

HONG KONG / JUDGMENT

MASTER OFFSET PRINTING CO LTD v. LAI LAU YING AND ANOTHER

COURT

District Court

DECIDED

26 July 2007

CASE / FILE NUMBER

DCCJ2421/2006

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bjbj DCCJ 2421/2006 IN THE DISTRICT COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE
REGION FORMTEXT CIVIL ACTION NO.2421 OF FORMTEXT 6

BETWEEN MASTER OFFSET PRINTING COMPANY LIMITED (IN CREDITORS VOLUNTARY
WINDING UP) Plaintiff and LAI LAU YING LAW MEI WO 1st Defendant 2nd Defendant

Coram: Deputy District Judge Abu B. bin Wahab (in Chambers, open to public) Date of Hearing:
21 May 2007 Date of Decision: 26 July 2007

FORMTEXT D E C I S I O N

The Plaintiff applies for summary judgment against the 2 Defendants in terms of paragraphs 4 to 7 of the prayer for relief in the Amended Statement of Claim (without asking for compound interest. See Hearing Bundle pages 43 to 44). Summary judgment is sought for:

- (1) A declaration that the 1st Defendant is holding the \$380,000 she received from the Plaintiff as a constructive trustee;
- (2) An order for payment by the 1st Defendant of \$380,000 due to the Plaintiff;
- (3) A declaration that the 2nd Defendant is holding the \$375,000 he received from the Plaintiff as a constructive trustee;
- (4) An order for payment by the 2nd Defendant of \$375,000 due to the Plaintiff Consequential orders of interests and costs are also asked for. The factual background that is not in dispute is recited in paragraphs 4 to 9 below.

4. At all material times up to 8 January 2003, a Mr. Lee Hon Lam (Mr. Lee), the 1st Defendant and the 2nd Defendant were the only shareholders and directors of the Plaintiff.
5. On 7 January 2003, the 3 of them entered into an agreement (Share Transfer Agreement) which provided, inter alia, to the effect that
 - a) Mr. Lee would purchase the shares of the 2 Defendants for the total sum of \$800,000;
 - b) Mr. Lee would pay on 15 January 2003 the amount of \$600,000 to the 2 Defendants to be shared equally by them (i.e. \$300,000 each);
 - c) Mr. Lee would pay the balance of \$200,000 within 20 months from 15 May 2003 to 14 December 2004. Such payment would be by monthly instalments of \$10,000 to be shared equally by the 2 Defendants (i.e. \$5,000 each);
 - d) Mr. Lee personally undertook to repay a debt of \$543,000 owed by Mr. Lee and the Plaintiff to the 1st Defendant. Payment would be made as follows: i) \$70,000 on 15 January 2003 and b) balance of \$472,000 by way of \$23,000 x 20 months commencing from 15 May 2003 to 14 December 2004 and
 - e) Mr. Lee personally undertook to repay a debt of \$246,000 owed by Mr. Lee and the Plaintiff to the 2nd Defendant as follows: \$12,300 x 20 months commencing from 15 May 2003 to 14 December 2004. (I have tried to describe the terms agreed upon in language as close as possible to that used in the Share Transfer Agreement. The description above thus appears convoluted at times. See Hearing Bundle pages 212 to 212c)
6. As a result of the Share Transfer Agreement, the 1st Defendant would get monthly payments of \$28,600 (\$5,000 plus \$23,600; s monthly payments) and the 2nd Defendant would get monthly payments of \$17,300 (\$5,000 plus \$12,300; s monthly payments).
7. On 8 January 2003, the 2 Defendants resigned as Directors of the Plaintiff and transferred their shares to Mr. Lee. A Mr. Wong was appointed Director.
8. Mr. Wong resigned as director on 25 February 2004 and a Miss Chan became Director until her resignation on 23 June 2005.
9. On or about 29 January 2003, the Defendants received \$300,000 each (see paragraph 5 b) and 11 e) herein). The 1st Defendant did receive 16 instalments of D1 s monthly payments. The 2nd Defendant did receive 15 instalments of D2 s monthly payments (see also paragraph 11 f) below).
10. A Mr. Ho Man Kit, certified public accountant and liquidator of the Plaintiff, swore an affirmation on behalf of the Plaintiff. He mentioned, inter alia, that:

- a) In May 2002, the Plaintiff secured a loan from Dah Sing Bank for \$600,000 (Dah Sing Loan). This was secured by a Charge (Charge No. 1) on a printing machine of the Plaintiff (Printing Machine). The 1st Defendant and Mr. Lee, jointly and severally, provided a continuing guarantee for the loan (Hearing Bundle page 292 to 297);
- b) On 17 January 2003 the Plaintiff entered into an Instalment Loan agreement with Inchroy Credit Corporation Limited (Inchroy Loan). The loan amount was \$995,000. Repayment was by 36 monthly instalments of \$31,371 each. A fixed charge on the Printing Machine (Charge No. 2) provided collateral for the loan. A personal guarantee was provided by Mr. Lee (Hearing Bundle pages 287 to 289);
- c) On 27 January 2003, Charge No. 1 was discharged (Hearing Bundle page 299);
- d) The consolidated statement of the Plaintiff s account at the Bank of Communications (Consolidated Statement) indicated a deposit of \$780,366 on 27 January 2003. It also indicated 2 withdrawals of \$300,000 each on 29 January 2003. These 2 withdrawals represented the \$300,000 to be paid to each Defendant pursuant to the Share Transfer Agreement (see paragraph 5 b) above. The cheques for such payment can be seen at Hearing Bundle pages 224 to 225. Cheque number 778355 is in favour of the 1st Defendant and cheque number 778357 is in favour of the 2nd Defendant (I note in passing, however, that the Consolidated Statement described the nature of transaction for these 2 cheques differently cheque number 778355 is described as whereas cheque number 778357 is described as . There is nothing before me to indicate that the difference in description is of significance to this hearing); e) From the General Ledger of the Plaintiff for the period 1st April 2002 to 31st March 2003 found out that there was a credit entry made on 27th January 2003-in the amount of \$780,366 with the description Inchroy Credit . There was a further debit entry made on 28th February 2003 in the amount of \$214,634 with the description Dah Sing Mortgage Red . These 2 sums add together amounts to \$995,000. Thus out of the amount borrowed by the Plaintiff under the Inchroy Loan, \$214,634 was used to redeem the Dah Sing Loan and \$780,366 was received by the Plaintiff (paragraph 22 of Mr. Ho s affirmation at Hearing Bundle pages 91 to 92. Pages of the General Ledger are at Hearing Bundle pages 301 to 304. For the entries referred to by Mr. Ho, see respectively page 304 and 302); the 15 cheques in payment of D1 s monthly payments and the 16 cheques in payment of D2 s monthly payments were drawn on the Plaintiff s accounts with either the Bank of Communications or Bank of East Asia (cheque copies can be found in the Hearing Bundle pages 227 to 238 and pages 240 to 250); Both Defendants had signed on the letterhead of the Plaintiff acknowledging receipt of their monthly payments (Hearing Bundle pages 315 to 318b); and Mr. Ho had written to the 2 Defendants asking about cheques number 778355 and 778357. Both Defendants responded by returning the letters with certain endorsements. The endorsement by the 1st Defendant was This is part of the proceeds for the sale of my shares in Master Offset Printing . The endorsement by the 2nd Defendant was received the money which represented part of the proceeds from former shareholder Lee Hon Lam for withdrawing share capital. The amount is exactly \$300,000 (Hearing Bundle pages 308 to

311a). In their affirmations, the Defendants mentioned, inter alia, that: Due to differences with Mr. Lee over the management and running of the business of the Plaintiff, the 2 Defendants sold their shares and resigned as Directors; There was never any plan or intention that the Plaintiff's assets would be used to pay the Defendants under the Share Transfer Agreement. The Defendants did not know whether the Plaintiff's assets had been so used; The Defendants had nothing to do with the Plaintiff after their resignation as Directors on 8 January 2003. They did not take any part in the Plaintiff's business and therefore did not have any knowledge of the operation and management of the Plaintiff (see Hearing Bundle pages 106 and 108). The 1st Defendant said that she expected the Dah Sing Bank loan and guarantee to be discharged. Both Defendants said they had no knowledge the subsequent of (sic) Inchroy Loan or the internal flow of funds within the Plaintiff. Specifically no idea whether the Inchroy Loan proceeds were used to pay the \$300,000 and there is no way could have known this (Hearing Bundle pages 110 and 121). At the time when the Share Transfer Agreement was signed, both Defendants asked Mr. Lee to provide all the payment by way of post dated cheques but he refused. Instead, Mr. Lee asked for information about (the Defendants) bank accounts for the purpose of making payments. (The Defendants) eventually agreed to such an arrangement (Hearing Bundle pages 108 and 119); The 1st Defendant said that on or about 29 January 2003, she was asked to attend the office of the Plaintiff and was provided with two cheques each in the amount of HK\$300,000 by Mr. Lee purporting to be payment to (the 1st Defendant) and the 2nd Defendant pursuant to the Share Transfer Agreement. The said two cheques were drawn on the Bank of Communications account of the Plaintiff (Hearing Bundle page 108. See also page 120). The 1st Defendant went on to say that at that time she did not pay any special attention to the account which the cheques were drawn, as (she) had no reason to suspect that anything improper had been done by Mr. Lee (Hearing Bundle pages 108 to 109). The 2nd Defendant said that he was not present on 29 January occasion. He had asked the 1st Defendant to deposit the cheque for him. He did not see the cheques at the time of receipt (Hearing Bundle page 120); and The monthly payments under the Share Transfer Agreement were made into the respective bank accounts of the 2 Defendants. After each payment, the 1st Defendant would be contacted by one Ko Shun Shui who was a staff member of the Plaintiff and informed that the money was being paid into the bank accounts. The 2 Defendants did not know until the recent litigation that each payment was made by way of cheques issued from the bank account of the Plaintiff (Hearing Bundle pages 109 and 120). Counsel for the Plaintiff, Miss Fong, clarified that the present application for summary judgment proceeded on the limb of knowing receipt. The essential requirements of knowing receipt were stated by Hoffmann LJ in *El Ajou v Dollar Land Holdings plc* (1994) 2 All ER 685, 700: For this purpose the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty. (per Nourse LJ in *BCCI (Overseas) Ltd. v Akindele* (2001) Ch 437, 448)

13. Counsel for the Defendants, Mr. Harris S.C., protested on the basis that the case for the Plaintiff as disclosed in the Amended Statement of Claim was knowing assistance (the main point being that the Defendants assisted in the breach of trust itself). The Amended Statement of Claim is so framed that one can easily empathise with this protest. However, I think there is still room for the knowing receipt limb though one is entitled to expect the pleadings to bring it out more clearly.
14. Did the payments to the 2 Defendants (pursuant to the Share Transfer Agreement) come out of the assets of the Plaintiff? We are here concerned with a private company limited by shares. Experience indicates that on occasions such companies have been used as instruments of convenience to carry out the personal transactions of the shareholders-cum-directors. It should not be done but is. The mere fact that cheques issued in favour of the Defendants were drawn on the Plaintiff's bank accounts is not a clear indication that the Plaintiff's assets were involved. The company accounts might have been used simply as a conduit to channel funds not belonging to the company.
15. The Plaintiff relies on matters stated in paragraph 10 b), d) and e) above. From the documents mentioned in those paragraphs, Mr. Ho concluded that the \$780,366 in the Plaintiff's Bank of Communications account (out of which cheques of \$300,000 were drawn in favour of the Defendants) had its provenance in the Inchroy Loan. He gathered this from entries in the General Ledger: there was a credit entry made on 27th January 2003 in the amount of \$780,366 with the description Inchroy Credit. There was a further debit entry made on 28th February 2003 in the amount of \$214,634 with the description Dah Sing Mortgage Red. These 2 sums add together amounts to \$995,000. Thus out of the amount borrowed by the Plaintiff under the Inchroy Loan, \$214,634 was used to redeem the Dah Sing Loan and \$780,366 was received by the Plaintiff. Although the arithmetic is correct, Mr. Ho got it wrong when he said the \$214,634 was a debit entry it is a credit entry. One is entitled to question the conclusion of Mr. Ho. Charge No. 1 was discharged on 27 January 2003 (see paragraph 10 c) above). Why should the General Ledger entry for Dah Sing Bank Red show a credit balance on 28 February 2003 (see Hearing Bundle page 302)? I am here assuming that the entry related to Charge No.1. Am I correct in making this assumption? There is an entry for 26 February 2003 relating to Inchroy Credit. This is debit entry of \$31,371 (Hearing Bundle page 302). This amount appears to be a repayment for the Inchroy Loan (see paragraph 10 b) above). If so, why should the entry for Inchroy Credit for 28 February 2003 still show the undiminished credit balance of \$780,366 (as shown for 27 January 2003. See Hearing Bundle page 304)? The circumstances in which the General Ledger was made and the bases for the entries are not known. How accurate and reliable are the entries? How should one read or interpret the General Ledger? The Defendants said that they had nothing to do with the Plaintiff after 8 January 2003 when they ceased to be shareholders and Directors. Through Counsel they have confirmed that that do not admit assets of the Plaintiff have been used to pay them. My view is that whether the Plaintiff's assets have been so used is a real and live issue, something to be threshed out at trial.

16. Is it clear that the Defendants had the required knowledge (see paragraph 12 above)? There seems some controversy as to whether actual knowledge is sine qua non (as Mr. Harris S.C. contended) or constructive knowledge will already suffice (see BCCI (Overseas) Ltd. V Akindele, op. cit., pages 450 to 455).
17. An example of the test for constructive knowledge is this: if a person shuts his eyes to the obvious, or if he wilfully and recklessly fails to make obvious enquiries, that person is guilty of unconscionable behaviour such that a court of equity might wish to impute to him the knowledge that he would have gained by opening his eyes or making the obvious enquiries (Baden and Others v Societe Generale etc. 1WLR 509, 576).
18. The Court of Appeal in BCCI (Overseas) Ltd. V Akindele, op. cit., identified the controversy (or perhaps one should describe it as differences of opinion) over the sufficiency of constructive knowledge for knowing receipt cases. The Court ultimately came to the view that, just as there is now a single test of dishonesty for knowing assistance, so ought there to be a single test of knowledge for knowing receipt. The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt. A test in that form, though it cannot, any more than any other, avoid difficulties of application, ought to avoid those of definition and allocation to which the previous categorisations have led. Moreover, it should better enable the courts to give commonsense decisions in the commercial context in which claims in knowing receipt are now frequently made (see page 455 of the judgment).
19. I agree with Mr. Harris S. C. that I cannot simply bulldoze out of the way what the Defendants explained in their affirmations. I am satisfied that there is clearly an issue as to whether the Defendants possessed the requisite knowledge (be it actual, constructive or knowledge such as to make it unconscionable for a person to retain the benefit of the receipt).
20. As I understood it, Miss Fong argued that the requisite knowledge (no matter how defined) had been clearly shown. Various points were advanced including:
 - a) Payments to the Defendants were made by cheques drawn on the bank accounts of the Plaintiff I have already dealt with this to a certain extent (see paragraph 14 above). The Defendants stance as stated in paragraph 11 e) and f) above cannot be regarded as frivolous and practically moonshine (see Lord Lindley in Codd v Delap (1905) LT 510, 511);
 - b) The Inchroy Loan The Defendants stance is stated in paragraphs 11 c) above. Again, I find myself unable to write off what the Defendants say without more;
 - c) The Defendants have been Directors of the Plaintiff for 10 odd years, they should be acquainted with provisions of the Companies Ordinance, Cap. 32 and Articles of Association of the Plaintiff which (putting it in very simplified terms) prohibit the Plaintiff giving financial assistance for the purchase of its own shares (the argument is that the Defendants should have made enquiries as to the source of funds used to pay them). I will just say that I

find this proposition of acquaintance with provisions of the Companies Ordinance and the Articles of Association highly debatable;

- d) The 1st Defendant obtained the \$300,000 cheques at the Plaintiff's office; the 2 Defendants acknowledged receipt of certain payments on the letterhead of the Plaintiff; a staff member of the Plaintiff informed (the 1st Defendant) that payments had been made and the Defendants response to Mr. Ho's inquiry (see paragraph 10 h) above) I fail to see anything here of assistance to the Plaintiff's case and
- e) The \$300,000 payments were made later than the date of 15 January 2003 as stipulated in the Share Transfer Agreement and were made around the time of the Inchroy Loan This is something to look into, if necessary, at trial. I do not see merits in the other points raised by the Plaintiff through Miss Fong (and, indeed, in the affirmation of Mr. Ho).
21. I find that there are triable issues in relation to: a) whether the Plaintiff's assets/funds have been used to pay the Defendants under the Share Transfer Agreement and b) whether the Defendants possessed the requisite knowledge (this involves questions of both law and fact). I am clear that the Defendants must not be denied their day in Court.
22. I grant the Defendants unconditional leave to defend. I make an order nisi that costs of this Order 14 application be costs in the cause with certificate for Counsel.
23. The Defendants have taken out a summons applying to amend their Defence. On paper, Miss Fong objected to the application. Towards the end of her oral submission before me, I heard Miss Fong say that if leave to defend were granted (whether it be conditional or unconditional), there would be no objection to the application to amend. In any event, I said (unwittingly) that I would deal with the application for summary judgment first and, if leave to defend were granted, I would listen to arguments on the application to amend. There is thus outstanding the application to amend. I order that this be adjourned to a date to be fixed with the hope that parties will resolve the matter without the need to appear in Court. (Abu B. bin Wahab) Deputy FORMTEXT District Court Judge Representation: Miss Yvonne Fong instructed by Messrs. Patrick K. H. Lam for the Plaintiff Mr. Paul Harris S. C. instructed by Messrs. Clarence Wong Cheung & Liu for the 1st and 2nd Defendants PAGE - PAGE A B C D E F G 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 A B C D E F G H I J K L M N O P Q R S T U V }m}m} vfZf &`#\$ @\\Hc-oa-ws-656\\HP LaserJet 1200 Series PCL 6 Ne00: winspool HP LaserJet 1200 Series PCL 6 \\Hc-oa-ws-656\\HP LaserJet 1200 Letter HP LaserJet 1200 Series PCL 6 Hjc)b 97wfj B]gT)Yn@{i9Z -9]pVvr) \\Hc-oa-ws-656\\HP LaserJet 1200 Letter HP LaserJet 1200 Series PCL 6 Hjc)b 97wfj B]gT)Yn@{i9Z -9]pVvr) Normal.dot setup Microsoft Word 9.0 Title Microsoft Word Document MSWordDoc Word.Document.8

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