Contentious Commentary Hong Kong

September 2016

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Defendant left holding the baby

Plaintiff prevails in distributor dispute

The defendant in *Hin Sang Hong Co Ltd v Kingdom Overseas Ltd* [2016] 2 HKLRD 1321, a BVI distributor of infant formula, became the exclusive distributor for Hong Kong and Macau for five years from July 2011. The plaintiff was to order a certain number of tins of the formula at the supplier's price which could be unilaterally adjusted by the defendant with written notice to the plaintiff. Although the distribution agreement referred to a *"recommended uniform retail price"* (the RURP), the plaintiff also had a discretion to determine the wholesale price at which to supply the products to retailers. The defendant could terminate the agreement only if the plaintiff supplied the products at low wholesale prices which caused the defendant to suffer losses.

The defendant failed to deliver all of the formula as ordered and in February 2012, issued a notice terminating the agreement which the plaintiff accepted. The plaintiff brought proceedings against the defendant for breach of contract.

Godfrey Lam J sitting in the Court of First Instance gave judgment for the plaintiff. On a proper construction of the agreement, the plaintiff had not agreed to a condition that the retail price would always be the RURP. The defendant was in breach by purporting to terminate the agreement without justification.

The judgment is notable as the defendant played no part in the proceedings and enquiries revealed it had been struck off the BVI register of companies on 1 November 2014 for non-payment of annual fees. A company whose name has been struck off the BVI register is not dissolved immediately, but continues to exist for another 7 years before being automatically dissolved. BVI company law states that the fact that a company is struck off the Register does not prevent any creditor making a claim against the company and pursuing the claim through to judgment or execution.

Assets frozen in fishy scheme

Court continues injunction as fictitious transactions alleged

In *Link Fish Import & Export SL v Multiply Import & Export HK Ltd* [2016] HKEC 1464, Recorder Madam Linda Chan SC gave judgment in an application for continuation of a Mareva injunction in favour of the plaintiff Spanish company engaged in the sale and purchase of promotional items for the alcohol industry.

The company was formed by Pedro Manual Lopez Moreno and Ms Maria-Teresa Aguado Mateos. Maria was a director of the plaintiff and ran its business operations. She introduced the plaintiff to the first and second defendants and the companies commenced trading.

In January 2016, Pedro was alerted to apparent irregularities in the way Maria was conducting the business, including allegations of fictitious transactions. When confronted, Maria denied any wrongdoing and immediately resigned. Following her resignation, Pedro uncovered a scheme in which the second defendant would place orders with the plaintiff which would then place the same orders with the first defendant. The plaintiff described this as a clear case of fraud with no goods having being delivered and leading to a loss of US$11.7 million.

The Court found there were strong grounds to believe the scheme was fraudulent. It was well established that a risk of dissipation of assets may be inferred where the defendant demonstrates an *"unacceptably low standard of commercial morality"*. The Court may more readily infer a *real risk of dissipation* if a good arguable case is established on a claim for fraud and dishonesty. The Court ordered the Mareva injunction be continued against the first defendant and granted costs to the plaintiff.

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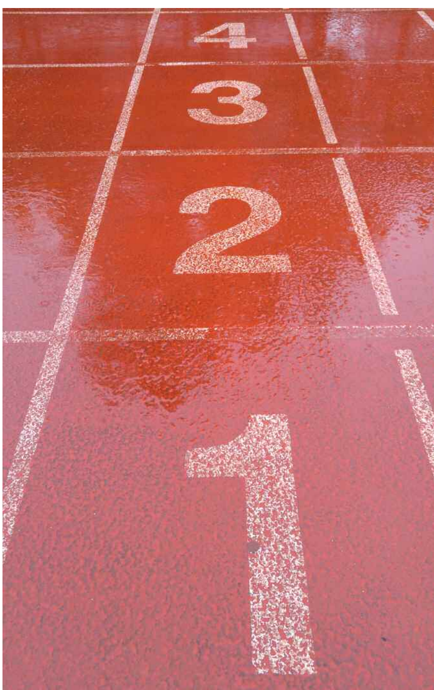
We can work it out

Defendants spared jail in dispute with liquidator

In March 2016, the Court of First Instance in *Bruno Arboit v Koo Siu Ying* HCMP [2016] HKEC 556 found two defendants guilty of contempt of court in breaching court orders requiring the disclosure of documents required by a liquidator. In May, the Court passed sentence for the contempt, sparing the defendants a term of imprisonment but ordering that each of them be fined HK$200,000.

The Court said the starting-point was to acknowledge that contempt of civil court orders is a serious matter and that they are meant to be obeyed. Here, there had been a *"wholesale failure"* to produce books and records of the company and the defendants had been *"steadfastly uncooperative"* with the liquidator. Despite this, the actual effect of the breach on the liquidator's work had not been substantial.

The defendants had also made concerted efforts to locate the documents



concerned since the March decision, thereby *"purging….the contempt at an exceptional speed"*. In circumstances in which both defendants had apologised to the Court unreservedly, there was no point in sending *"two truly remorseful persons to prison"*.

The decision reinforces the view that the threat of committal proceedings can be an extremely useful weapon in the hands of a liquidator when faced with uncooperative respondents.

You win some, you lose some…

Courts reach different conclusions in misselling cases

The Court of Appeal in *DBS Bank (Hong Kong) Ltd v Sit Pan Jit* 2016 HKEC 1307 unanimously upheld the decision by the trial judge handed down in April 2015.

The appellant, Mr Sit, had entered into a number of contracts with DBS and had suffered significant losses on those products during the 2008 financial crisis. He alleged that DBS had breached its fiduciary, tortious and contractual duties to him. DBS denied the allegations and relied on its standard non-reliance clauses in the underlying contracts, the effect of which was that DBS had no duty to give investment advice to the customer and, even if it did give any investment advice, it was on an "execution only" basis on which the customer was not entitled to rely.

In rejecting every ground of appeal raised by the appellant, the Court found that the approach adopted by the judge at first instance was "impeccable" and there was nothing to indicate the trial judge's decision should be overturned.

A few weeks later, however, the Court of First Instance found in favour of two elderly customers who claimed they had been sold complex products they did not understand and that were completely unsuitable for them.

Although the language of the contracts in *Chang Pui Yin v Bank of Singapore Ltd* [2016] HKEC 1721 was not clear cut, the Court found the bank had a contractual duty to advise and that the relationship was not execution only. The Court distinguished this case from previous cases such as *DBS Bank (Hong Kong) v San-Hot HK Industrial Co Ltd* [2013] HKEC 352 and *Kwok Wai Hing Selina v HSBC Private Bank (Suisse) SA* [2012] HKEC 903, which had resulted in wins for the banks.

With the SFC requiring a new clause to be inserted into client agreements ensuring that any financial product solicited for sale or recommended to a client is reasonably suitable for the client, regardless of what is stated elsewhere, it will be important for banks to observe and carefully document their suitability obligations as a defence against future mis-selling claims.

From Hong Kong to Japan

Applicants challenge SFC's right to give documents to foreign regulators

The applicants in *AA & EA v Securities and Futures Commission* [2016] HKCU 1057 won leave from Zervos J sitting in the Court of First Instance to bring judicial review proceedings against the SFC in relation to information the SFC had obtained during the course of an investigation and then disclosed to Japanese regulators.

The applicants claimed they had provided information and materials to the SFC under compulsion purportedly pursuant to its statutory powers. They said the SFC had then transmitted the information and materials to the Japanese regulators which had led to *"wanton leaking and breaches of secrecy"*.

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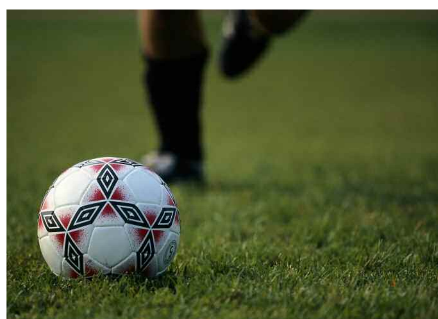
At the heart of the issue is section 181 Securities and Futures Ordinance which the applicants claim is unconstitutional. The section gives the SFC the power to require and compel disclosure of information about specified transactions, including client details and the instructions provided. The Court found it was reasonably arguable that the SFC had (i) acted unlawfully in supplying the contents of an interview without proper protection, and (ii) failed to properly ensure that secrecy would be observed by Japanese regulators. The Court also found it reasonably arguable that section 181 had a disproportionate impact upon the privilege against self-incrimination.

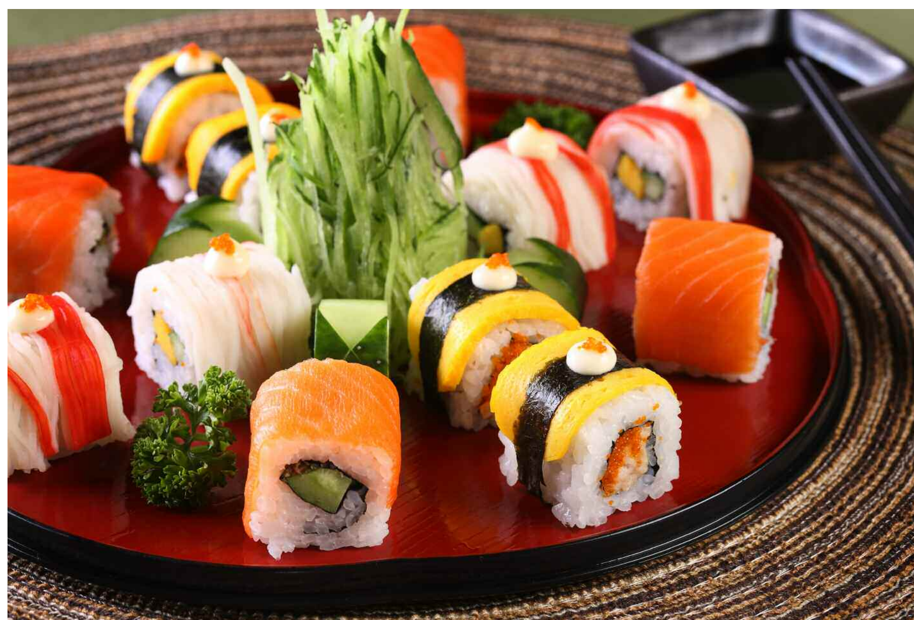
It will be interesting to see if the court finds the SFC is at fault in the way it responds to requests for assistance under the regime and whether it needs to build in greater safeguards in its processes.

They think it's all over…

Hong Kong follows traditional "penalties" test

In the first major Hong Kong decision dealing with the law on penalties since last November's landmark Supreme Court case of *Cavendish Square Holding BV v Talal El Makdessi and Parking Eye Limited v Beavis* [2015] UKSC 67, the Court of Appeal held in *Brio Electronic Commerce Limited v Tradeline Electronic Commerce Limited* [2016] 2 HKLRD 1449 that a contractual clause specifying a sum of HK$5 million as liquidated damages was not a penalty and was therefore enforceable.





The Court reaffirmed the traditional test for determining whether a clause is a liquidated damages clause, ie. whether a clause that took effect on breach is a "genuine pre-estimate of loss" or whether it was aimed at deterring a breach and is therefore an unenforceable penalty. The traditional test derived from *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 847 is more restrictive than that espoused in Cavendish, which held that the question was whether a contractual protection for an innocent party's legitimate business interests was *"extravagant, exorbitant or unconscionable"*.

Interestingly, Cavendish was not referred to in the judgment and it remains to be seen whether, when it comes to be formally considered, Hong Kong will follow the broader test now adopted in England & Wales. Despite the apparent divergence, it appears that Hong Kong courts are now more open to looking at the wider context in interpreting commercial contracts. Those entering into contracts should satisfy themselves that, where a genuine pre-estimate of loss is not possible, that the amount stipulated can be commercially justified.

Sushi solution

Court of Final Appeal rules on directors' duties

The CFA looked at the scope of a director's duty of loyalty to act in the best interests of the company and the rule providing that a fiduciary may not allow his own interests to conflict with those of the company.

The dispute, which ran for more than ten years, concerned a business venture between brother and sister Jason and Daisy Poon and Ricky Cheng who together set up the first *Itamae* restaurant through Smart Wave Limited, of which the three were directors. Ricky Chen later then struck out on his own by expanding the Itamae chain and Itacho group of restaurants as sole shareholder.

The CFA held in *Poon Ka Man Jason v Cheng Wai Tao* [2016] HKEC 759 that Ricky was in breach of his fiduciary duties towards Smart Wave because the first restaurant *"was the first of what was to become a chain of restaurants"* and that the setting up of additional restaurants by Ricky in competition with Smart Wave had diverted business opportunities and profits away from the company.

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"Thought crimes" and "favourable dispositions"

Bribery and money laundering under the spotlight

In two recent highly publicised criminal cases, the CFA continued the trend of lessening the burden on prosecutors in cases involving financial crimes such as money laundering and bribery. In the appeal from the money laundering conviction of Carson Yeung, the former Birmingham City Football Club chairman, the CFA confirmed that a person can be sent to jail for handling money they "thought" or had reasonable grounds to believe derived from a crime, whether it did or not.

The following day, the CFA gave leave to appeal to Rafael Hui, the former Chief Secretary of Hong Kong, and Thomas Kwok, the former chairman of Sun Hung Kai Properties (SHKP), against their 2014 convictions for misconduct in public office. At issue is whether prosecutors only have to show that Hui was "favourably disposed" towards SHKP, without having to point to any specific criminal act.

Taken together, these decisions point toward the criminalisation of motive and thought, without actual criminal conduct, making it much easier to obtain convictions for alleged financial crimes.

Disclose? Or not disclose? That is the question

Should expert reveal details of disciplinary proceedings against him?

The Court of Appeal in *Harvest Treasure Ltd v Cheung Fat Enterprises Ltd* [2016] HKEC 1550 considered the question of whether an expert has a duty to give voluntary disclosure regarding professional disciplinary proceedings against him.

The Applicants in a land dispute had written to inform the Tribunal that their expert, who had given evidence the previous month, had been found guilty by the Hong Kong Institute of Surveyors of a charge of giving opinions in his professional capacity that were not, to the best of his ability, objective, reliable and honest. His membership was suspended for a year. The Tribunal had held that his evidence was admissible notwithstanding the outcome of the disciplinary proceedings. The Respondents challenged the finding.

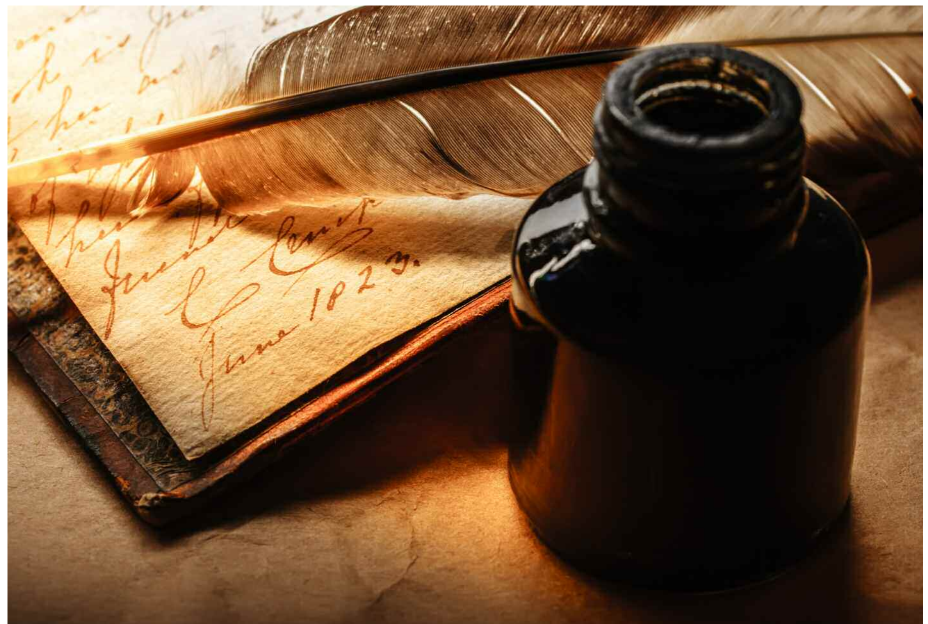
The Court of Appeal ruled that even assuming there had been a breach of duty, this went to the issue of the *weight* to be accorded to the evidence rather than to any issue of *admissibility*. The admission of evidence regarding disciplinary proceedings would "*invariably lead the court down the slippery slope of examining the merits of the disciplinary charge*".

If a pending disciplinary charge *"could be relevant and should be disclosed, why not the fact that the evidence of an expert had been rejected or commented on adversely by courts on previous occasions?"*. The Court ruled an expert has a duty to disclose voluntarily the outcome of disciplinary proceedings if it results in a sentence which curtails his ability to practise as a member of that professional body. Other than that, the Court found there is no duty on the expert witness to give any voluntary disclosure of disciplinary matters.

If you're not with us, you're against us

Conflicts of interest in expert evidence

The plaintiff in *Capital Wealth Finance Co Ltd v Lai Yueh Hsing* [2016] HKEC 1534 applied for leave to change its expert and to hold that the defence expert report should be inadmissible in evidence because of a conflict of interest. The defence expert, a Mr SC Leung, had initially been appointed as expert for the plaintiff before switching sides. The plaintiff also applied for enforcement of an order that the defence produce documents used by Mr Leung to compile his report.



The defence argued that the plaintiff had not previously complained about Mr Leung's expertise and that to allow the plaintiff to change expert would be tantamount to expert shopping. Registrar KW Lung said that to order Mr Leung to be expert for the plaintiff would amount to the Court ordering a single joint expert for the parties despite the plaintiff's objections and despite the fact the expert's report would be adverse to the plaintiff's interests.

The Court granted leave to the plaintiff to appoint a new expert, at the same time ordering production of the documents requested. The question of whether Mr Leung's report should be admitted in evidence was left to the trial judge.

The means, not the merits

Tronic International Pte Ltd (Singapore) v Topco Scientific Co Ltd (Taiwan) [2016] HKCU 1948

The Court of Appeal dismissed an appeal by the plaintiff against an October 2013 order refusing to set aside a final award in favour of the defendants in an ICC arbitration. The plaintiff claimed that the tribunal's refusal to allow him to inspect documents and equipment meant he was unable properly to present his case; and also that the tribunal had exceeded its powers by itself raising an issue that would affect the assessment of damages.

The Court reaffirmed that when considering an application to set aside an award, the court was not concerned with the correctness of the decisions reached by the tribunal but rather by the fairness of the process. As long as the parties were able to make representations in respect of any issue that might affect the decision, they would have been given a fair hearing.

The Court of Appeal agreed with the trial judge that the tribunal was permitted under the ICC Rules to raise issues that had not been raised by the parties. The Court ordered the plaintiff to pay the defendants' costs on an indemnity basis.

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