtain in the absence of the Scheme – multiple issues will have to be determined, which includes, amongst others, the validity of the security claims asserted by various creditors over the Uninjuncted Proceeds; and tracing and identifying the oil which the creditors may have security over due to extensive co-mingling.

(b) the time before which the creditors will be able to receive any recoveries in the absence of the Scheme – it could take years before the aforementioned issues can be fully and finally resolved.

To implement the Scheme, the liquidators of HLT applied to Court for leave to convene a Scheme meeting for the creditors to consider and approve the Scheme (the "**Convening Application**"). The creditors were given the opportunity to file a reply affidavit in response to the application but no reply affidavit was filed. Various creditors (including UTSS) were represented at the hearing and none of them objected to the Convening Application. The Court granted the application (the "**Convening Order**").

This was followed by the Scheme meeting, during which overwhelming support for the Scheme was obtained – only UTSS voted against the Scheme.

The liquidators thereafter applied to Court for the sanction of the Scheme ("**Sanction Application**"). It was only at this stage that UTSS raised objections to the proposed terms of the scheme of arrangement. Amongst others, two main issues decided by the Court were:

(a) whether it is permissible for the Scheme to classify the creditors as Potential Secured Creditors and Unsecured Creditors; and

(b) whether the Court should entertain objections at the Sanction Application when they could have been raised at the Convening Application.

WHETHER IT IS PERMISSIBLE FOR THE SCHEME TO CLASSIFY THE CREDITORS AS "POTENTIAL SECURED CREDITORS" AND "UNSECURED CREDITORS"

The Court did not agree with the arguments by UTSS that one had to determine the security rights of every creditor claiming to have security and how the secured creditors ranked as between themselves. Amongst others, the Court considered that:

(a) there are precedents of schemes including claims with elements of contingency and futurity, and which are of uncertain quantum, indicating that it was possible to classify creditors according to their potential rights.

(b) even if the security claims were not conclusively determined, one could readily compare the position of the creditors with or without the Scheme – the Potential Secured Creditors could give up their claims to security and be treated *pari passu* together with Unsecured Creditors or their security claims could be determined; and the Unsecured Creditors could agree to the Scheme and receive *pari passu* distribution or they could wait for a determination of the security claims.

The Court took the view that the liquidators were justified in regarding UTSS, similar to the creditors who were financing banks, as a party that had asserted a security interest over the Uninjuncted Proceeds for the purposes of classifying them as Potential Secured Creditors because their rights were not so dissimilar that they could not consult together with a view to their common interest. Even if UTSS had a better claim than the claims of the financing banks, the liquidators were entitled to adopt a fairly robust approach to classify creditors in a broad and objective manner.

WHETHER THE COURT SHOULD ENTERTAIN UTSS' OBJECTIONS AT THE SANCTION STAGE, WHEN UTSS HAD NOT RAISED THEM AT THE CONVENING STAGE

When a scheme of arrangement is being proposed, the first opportunity which creditors had to oppose to the scheme of arrangement was at the Convening Application. However, UTSS did not raise any objections at that stage.

It was only after the Convening Order was granted and a week before the Scheme meeting that UTSS applied to Court to set aside the Convening Order (the "**Setting Aside Application**") and to defer the Scheme meeting until after the Setting Aside Application had been determined. The Court declined to defer the Scheme meeting.

At the hearing of the Sanctions Application, the Court took the view that if creditors had not objected to creditor classification at the convening stage, but raised such objections in opposing sanction of the scheme, the Court will expect a good explanation / reason as to why this was not raised earlier; and if there is no good reason and no material change of circumstances, the Court is not required to revisit those creditor issues at the sanction stage.

On the facts of the case, the Court considered that it was allowed to decline to revisit the issue of creditor classification particularly when the Court had given directions for the filing of reply affidavits to the liquidators' Convening Application, but UTSS had chosen not to file any such affidavit. The Court therefore was entitled to decline revisiting the issue of creditor classification at the hearing of the Sanctions Application.

In any event, the Court went on to consider the classification of "Potential Secured Creditors" and "Unsecured Creditors" proposed by the liquidators.

CONCLUSION

The Court sanctioned the Scheme after concluding that the Scheme was one which a man of business or an intelligent and honest man, being a member of the class concerned and acting in respect of his interest, would reasonably approve. The Court considered the Scheme was a fair and equitable one, and was strongly influenced by the large majority vote in favour of the Scheme.

The case has been appealed, and the Court of Appeal has heard the matter so stay tuned for the next edition of the Going Concerns for an update.

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In Group Lease Holdings Pte Ltd (in liquidation) and another v Group Lease Public Co Ltd [2024] SGHC 302, the Court provided guidance on how a liquidator could obtain an injunction to restrain its creditor from exercising its rights under certain security agreements on the grounds of unfair preference.

BACKGROUND

Group Lease Holdings Pte Ltd (in liquidation) ("**GLH**") is the holding company for subsidiaries of the Group Lease group of companies operating in various Southeast Asian countries. Group Lease Public Company Ltd ("**GL Thailand**") is a Thailand-incorporated company and is the sole shareholder of GLH.

JTrust Asia Pte Ltd ("**JTA**") commenced two legal proceedings against various parties, including GLH, and had in the course of each proceeding obtained a *Mareva* injunction against GLH restraining GLH from disposing of its assets other than in the ordinary course of business until full satisfaction of the respective judgment debt.

GL Thailand extended inter-company loans to GLH via 35 loan agreements – the latter 7 of which were entered into to enable GLH to satisfy the first judgment debt owed to JTA and discharge the first *Mareva* injunction.

Beginning shortly before the lapse of the first *Mareva* injunction and until the issue of a second *Mareva* injunction, GL Thailand and GLH entered into various arrangements (the "**Security Agreements**") that had the effect of granting security over, or assigning, substantially all of GLH's assets to GL Thailand.

GLH was subsequently wound up. GLH and its liquidator (collectively, the "**Claimants**") commenced legal proceedings seeking various reliefs which centered on the Security Agreements being unfair preference transactions ("**OC 565**"). In advance of the determination of OC 565, the Claimants applied for, amongst others, interim injunction, against GL Thailand to restrain GL Thailand from enforcing or exercising its rights under the Security Agreements.

Amongst others, the issues dealt with the Court are:

(a) the law on unfair prejudice transactions; and

(b) the applicable legal framework on injunctions.

THE LAW ON UNFAIR PREJUDICE TRANSACTIONS

In determining whether there was a serious question to be tried (for the purposes of considering whether to grant an injunction – to be discussed below), the Court set out the legal principles on unfair preference transactions.

A transaction will constitute an unfair preference if the following conditions are met:

(a) First, there must be a pre-existing relationship of debtor and creditor between the insolvent company and the transaction counterparty.

(b) Second, the transaction that is alleged to be a preference must be referable to an antecedent debt between the company and the transaction counterparty.

If the company grants security to the counterparty to secure both *existing* indebtedness and *contemporaneous* advance of monies, it will be a partial preference to the extent that it relates to the existing indebtedness.

(c) Third, the company must have done something that had the effect of putting the counterparty in a better position in the company's liquidation than it would otherwise have been; and the advantage to the counterparty must have come at the expense of the company's other unsecured creditors.

(d) Fourth, the company must have been influenced by a desire to prefer the transaction counterparty.

The burden of proof is on the liquidator to establish that the company had the requisite desire to improve the position of the preferred creditor.

However, where the recipient of the preference is a person connected to the company, the burden will lie on the connected person to establish that the company was not influenced at all by any desire to place the connected person in a preferential position and a bare denial will not suffice.

(e) Fifth, the transaction must have taken place within one year before the commencement of the winding up (or two years where the counterparty is a connected person to the company); and the transaction must either have taken place when the company was insolvent or the company became insolvent as a result of the transaction.

On the facts, the Court was satisfied that there was a serious issue to be tried as to whether the Security Agreements constituted unfair preferences.

(a) It was not disputed that there was a pre-existing debtor-creditor relationship between GLH and GL Thailand and that almost all of the Security Agreements were executed after all 35 loan agreements between GLH and GL Thailand were entered into, and within two years before the commencement of the winding up.

(b) The transactions gave GL Thailand a factual preference relating to antecedent debts owed under the loan agreements. Though it was a plausible argument that GL Thailand had only agreed to enter into the last 7 loan agreements with GLH on the basis that GLH would provide security for the same after the first *Mareva* injunction was lifted, the veracity of such an allegation was better suited to be tested at trial as the threshold at this stage was only a serious issue to be tried.

(c) As a connected company to GLH, GL Thailand failed to show that it was plainly unarguable that GLH had been influenced at all by a desire to prefer GL Thailand.

THE APPLICABLE LEGAL FRAMEWORK ON INJUNCTIONS

The interim prohibitory and mandatory injunctions sought by the Claimants were pursuant to the Court's general jurisdiction to grant injunctions (under section 18(2) read with paragraphs 5 and 14 of the First Schedule to the Supreme Court of Judicature Act 1969 and section 4(10) of the Civil Law Act 1909) and the Court's specific jurisdiction under section 270 of the

Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**").

GENERAL JURISDICTION TO GRANT INJUNCTIONS

The general rule is that a Court will grant an interim injunction if (a) there is a serious issue to be tried; and (b) the balance of convenience lies in favour of granting the injunction.

Though arguments were raised that there is a higher threshold guarding the Court's jurisdiction to grant mandatory injunctions, the Court disagreed and took the view that the fundamental principle of choosing the path of least injustice underlies both interim mandatory injunction and interim prohibitory injunction.

Nonetheless, the distinction between mandatory and prohibitory injunctions is not redundant. Where the protection sought from a mandatory injunction can be appropriately or sufficiently achieved through a properly framed prohibitory injunction, the latter option should be pursued.

On the facts, the Court granted the interim prohibitory injunctions and refused the interim mandatory injunctions because the net effect of the injunctions was identical – the Claimants' interest can be adequately protected by the prohibitory injunctions.

In deciding to grant the interim prohibitory injunction, the Court was satisfied that:

(a) amongst others, there was a serious issue to be tried as to whether the Security Agreements constituted unfair preferences (as discussed above).

(b) the balance of convenience lay in favour of granting the interim prohibitory injunctions sought by the Claimants because, amongst others:

   (i) damages would not be an adequate remedy for the Claimants as it would be difficult to quantify the sum representing the diminished value of the shares in GLH's subsidiaries if allowed to be dealt with by GL Thailand. On the other hand, damages would be an adequate remedy for GL Thailand because there was no indication that GLH's liquidator was incapable of performing his duty to preserve the value of GLH's assets and it was speculative whether the value of the securities would fall in value as a result.

   (ii) there was a real risk that GL Thailand would dissipate the assets of GLH's subsidiaries if not restrained by injunction pending the determination of OC 565 (which would have the effect of defeating the efficacy of the Court's order in OC 565) because it is arguable that GL Thailand's conduct in enforcing some of the disputed securities under the Security Agreements constituted a breach of the second *Mareva* injunction.

IRDA JURISDICTION TO GRANT INJUNCTIONS

Though the Court had granted the injunctions sought via its general jurisdiction, the Court was of the view that it would have been prepared to grant an injunction pursuant to section 270 of the IRDA.

The Court set out the general framework for approaching applications for injunctions pursuant to its specific jurisdiction under section 270 of the IRDA:

(a) First, has there been, or will there be, a contravention of Parts 4 to 11 of the IRDA? Such contravention may be by positive acts or omissions.

(b) Second, does the applicant have *locus standi* to seek a statutory injunction under section 270 of the IRDA – i.e. the person is the Official Receiver, or whose interests have been, are or would be affected by the conduct amounting to a contravention of Parts 4 to 11 of the IRDA.

(c) Third, should the Court exercise its discretion to grant an injunction? The Court must consider if the grant of an injunction would be consistent with and further the statutory purpose. While the

Court may refer to the principles applicable to the grant of injunctions under the general law, it is not exhaustive of the Court's power – i.e. it is possible that the Court need not consider the adequacy of damages for the defendant.

On the facts of the case, the Court took the view that:

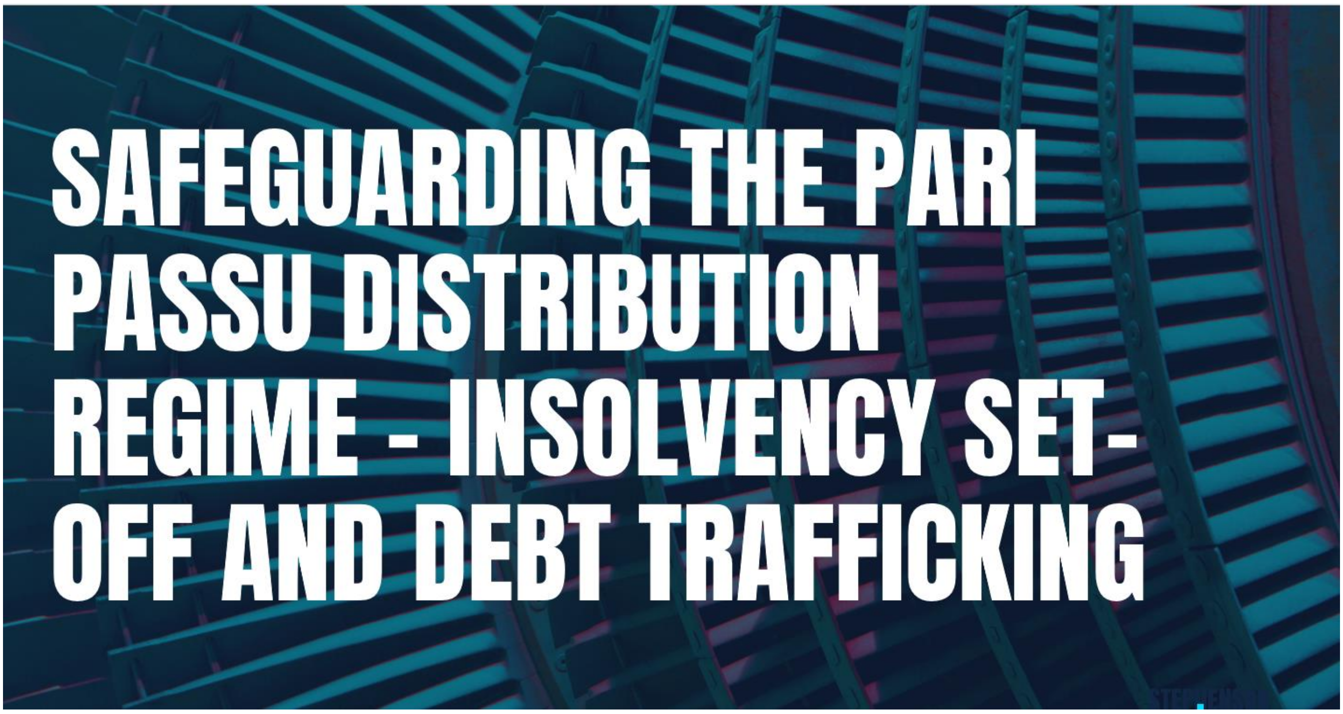
(a) the unfair prejudice transaction is a transaction entered into in contravention of Part 9 of the IRDA (section 225 (Unfair preferences) in particular).

(b) the Claimants had *locus standi* to apply under section 270 of the IRDA. GLH's interests should be viewed to include the interests of its creditors who, in light of the insolvency, are the main economic stakeholders of GLH.

(c) the Court would have exercised its discretion for the same reasons it would grant the injunction under its general jurisdiction; and the case for granting the injunction would arguably be stronger given that the Court is in principle entitled to place less weight on the Claimants' inability to potentially compensate GL Thailand.

CONCLUSION

The case provided much clarity to the considerations of the Court in granting injunctions (prohibitory and mandatory) and the setting aside of unfair prejudice transactions. This will assist the insolvent company and liquidator to preserve the assets of the company.



SAFEGUARDING THE PARI PASSU DISTRIBUTION REGIME - INSOLVENCY SET-OFF AND DEBT TRAFFICKING

Further to our July 2024 edition of the Going Concerns, we touch upon yet another Singapore Court of Appeal ("SGCA") decision in *DGJ v Ocean Tankers (Pte) Ltd (in liquidation) and another appeal* [2024] SGCA 57 ("Ocean Tankers") which reinforced the foundational *pari passu* distribution regime in insolvency.

In *Ocean Tankers*, the SGCA considered whether a debtor ("**Debtor**") of Ocean Tankers (Pte) Ltd ("**OTPL**"), which was undergoing liquidation, could avoid the *pari passu* distribution regime by procuring the assignment of claims from a related entity ("**Assignor**") to itself with the aim of then asserting an insolvency set-off. The SGCA answered this question in the negative, holding that such assignments were void and unenforceable, and insolvency set-off was ineffective.

This article explores the key aspects of this case and its implications for creditors navigating the complexities of insolvency law.

THE PARI PASSU PRINCIPLE

The *pari passu* principle is a cornerstone of Singapore's insolvency framework which ensures fairness during the distribution of an insolvent company's assets. However, as this case demonstrates, creditors may attempt to circumvent this principle through strategic assignments of debt in order to secure priority and at the same time deprive the insolvent company (and its unsecured creditors) of the full value of its assets that should be available in the insolvency. The SGCA's firm rejection of such attempts in *Ocean Tankers* reaffirms its commitment to maintaining the integrity of the insolvency regime.

CASE BACKGROUND

In 2020, the Debtor entered into a series of charterparties (the "**Charterparties**") with OTPL. OTPL was placed under judicial management shortly thereafter. During OTPL's judicial management, the Debtor commenced arbitration proceedings against OTPL in respect of alleged breaches under the Charterparties.

OTPL counterclaimed for, amongst others, freight and demurrage under the Charterparties. Subsequently, the Debtor acquired two claims against OTPL through deeds of assignments executed by the Assignor (collectively the "**Assignments**").

CASE BACKGROUND

In 2020, the Debtor entered into a series of charterparties (the "**Charterparties**") with OTPL. OTPL was placed under judicial management shortly thereafter. During OTPL's judicial management, the Debtor commenced arbitration proceedings against OTPL in respect of alleged breaches under the Charterparties. OTPL counterclaimed for, amongst others, freight and demurrage under the Charterparties. Subsequently, the Debtor acquired two claims against OTPL through deeds of assignments executed by the Assignor (collectively the "**Assignments**"):

1. Under the first assignment, the Debtor was assigned the Assignor's rights in relation to a default judgment obtained by the Assignor against OTPL relating to the Assignor's claims against OTPL arising out of and/or in connection with OTPL's non-delivery of cargo on board a vessel ("**First Assignment**"); and
2. Under the second assignment, the Debtor was assigned the Assignor's claims against OTPL arising out of and/or in connection with a cargo sale contract and storage agreement entered into between the Assignor and OTPL ("**Second Assignment**").

The Debtor's lawyers stated that the Assignments as an optimisation of their liabilities and it was not denied that the Assignments were carried out with the aim of gaining a tactical advantage over other unsecured creditors.

OTPL was thereafter placed in liquidation and filed applications to the Singapore Courts for, amongst others, a declaration that the Assignments were void and/or unenforceable against OTPL and its judicial managers or liquidators in the event OTPL was wound up.

COURT DECISION

The first instance judge found, amongst others, that the First Assignment was a valid assignment of a judgment debt, whereas the Second Assignment was invalid as it was a champertous assignment of a bare right to litigate and therefore void and/or ineffective. Further, insolvency set-off took effect immediately prior to the commencement of winding up in relation to the First Assignment.

APPEAL TO THE SGCA

The Debtor and OTPL both appealed against the lower Court's decision where the Debtor posited that it should be entitled to assert insolvency set-off in respect of all the Assignments, whereas the Liquidators contended that none of the Assignments should be the subject of an insolvency set-off.

The SGCA considered two critical legal questions:

1. First, whether the Assignments procured by the Debtor were rendered void, unenforceable and/or ineffective against OTPL on the grounds of public policy; and
2. Second, whether insolvency set-off could be legitimately asserted in respect of the assigned claims, thereby allowing the Debtor to reduce its liabilities to OTPL at the expense of other creditors.

The SGCA decisively ruled in favour of the liquidators, finding the Assignments void and unenforceable and liable to be struck down on public policy grounds, given that the Assignments had subverted the regime of *pari passu* distribution in liquidation.

First, the SGCA provided a new framework for challenging an assignment on grounds of public policy, just as other contractual arrangements may be struck down for illegality, as follows:

1. Insofar as assignments of bare causes of action are concerned, the test in *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597 ("***Re Vanguard***") would continue to apply with the burden of proof unchanged – i.e. a party seeking to assert that the assignment of a bare cause of action is valid has the burden of

proving that the assignment does not contravene the policy against maintenance by showing that he comes within the exceptions set out in *Re Vanguard*. The SGCA further added an independent requirement that the assignment must not adversely impact the administration of justice; and

2. If the assignment does not relate to bare causes of action, the party seeking to impugn the assignment must show that there is a policy that applies and that the policy is likely to be contravened by the purported assignment.

The SGCA then provided guidance in assessing whether a relevant public policy consideration has been breached. Here, the SGCA first found it "*necessary to consider the effect and purpose of the assignment*". In the context of liquidation, the Singapore Courts "*will typically have regard to the public policy that inheres in the insolvency regime*" and a fundamental public policy to insolvency law was that "*private arrangements which contravene or otherwise undermine the rule of pari passu distribution in liquidation will not be given effect*".

Given that the Debtor itself did not deny that the Assignments were carried out with the aim of gaining a tactical advantage over other unsecured creditors, the SGCA found that the Assignments were tantamount to "*an abuse of the insolvency set-off process in an effort to steal a march on the other unsecured creditors*". Such actions, the SGCA emphasised, are fundamentally incompatible with the statutory framework governing liquidation.

IMPLICATIONS FOR CREDITORS AND THE INSOLVENCY FRAMEWORK

This landmark decision has far-reaching implications for creditors, insolvency practitioners, and the broader legal community. First and foremost, it underscores the inviolability of the *pari passu* principle in insolvency proceedings. Creditors must operate within the bounds of this collective framework and refrain from pursuing strategies that prioritise their claims at the expense of others. Any attempt to circumvent the *pari passu* principle, whether through assignments or other "debt trafficking" mechanisms, will be met with stringent judicial scrutiny and is likely to be struck down.

The judgment also serves as a cautionary tale for parties engaging in assignments during insolvency. Creditors and assignees must avoid any arrangements which may infringe on the *pari passu* principle. The SGCA stated that "*it does not matter that the parties might have had good business reasons and did not direct their minds to the question of how the arrangement might be affected by or might affect insolvency proceedings*" - as long as the parties' arrangements had put one or more of the parties in a preferential position in relation to other creditors in a liquidation, the *pari passu* principle would operate to strike down such arrangements.

For liquidators and insolvency practitioners, the judgment provides a clear mandate to challenge assignments that compromise parity between unsecured creditors. It affirms their role in safeguarding the collective enforcement process of *pari passu* distribution. This proactive approach is essential to maintaining confidence in Singapore's insolvency regime and safeguarding the interests of all stakeholders, especially unsecured creditors of Singapore-incorporated companies.

CONCLUSION

The decision in *Ocean Tankers* represents a critical reaffirmation of the principles that underpin Singapore's insolvency framework. By voiding assignments that seek to circumvent the *pari passu* rule, the SGCA has upheld the integrity of the insolvency process and sent a strong signal against opportunistic practices. Unsecured creditors must respect the *pari passu* principle and avoid actions that undermine the insolvency collective framework.

LIQUIDATORS' VICTORY IN FRAUDULENT TRADING CLAIMS

Re: Days Impex Limited (in liquidation) and Days International Limited (in liquidation)
[2024] HKCFI 3386

INTRODUCTION

The liquidators took out fraudulent trading claims against a former officer of the companies following his criminal convictions of conspiracy to defraud creditors. After a 9-day trial, the Court granted declarations and judgment in favour of the liquidators.

The case is the first reported Hong Kong judgment of a trial on fraudulent trading claims pursuant to section 275 of Cap 32. The Court discussed the elements of the claim in detail and explained the scope of what is recoverable.

BACKGROUND

The two companies were part of the family group business run by the respondent and his father.

The business group engaged in the import and export business, and the two companies had access to credit facilities from three banks totalling at least HKD 365 million and USD 11 million.

The respondent and his father were convicted of 9 counts of conspiracy to defraud[1] by causing the companies to apply for (and the companies to receive) loans from three banks during March to September 2011 which they knew were not to be used for their intended purpose. Charges 1 to 6 were related to import loans, while charges 7 to 9 were related to export loans. The two were sentenced to 10 years of imprisonment, and the appeals against their convictions in the Court of Appeal[2] and the Court of Final Appeal[3] were refused.

Amongst the evidence is a report prepared by a forensic accountant of the Hong Kong Police Force, which analysed a total of 161 import loan applications (156 of which formed the subject matter of charges 1 to 6 and 5 additional ones which did not form part of any charges).

Charges 1 to 6 were worded in a similar way, each providing that the respondent conspired together with other persons to defraud the bank by dishonestly and falsely (i) representing in the loan applications a genuine supplier; and (ii) submitting false sales invoices; thereby inducing the bank to approve the import loan applications and to release funds.

In convicting the respondent, the jury had to be sure that the prosecution have proved beyond reasonable doubt that: (1) there existed fictitious transactions with no underlying goods; (2) the respondent was a party to the agreement; (3) he intended the agreement to be carried out; and (4) he acted dishonestly.

[1] HCCC 2 of 2014
[2] CACC 274 of 2015
[3] FAMC 7 of 2017

THE FRAUDULENT TRADING CLAIM

The liquidators took out summonses pursuant to sections 275 and 276 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) for fraudulent trading and misfeasance against the respondent and another director of the companies (who had been acquitted of the charges brought against her in the criminal proceedings) in respect of the 161 import loans. The respondent's father was made bankrupt and had by this time passed away. At the trial, the only application pursued was fraudulent trading against the respondent.

EVIDENTIAL RELEVANCE OF THE CONVICTION

Section 62 of the Evidence Ordinance (Cap 8) shifts the legal burden of proof to the defendant to prove that he did not commit the acts constituting the criminal offence for which he has been convicted.

The conviction was a subsisting one as it had not been overturned on appeal. In the fraudulent trading proceedings, the respondent was taken to have committed the 9 counts of conspiracy to defraud.

Harris J agreed that the respondent's conviction shifted the legal burden of proof to the respondent to show that:

1) the transactions underlying the 156 import loan applications were genuine; and/or
2) he was not a party to the conspiratorial agreement to defraud; and/or
3) he did not intend the agreement to be carried out; and /or
4) he acted honestly.

ELEMENTS OF FRAUDULENT TRADING

The liquidators must show that:

1) certain business of the subject company was being carried on with the intention to defraud creditors or for any fraudulent purpose;
2) the defendant was knowingly a party to the carrying on of such business in such matter; and
3) there must be actual dishonesty and it is necessary to show either an intent to defraud or a reckless indifference whether the creditors were defrauded (including a party shutting their eyes to the obvious).

WERE THE TRANSACTIONS GENUINE?

Crucial to the liquidators' case is the Police's forensic accountant report as well as the fund flow analysis carried out by the liquidators. It was found that those are round robin transactions - the import loans were paid to the purported supplier, who in turn paid the remittance agent, who then transferred the money back to the companies as well as other entities in the group. Some of the funds were used to pay off existing loans of the companies. Harris J considered that the analysis points compellingly to the conclusion that there are no genuine transactions.

The respondent had sought to challenge the liquidators' case by explaining the business model of the companies but was unable to answer detailed questions about the transactions. Also, the matters raised by the respondent did not explain the fund flow.

There was no attempt by the respondent in its closing submissions to undermine the fund flow analysis.

Harris J concluded that the 161 transactions were not genuine and the associated import loan applications were fraudulent.

BUSINESS CARRIED ON WITH INTENT TO DEFRAUD CREDITORS

The respondent explained in his evidence that the companies' business model has evolved to include financing.

Harris J explained that carrying on business is broadly defined and encompassed one transaction provided it can properly be described as a fraud on a creditor perpetrated while carrying on business; there was no dispute that the 161 transactions come within the part of the business activity of the companies as explained by the respondent.

Harris J concluded that the companies were clearly "carrying on business" in the sense required for section 275.

THE RESPONDENT WAS A KNOWING PARTY

Although the respondent attempted to distance himself from the fax instructions to the remittance agent, it was the respondent's own evidence that he was the head of the accounts and finance department, and he decided which credit line to utilize, which credit line to repay, and the order of repayments.

Harris J concluded that the respondent at least knew that payments were being made by the alleged supplier to the remittance agent, and hence they were not made in respect of genuine transactions, or more likely he was orchestrating the fraudulent scheme to keep the companies afloat.

Harris J was satisfied that the respondent was knowingly a party to the companies carrying on their business in a fraudulent manner.

The respondent raised a number of matters in his defence. This included the argument that the transactions underlying the import loans were genuine and the goods were sold in the Brazilian market. Nevertheless, Harris J observed that the respondent had not adduced any substantive evidence to support the argument even though he was fully aware of the need to so.

WHAT IS RECOVERABLE UNDER SECTION 275?

The Court has a discretion to declare that the person found liability "*shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct.*"[4]

In respect of what payments the Court is allowed to order, the wording of section 275[5] and that of the current English legislation[6] are substantially different. Harris J explained that section 275 gives the Court a wide power to order payment of such sum as it thinks appropriate, which could be more or less than the amount of the relevant debt. However, the Court has to approach the assessment of the amount to be paid in a principled way.

It was common ground between the parties that there must be some nexus between the loss caused to the creditors as a result of the fraudulent trading and the sum payable by the party liable for fraudulent trading. What was in dispute was whether the fact that most of the import loans were used to repay existing debts (hence reducing the companies' benefits) should be taken into account.

Broadly agreeing with the approach in the Singapore decision of *Tendcare Medical Group Holdings Pte Ltd v Gong Ruizhong*[7], Harris J decided that the correct approach is to assess the amount by reference to the amount of the debts directly attributed to the fraud unless a substantial reason is advanced for doing otherwise, and generally, it would be for the fraudster to do so.

Harris J decided that unless there is a good reason otherwise, the amount is calculated by reference to the amount of the debts incurred attributable to the fraudulent trading less the debts that were repaid, without taking into account any amount of the loans which was used to repay the companies' existing debts. In the present case, it was the 161 import loans minus 12 import loans which were repaid.

Harris J granted declarations that respondent was knowingly a party to the carrying on the business of the companies with intent to defraud creditors, as well as ordered payment of over USD 39 million and interest.

Stephenson Harwood acts for the liquidators in these proceedings.

TAKEAWAY POINTS

Fraudulent trading claims are a rarity because of the high threshold of proving fraud.

This is the first reported Hong Kong judgment of a trial on fraudulent trading. The judgment provided helpful guidance as regards the elements of the claim as well as calculation of the quantum.

Applying the Singapore approach, the Court clarified the quantum for fraudulent trading under the Hong Kong legislation is the amount of the debts directly attributed to the fraud and there is no need to reduce any benefit obtained by the company from the use of the proceeds of fraudulent trading.

[4] Section 275(1) of Cap 32
[5] The same wording as section 332(1) of the Companies Act 1948
[6] Section 213 of the Insolvency Act 1986
[7] [2021] SGHC 80

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