

HONG KONG / JUDGMENT

JIMBUS LTD v. CITY NOBLE DEVELOPMENTS LTD

COURT

Court of First Instance

DECIDED

23 July 2007

CASE / FILE NUMBER

HCMP1934/2006

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bjbj HCMP 1934/2006 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION COURT OF FIRST INSTANCE MISCELLANEOUS PROCEEDINGS NO. 1934 OF 2006

IN THE MATTER of an Agreement for Sale and Purchase dated 10th August 2005 (the 1st Agreement) and registered in the Land Registry by Memorial No. 05090300490061 in respect of a Property known as All Those 4/1,370th parts or shares of and in All That piece or parcel of ground registered in the Land Registry as Yuen Long Town Lot No. 274 (Shop Space No. G037 on Ground Floor of the Arcade of Kar Shing Building, Nos. 15 & 19 Kau Yuk Road, Yuen Long, New Territories, Hong Kong)(the 1st Property) and IN THE MATTER of an Agreement for Sale and Purchase dated 10th August 2005 (the 2nd Agreement) and registered in the Land Registry by Memorial No. 05090300490077 in respect of another Property known as All Those 4/1,370th parts or shares of and in All That piece or parcel of ground registered in the Land Registry as Yuen Long Town Lot No. 274 (Shop Space No. G038 on Ground Floor of the Arcade of Kar Shing Building, Nos. 15 & 19 Kau Yuk Road, Yuen Long, New Territories, Hong Kong)(the 2nd Property) and IN THE MATTER of an application under Section 12(1) of the Conveyancing and Property Ordinance (Cap. 219)

BETWEEN JIMBUS LIMITED Plaintiff and CITY NOBLE DEVELOPMENTS LIMITED Respondent

Before: Hon Fung J in Chambers (open to public) Date of Hearing: 18 July 2007 Date of Decision: 18 July 2007 Date of Reasons for Decision: 23 July 2007

REASONS FOR DECISION

This is an application for security for costs taken out by the defendant under section 357 of the Companies Ordinance (Cap.32). At the hearing, I ordered the plaintiff to give security in the sum of \$270,000. I now give my reasons.

Background

By the Originating Summons, the plaintiff sought a declaration that the requisitions raised by the plaintiff in a conveyancing transaction has not satisfactorily or sufficiently been answered by the defendant, and an order for the refund of the deposits paid. The plaintiff was the purchaser and the defendant the developer and vendor of Shops G37 and G38 in a shopping arcade. The purchase price was in the total sum of about \$4.3 million. The defendant had taken out a loan from the lender, secured by a mortgage in the form of the Debenture and the Earnings Assignment registered in the Land Registry. Those documents referred to a Loan Agreement. Clause 30 of the Sale and Purchase Agreement dated 10 August 2005 provided that: The Purchaser acknowledges that the Property is now mortgaged/ charged by the Vendor to the Lehman Brothers Commercial Corporation Asia Limited. The Vendor hereby agrees and undertakes to release/discharge/partial release the Property from the existing Debenture on or before completion of the sale and purchase hereof. Deposits totalling \$879,200 were paid by the plaintiff by 25 July 2005. On 18 January 2006, the plaintiff's former solicitors raised the requisition, inter alia, that copy of the Loan Agreement be produced. The defendant's solicitors replied that the Loan Agreement was not a registered document and the defendant was not obliged to produce it. They also pointed out that both the Debenture and Earning Assignments would be discharged upon completion. On 1 February 2006, the defendant's solicitors gave notice that completion shall be on or before 15 February 2006. The plaintiff's solicitors requested postponement of completion to 15 March 2006. There is a dispute as to whether the postponement was agreed. But be that as it may, by a letter dated 15 February 2006, the plaintiff's former solicitors asserted that the non-production of the Loan Agreement amounted to a repudiation of the Agreement for Sale and Purchase. On 23 January 2006, the Debenture and Earnings Assignment were discharged and the release was registered in the Land Registry on 25 February 2006. By a letter dated 1 April 2006, the defendant's solicitors gave notice to complete on or before 14 April 2006, failing which the defendant would forfeit the deposits and enforce its rights under the Sale and Purchase Agreement. Principles on security for costs Section 357 of the Companies Ordinance provides that: Where a limited company is plaintiff in any action or other legal proceeding, any judge having jurisdiction in the matter may, if it appears by credible testimony that there is reason to believe that the company will be unable to pay the costs of the defendant if successful in his defence, require sufficient security to be given for those costs, and may stay all proceedings until the security is given. The relevant principles on security for costs are set out in the Hong Kong Civil Practice 2007 para. 23/3/14 and may be summarized as follows:

- (1) It is a matter within the discretion of the court.

- (2) The applicant has to show that the company will not (as opposed to may not) be able to meet its debts when an order for costs is made against it.
- (3) A major issue for consideration is the plaintiff's prospects of success (without going into the merits in details): *Porzelack KG v. Porzelack UK Ltd* [1987] 1 WLR 420.
- (4) If the case of the plaintiff is genuine and strong, no order for security would be granted.
- (5) Whether the application for security for costs is being used oppressively, e.g. so as to stifle a genuine claim is relevant.
- (6) In considering whether the plaintiff's claim would in fact be stifled, it will be taken into account whether the plaintiff can raise funds outside its own resources to conduct the litigation (e.g. funds from shareholders, directors or other backers), the onus being on the plaintiff to satisfy the court that no such resources are available.
- (7) Whether the application is made at a late stage is relevant.

Issues

There are 3 issues in this application:

- (1) Whether the defendant has shown that the plaintiff will not be able to meet its debts when an order for costs is made against it;
- (2) The respective prospects of success of the parties;
- (3) The amount of the security. There is no suggestion that the plaintiff's claim will be stifled by an order for security, nor that the plaintiff is unable to raise the security through its sole shareholder and director. Inability to pay costs Mr. Tang, for the defendant, submitted that the application was taken out on the bases that:
 - (1) The plaintiff has paid-up capital of only \$10,000.
 - (2) The payment of the deposit of \$879,200 must have been raised through loan finance.
 - (3) The plaintiff's registered and business address is at a residential property, and the plaintiff's past activities were only purchases and subsequent sales of 2 other properties resulting in a small profit, which prima facie shows that the plaintiff is a corporate vehicle for property transactions. Upon the application herein, the plaintiff produced its Reports and Financial Statements for the period from 6 August 2004 (Date of Incorporation) to 31 December 2005, which showed:
 - (1) There was a shareholder's deficit of \$53,836.35 on the balance sheet.
 - (2) There was cash at bank of just over \$1 million but matched by an amount due to a director of virtually the same amount.

- (3) The auditor has included in the auditor's report a section headed Fundamental uncertainty stating that the auditor stated that the financial statements had been prepared on a going concern basis, which assume that adequate support will continue to be received from the shareholder of the company. The plaintiff has also produced bank statements for July, September and October 2006 showing a balance of about \$450,000 as at October 2006. Mr. Tang submitted that the plaintiff's disclosure of financial statements was selective and not up to date. Although more up to date audited accounts might not be available, management accounts should be available. Mr. Chan, for the plaintiff, submitted that evidence of the plaintiff's financial position was produced back in March 2007. At that stage, the 2006 audited accounts were unavailable. Without saying whether they are now, Mr. Chan made the excuse that no leave had been obtained to file further evidence. The burden is on the defendant to show the plaintiff's inability to pay costs. The plaintiff has chosen to put in evidence of its financial position, which is outdated and incomplete, and raises more question than it answers. The evidence available shows that the plaintiff has no substantial equity and its assets (sometime in the past) were only cash at bank matched by shareholder's loan. The plaintiff is a corporate vehicle for property investments, and has no independent financial viability other than continued support from the shareholder, which can only be assumed as opposed to be confirmed. I draw the adverse inference against the plaintiff that the selective disclosure of outdated financial statements means that there is no improvement from the deficit shown. I find that the plaintiff is unable to pay costs in the event of an adverse costs order. Prospects of success Mr. Chan's original argument (which was the plaintiff's reason for raising the requisition) was that the defendant was obliged to produce the Loan Agreement as a document referred to in the mortgage under section 13(1) of the Conveyancing and Property Ordinance (Cap.219). Section 13(1) states that:
- (1) Unless the contrary intention is expressed, a purchaser of land shall be entitled to require from the vendor, as proof of title to that land, only production of the Government lease relating to the land sold and -
 - (a) proof of title to that land -
 - (i) where the grant of the Government lease was less than 15 years before the contract of sale of that land, extending for the period since that grant; or (ii) in any other case, extending not less than 15 years before the contract of sale of that land commencing with an assignment, a mortgage by assignment or a legal charge, each dealing with the whole estate and interest in that land;
 - (b) production of any document referred to in the assignment, mortgage or charge mentioned in paragraph (a) creating or disposing of an interest, power or obligation, which is not shown to have ceased or expired and subject to which any part of that land is disposed of; and (c) Mr. Chan submitted that a loan agreement may touch and concern or affect land, e.g. in giving the lender certain rights over land as security. One will never be sure without looking at it. Mr. Tang submitted that under section 13(1)(b), the obligation is only to produce documents of title which create or dispose of an existing encumbrance or interest

affecting the land. In *Greatek Investments Ltd v. Lam Kit Sum* [2000] 4 HKC 761, Hartmann J said at p. 769H that: In my judgment, on an ordinary reading of s.13(1)(b), the defendant was obliged to produce any document referred to in the title deeds which identified what could well be an existing obligation; that is, an obligation to which the purchaser could well be subject. A loan agreement is only a contract between the lender and the borrower. It does not touch and concern, or otherwise affect the land. The defendant was not obliged to produce the loan agreement as it was not a document of title referred to in the intermediate root of title. Mr. Tang submitted that the discharge of the Debenture and Earnings Assignment is a matter of mere conveyance, which the defendant as vendor can remove independently of another person, and it does not fall within the duty to show a good title. Upon their discharge, the underlying loan would necessarily be discharged as well. He referred to *Sihombing & Wilkinson: Hong Kong Conveyancing 1 Law and Practice* (Issue 40) p. 103A paras. [161] to [165] which state: Matters of mere conveyance The duty to give a good title does not, however, extend to matters of mere conveyance. What this means is that good title is not adversely affected by a defect which the vendor can remove independently of the concurrence of a third person. The most common example of a matter of mere conveyance would be the discharge of a mortgage over the property by the vendor: *Re Jackson and Oakshott* (1880) 14 Ch D 851. Mr. Chan's alternative argument was that the Loan Agreement was a document referred to in the Debenture as part of the definition section of the Debenture, and must be read together with the Debenture to fully understand the terms. Under the Debenture, event of default was defined to mean circumstances as specified in clause 2.1 of the Loan Agreement; and secured indebtedness was defined to mean all sum payable by the borrower and the other Financing Parties to the Lender under the Financing Agreements (including this Debenture). Mr. Chan submitted that there was no definitions for Financing Parties or Financial Agreements in the Debenture, and those definitions might well be contained in Loan Agreement. Mr. Chan submitted that the Loan Agreement was document of the sort (such as occupation permit and certificate of compliance of the land grant) which demonstrated that the vendor was entitled to legal estate and that title was not defeasible, and was instrument by which the premises might be affected and ought to be produced when the purchaser asked for it. It may well be that upon perusal of the document, the enjoyment of a property was hardly affected so that it would not have any effect on title. However, without actually seeing the document, the purchaser could hardly be expected to know in what way, if at all, he would be effected. Mr. Tang submitted that Mr. Chan's proposition is an incomplete and misleading quotation from *Sihombing & Wilkinson* ob. cit. p. VI 23A para. [65]. The complete passage states:

- [65] Additional documents of title that must be produced Subject to any agreement to the contrary, the duty of a vendor by way of showing title is to produce to the purchaser all documents of title. We have already considered the scope of the vendor's statutory duty under section 13(1) of the Conveyancing and Property ordinance. By way of showing good title the vendor must also produce the originals or certified copies of the relevant title deeds. As we have seen, Recorder Edward Chan QC in *Wong Bik Ching v. Yu Hon Cheung* [1997] 4

HKC 38 said: I am of the view that prima facie when an instrument was registered against the property and it was not apparent from the land search that the document had ceased to affect the property, the document ought to be treated as part of the title deeds which the vendor should make available to the purchaser. It may well be that, upon perusal of the documents, the enjoyment of the property was hardly affected by this document so that it would not have any effect on whether a good title to the property had been shown. However, without actually seeing the document, how can the purchaser know in what way, if at all, he would be affected by the document? (Emphasis added.) These words were quoted with approval by Li CJ in *Chen Paul v. Lord Energy Ltd.* [1999] 1 HKC 1, [1999] 1 HKLRD 205 (CFA), where the learned Chief Justice said: It should be emphasized that on this approach the matter is only prima facie and it may be displaced on examination. Provided this approach is understood to apply to registered instruments that are properly registrable under the Land Registration Ordinance, I think it is sound. In the same case Godfrey JA in the Court of Appeal ([1998] 1 HKC 702) said that documents such as occupation permits, certificates of compliance and other documents of that sort which demonstrate that the vendor was entitled to a legal estate in the premises and that his title was not defeasible were instruments by which the premises might be affected and ought to be produced when the purchaser asked for them (Emphasis added.) Mr. Tang submitted that the sort of documents referred to in *Wong Bik Ching* were documents of title. He reiterated that the Loan Agreement was a contract between the vendor and the lender and the discharge of the Debenture is a matter of mere conveyance. It may be of interest to find out the transaction between the vendor and the lender, but the ultimate question is whether the encumbrance is discharged and the property released upon completion. If yes, the transaction proceeds, and if not, it falls through. Hence, the Loan Agreement is not relevant. Mr. Chan also referred to *Chan Wing Mun Anita v. Fortune Speed Ltd* [1996] 4 HKC 222 for the proposition that an unregistered loan agreement may reveal a resulting trust, and if not produced, the vendor cannot show good title. In the *Fortune Speed* case, one Besteco Investment Ltd agreed to sell the property to the defendant, and the defendant agreed to sub-sell to the plaintiff. Before completion, the defendant's solicitors gave the plaintiff a document entitled Loan Agreement made between Sinolite (Hong Kong) Ltd and Vincent Max Ltd (). The Loan Agreement stated that the VML entrusted Sinolite to purchase the property in the name of Besteco, and Sinolite provided VML with all the purchase moneys through a bank mortgage and cash loan, and VML will be responsible for Sinolite with the monthly instalment for the bank mortgage. The Loan Agreement was delivered to the Land Registry but was eventually not registered. The plaintiff raised requisition requiring the defendant to obtain VML's confirmation that it approved the sale by Besteco to the defendant. The plaintiff considered the requisitions not satisfactorily answered, and the defendant terminated the sub-sale and forfeited the deposits. The plaintiff took out a vendor and purchaser summons. Woo J (as he then was) held that as there was the possibility that the purchase price was paid by or on behalf of VML, there existed a real risk that VML was the beneficial owner by way of resulting trust by operation of law, which was not required to be in writing or evidenced by writing. The Loan Agreement could not be treated as an instrument in writing binding upon

Besteco that it had agreed to hold the property on trust for VML or that it had confirmed the resulting trust as it was not signed by or on behalf of Besteco. Hence, the Loan Agreement did not supercede the resulting trust and was not registrable. Both the defendant and the plaintiff, as successors in title to Besteco, were affected by notice of VML's unwritten equity through their knowledge of the contents of the Loan Agreement. Mr. Tang submitted that Fortune Speed does not assist the plaintiff as it is very different on the facts. It is concerned with notice of a resulting trust, where there is no need for registration. The requisition in Fortune Speed was for the confirmation from the party providing the fund that there was not any interest in trust. In any event, if by any chance the Loan Agreement here touches and concerns the land, any bona fide purchaser without notice is free from any unregistered equities. I am mindful that I am not dealing with the trial of the Originating Summons at this stage, and the rehearsal of the arguments is only to enable me to consider the relative merits of the parties' cases. I am not convinced that the plaintiff has such a strong case that I should, in my discretion, refuse any security for costs. Quantum In the original skeleton bill, the plaintiff gave the estimate of \$350,000 for the entire action (including the application for security for costs). In the revised skeleton bill, the amount is revised up to \$450,000 taking into account the additional costs for further affidavit and correspondence in the security for costs application. Mr. Tang accepted that the estimates were prepared on a solicitor and own client basis. Mr. Tang submitted that unlike a writ action where it is more usual to award security for costs by stages, in proceedings by Originating Summons (and a fortiori in the present case), the final battle line is drawn and there is no further development likely to affect progress to the final hearing. Hence, security for the entire proceedings should be given. I consider that it is right to consider the entire proceedings as a whole. However, I consider that the increase of \$100,000 seems to be extravagant for the additional items included, and allowance must be given for taxation on a party and party basis. Hence, I shall order that security in the sum of \$270,000 be given. Costs I make an order nisi that the plaintiff do pay the costs of the application for security for costs to the defendant in any event. (B Fung) Judge of the Court of First Instance High Court Mr Maurice J Chan, instructed by Messrs Fung Wong Ng & Lam, for the Plaintiff Mr Ronald Tang, instructed by Messrs Edmund Cheung & Co., for the Defendant PAGE - 1udk 1udk H I J K L M N O P Q R S T U V A B C D E F G H I J K L M N O P Q R S T U V p0{ i\$&`G <`O< `2IR p0{ <`O< hccw (for Susan Kwan only).dot setup Microsoft Word 9.0 Judiciary Hong Kong Title Microsoft Word Document MSWordDoc Word.Document.8

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