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What's inside

The Duty of Directors to Avoid Conflicts of Interest 2

Review of Telecommunications Regulatory Regime for the Arrival of 5G 3

SME Financing Guarantee Scheme under the Anti-Epidemic Fund 5

AA & Anor v Securities and Futures Commission [2019] 3 HKC 187 6

The Hongkong and Shanghai Banking Corp v SMI Holdings Group [2020] 1 HKC 515 8

Perfekta Enterprises Ltd. v Commissioner of Inland Revenue [2019] HKC 383 9

Editorial

We feature three articles in this edition.

The first article talks about the common law principle of "no conflict rule" in which directors have a duty not to put themselves in a position where there is a conflict between their personal or separate interests and their duty owed to the company to act in the company's interest. It is possible for a company's articles to include provisions relaxing the no conflict rule.

The second article briefly sets out the Government's proposals to amend the Telecommunications Ordinance (Cap. 106) for the arrival of 5G services.

The third article discusses the SME Financing Guarantee Scheme which launches a new product in April 2020 to provide guarantee coverage of 100% of loans approved by participating lending institutions.

We also feature three case reports.

The first case is about s.181 of the Securities and Futures Ordinance (Cap. 571). The Court of First Instance held that s.181 did not override or abrogate the privilege against self-incrimination and that the section struck a fair, reasonable and proportionate balance between the legitimate aim of the SFC's power of ensuring the fair and honest operation of the Hong Kong financial markets and the right to privilege against self-incrimination.

The second case is about the Quincecare duty owed by a bank to its customer – the bank must refrain from executing an order if the bank is "put on inquiry", namely it has reasonable grounds to believe that the order is an attempt to misappropriate the funds of the customer.

The third case involved the redevelopment of a piece of land in Kwun Tong owned by the appellant. The appellant entered into an agreement with a developer under which the developer paid a sum of money to the appellant for the appellant's agreement to transfer the land to its wholly-owned subsidiary which would enter into a joint venture agreement with the developer to redevelop the land. Was the sum of money a profit arising from the sale of a capital asset by the appellant (and not chargeable to profits tax) or a profit from its carrying on of a trade by participating in the joint venture (via its wholly-owned subsidiary) to redevelop the land (and chargeable to profits tax)?

YUNG Lap-yan

No conflict rule

Directors, as fiduciaries, have a duty not to put themselves in a position where there is a conflict (actual or potential) between their personal or separate interests and their duty owed to the company to act in the company's interests.[1] This common law principle is often referred to as the "no conflict rule".

Conflict of interest

The existence of any conflict of interest is a question of fact and involves an objective test which examines whether "*the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict*".[2]

It is suggested that the term "interest" means: "… *the presence of a personal concern of possible significant pecuniary value in a decision taken, or transaction effected, by a fiduciary, whether immediate (a sale of property to the company), indirect (a shareholding in a supplier to the company) or contingent ... (where a dealing with an agent proceeds on the assumption that a success fee is to be paid if a transaction is effected).*"[3]

An obvious example of the existence of a conflict of interest is where a director enters into a contract with the company. The no conflict rule does not, however, mean that the director can never contract with the company. The rule merely prevents the director from contracting with the company in the absence of the informed consent of the company or otherwise as allowed by its articles.[4]

The no conflict rule can apply to not only contracts between the company and its directors, but also contracts between the company and a partnership of which the director is a partner, and those between the company and another company in which the director is also a shareholder or in respect of which the director has a conflicting duty because of also being a director in the other company.[5]

Disclosure and other action required to avoid breach of duty

The no conflict rule is not breached so long as the director discloses the conflicting interest to the company in general meeting and obtains the shareholders' approval.[6]

S.536 of the Companies Ordinance supplements the common law in relation to transactions with the company. S.536 provides that a director who is directly or indirectly interested in a transaction, arrangement or contract, or a proposed transaction, arrangement or contract, with the company must declare the nature and extent of the director's interest to the other directors. Disclosure is required only if the director's interest is material and the transaction, arrangement or contract is significant in relation to the company's business. For public companies, the director's duty of disclosure extends to material interests of entities connected with the director. Disclosure is not required if the director is not aware of the interest or the transaction, arrangement or contract in question.

S.536 does not replace the common law duty requiring disclosure to the company in general meeting but, rather, imposes an additional requirement for disclosure to the board.

It is possible for a company's articles to include provisions relaxing the no conflict rule to a certain extent. For example, the articles could provide that disclosure of a conflict of interest be made to the board without the need for disclosure to the general meeting.[7] However, the articles cannot waive the requirements of s.536.[8]

Apart from disclosure of a conflicting interest, an interested director should also abstain from voting and discussion of the matter at the board meeting unless the director is authorized to act by the general meeting or is authorized to vote at the board meeting under the company's articles of association. Under the Model Articles, a director must neither vote nor be counted for quorum purposes in respect of the transaction, arrangement or contract in which the director is interested,[9] but a company's articles may provide differently from the Model Articles and permit the interested director to vote.[10]

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1 Lo and Qu, *Law of Companies in Hong Kong* (3rd ed., 2018), [8.071]; *Company Law in Hong Kong – Practice and Procedure 2020*, [7.008]

2 *Boardman v Phipps* [1967] 2 AC 46, 124 (HL)

3 Stafford and Richie, *Fiduciary Duties: Directors and Employees* (2nd ed., 2015), [2.124], cited in *Grand Field Group Holdings Ltd v Chu King Fai* [2016] 1 HKLRD 1316, [4.8] (CA)

4 *Law of Companies in Hong Kong*, [8.071]

5 *Ibid*, [8.072]

6 *Ibid*, [8.078]

7 Kwan, *Hong Kong Corporate Law* (loose-leaf ed.), [4054]

8 *Law of Companies in Hong Kong*, [8.091]

9 Cap. 622H Sch 1 s.15(3), Sch 2 s.16(3) and Sch 3 s.15(3)

10 Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (17th ed., 2018), 617

Although directors may avoid a breach of the no conflict rule by disclosure and compliance with the articles (abstaining where necessary), in some cases directors may need to take further action to protect the company's interests, otherwise they may be in breach of other fiduciary duties (such as the duty to act in the interests of the company).[11]

Nominee directors

Nominee directors may be put in a dilemma as the interests of the company may conflict with the interests of their nominators. Prima facie, such directors are still bound by their duties owed to the company, and the no conflict rule still applies to nominee directors. In *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*,[12] it was stated that the nominee directors could not plead any instruction from their nominator as an excuse for breach of their duties to the company.

It seems possible, however, for a company's articles or a shareholders' agreement to be drafted in a way which can enable a nominee director to act in the interests of the nominator.[13] There may still be some limits on the scope of such a provision though. For example, it may be that the duties to the company cannot be attenuated to such an extent as to permit the nominee director to embark on a course of oppressive conduct designed to injure minority shareholders by destroying the company's business.[14]

Remedies for breach

A breach of the no conflict rule generally gives rise to equitable remedies, for example, court orders for rescission of the contract entered into by the company or for restitution of property, account of profits, equitable compensation and injunctive relief against the director.[15]

A director's failure to comply with the statutory rules of disclosure in s.536 will also subject the director in default to a fine of up to HK$100,000.

Ida Chan

[11] Langford and Ramsay, "Conflicted Directors: What is Required to Avoid a Breach of Duty?" (2014) 8 *Journal of Equity* 108

[12] [1990] BCC 567, 586

[13] *Levin v Clark* [1962] NSWR 686

[14] *Ford, Austin and Ramsay's Principles of Corporations Law*, 678

[15] *Law of Companies in Hong Kong*, [8.162]

Review of Telecommunications Regulatory Regime for the Arrival of 5G

Background

Telecommunications technologies have undergone transformative advancement in recent years. A big wave of telecommunications development is brought by the arrival of the fifth generation mobile communications ("5G") services and their application in the era of Internet of Things ("IoT"). This latest generation of mobile services will support faster data transmission rate and transmission with ultra-low minimal latency and will be deployed to connect to a vast amount of smart devices. Everything in our daily life can potentially be embedded with telecommunications functions and can be connected to and communicate with each other to form a networked environment.

To ensure that the regulatory framework for telecommunications is well-equipped to embrace the challenges brought by the arrival of the 5G and IoT technologies, the Government has been reviewing the Telecommunications Ordinance (Cap. 106) ("TO"). After the review, the Government considers that the TO be amended in the following four aspects.

Regulation of telecommunications functions of devices in the 5G and IoT era

In the IoT era that everything can potentially be connected, it is envisaged that network connectivity will likely become a regular feature of most digital devices. Even though telecommunications may not be the primary purpose of these devices, they could be built in with telecommunications chips or modules. The Government considers that the telecommunications chips or modules embedded therein are performing the same telecommunications functions as other telecommunications equipment and such functions should be regulated by the TO in the same way.

The Government therefore proposes that the Communications Authority ("CA") be empowered to prescribe standards and specifications for the

telecommunications functions of such devices, including the embedded modules for communications. Meanwhile, the non-telecommunications functions of such devices (such as electrical and other general safety aspects) will not be governed by the TO and will be regulated by other relevant legislation as appropriate.

Protection of underground telecommunications infrastructure

With the arrival of 5G services and potentially more extensive use of smart devices, the Government considers that there is a need to step up the protection of the underground telecommunications infrastructure. Under s.18 of the TO, any person who proposes to carry out any work that may affect a telecommunications line or radiocommunications installation maintained by the CA or a licensee shall take all reasonable precautions to prevent damage to such facilities. The licensee or the CA (as the case may be) may initiate civil claims to recover from that person any expenses incurred by them in making good any damage to the facilities. There is, however, no provision on which the Government can rely to initiate punitive action against any person negligently causing damage to the underground telecommunications lines.

The Government proposes to create new criminal offences under the TO against negligent damage to the underground telecommunications facilities. Under the proposal, anyone who fails to take precautionary measures before the relevant works begin, or fails to take precautionary measures during the carrying out of the works to prevent damage to the underground telecommunications lines shall be criminally liable. In addition, if the failure to take precautionary measures during the carrying out of the works results in an interruption to a telecommunications service, heavier penalties will be imposed. It is proposed that compliance with the relevant guidelines promulgated by the CA shall constitute a defence to a charge under the proposed offences.

Simplifying the issue of non-carrier licences

Carrier licences are issued by the CA for the establishment or maintenance of telecommunications networks for carrying communications to or from various locations of the territory. Carrier licences are designed to regulate large-scale, territory-wide telecommunications operations and services. Certain facilities-based services which are generally of a more limited scope with a smaller scale of operation are also caught by the generic and broad definition of "carrier licence" under the TO since they share some characteristics of a carrier licence. As for such services, the Government proposes to apply a less stringent set of conditions under non-carrier licences.

The Government considers that there is a need for the expeditious issue of licences in the 5G and IoT era and proposes to streamline the existing mechanism for issuing non-carrier licences for certain facilities-based telecommunications services. The Government proposes to simplify the existing mechanism by empowering the Secretary for Commerce and Economic Development to publish a notice in the Gazette to specify non-carrier licences instead of specifying these non-carrier licences under Schedule 1 to the TO. Under the new mechanism, the issue of non-carrier licences will not require legislative amendments to the TO. These non-carrier licences would be subject to a set of less stringent conditions to be determined by the CA as compared to those applicable to carrier licences.

Improving the appeal mechanism under the TO

Currently, the TO provides for an appeal mechanism under the Telecommunications (Competition Provisions) Appeal Board ("TCPAB") for matters relating to competition. S.7Q of the TO provides that a licensee in a dominant position in a telecommunications market must not engage in conduct that in the opinion of the CA is exploitative. Any person aggrieved by the CA's decision relating to this section may appeal to the TCPAB. Other than this, a licensee who wishes to challenge other decisions of the CA cannot appeal to the TCPAB and can only resort to judicial review.

In light of the increasingly complicated and fast changing telecommunications market, the Government considers that there is a need for a more efficient avenue to redress appeals concerning certain non-competition related regulatory decisions made by the CA. The Government therefore proposes to expand the jurisdiction of the TCPAB to cover such appeals.

Connie Yip

SME Financing Guarantee Scheme under the Anti-Epidemic Fund

Background

The SME Financing Guarantee Scheme ("SFGS") was launched in January 2011 by The Hong Kong Mortgage Corporation Limited ("HKMC"). The SFGS aims to assist Hong Kong enterprises, particularly the small and medium-sized ones, to obtain loans from participating lending institutions ("PLIs") with lower interest rates for their daily business operations or equipment procurement. Since 1 May 2018, the SFGS business has been transferred and operated by the HKMC Insurance Limited ("HKMCI"), i.e. HKMC's wholly-owned subsidiary.

SFGS has been continually enhanced with differentiated loan products on account of business environment. In May 2012, HKMC launched concessionary measures by issuing guarantees to PLIs for guaranteeing repayment of 80% of loans provided by PLIs to eligible enterprises (at concessionary guarantee fees paid by eligible enterprises) ("80% Guarantee Product"). If the guarantee fees paid by, and the recoveries from, the eligible enterprises are insufficient to repay the PLIs, HKMC would pay PLIs up to a sum of 80% of the loans and look to the Government for repayment of such sum. In December 2019, HKMCI launched another guarantee product with the guarantee coverage to PLIs increased to 90% of loans provided by PLIs to eligible enterprises ("90% Guarantee Product"), and the Government's obligation to pay HKMCI increased to 90% of the loans correspondingly.

Enhancements to SFGS under the Anti-Epidemic Fund

100% Guarantee Product

In view of the COVID-19 outbreak, a new guarantee product was launched in April 2020 whereby HKMCI issued guarantees to PLIs for guaranteeing repayment of 100% of loans provided by PLIs to eligible enterprises ("100% Guarantee Product"). The Government provides HKMCI a total guarantee commitment of HK$50 billion under the Budget 2020-21 and the Anti-epidemic Fund for the 100% Guarantee Product. The product aims at alleviating the burden of paying employee wages and rents by enterprises which are suffering from reduced income to help minimize enterprise shutting down and layoffs.

The key features are summarized below.

Target Segment	Hong Kong enterprises of all sectors (e.g. retail outlets, travel agents, restaurants and transport operators).
Eligible Borrower	1. Eligible enterprises must have business operation in Hong Kong with a valid Business Registration Certificate issued under the Business Registration Ordinance (Cap. 310). Listed companies, lending institutions and affiliates of lending institutions are not eligible. 2. Since February 2020, their monthly sales turnover has declined by at least 30% in any month compared with the monthly average of any quarter in 2019.
Business Operation History	Eligible enterprises must have business operation for at least 3 months by December 2019.
Maximum Guarantee Period	3 years.
Maximum Facility Amount Per Borrower	Total amount of (a) employee wages and (b) rents for 6 months per enterprise, or HK$4 million, whichever is lower.
Type of Credit Facilities	Term loans only.
Interest Rate	Annual interest rate at 2.5% below the Hong Kong prime rate quoted by HKMC from time to time will be charged (i.e. currently at 2.75% per annum).
Guarantee Fee	Nil.

A borrower applies to a PLI for a loan under the 100% Guarantee Product through the SFGS. After receiving the borrower's application, the PLI applies for covering guarantee from HKMCI under the SFGS for the loan proposed to be provided to the Borrower. The Government guarantees to repay HKMCI for the guarantee payouts made by HKMCI to PLIs for settling the borrowers' default claims and related costs subject to a cap of HK$50 billion.

PLIs are required to exercise professional skills, judgement and due diligence to check mainly the eligibility of loan applicants when processing the applications[16]. HKMCI will be responsible for operating the 100% Guarantee Product but no credit assessment would be carried out[17]. However, to prevent abuse of the loan, a person or group of persons holding more than 50% of the issued share capital or equity interest of a borrower shall enter into an irrevocable and unconditional personal guarantee in favour of the PLI in relation to the relevant loan. In the case of a group of persons, the guarantee shall be given by them on a joint and several basis[18].

In the event a borrower defaults on repayment for a loan, a PLI will, based on its own policy and usual commercial practice, takes appropriate recovery actions against the borrower and/or the persons who gave personal guarantee(s) to the PLI in respect of the loan.

80% and 90% Guarantee Products

Supported by the Anti-epidemic Fund, the Government also introduced further enhancement measures for the 80% and 90% Guarantee Products. These measures (which took effect in late May 2020) include the following:-

(1) the maximum loan amount per enterprise will increase from HK$15 million to HK$18 million (for 80% Guarantee Product) and from HK$6 million to HK$8 million (for 90% Guarantee Product);

(2) the Government will provide, for a one-year period, interest subsidy for the loans under the 80% and 90% Guarantee Products at a level so as to bring the interest rate per annum on par with that of the 100% Guarantee Product (i.e. currently at 2.75%) subject to a subsidy cap of 3%; and

(3) the eligibility criteria of 80% and 90% Guarantee Products will be extended, for a one-year period, to cover publicly listed companies in Hong Kong, subject to personal guarantee by individual shareholder(s) holding more than 50% of the equity interest of the enterprise[19].

Contractual Arrangements

Between the Government and HKMCI, there are agreements which set out their respective rights and obligations in respect of the operation of different guarantee products. These cover HKMCI's obligations to:-

(1) report regularly to the Government on the operation of the guarantee products (e.g. the usage of the overall loan guarantee commitment, the number of applications approved and beneficiary enterprises, default claims and the associated payouts made and expenses incurred); and

(2) submit annual audited accounts audited by an independent auditor for the operation of the guarantee products[20].

Ada Ng

AA & Anor v Securities and Futures Commission [2019] 3 HKC 187

Facts

The 1st applicant ("AA") was a licensed corporation under the Securities and Futures Ordinance (Cap. 571) ("SFO") and the investment manager of a hedge fund (the "Fund") which engaged in constituent stocks investment in the Japanese Nikkei Index market. The 2nd applicant was a 95% majority shareholder and a responsible officer of AA.

[16] The Financial Secretary's blog "To Save our economic vitality" dated 22 March 2020.

[17] Footnote 5 of Para 17 of the Finance Committee Paper FCR(2019-20)48 on 20 March 2020, at: https://www.legco.gov.hk/yr19-20/english/fc/fc/papers/f19-48e.pdf

[18] SME Financing Guarantee Scheme Factsheet, p. 8, at: http://www.hkmc.com.hk/files/product_shortcut/6/74/eng/SFGS%20Factsheet%20202005_Eng.pdf

[19] Para 6 of Enclosure F of the Finance Committee Paper(2020-21)2 on 17 April 2020, at: https://www.legco.gov.hk/yr19-20/english/fc/fc/papers/f20-02e.pdf

[20] Para 16 of the Finance Committee Paper FCR(2019-20)48 on 20 March 2020, at: https://www.legco.gov.hk/yr19-20/english/fc/fc/papers/f19-48e.pdf

In 2014, upon receiving a report of suspected market manipulative activities by the Fund in relation to the shares of a company listed on the Tokyo Stock Exchange, the Securities and Futures Commission (the "SFC") issued a s.181 notice[21] to AA asking for details of its trades in the shares of the Japanese company. It also contained a warning that non-compliance may constitute an offence, but it did not make any reference to AA's right to remain silent or any warning against self-incrimination. AA provided the required information and voluntarily disclosed additional information it believed would assist the SFC in its investigation.

The SFC subsequently commenced a formal investigation against AA by issuing directions under s.182 of the SFO relating to the suspected breaches of the false trading or price rigging provisions of the SFO (covering market manipulative activities of overseas stocks) and also the relevant provisions of the Financial Instruments and Exchanges Act of Japan. A further notice was issued under s.183 of the SFO to AA as a "person under investigation" demanding production of documents and written answers regarding the Fund and the trading activities in the shares of the Japanese company. Another s.183 notice was issued to the 2nd applicant compelling it to attend an interview. The 2nd applicant claimed privilege against self-incrimination when later answering questions at the SFC's interviews.

Throughout the investigation, the SFC shared information with the Japanese regulators and repeatedly reminded the Japanese regulators that the information was being shared pursuant to s.378 of the SFO[22] and should not be disclosed to any third party other than in accordance with the International Organization of Securities Commissions Multilateral Memorandum of Understanding. Before the interview with the 2nd applicant, the SFC also obtained the Japanese regulators' undertaking not to use the information in any criminal proceedings.

Soon after the interview, the Japanese regulators issued an administrative monetary penalty order (in the sum of approximately JPY684 million against AA) in light of its findings of AA's market manipulation concerning the trades of the shares of the Japanese company. Upon being penalized, AA and the 2nd applicant sought to challenge the actions of the SFC by way of application for judicial review in Hong Kong.

Grounds for Judicial Review

Three major grounds were advanced by the applicants for judicial review:

(1) the administrative monetary penalty proceedings in Japan, were, actually criminal proceedings according to the characterisation criteria set out by the Court of Final Appeal ("CFA") in *Koon Wing Yee v Insider Dealing Tribunal*[23]. As such , the SFC acted unlawfully by transmitting to the Japanese regulators materials obtained through its compulsory powers for use in criminal proceedings in Japan;

(2) the SFC failed to ensure that the Japanese regulators had complied with the secrecy requirements under the SFO, leading to the leakage of information on the investigation to the media prior to the announcement by the Japanese regulators; and

(3) s.181 of the SFO was unconstitutional for abrogating the privilege against self-incrimination and in contravention of Article 10 of the Hong Kong Bill of Rights Ordinance (Cap. 383).

All of these arguments were dismissed by Zervos JA in the judgment.

Decision

Use of materials obtained through its compulsory powers outside Hong Kong

S. 186(6) of the SFO made it clear that the right to privilege against self-incrimination would prevent the compelled materials from being used in criminal proceedings against the disclosing party. In this case, whether the transmission of the materials to the Japanese regulators was lawful depended on whether the action taken by the Japanese regulators against AA was criminal in nature.

The CFA in *Koon Wing Yee* established that, in determining whether the proceedings were criminal in nature, the following three criteria were relevant:

(a) the classification of the offence under domestic law;

[21] S.181 of the SFO empowers the SFC to demand for disclosure of information. A person who fails to comply with such demand without reasonable excuse commits a criminal offence.

[22] S.378 of the SFO requires the SFC and other parties receiving information related to an investigation to preserve secrecy.

[23] [2008] HKCFA 21

(b) the nature of the offence; and

(c) the nature and severity of the potential sanction.

Regarding the first criterion, the applicants agreed that the Japanese proceedings were administrative in nature under Japanese domestic law. As to the second and third criteria, it was found that the Japanese proceedings were civil in nature for a preventative purpose (rather than punitive or deterrent) by imposing administrative monetary penalty order to disgorging improper profits made by AA. It was held that the transmission of the materials by the SFC to the Japanese regulators for the administrative proceedings in Japan was lawful.

The SFC's duty to ensure adequate secrecy over compelled information

The court held that the SFC had taken all reasonable steps and implemented extensive measures to ensure that the secrecy provisions were observed by the Japanese regulators. It was also found that the SFC had reminded the Japanese regulators that such privileged information would not be disclosed to any other person without the SFC's consent.

Constitutionality of s.181 of the SFO

S.181 empowers the SFC to demand for disclosure of information. A person who fails to comply with such demand without reasonable excuse commits a criminal offence.

The applicants argued that the demand under s.181 in effect compelled production of potentially self-incriminatory materials. The court held that s.181 did not intend to override or abrogate the privilege against self-incrimination, which was available to be exercised where the circumstances permitted. It was found that s.181(7) expressly allowed for non-compliance with a s.181 demand where there was "reasonable excuse" and did not contain any words that excluded the privilege. The court was satisfied that the privilege constituted a reasonable excuse for non-compliance under s.181 and held that s.181 struck a fair, reasonable and proportionate balance between the legitimate aim of the SFC's power (of ensuring the fair and honest operation of the Hong Kong financial markets) and the right to privilege against self-incrimination.

The court dismissed the application for judicial review.

Danny Yuen

The Hongkong and Shanghai Banking Corp v SMI Holdings Group [2020] 1 HKC 515

Facts

The Respondent was a company incorporated in Bermuda and listed in Hong Kong. The Respondent issued a cheque for HK$14.8 million (the "Cheque") to a payee (the "Payee") when the Respondent had about HK$2.2 million in its current account with the Petitioner bank. The Cheque was cleared which resulted in an overdraft of some HK$12.6 million (the "Overdraft"). After serving a statutory demand on the Respondent, the Petitioner sought to wind up the Respondent to recover the debt owed under the Overdraft. The Respondent sought to dismiss the petition by claiming that there was (i) a *bona fide* dispute on substantial grounds on whether the Cheque was countermanded before clearance; and (ii) a defence or a *bona fide* cross-claim arising from the Petitioner's alleged breach of the *Quincecare* duty.[24]

Decision

A winding up petition may be dismissed by the court where there is a *bona fide* dispute regarding the debt on substantial grounds. The principles are well-established:-

(a) The company has the burden to establish a genuine dispute of the debt on substantial grounds. "Substantial" means having substance and not frivolous. An honest belief in an insubstantial ground of defence is not sufficient to avoid a winding-up order.

(b) The court should look at the company's evidence against so much of the background and evidence that is not disputed and not capable of being disputed in good faith; in other words, the evidence is not to be approached with a wholly uncritical eye.

(c) The court would caution itself against unsubstantiated and unparticularised assertions, especially where particulars and information had been sought by the other side. It is incumbent on the company to put forward sufficiently precise factual evidence to substantiate its allegations.

(d) The court does not try the dispute on affidavit but is to determine whether a substantial dispute

[24] Barclays Bank plc v Quincecare Ltd [1992] 4 All ER 363

exists. In doing so, the court necessarily has to take a view on the evidence, to see if the company is merely "raising a cloud of objections on affidavits" or whether there really is substance in the dispute raised by the company. Even where the company has obtained unconditional leave to defend in an application for summary judgment, the court is not precluded from examining the evidence and taking a view on whether the debt is disputed on substantial grounds.

In the case, the Respondent alleged that the Petitioner failed to countermand the Cheque as requested. The Respondent claimed that it had been misled by its former director and chairman into thinking that the Respondent owed monies to the Payee. However, no evidence about the alleged countermand was given via affirmation from the Respondent's former staff member who was said to have handled the countermand request and the Respondent gave no adequate explanation on why such evidence was not provided nor whether the former staff member was willing to otherwise give evidence at trial. Also, the exhibited email chain between the parties following the issuance of the Cheque did not show any contemporaneous complaint that a timely request for countermand had been made but ignored. The Court held that the Respondent had failed to demonstrate a *bona fide* dispute on substantial grounds.

On the Petitioner's alleged breach of its *Quincecare* duty, the Court cited various authorities and set out the following principles.

In carrying out a transfer the bank owes the customer the usual banker-customer duty to exercise reasonable care and skill, which co-exists under both contract and in tort. The bank must refrain from executing an order if the bank is "put on inquiry", namely it has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company.

To assess whether the bank was put on inquiry, it is relevant to consider factors such as (i) the standing of the corporate customer; (ii) the bank's knowledge of the signatory; (iii) the amount involved; (iv) the need for a prompt transfer; (v) the presence of unusual features; and (vi) the scope and means available to the bank for making reasonable inquiries.

The Court rejected most of the Respondent's arguments on whether there was a breach of the *Quincecare* duty on the facts. The Respondent argued that the Petitioner was put on inquiry because of the significant amount of the Overdraft, with the bank balance shifting from a positive HK$2 million to minus HK$12 million. The Court accepted that this is a relevant factor to look at but the Court pointed out that this piece of evidence should not be looked at in isolation. In assessing if the Overdraft should have raised suspicion, the Court also considered that (i) the Petitioner was not the Respondent's principal bank; (ii) the Petitioner would have known about the Respondent's overall financial resources (which were sizeable as the Respondent had a turnover of over HK$3 billion, profits of HK$300 million and liquidity in excess of HK$200 million); and (iii) hundreds of millions had previously been transferred out of the Respondent's account and other sums were transferred out of the account of one of the subsidiaries of the Respondent without any problems being raised by the Respondent.

The Court held that there was insufficient evidence to put the Petitioner on inquiry. It could not be said that the Petitioner should have considered there to be "a serious or real possibility albeit it not amounting to a probability" that the Respondent might be defrauded. The Petitioner did not breach its *Quincecare* duty.

The Court was prepared to grant a winding up order save for the parties' indication to the Court of their wish to discuss further regarding a proposed adjournment of the petition.

Kennis Lam

Perfekta Enterprises Ltd. v Commissioner of Inland Revenue [2019] HKC 383

Facts

Perfekta Enterprises Limited (the "Appellant") was a toy-manufacturing company. From 1969 to 1977, it acquired a building on a site in Kwun Tong (the "Lot") which it used as its manufacturing base in Hong Kong. In the late 1970s, the Appellant's manufacturing base shifted from Hong Kong to the Mainland. The Appellant had made various applications for permission to develop a composite industrial and office building on the Lot since 1991. In 1993, the redevelopment was approved.

In July 1994, the Appellant entered into a Redevelopment Agreement with Cheung Kong (Holdings) Limited ("CK") and Great Poka Limited ("GP"), a CK's subsidiary. According to the

Redevelopment Agreement, the Appellant would grant the right to redevelop the Lot to GP and the Appellant would transfer the Lot to its new wholly-owned subsidiary company and procure that new company to enter into a joint venture agreement for the redevelopment of the Lot. In return, GP paid HK$165,104,000 as "Initial Payment" to the Appellant as consideration for the right to redevelop the Lot. In November 1994, the Appellant assigned the Lot to its newly formed subsidiary, Prodes Company Limited ("P"). P, GP and CK then entered into a New Agreement for the carrying out of the redevelopment joint venture.

The Commissioner of Inland Revenue (the "CIR") was of the view that the Initial Payment was chargeable to profits tax. The Appellant objected, contending that the Initial Payment was a capital receipt for which profits tax could not be charged.

Issue

According to s.14(1) of the Inland Revenue Ordinance (Cap.112) (the "IRO"), profits tax would not be chargeable on the Initial Payment if it was a profit arising from the sale of a capital asset and would only be chargeable if it was derived by the Appellant from its carrying on of "a trade, profession or business" in Hong Kong. As the Property had been held by the Appellant as a long-term capital asset prior to its disposal, the main issue before the Court of Final Appeal (the "CFA") was whether the Appellant had changed its intention from capital holding to disposing of the building on the Lot as part of a trade or business, thereby rendering the Initial Payment taxable under s.14(1) of the IRO.

Decision

The CFA overturned the lower courts' judgments and held unanimously that the Appellant did not change its intention from capital holding to trading via its subsidiary. The CFA's analysis is summarized below.

(a) Whether the Appellant had an intention to trade was a question of fact to be determined objectively having regard to all the surrounding circumstances. In determining an intention to trade, the CFA considered it important to identify the activity that was said to amount to trading and, in practical terms, to ask the question: "What trading or business venture has the taxpayer embarked upon?"

(b) The Lot was held by the Appellant as a long-term capital asset. The steps taken by it, from 1991 onwards to enhance the value of the Lot by obtaining planning permission, government consent for a variation of the lease and approval of building plans, were steps that were consistent with the Appellant disposing of the Lot as a capital asset for the best price obtainable and did not necessarily evidence its intention to enter into a venture in the nature of a trade.

(c) The intention to trade was that of P, not the Appellant. The lower court's conclusion that P was only a method or mechanics of implementing the Appellant's intention to trade wrongly treats P as a mere nominee or alter ego of the Appellant. P and the Appellant were two separate legal entities and the court could not disregard the principle laid down in *Salomon v A. Salomon & Co. Ltd*[25], save in limited circumstances. One such circumstance might have been where the CIR was able to rely on s.61 or s.61A of the IRO, which respectively deal with "artificial or fictitious" transactions and transactions designed to avoid liability for tax, but there was no suggestion in the present case that those provisions would apply and the CIR has not sought to invoke them. The courts below wrongly overlooked the fact that P was a separate legal entity embarking on its own account on a trading venture to redevelop the Lot.

(d) The CFA rejected the CIR's argument that the Appellant was carrying on a trade by itself participating in the joint venture to redevelop the Lot. The whole structure of the contractual arrangements was for P to carry out the property redevelopment and for the Appellant to drop out of the picture. Subsequent to the execution of the Redevelopment Agreement, the Appellant assigned the Lot to P, and P entered into the New Agreement with GP and CK. The Appellant was not a party to the New Agreement. The profits of the joint venture envisaged by the New Agreement were to be shared equally between P on the one hand and GP and CK on the other. There is nothing in the facts to suggest that the Appellant's intention to dispose of the Lot to its subsidiary and to use that subsidiary as a separate entity to carry out the redevelopment joint venture of the Lot ever changed.

(e) The CFA also rejected the CIR's alternative argument that the Appellant was engaged in a trade of procuring its subsidiary to enter into the redevelopment joint venture. The substance of the transaction was that the Appellant had enhanced

[25] [1897] A.C. 22

the value of a capital asset prior to disposing it by way of assignment to its subsidiary who was intended to participate in a joint venture to develop the Lot. No part of the Appellant's toy-manufacturing business is to act as a procurer of joint venture participants for property developers.

The CFA therefore took the view that the true and only reasonable conclusion on the undisputed evidence was that the Appellant did not change its intention in relation to the Lot and did not enter into a venture in the nature of a trade in respect of the Lot.

The CFA unanimously allowed the appeal and annulled the Commissioner's assessment.

Patrick Yeung

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