Final Victory for Liquidators

In the landmark case of *Tradepower (Holdings) Limited (In Liquidation) v Tradepower (Hong Kong) Limited and others* FACV 5/2009 (judgment handed down on 30 November 2009), the Court of Final Appeal ("**CFA**") propounded an authoritative interpretation of section 60 of the Conveyancing and Property Ordinance (Cap 219), which would prove to be an important tool for liquidators to recover assets for wound-up companies and protect the interests of creditors.

Intent to defraud creditors: A subjective or objective intent?

Section 60 of the Conveyancing and Property Ordinance (Cap 219) ("**CPO**") and its predecessor, which provides for setting aside transactions with intent to defraud creditors, has been in our statute books for more than a century. The CFA decision in the *Tradepower* case is the first authoritative case in Hong Kong that contains a substantive discussion on its proper interpretation and application.

As put by Litton NPJ, at the heart of the *Tradepower* case are the words "with intent to defraud creditors" as they appear in section 60 of the CPO.

In the Court of First Instance (HCA 1796/2005), the Trial Judge, Recorder Jat Sew Tong SC, relied on *Lloyds Bank Ltd v Marcan* [1973] 1 WLR 1387, *Skink Ltd v Comtowell Ltd* [1994] 2 HKC 286, and *Cannane v J Cannane Pty Ltd* (1998) 192 CLR 557, and held that proof of an ***actual subjective intent*** to defraud creditors on the disponor's part was necessary for establishing the requisite statutory intent in section 60 CPO. The Recorder in turn concluded that an intent to defraud had not been established against the Defendants as they were primarily motivated by some other 'legitimate concerns' and did not carry out the transaction with the intent to defraud creditors.

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In the Court of Appeal ("**CA**") (before Rogers VP, Le Pichon JA and Chung J), the CA distinguished the cases relied on by the Recorder and held that on the facts of this case, the Recorder ought to have applied the approach adopted in *Freeman v Pope* (1870) 5 Ch App 538 which mandates or facilitates the drawing of inferences of an intent to defraud in cases involving voluntary dispositions made by insolvent persons. As such, ***a subjective intention could be inferred from objective facts*** without speculating as to what was passing in the Defendants' minds, and the professed beliefs of the Defendants were therefore rendered irrelevant. On the facts of the case, the CA found that the inference of "intent to defraud" was simply irresistible.

The rule in *Freeman v Pope*

Section 60 CPO is based on section 172 of the English Law of Property Act 1925 and both statutes are derived from an Elizabethan statute, the statute 13 Eliz I, c 5 enacted in 1571. At the hearing before the CFA, a comprehensive survey was conducted of authorities dating back to the 19th century and across various common law jurisdictions that have derived similar statutes.

In the CFA (before Bokhary PJ, Chan PJ, Ribeiro PJ, Litton NPJ and Lord Walker NPJ), it was held that the rule in *Freeman v Pope* is applicable to the facts of the case which Ribeiro PJ succinctly formulated at paragraph 88 of the judgment:

> *"Where it is objectively shown that a disposition of property unsupported by consideration is made by a disponor when insolvent (or who thereby renders himself insolvent) with the result that his creditors (including his future creditors) are clearly subjected at least to a significant risk of being unable to recover their debts in full, such facts ought in virtually every case to be sufficient to justify the inference of an intent to defraud creditors on the disponor's part."*

It can be seen from Ribeiro PJ's formulation that there are three conditions for the rule in *Freeman v Pope* to apply :-

1. The disposition is for no consideration;

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2. If the disposition is effectual, the disponor's creditors will be exposed to a risk of being unable to recover their debts in full; and

3. The disponor was insolvent at the time when the disposition was made.

Ribeiro PJ went on to state that whether the disposition was made for consideration and whether the disponor was insolvent at the material time are questions of fact to be objectively determined. Where the insolvency of the disponor becomes clear a relatively short time after he disposed of his property, the onus falls upon him to show that he was not insolvent when or upon making the disposition. Ribeiro PJ remarked that by the time of *Freeman v Pope*, the rule was considered well-settled and cases from the late-19th century show that it had become the practice for solicitors to advise clients intending to make voluntary settlements that such settlements were valueless unless the clients were solvent.

In cases where the rule in *Freeman v Pope* applies, it is even more apparent that the disposition is less than honest in the context of a debtor-creditor relationship. The CFA was of the view that the relationship would not only be regarded as material and thus "making it easier to draw the inference", but it would be hard to see why any other ingredients should be needed to justify drawing the inference. The CFA agreed with Tipping J in the New Zealand Supreme Court's decision in *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433 that the practical basis for the rule in *Freeman v Pope* is the difficulty of contemplating circumstances in which an inference of intent to defraud should not be drawn when an insolvent debtor gives away property.

Cases outside the rule in *Freeman v Pope*

In his formulation of the rule in *Freeman v Pope*, Ribeiro PJ pointed out that in cases where the disposition is made for valuable consideration, or where the disponor is not insolvent or where the disposition does not deplete the fund potentially available to the creditors, that is, cases falling outside the rule, an actual intent to defraud creditors must be shown as an inference properly to be drawn on the available evidence before section 60 CPO is engaged.

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Conclusion

With the clarification of the law by the CFA, it can now be confidently said that in cases where transactions were undertaken shortly before the winding up of a company (or bankruptcy of an individual) with the effect of substantially diminishing the assets available for distribution to creditors, it would not be necessary for the liquidators to prove that the directors/bankrupt carried out the transactions with a subjective intent to defraud creditors and for no other valid reasons. The directors/bankrupt may seek to put up justifications for such transactions but the circumstances in which such justifications are accepted would be extremely rare.

This decision is to be welcome as it gives the liquidators a much needed weapon in their work against delinquent directors/bankrupts.

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IMPORTANT:
The law and procedure on this subject are very specialized and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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