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Editorial

We feature three articles in this edition. The first article discusses the key features of a proposed Special Needs Trust (the "SNT") to be set up for the benefit of persons with special needs (e.g. children with intellectual disabilities). The Government will take the lead in setting up the SNT, with the Director of Social Welfare as the trustee, to provide reliable and affordable trust services for managing the assets of the parents of persons with special needs.

The second article discusses the two-tiered profits tax regime to be introduced by the Inland Revenue (Amendment) (No. 3) Ordinance 2018 which cuts the profits tax rate for the first HK$2 million of assessable profits of all enterprises by half in order to enhance Hong Kong's competitiveness.

The third article talks about the effect of liquidation on a company's contracts.

We also features three case reports in this edition. The first case is about the Court's power to make an order under s.214 of the Securities and Futures Ordinance to disqualify a director, and the considerations that the Court will take into account in determining the appropriate period of disqualification.

The second case is an interesting English Supreme Court decision on whether a written contract which contained a "no oral modification" clause could be modified orally.

The third case is about payments made by a person to his relatives before his bankruptcy. Would such payments constitute transactions at an undervalue or unfair preference under the Bankruptcy Ordinance?

YUNG Lap-yan

Special Needs Trust

Background

Parents of children with special needs (in particular those with intellectual disabilities) are concerned that after they pass away, there is no reliable institution to safeguard the financial benefit and well-being of their children. Even if the parents have the financial means to meet the long-term living expenses of their children, they are still worried about the care of their children when they are no longer around. There is also concern as to who should manage their estate for the benefit of their children. Some parents have pointed out that even if they can find relatives or friends to take care of their children, they might not wish to entrust all their assets to their relatives or friends[1].

While the parents may consider setting up a private trust with a professional trustee for their children, the fees for setting up and maintaining such a trust are high and will significantly deplete the assets earmarked for paying their children's living expenses. Some countries, such as Singapore and the United States, have set up different forms of special needs trust ("SNT") to plug the gap for those who cannot afford the services of a professional trustee.

What is an SNT?

A trust involves a tripartite relationship where the settlor (i.e., the creator of the trust) settles his or her property to the trustee who will hold it for the benefit of the beneficiary. A trust can be created when the settlor enters into a trust deed with the trustee and assigns property to the trustee absolutely with an ascertainable person or entity as the beneficiary. Although the beneficiary is not a party to the trust deed, the terms on which he or she may benefit from the trust property are set out in it. Broadly speaking, the trustee's duty is to manage the trust property for the benefit of the beneficiary in accordance with the trust deed and applicable trust law.

An SNT is an affordable trust especially designed for persons with special needs. One special feature of an SNT is that it will pool funds contributed by individual settlors (which could be the parents or other family members of the persons with special needs) for making investment to achieve economies of scale, thereby reducing the costs of management. The amount of trust funds designated for each beneficiary will be segregated. The trustee will allocate investment gains or losses to individual trust accounts on a pro rata basis.

Recent development in Hong Kong

In June 2016, the Labour and Welfare Bureau established a working group comprising of parents with special needs children, representatives of non-governmental organisations in the rehabilitation sector, professionals from the legal, financial and academic fields, a person with autistic characteristics and representatives of the relevant government departments to explore the feasibility of setting up an SNT in Hong Kong. Following the feasibility study, the Government announced in the Chief Executive's 2017 Policy Address that it will take the lead in setting up an SNT, with the Director of Social Welfare as the trustee, to provide reliable and affordable trust services for managing the assets of such parents. The Government has earmarked $50 million for setting up a dedicated office towards the end of 2018 to provide the SNT services to the public. It is expected that the SNT scheme will be launched in end 2018 or early 2019[2].

Key features of the proposed SNT scheme

The Director of Social Welfare Incorporated ("DSWI"), a corporation sole incorporated under the Director of Social Welfare Incorporation Ordinance (Cap. 1096), will act as trustee for the SNT scheme. Under Cap. 1096, DSWI is empowered to act as trustee of any trust created for the benefit of persons in the care of the Social Welfare Department ("SWD") or of any trust created in connection with the work of SWD. DSWI also has the power to invest any trust funds in its hand in accordance with the provisions of the Trustee Ordinance (Cap. 29).

Before setting up an SNT, the settlor will, with the

1 Legislative Council Panel on Welfare Services - Preliminary Framework of Special Needs Trust (LC Paper No. CB(2) 1364/17-18(03)) at https://www.legco.gov.hk/yr17-18/english/panels/ws/papers/ws20180514cb2-1364-3-e.pdf

2 *Ibid*; see also https://www.info.gov.hk/gia/general/201804/20/P2018042000358.htm

help of SWD staff, devise a care plan for the beneficiary. The care plan will set out the care needs of the beneficiary and project the expenditures required for meeting such needs. The settlor will also write a letter of intent to appoint an individual or institutional carer for the beneficiary and set out his or her wishes and preferences on how the trust funds should be used for the care and benefit of the beneficiary after the demise of the settlor. The settlor may during his or her lifetime modify the care plan and letter of intent as needed for changes in care needs (e.g., education and medical care) of the beneficiary.

To set up a trust under the SNT scheme, the settlor must sign a trust deed with the trustee and transfer an initial sum of money to the trust. The settlor does not need to settle all of the assets at the outset as the settlor will make a will to instruct the executor to transfer a further sum of money from his or her estate into the trust upon his/her death. To reduce management costs, the SNT will only accept cash but not other forms of assets (e.g., real property). The trustee will invest the funds received from the settlor in accordance with the provisions of the Trustee Ordinance (Cap. 29). Funds contributed by individual settlors will be pooled together for investment. Investment gains or losses will be allocated to the individual trusts on a pro rata basis.

When the settlor passes away, the trust will be activated, meaning that the trustee will start making regular payments to the carer who will use the money for implementing the care plan for the beneficiary. The trustee will disburse funds to the carer in accordance with the wishes and preferences set out in the settlor's letter of intent. However, as the letter of intent is not legally binding, the trustee may deviate from the letter if it is in the beneficiary's best interest to do so. For instance, the trustee could pay for medical treatments not provided for in the letter of intent if the trustee considers that such treatments are in the best interest of the beneficiary.

To safeguard the well-being of the beneficiary, the trustee (through SWD staff) will review the implementation of the care plan on a regular basis. To protect the beneficiary's interest, the trustee could replace the existing carer with a new carer if it is in the best interest of the beneficiary to do so. For instance, the trustee could replace the existing carer if such carer is found to have abused the beneficiary physically, financially or psychologically.

The trust will be terminated upon the demise of the beneficiary or when the trust funds are exhausted before the demise of the beneficiary.

The trust is irrevocable. However, if the beneficiary predeceases the settlor, the trust will automatically be revoked.

Blondie Poon

The Two-tiered Profits Tax Rates

Background

The Inland Revenue (Amendment) (No.3) Ordinance 2018 was gazetted on 29 March 2018 to implement the two-tiered profits tax rates regime (the "Regime") announced in the 2017 Policy Address. The Regime aims at reducing the tax burden on enterprises (especially small and medium enterprises and startup enterprises) in order to help foster a favourable business environment, drive economic growth, create job opportunities and enhance Hong Kong's competitiveness.

Main Features

(1) Lower tax rates

The Regime is applicable to any year of assessment commencing on or after 1 April 2018. For corporations, the first HK$2 million of assessable profits is taxed at one-half of the rate, i.e., 8.25%, and the remaining profits continue to be subject to the tax rate of 16.5%. For unincorporated businesses (i.e., partnerships and sole proprietorships), the profits tax rate for the first HK$2 million of assessable profits is also lowered by half to 7.5% and the remaining profits continue to be subject to the tax rate of 15%. A corporation and an unincorporated business may save up to HK$165,000 and HK$150,000 each year respectively.

(2) Only one entity in each group is eligible

To avoid a group enterprise splitting income amongst its various "connected entities" so as to repeatedly enjoy the lower tax rates, the Regime requires that the group has to identify only one of its connected entities for the lower rates. Under the Regime, an entity[3] is a "connected entity" of another entity if (a) one of them has "control" over the other, or (b) both of them are under the "control" of the same entity. "Control" over another entity means holding directly or indirectly more than 50% of issued share capital, voting rights, capital or profits in that entity. For sole proprietorship business, one is connected to another if they are carried on by the same natural person. The "connected" relationship of the entities is determined by their status at the end of the basis period for a particular year of assessment. The nominated entity in the group may make the election by declaring in its tax return that it is chargeable at the two-tiered profits tax rates for the relevant year of assessment whereby no other connected entity in the group elects to be so chargeable. Once the election is made, it is irrevocable for that year. However, a different connected entity in the group may elect the two-tiered profits tax rates for a different year of assessment.

(3) No double benefits

In order to avoid double benefits, enterprises electing the existing preferential half-rate regimes (e.g., professional reinsurance companies[4], captive insurance companies[5], corporate treasury centers[6] and aircraft leasing companies) are excluded from the Regime. Also, excluded from the Regime are the assessable profits for sums received by or accrued to holders of qualifying debt instruments[7] as interest, gain or profit which are already taxed at half-rate (i.e., 7.5% or 8.25% as the case may be).

3 "Entity" means a natural person, a body of persons, or a legal arrangement which includes a corporation, a partnership and a trust (s.14AA of the Inland Revenue Ordinance, Cap.112).

4 As opposed to a direct insurance company which also provides reinsurance, a specialized or professional reinsurance company is a reinsurer who writes reinsurance business exclusively.

5 Captive insurance is a form of self-insurance by companies. A company may wish to set up a captive insurer to provide coverage of specific risks that is not readily available in the market.

6 A corporate treasury center is an "in-house bank" within a multinational corporation focusing on the optimal procurement and usage of capital for the operations of the entire group.

7 See s.14A for the meaning of "qualifying debt instruments". A list of the qualifying debt instruments is available at Inland Revenue Department's website : (www.ird.gov.hk/eng/tax/bus_qdi.htm).

Impact on Hong Kong Economy and Businesses

It has become an international trend to reduce corporate tax rates to attract more foreign businesses. In the United States, the Tax Cuts and Jobs Act introduced on 1 January 2018 reduce federal corporate income tax rate from 35% to 21%. The United Kingdom government has also announced that the corporation tax rate will be lowered from 19% to 17% for the year commencing on 1 April 2020. Hong Kong's corporate tax rate of 16.5% is still among the lowest in the world. The Regime further enhances the competitiveness of our taxation system.

The Regime only reduces the rates of charging assessable profits. It does not change or narrow the tax base. On the assumption that 20% of the tax-paying enterprises are connected enterprises, the tax revenue forgone under the Regime is estimated to be about HK$5.8 billion per year, or around 4.2% of the total profits tax received in 2017-2018. The Government expects that the tax savings by enterprises can be reinvested in upgrading their hardware or software, thereby boosting the overall scale of operation and efficiency which in turn can bring in additional tax revenue in the long run.

In Hong Kong, about 80% of taxpaying enterprises have assessable profits of HK$2 million or below[8]. Many of them are small, medium and startup businesses. Setting the threshold for the lower tax rates at HK$2 million is intended to focus the tax benefit on these businesses. The Government expects that the lower tax rates can benefit the more successful social enterprises by alleviating their tax burden. The tax saved will enable these enterprises to pursue their social objectives (e.g. enhancing their services and creating more employment and training opportunities for the socially disadvantaged).

There were opinions that the Regime should impose restrictions on the size of eligible enterprises, thereby excluding multi-national and larger enterprises from the benefit of the lower rates. However, to balance the need for a simple tax regime, the Regime has been designed to benefit all eligible enterprises with assessable profits irrespective of their size and number of employees.

8 In 2015-2016, about 111,900 enterprises had assessable profits of HK$2 million or below whereas about 23,900 enterprises had assessable profits over HK$2 million.

Conclusion

Without compromising the simplicity of Hong Kong's profits tax system, the Regime provides tax benefit for enterprises of all sizes while targeting small, medium and startup businesses in particular, with an aim to making Hong Kong's tax regime more competitive, thereby promoting a more favourable business environment.

Patrick Yeung

Effect of Liquidation on a Company's Contracts

Introduction

When a company goes into liquidation, an issue arises as to what happens to the company's pre-existing contracts. It is important for the company and the other party to the contract to know what effect the company's liquidation has on the company's contracts. There is no provision in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO") that covers this issue squarely. Much depends on application of common law principles of contract law, including those on termination of contracts.

Contracts in general

Liquidation of a company does not, in itself, terminate the company's contracts. Generally, a contract may continue until the liquidator repudiates or disclaims it. The liquidator may expressly repudiate the contract, or may so suggest by conduct which is inconsistent with the company's continuing readiness to perform[9]. If the liquidator has advised that the company is unable to fulfil the terms of the contract, the other party to the contract may regard this as an immediate breach and seek to recover damages[10].

Alternatively, the liquidator may affirm and continue with any contracts whose further performance is likely to benefit the company, and hence its general creditors[11].

It is also possible that the liquidation operates to discharge the company's contract by frustration, in which case the obligations of both parties come to an end. However, this is uncommon and would only occur where the continued existence of the company or its business is a condition precedent to the operation of the contract, with the result that liquidation renders the contract impossible to perform[12].

Ipso facto clauses

Although contracts to which a company is a party are not automatically terminated by the company's liquidation, there could be immediate termination upon liquidation if there is a contractual term to that effect[13]. It is quite common to include in a commercial contract a clause which provides to the effect that the contract is terminated if an insolvency event occurs (e.g. a party to the contract goes into liquidation). Such a clause is known as an "*ipso facto* clause" and can be effective to bring about termination[14].

Contracts of employment

Prima facie, publication of a compulsory winding-up order discharges all persons employed by a company, giving them a right to damages for wrongful dismissal, as publication of the order amounts to notice that the company cannot continue to fulfil its obligations under its employment contracts[15]. However, this principle only applies if there is an immediate termination of the company's business when the winding-up order is made. The liquidator may waive the dismissal brought about by publication of the winding-up order, and where the liquidator does so, the old contract of employment continues[16]. If

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9 *Palmer's Company Law*, Vol. 4, para. 15.538

10 *McPherson and Keay: The Law of Company Liquidation* (4th edition, 2018), para. 7-056

11 See fn. 9 above

12 See fn. 10 above

13 See fn. 9 above

14 Keay and Walton, *Insolvency Law: Corporate and Personal* (4th edition, 2017), para. 15.4

15 *Chitty on Contracts* (32nd edition, 2015), Vol. I, para. 10-047; Vol. II, para. 40-181

16 See fn. 15 above, Vol. I, para. 10-047; *Re English Joint Stock Bank Ex p. Harding* (1867) LR 3 Eq 341

the company continues in business so that there is work to occupy the employees, they must continue under the old contract[17].

For a voluntary liquidation, the position depends on the particular circumstances. The balance of authority suggests that voluntary liquidation does not operate to dismiss employees[18]. However, if a company goes into voluntary liquidation because of insolvency, its resolution to wind up indicates that the company is unable to perform its obligations under the employment contract and as a consequence the resolution acts as a dismissal notice[19].

<u>Disclaimer</u>

If the liquidator repudiates a contract of the company, the other party may elect to accept the repudiation or to keep the contract on foot. If the other party does not accept the repudiation and does not exercise its right to terminate, the continuation of the contract can potentially be disadvantageous to the company (e.g. depleting the company's funds to the detriment of the creditors of the company or holding up due administration of the liquidation). In such a situation, the liquidator may invoke the right to disclaim the unprofitable contract under s.268 of CWUMPO (which deals with disclaimer of onerous property of the company) in order to release the company from its continuing obligations under the contract.

The disclaimer operates to determine, as from the date of disclaimer, the rights, interest, and liabilities of the company, but third parties are only to be affected so far as necessary to release the company and its property from liability. Any person injured by the disclaimer is deemed to be a creditor of the company to the amount of the injury, and may prove the amount as a debt in the winding up.

<u>Enforcement of contractual rights</u>

In light of the above, the following summarises the position in respect of enforcement of contractual rights by either the company or the other party to the contract after commencement of the company's liquidation. Where the company has fully performed its obligations under the contract and the other party has not so performed before the liquidation, the liquidator can take action on behalf of the company to enforce its contractual rights against the other party. Where the other party has so performed but not the company, the other party can claim as a creditor against the company in the liquidation for sums owed or for a sum representing the amount of damages for breach of contract.

In the case of executory contracts (where both parties to the contract have not fully performed their respective obligations), if the liquidator is willing to procure the company to so perform, the liquidator can enforce on the company's behalf the company's contractual rights against the other party. If the liquidator does not procure the company's performance, the other party can terminate the contract (e.g. on the basis of the company's repudiation under ordinary contractual principles) and can claim against the company as a creditor in the liquidation in respect of any losses suffered. If the other party does not exercise its right to terminate or rescind the contract, the liquidator may be able to disclaim the contract pursuant to s.268. Where the other party to the contract has proprietary claims against the company's assets, that party is entitled to enforce its real rights over those assets[20].

Ida Chan and Angel Li

Re First China Financial Network Holdings Ltd [2015] 5 HKLRD 530

<u>Facts</u>

D1, D2 and D3 (together, the "Directors") were directors of First China Financial Network Holdings Limited (the "Company"), a company listed on the Hong Kong Stock Exchange. The Directors had acted dishonestly in putting forward a non-existent Mutual Understanding and Agreement (the "MUA"). As a consequence, assets belonging to the Company, in the sum of RMB18,692,000, were wrongfully paid to Fame Treasure, a company owned by D3. D3 was the instigator of the dishonest enterprise. D2 yielded to the pressure exerted on him by D3 and had failed to consider the matter carefully with due regard to the interests of the Company. D1 was the least culpable party because he did try to resist D3's pressure. Neither D1 nor D2 had derived any financial benefit from the dishonest enterprise.

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17 <u>*Re Oriental Bank Corporation (Macdowall's Case)*</u> (1886) 32 Ch D 366; <u>*Re Associated Dominions Assurance Society Pty Ltd*</u> (1962) 109 CLR 516

18 See fn. 14 above

19 See fn. 10 above, para. 7-058

20 Lo and Qu, *Law of Companies in Hong Kong* (3rd edition, 2018), para. 20.100

The Securities and Futures Commission sought disqualification orders against the Directors pursuant to s.214(2)(d) of the Securities and Futures Ordinance (Cap. 571). S.214(2)(d) gives the court power to impose a disqualification order for a maximum period of 15 years on a person who is wholly or partly responsible for the business or affairs of a listed corporation being conducted in, amongst other grounds, a manner oppressive or unfairly prejudicial to its members, or involving defalcation, fraud, misfeasance or other misconduct.

Issue

There was no dispute that the conduct in question merited a period of disqualification in respect of each of the Directors. The issue in the case was the appropriate period of the disqualification orders.

Legal principles

Disqualification is not mandatory but entirely within the discretion of the Court. The purpose of imposing a disqualification order is two-fold: (i) protecting the public; and (ii) general deterrence.

In determining the length of a disqualification order, the Court will approach the question by determining whether the case falls under the top, middle or minimum bracket. The top bracket of over 10 years is reserved for particularly serious cases; the minimum bracket of below 5 years is reserved for cases which are, relatively, not very serious; and the middle bracket of 6 to 10 years is applicable to serious cases which do not merit the top bracket.

The period of disqualification is determined with reference to a wide spectrum of considerations, with the dual objective of protecting the public and deterrence, as follows:

(a) It is of the greatest importance that any individual who undertakes the statutory and fiduciary obligations of being a company director should realise that these are personal responsibilities.

(b) The primary purpose of disqualification is to protect the public and to deter against unscrupulous behaviour of directors.

(c) The period of disqualification must reflect the gravity of the offence.

(d) The period of disqualification may be fixed by starting with an assessment of the correct period to fit the gravity of the conduct, and a discount is then given for mitigating factors.

(e) A wide variety of factors, including the director's age and state of health, the length of time he has been in jeopardy, whether he has admitted the offence, his general conduct before and after the offence, and the periods of disqualification of his co-directors that may have been ordered by other Courts.

(f) Other criteria which govern the Court's exercise of the power of disqualification are: (1) character of the offenders; (2) nature of breaches; (3) structure of the companies and the nature of their business; (4) interests of shareholders, creditors and employees; (5) risks to others from the continuation of offenders as company directors; (6) honesty and competence of offenders; (7) hardship to offenders and their personal and commercial interests; and (8) offenders' appreciation that future breaches could result in future proceedings.

In the determination of a disqualification period, the Court adopts a reasonably broad-brush approach and earlier decided cases are of limited assistance to the Court.

Decision

The Court found that the Directors had acted dishonestly in putting forward the non-existent MUA. The Court noted that breach of trust by a fiduciary is a very serious matter and that a large sum of money was involved. However, the Court accepted on the evidence that the conduct was out of character for the Directors and considered that there was no real risk of similar misconduct by the Directors should they become directors again. The Court also took into account the personal circumstances of the Directors, including their ages (the Directors were in their 50s and 60s). Taking all relevant matters into the weighing exercise, the Court ordered that the disqualification periods for D1, D2 and D3 be 4 years, 5 years and 7 years respectively.

The Court refused to make an exception in the disqualification order to enable D3 to work as a manager in a mainland company which held shares in a Hong Kong company. Such an exception will allow D3 to do indirectly what he is prohibited from doing as a consequence of a disqualification order and would defeat the twofold purpose of a disqualification order.

Angel Li

MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2018] 2 WLR 1603

This English case examines the validity of an oral variation of an existing contract which contained a "no oral modification" clause ("NOM clause").

Facts

The defendant company ("Rock") entered into a contractual licence with the plaintiff company ("MWB") for occupying office space operated by MWB. The licence agreement contained a NOM clause which stipulated that "all variations to this licence must be agreed, set out in writing and signed on behalf of both parties before they take effect". Rock had accumulated licence fees in arrears. Rock's sole director proposed a revised payment schedule to an MWB's employee ("Employee"). The effect of the proposed revised payment schedule was that part of the payments would be deferred and the accumulated arrears would be spread out over the remainder of the licence term. Rock then discussed the proposal with the Employee over the phone and claimed that the Employee had agreed to vary the licence agreement in accordance with the revised payment schedule. The Employee denied this and proceeded to treat the revised payment schedule as a proposal and took it to her boss. The boss rejected such proposal.

Subsequently, MWB locked Rock out of the premises for a failure to pay the arrears and terminated the licence. MWB then instituted proceedings for payment of the balance of arrears. Rock counterclaimed for damages for wrongful exclusion from the premises.

The crux of the dispute is whether the NOM clause is legally effective such that oral variation to the licence is not legally valid.

Central London County Court

The County Court decided it in favour of MWB. It found that an oral agreement had been made with the Employee to vary the licence in accordance with the revised payment schedule and that the Employee had ostensible authority to make such agreement. Since the revised payment schedule brought practical advantage to MWB, the County Court held that the variation agreement was supported by consideration. Nevertheless, such variation was ineffective since it was not recorded in writing signed on behalf of both parties, as required by the NOM clause.

Court of Appeal

On appeal by Rock, the Court of Appeal overturned the County Court's decision and held that not only was the variation supported by consideration, the oral agreement to revise the payment schedule amounted to an agreement to dispense with the NOM clause. It followed that MWB was bound by the variation and was not entitled to claim the arrears at the time when it did.

Supreme Court

MWB appealed to the Supreme Court. It allowed the appeal and restored the order of the County Court, holding that the oral variation was not valid.

In examining the legal effect of the NOM clause, the Supreme Court opined that there were legitimate commercial reasons for including a NOM clause in a contract – such clause (i) prevents abusive attempts to undermine written agreements by informal means; (ii) avoids disputes and misunderstandings between parties; and (iii) facilitates corporations in policing their internal rules.

On the other hand, the Supreme Court acknowledged that there were reasons for not treating the NOM clause as effective – (i) the variation of an existing contract is itself a contract; (ii) the parties may agree informally to dispense with an existing clause which imposes requirements of form on the making of contracts because the common law imposes no such requirements; and (iii) parties must be taken to have intended to do this by the mere act of agreeing a variation informally when the principal agreement required variation to be put in writing.

Therefore, the effect of a NOM clause seemed to pose a paradox – if the parties' will was paramount, could they make a contract term so binding that even they could not vary it? The Court of Appeal thought they could not on the ground that it would be an infringement of the parties' autonomy. The Supreme Court disagreed. It found that the proper understanding of "party autonomy" is that parties may agree to bind their future conduct. After parties reach an agreement as to their future conduct, that agreement sets the boundaries of party autonomy. Thus, party autonomy operates up to the point when the contract is made, but thereafter only to the extent that the contract allows. This leads to the conclusion that should a contract require variations to the contract to be in writing, an oral variation of the contract will be invalid. That said, parties are still free to vary a NOM clause in the form the contract specifies for variation i.e. in writing.

Lord Sumption, who gave the majority judgment, pointed out that parties who agree an oral variation despite the presence of the NOM clause do not necessarily intend to dispense with the formal requirement stipulated therein and may often have overlooked it.

Despite the above, the Supreme Court recognizes the possibility of a situation where parties agree orally to vary a contract and then a party acts on the variation. In this situation the doctrine of estoppel will act to prevent a party from relying on the NOM clause to invalidate the oral variation. However, the Supreme Court ruled that estoppel did not arise on the facts of this case as the steps taken by Rock were minimal. It held that there had to be some words or conduct unequivocally representing that the variation was valid and something more than the informal promise itself.

Lord Briggs gave a separate concurring judgment. Although he agreed that the oral variation was invalid in this case, his decision was reached on different grounds – because the parties had not made any express reference to the NOM clause when they were negotiating the proposal. In his view, had the parties specifically turn their minds to the question of the effect of the NOM clause during the negotiation and decided that it should no longer pertain, they could orally vary the license agreement. Lord Briggs believed that having recognized the NOM clause's continuous binding effect until the parties have expressly agreed to do away with it would give the parties most of the commercial benefits of certainty and avoid abusive litigation about the alleged oral variation.

Fiona Lai

Cheung Siu Kin (a bankrupt) [2015] 5 HKLRD 923

Facts

The trustees in bankruptcy (the "Trustees") of a bankrupt ("Bankrupt") applied to set aside certain transfers of money made by the Bankrupt to the 1st and 2nd Respondents ("Respondents") under ss.49 and 50 of the Bankruptcy Ordinance (Cap. 6) (the "Ordinance"). The Bankrupt is the elder brother of the 1st Respondent, and the 2nd Respondent is the wife of the 1st Respondent.

Since 2005, the Bankrupt traded securities through an account at Quam Securities Company Limited ("Quam"). In August 2008, the Bankrupt suffered substantial loss and owed around $17 million to Quam. On 25 August 2008, Quam petitioned for the Bankrupt's bankruptcy and a bankruptcy order was made on 26 November 2008.

The Trustees noticed that there had been mutual payments between the Bankrupt and the Respondents/ some third parties between 2003 and 2008. The Trustees sought to impugn 46 transfers of money by the Bankrupt to the Respondents.

Transactions at an undervalue

The Trustees claimed that the payments from the Respondents were gifts of money to help the Bankrupt out. The Bankrupt was not legally obliged to repay the Respondents. The Bankrupt repaid out of moral obligation and thus the repayments were also *gifts* or *payments for no consideration* to which s.49 applied.

The Respondents denied the Trustees' claim and contended that the Bankrupt was running a private *investment fund*: The money paid to the Bankrupt was for investment, and the money paid or returned was *trust money* belonging beneficially to the Respondents throughout.

Gifts or payments for no consideration

S.49(1) provides that where a debtor is adjudged bankrupt and has at a relevant time entered into *a transaction with any person at an undervalue*, the trustee may apply to the court to set aside the transaction. S.49(3)(a) provides that for the purpose of s.49(1), a debtor enters into a transaction with a person at an undervalue if "he makes a gift to that person or he otherwise enters into a transaction with that person on terms that provide for him to receive no consideration".

The Court considered that whether the payments were gifts has to be determined with reference to the intention of the payer[21]. There was no evidence that the Bankrupt was experiencing financial hardship when the payments were made such that Respondents would want to gift substantial sums to the Bankrupt. As for consideration, the Respondents expected repayment and the Bankrupt did make repayments. Hence, the payments made by the Bankrupt to the Respondents were not gifts or payments made for no consideration.

Trust money

The Court did not find the requisite intention to create a trust in respect of the money paid to the Bankrupt. There was no agreement for the Bankrupt to keep the money separate from his personal assets and he did not keep separate accounts for the Respondents' money. The Bankrupt was at liberty to use the money. Even if the payments made by the Bankrupt to the Respondents were made on account of the "investment fund", they were repayments pursuant to the Bankrupt's personal obligation rather than return of trust money already beneficially owned by the Respondents.

Unfair preferences

The Trustees also claimed that the Bankrupt had given unfair preferences to the Respondents under s.50 of the Ordinance.

S.50(3) provides that a debtor gives an unfair preference to a person if that person is the debtor's creditor and the debtor does anything which has the effect of putting that person into a position better than that he would have been in.

Under s.50(4), a debtor does not give an unfair preference unless his decision to give such preference is influenced by a desire to prefer. S.50(5) presumes influence by a desire to prefer (unless the contrary is shown) if a preference is given by the Bankrupt to his "associate".

In the present case, the Respondents were "associates" of the Bankrupt[22].

The Court, applying *Joint and Several Trustees of the Property of Hau Po Man v Hau Po Fun*[23], stressed that s.50(5) only presumes influence by a desire to prefer and not existence of the desire.

Having looked at the evidence as a whole including (i) the history of the financial dealings between the Bankrupt and the associates, (ii) the overall conduct of the Bankrupt and the associates (including payments made by the associates to the Bankrupt subsequent to the Bankrupt's worsened financial position known to the associates) and (iii) the Bankrupt's payments to other creditors who were not associates, the Court found no requisite desire to prefer and nothing to turn on the presumption under s.50(5). The Court concluded that the Bankrupt's repayments were not influenced by such desire. The Trustees' claim of unfair preference under s.50 failed.

Conclusion

The case illustrates that recurrent money transfers between family members prior to bankruptcy may not necessarily constitute transactions at an undervalue or unfair preferences. The court will evaluate all the evidence to ascertain whether a bankrupt had the requisite intention to make gifts to creditors (in respect of transactions at an undervalue) and whether a bankrupt had the requisite desire to prefer (in respect of unfair preferences).

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21 *Dewar v Dewar* [1975] 2 All ER 728 at [732-733]; *Meisels v Lichtman* [2008] EWHC 661 (QB)

22 According to s.51B(2) and (7), a debtor's brother (a relative) and the spouse of the debtor's brother (the spouse of the relative) are "associates".

23 [2005] 2 HKLRD 262, [2005] 2 HKC 227