DLA Piper Hong Kong
Financial Services Dispute Quarterly Law Report – February 2024

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Foreword

Welcome to the second edition of the DLA Piper Hong Kong Financial Services Dispute Quarterly Law Report.

In this issue, we will start by examining the long-awaited and recently implemented "Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and Hong Kong", which has significant implications to the commercial and legal landscape and those stakeholders with financial interests or operations located across the Mainland-Hong Kong border.

We will also discuss the landmark ruling in *Re China Evergrande Group* [2024] HKCFI 363, whereby the once largest property developer in the world was wound up by the Hong Kong Court, and provide an overview of other recent court judgments that expand upon or clarify important legal principles that are relevant to the financial services ("**FS**") industry.

As with the previous edition, this publication serves to highlight key developments in the case law as well as legislative changes, and will be a useful reference for stakeholders in the FS industry with presence or financial interests in the region.

Finally, in the last issue, we talked about the Hong Kong Court of Appeal's decision *in China Life Trustee Limited v China Energy Reserve and Chemicals Group Overseas Limited* (2023) HKCA 966 and reported that the leave to appeal to the Court of Final Appeal ("**CFA**") was granted on 27 October 2023. The final appeal before the CFA has now been fixed on 3 May 2024 and we will report on the decision of the CFA further.

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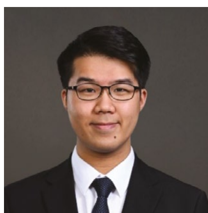

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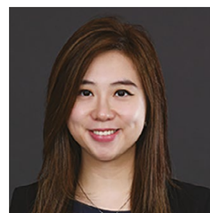

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Major milestone reached as long-awaited arrangement on cross-border enforcement of judgments came into effect

The cross-border enforcement of judgments between Hong Kong and Mainland China received a major boost earlier this year as the new *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and the Hong Kong Special Administrative Region* (the "**Arrangement**") came into operation on 29 January 2024. The Arrangement is implemented through the *Mainland Judgments in Civil and Commercial Matters (Reciprocal Enforcement) Ordinance* (Cap. 645) (the "**Ordinance**") in Hong Kong, and by way of judicial interpretation promulgated by the Supreme People's Court in Mainland China.

The Arrangement establishes a comprehensive framework and a simplified registration procedure that streamlines the reciprocal enforcement process for a broader scope of judgments from each jurisdiction. Where previously only monetary judgments issued pursuant to an exclusive jurisdiction clause from Hong Kong could be enforced in Mainland China and vice versa, the Arrangement now removes these limitations and allows for easier recognition and enforcement of a wider range of civil and commercial rulings across Mainland China and Hong Kong. The availability of the registration procedure means that there is no need to rely on the enforcement by way of common law and commence a new action in Hong Kong based on the Mainland judgment to enforce the same.

The Ordinance will apply to judgments given on or after its commencement date (i.e. 29 January 2024), and the default in complying with the relevant judgment must have occurred within two years before the date of the application to register the judgment.

The Arrangement strengthens Hong Kong's position as a leading cross-border financial dispute resolution hub, especially for disputes involving parties with financial interests or operations located across the border in Mainland China.

Replacement of the Exclusive Jurisdiction Requirement with the "Connection" Test

One of the most significant changes under the Arrangement is the removal of the "exclusive jurisdiction" requirement, which was required under the *Mainland Judgments (Reciprocal Enforcement) Ordinance* (Cap. 597) since its enactment in 2008 – a judgment creditor was previously required to show that the parties have, in their underlying contract, agreed to submit to the exclusive jurisdiction of the courts in Mainland China or Hong Kong.

Under the Arrangement, a judgment creditor will be able to satisfy the jurisdiction requirement by showing to the Hong Kong court how the original proceedings had sufficient "connection" with Mainland China at the time when the proceedings were brought or accepted.

The "connection" test presents a much lower hurdle and may be satisfied when:-

- the defendant's place of residence, or its representative office, branch, office, place of business or other establishment, was in the Mainland;
- the place of performance of the disputed contract was in the Mainland;
- the place of commission of the alleged tort was in the Mainland; or
- there is a written exclusive or non-exclusive jurisdiction agreement in favour of the Mainland courts accompanied by, if the place of residence of all the parties is in Hong Kong, a connection between the dispute and the Mainland.

Expansion in Scope and Categories of Enforceable Judgments

The previous framework under the *Mainland Judgments (Reciprocal Enforcement) Ordinance* (Cap. 597) was limited in several key respects. In particular, it only applied to judgments for monetary relief in commercial matters issued by higher level courts. The Ordinance now removes these limitations. It expands the coverage to judgments arising from most civil and commercial matters concerning both monetary and non-monetary reliefs, and also to judgments made by a number of lower courts and tribunals in Hong Kong and the Mainland.

The overriding principle under the Arrangement is that any judgment legally enforceable under the laws of the jurisdiction where it was issued will qualify for recognition and enforcement. In other words, so long as the rendering court had proper jurisdiction according to its own law, the resulting judgment may be enforced across the borders.

The Ordinance excludes only limited types of judgments in civil and commercial matters, such as insolvency and bankruptcy cases, certain arbitration-related matters, certain matrimonial, family and succession cases, certain intellectual property and maritime matters. However, it is noteworthy that most of these matters are covered under other existing mutual assistance arrangements between Hong Kong and Mainland China.

Registration Procedures in Hong Kong

The Ordinance enables judgments obtained from Mainland courts to be enforced in Hong Kong, as if they were Hong Kong court judgments, by way of a simple registration procedure.

The registration application must be made *ex parte* to the Court of First Instance in Hong Kong by way of Originating Summons in the prescribed form, and must be supported by an affidavit. The judgment creditor must also draw up the registration order, which must specify that an action to enforce the judgment may only be taken after the expiry period within which a setting aside application may be made or after such application has been finally disposed of.

There are extremely limited mandatory and discretionary grounds on which the judgment debtor may contest and set aside the registration. These are generally confined to jurisdiction, procedural fairness and public policy.

Takeaways

The long-awaited broadening of the Mainland-Hong Kong regime for reciprocal enforcement of court judgments is tremendously welcomed, especially in view of the deepening economic and business bonding between Mainland China and Hong Kong. The Ordinance adds to Hong Kong's supportive legal framework which already includes, among other regimes, arrangements for enforcement of arbitral awards and interim measures in support of Mainland arbitral proceedings.

Notably for banks, issuers, asset managers and other institutions in the FS sector, they will directly benefit from the ability to swiftly recognise and leverage Mainland judgments locally in Hong Kong. The Arrangement, which offers a more cost-efficient, streamlined and straightforward mechanism for cross-border enforcement of Mainland judgments, saves the parties from the present inconvenience arising from the need to start an action afresh under common law and adduce foreign law expert evidence in Hong Kong, or re-litigate the same disputes in both Mainland China and Hong Kong. Having obtained a Mainland judgment, the judgment creditor can now directly register it in Hong Kong pursuant to the simplified registration procedure laid down in the Ordinance and, once registered, the judgment creditor can proceed directly with enforcement processes to safeguard its interest, such as applications for garnishee and charging orders. With the certainty and predictability offered by the Ordinance, this will help FS sector participants reduce litigation risks and save time and costs typically associated with cross-border enforcement.

The certainty of the direct enforcement pathways also supports continued development of robust commercial ties across Greater China's financial hubs. The Arrangement strengthens the foundation for the long-term development and integration of robust cross-border capital markets, and the commercial and investment activities and linkage between Hong Kong and Mainland China.

The broadened enforceability of Mainland judgments in Hong Kong (and vice versa) will be an important factor in drafting the dispute resolution provisions in commercial contracts. In particular, the removal of the exclusive jurisdiction requirement provides greater flexibility to parties when negotiating dispute resolution mechanisms and determining the forum to bring their claims. Notably, parties will be able to benefit from having the choice of resolving disputes in Hong Kong, a well-developed common law jurisdiction, while preserving the avenue to enforce in the Mainland.

Overall, the Arrangement unquestionably has significant implications for the commercial and legal landscape between Mainland China and Hong Kong. Our team will continue to monitor the implementation of the Arrangement and provide necessary updates.

The end of the road for China Evergrande Group – Hong Kong Court winds up the world's most indebted property developer

Re China Evergrande Group (2024) HKCFI 363

On 29 January 2024, the High Court of Hong Kong wound up the world's most indebted property developer – China Evergrande Group ("**Evergrande**"). The fact that Evergrande has been in serious financial trouble is no news. The decision of the Court came after winding-up proceedings were commenced against Evergrande more than 1.5 years ago. It offers insight into Evergrande's ultimately unsuccessful efforts to fend off the winding-up proceedings and the reasoning behind the Court's decision to put the company into liquidation notwithstanding its purported restructuring efforts, opposition from some of its creditors and the Petitioner's reluctance to push for an immediate winding-up order.

Factual Background

Evergrande was incorporated in the Cayman Islands with its shares listed on the Main Board of the Hong Kong Stock Exchange. It serves as the ultimate investment holding company of a group of companies known as Evergrande Real Estate Group (the "**Group**"), which was founded by Mr Hui Ka Yan with its headquarters in Guangzhou, as well as the main offshore financing platform for the Group to raise capital. Evergrande has direct and indirect subsidiaries incorporated in Hong Kong, the Cayman Islands, the British Virgin Islands and Bermuda.

In 2022, after Evergrande failed to pay an undisputed debt owed to the Petitioner and failed to comply with a statutory demand served upon it, the Petitioner commenced winding-up proceedings against the company on 24 June 2022. As of 30 June 2023, Evergrande had total assets of RMB1,743,997 million while its total liabilities were RMB2,388,200 million. It was evident that the company was grossly insolvent and unable to pay its debts.

Besides the Petitioner and Evergrande, the main parties participating in the winding-up proceedings also included (i) an ad *hoc* group of noteholders holding USD3 billion in aggregate principal amount of offshore notes ("**AHG**"); and (ii) a group of creditors holding guarantees executed by Evergrande in the aggregate principal amount of USD511.92 million which opposed the winding-up petition (the "**Opposing Creditors**").

There was a total of six court hearings of the winding-up petition. At the first three hearings held on 5 September 2022, 28 November 2022 and 20 March 2023, notwithstanding the Petitioner's request for the Court to make an immediate winding-up order, Evergrande was able to convince the Court to adjourn the petition on the ground that it would put forward a comprehensive restructuring in respect of its offshore debts which could restore the solvency of the company if implemented. At that stage, Evergrande filed affirmations ahead of each hearing to update the creditors and the Court on the progress of the proposed restructuring. The Court acceded to Evergrande's applications for adjournment in view of (i) the magnitude and complexity of the proposed restructuring; (ii) the progress made by Evergrande; and (iii) the views of creditors such as AHG and the Opposing Creditors who were supportive of Evergrande's applications for adjournment. At one point, Evergrande commenced proceedings to seek the Court's sanction for its restructuring schemes and the Court gave directions for the conduct of the convening hearings, creditors meetings and sanction hearings for the schemes.

However, the schemes ultimately did not come into fruition. Evergrande adjourned the scheme meetings and eventually cancelled them, announcing that there was a need to re-assess the terms of the schemes as the sales of the Group had been weaker than expected and that the company faced PRC regulatory issues which inhibited the Group from issuing the new debt instruments contemplated under the schemes. When it became clear that Evergrande could not proceed with the schemes, the scheme proceedings were dismissed by the Court.

At the 4th hearing of the petition on 30 October 2023, the majority of the creditors appearing supported to give Evergrande a further opportunity to come up with a revised restructuring proposal. The Court therefore adjourned the petition but indicated to Evergrande in clear terms that the Court would make a winding-up order at the next hearing unless it is able to come up with a fully formulated restructuring proposal beforehand.

Evergrande was unable to come up with a satisfactory restructuring proposal ahead of the 5th hearing of the petition on 4 December 2023. While the Petitioner heavily criticized the revised proposal in its skeleton submissions, the Petitioner suddenly changed its stance and informed the Court that it would not seek an immediate winding-up order against Evergrande and would not oppose a further adjournment of the petition. The Court was taken by surprise, but reluctantly adjourned the petition for a further 8 weeks. The Court expressed that it expected Evergrande to provide at the next hearing (i) a refinement of the revised restructuring proposal; (ii) support from the requisite majorities of creditors on the revised proposal; (iii) an independent legal opinion on the PRC regulatory issues; and (iv) full transparency and updates on the restructuring efforts and steps taken by it.

At the 6th hearing of the petition on 29 January 2024, things came to a head when Evergrande failed to provide the Court with any further revised restructuring proposal other than some general ideas about what it may or may not be able to put forward in the form of a restructuring plan. Worse still, when the Petitioner maintained its stance of not pushing for an immediate winding-up order, another participating creditor made an application to substitute the Petitioner. Evergrande and the Opposing Creditors oppose the substitution application and asked that the application be adjourned for substantive argument.

The Decision

The Court made an immediate winding-up order against Evergrande at the 6th hearing on 29 January 2024.

In view of the opposing stance taken by Evergrande and the Opposing Creditors towards the substitution application, the Court was of the view that allowing the substitution application or adjourning it for substantive arguments would both only result in further unnecessary delay in the determination of the petition. The Court opted for the more expedient course to determine whether there is proper basis to exercise its discretion to grant a further adjournment of the petition, given that the petition remains extant and has not been withdrawn by the Petitioner.

The Court refused to grant a further adjournment on the ground that Evergrande has failed to demonstrate any useful purpose for a further adjournment, given that there is no viable restructuring proposal backed by the support of the requisite majorities of creditors. The Court also opined that the interests of creditors would be better protected if Evergrande is wound up so that independent liquidators can take control over it, secure and reserve its assets as well as review and formulate a restructuring proposal if they consider it appropriate.

Takeaways

The Court's decision is significant not only because it has marked the liquidation of one of the largest conglomerates listed in Hong Kong, but also because it provides important insight into the Court's approach when dealing with attempts to fend off winding-up proceedings with large-scale and complicated restructuring proposals. The key takeaways are as follows.

In general, notwithstanding that a company is insolvent, the Court can adjourn a winding-up petition if a viable restructuring plan exists, but it would only do so if it is satisfied that (i) there is funding for the proposed restructuring; (ii) there is a restructuring plan; and (iii) the plan has a timetable. When seeking an adjournment, the company must be able to demonstrate to the Court that there are some useful purposes or utilities in granting an adjournment.

As evident from this decision, it does not mean that companies would be able to fend off winding-up petitions by putting forward any sort of restructuring proposal. Companies should expect that the Court would carefully examine the viability of the proposal and whether the company is making real progress in its proposed restructuring. The Court would not indulge companies with an indefinite number of adjournments, and it is crucial to present a viable proposal carrying the support from the requisite majorities of creditors before the Court's patience is exhausted.

As illustrated in the history of this case, Evergrande was able to secure successive adjournments of the petition at the initial stage of the proceedings as it was able to update the Court and the creditors with concrete details concerning its progress in the proposed restructuring, including entering into restructuring support agreements with creditors, entering into term sheets in relation to the restructuring schemes, publishing practice statement letters to provide material information in relation to the restructuring schemes, preparing draft scheme documents and finalising the audited accounts to be included in the draft scheme documents, commencing proceedings to seek the Court's sanction for the restructuring schemes and the fixing of dates for the convening hearings and sanction hearings.

Conversely, after the initial concrete restructuring plan put forward by Evergrande has fallen through, the Court found the so-called revised restructuring proposal of Evergrande to be a lackluster and was therefore not minded granting any further time and indulgence to Evergrande. The failure of the revised proposal to address issues such as (i) the return to the creditors; (ii) whether there is a proper basis to treat creditors of different classes in the same class in light of the difference in their rights; and (iii) whether the revised proposal could address the relevant PRC regulatory hurdles (supported by legal opinion) all came under heavy scrutiny by the Court.

The Court also took the decision as an opportunity to remind parties of the Court's discretion to order a company to be wound up if circumstances warrant, even if all parties to the petition agree to have the petition dismissed or adjourned. In this decision, the Court was not minded wasting further judicial resources and time for parties to argue over the application to substitute the Petitioner (which would stall the determination of the petition and indirectly allow Evergrande and the Opposing Creditors to put off the evil day), but resolved to immediately wind up Evergrande.

In light of the above, creditors who petition for the winding up of debtor companies should note that they could risk losing control over the conduct of the winding up proceedings should they subsequently change their minds about putting the debtor companies into liquidation. This outcome may come in the form of the original petitioner being substituted by another creditor interested in seeking a winding up order, or the Court making a winding-up order against the wishes of the petitioner. In this decision, Evergrande was wound up, notwithstanding the Petitioner's change of stance for not pushing for a winding up order being made and not opposing Evergrande's requests for further adjournments of the petition, which might be attributable to Evergrande's attempts to pacify the Petitioner by conducting "off the record discussions" with it regarding a new restructuring proposal (for which other creditors like AHG were frozen out of and not made privy to). Time and time again, the Court has reminded parties that winding up proceedings should not be used a means to exert pressure on debtor companies and a debt-collection tool. Any creditors who present a winding up petition should be prepared for the possibility that the Court would ultimately exercise its judicial power to wind up the debtor company.

On the other side of the coin, companies facing winding up proceedings who would like to restructure its debts and avoid the catastrophic consequence of a winding up order being made should seek professional assistance from lawyers and financial advisors in order to put together a viable and satisfactory restructuring proposal in a timely manner.

Rights of ultimate investors against defaulting issuers

China Ping an Insurance Overseas (Holdings) Limited v Luck Gain Limited and ORS (2023) HKCFI 3315

Our firm recently represented China Ping An Insurance Overseas (Holdings) Limited ("**China Ping An**") in successfully obtaining a summary judgment against Luck Gain Limited ("**Luck Gain**") and China Aoyuan Group Limited ("**China Aoyuan**") for specific performance of Luck Gain's obligation to exchange the global certificate into definitive certificates, allowing China Ping An to recover its investment in the USD200,000,000 guaranteed bonds issued by Luck Gain (the "**Bonds**").

In this case, the Court of First Instance allowed China Ping An, as the ultimate investor of the Bonds that are held through an intermediated securities platform, to enforce its rights against Luck Gain, which is conventionally not allowed due to the "no look through" principle. In normal circumstances, the "no look through" principle restricts bondholders to obtain recourse only against their immediate counterparty to ensure that there is no duplicity of actions. In other words, the ultimate investor has no rights against the issuer, but only its accountholder, for example the banks or brokers holding accounts with the clearing system.

Factual Background

On 8 December 2020, Luck Gain issued the Bonds through a Subscription Agreement (the "**Subscription Agreement**") with China Aoyuan acting as Luck Gain's guarantor. The Bonds were cleared and settled through Euroclear Bank S.A./N.V. ("**Euroclear**"), a major clearing house that settles and clears securities trades executed on European exchanges. The Bonds were represented by a global certificate (the "**Global Certificate**"), which was held by CCB Nominees Limited as a custodian on behalf of Euroclear. The Bonds were also subject to a Fiscal Agency Agreement entered into between Luck Gain, China Aoyuan and China Constructions Bank (Asia) Corporation Limited, being the registrar (the "**Registrar**").

China Ping An invested a total amount of USD190,000,000 in the Bonds (USD50,000,000 under the Subscription Agreement and USD140,000,000 through the market). Since China Ping An is not an account holder of Euroclear, it holds its beneficial interests in its portion of Bonds through Bank of China (Hong Kong) Limited, which is an account holder in Euroclear.

Pursuant to Clause 4.2 of the Subscription Agreement, Luck Gain and China Aoyuan are required to arrange to deliver the certificates to the Registrar for authentication in accordance with the Fiscal Agency Agreement. The Fiscal Agency Agreement and the Global Certificate provide that the Global Certificate could be exchanged for duly authenticated and completed definitive certificates (the "**Definitive Certificates**") if there was an event of default and that failure to pay the principal or any interests of the Bonds upon it falling due would be an event of default.

Subsequently, neither Luck Gain nor China Aoyuan paid the principal amount of USD190,000,000 due and owing to China Ping An on the maturity date (the "**Debt**"). China Ping An attempted to enforce the Debt directly by presenting a winding up petition against Luck Gain in April 2022, but the winding up petition was dismissed on the basis that China Ping An has no standing to recover the outstanding principal and interest due under the Bonds.

China Ping An commenced the action for breach of contract and relied on Clause 4.2 of the Subscription Agreement for specific performance of Luck Gain's obligation to exchange the Global Certificate for Definitive Certificates so as to allow it to recover the principal from Luck Gain.

The Decision

China Ping An argued that the wordings of the Subscription Agreement, the Global Certificate and the Fiscal Agency Agreement are clear to confer a direct enforcement right on China Ping An to compel Luck Gain and China Aoyuan to have the Global Certificate exchanged into Definitive Certificates to be registered in the name of China Ping An.

Luck Gain and China Aoyuan submitted that by construing the Subscription Agreement against the background, including the Deed of Covenant, the Fiscal Agency Agreement and the Global Certificate, it is not the intention of the parties that Luck Gain and China Aoyuan could be compelled to issue the Definitive Certificates in favour of China Ping An. Further, it was argued that allowing an ultimate investor to have direct recourse against a bond issuer is not in line with commercial reality, as the default position in the intermediated securities system should be that ultimate investors should not have any direct right of enforcement unless expressly provided for in the bond documents.

Deputy High Court Judge Jonathan Chang SC held that the words used in Clause 4.2 of the Subscription Agreement are clear to impose an obligation on Luck Gain and China Aoyuan to ensure that the Global Certificate is exchangeable when there is an event of default. In terms of commercial reality, the Court found no commercial reason why China Ping An, being a sophisticated investor and direct subscriber of the Bonds, would want to exclude any right of direct recourse against Luck Gain and China Aoyuan. Specific performance is therefore granted in favour of China Ping An.

Takeaways

The "no look through" principle has always created obstacles for ultimate investors of intermediated bond securities to enforce their rights when the issuer is in default. By this decision, the Hong Kong Court has confirmed that if there is a proper mechanism set out in the bond documents, there could be a way for the ultimate investors to seek to enforce their rights against the defaulting issuer directly.

In this respect, existing investors of intermediated bond securities who would like to seek direct enforcement of their rights against the issuer may review the bond documents and ascertain if a mechanism for the exchange of certificates similar to the one as set out in this case exists. If such mechanism is in place, the investors may consider taking steps to compel the issuer (and other relevant parties) to comply with its obligations under the bond documents, so as to enable them to enforce their rights against the issuer directly.

Perspective investors of intermediated bond securities should also pay attention to the terms of the bond documents before subscribing the bonds, so as to ascertain if there is any mechanism in the bond documents which may give rise to a potential right of direct enforcement against the issuer in the event of default.

Knowing receipt – claim against a subsequent legal owner failed even where it was aware that the property was transferred in breach of trust

Byers and Others V Saudi National Bank (2023) UKSC 51

In *Byers and others v Saudi National Bank* (2023) UKSC 51, the UK Supreme Court unanimously upheld the dismissal of a knowing receipt claim by Saad Investments Co Ltd and its joint liquidators ("**Saad**") against the Samba Financial Group ("**Samba**"), a Saudi Arabian financial institution, which received shares in certain Saudi Arabian companies held on trust for Saad. The UK Supreme revisited the underlying equitable principles of knowing receipt in delivering its judgment against Saad who is the "victim" in a breach of trust.

A knowing receipt claim arises under equity where a claimant may recover property transferred to the transferee who has knowledge that the receipt of the property in question is in breach of trust. A claimant for knowing receipt is required to have a continuing proprietary interest in the property in dispute.

The case is unique as the parties agreed that Samba knew or ought to have known that the share transfer was a breach of trust. However, Saudi Arabian law, which governs the share transfer, does not recognise a distinction between legal and beneficial ownership, meaning that Saad's proprietary interest in the shares extinguished or overridden after the share transfer.

Factual Background

Mr Maan Al-Sanea ("**Mr Al-Sanea**") held shares in five Saudi Arabian companies valued at over USD200 million (the "**Shares**") on trust for Saad under various trust arrangements governed by Cayman Islands law. A few days before a winding up order against Saad was made by the Cayman court on 18 September 2009, Mr Al-Sanea transferred the Shares to Samba to settle his personal debts owed to Samba (the "**2009 Transfer**"). Samba had since then become the registered owners of the Shares.

Under the applicable Saudi Arabian law, the transfer gave Samba clear title to the Shares, free from Saad's beneficial interest in them.

Saad commenced its journey to recover the Shares in 2013 when it sought to set aside the 2009 Transfer under section 127 of the UK Insolvency Act 1986 as a void disposition of property after the commencement of its winding up proceedings (the "**Setting Aside Claim**"). The Setting Aside Claim went all the way to the UK Supreme Court which held that Saad's equitable proprietary rights over the Shares had not been disposed of by the 2009 Transfer (because the extinguishing of Saad's rights over the Shares under the trust did not constitute a disposition of those rights). After the Setting Aside Claim failed, Saad issued a new claim alleging knowing receipt against Samba.

Saad's claim in the English High Court and its appeal to the Court of Appeal were dismissed because, among other reasons, Saad no longer had any interest in the Shares after Samba became the Shares' registered owner. In Saad's appeal to the UK Supreme Court, it argued that continuing equitable proprietary interest is not a requirement for a knowing receipt claim – it was unconscionable for Samba to benefit from the Shares when it knew that the Shares were transferred in breach of trust.

The Decision

The issue before the UK Supreme Court is whether a knowing receipt claim would succeed when Saad's proprietary interest in the Shares was extinguished or overridden by the 2009 Transfer. The UK Supreme Court delivered three judgments, but all five judges held unanimously that continuing proprietary equitable interests in the property in dispute is required for a knowing receipt claim. Saad's appeal was dismissed accordingly.

Having examined the relevant case law, UK Supreme Court remarked that the law on knowing receipt was not indicative on the issue and the Court had to consider the application of equitable principles. Finding against Saad, the UK Supreme Court revisited and confirmed the following key principles in respect of claims in knowing receipt: –

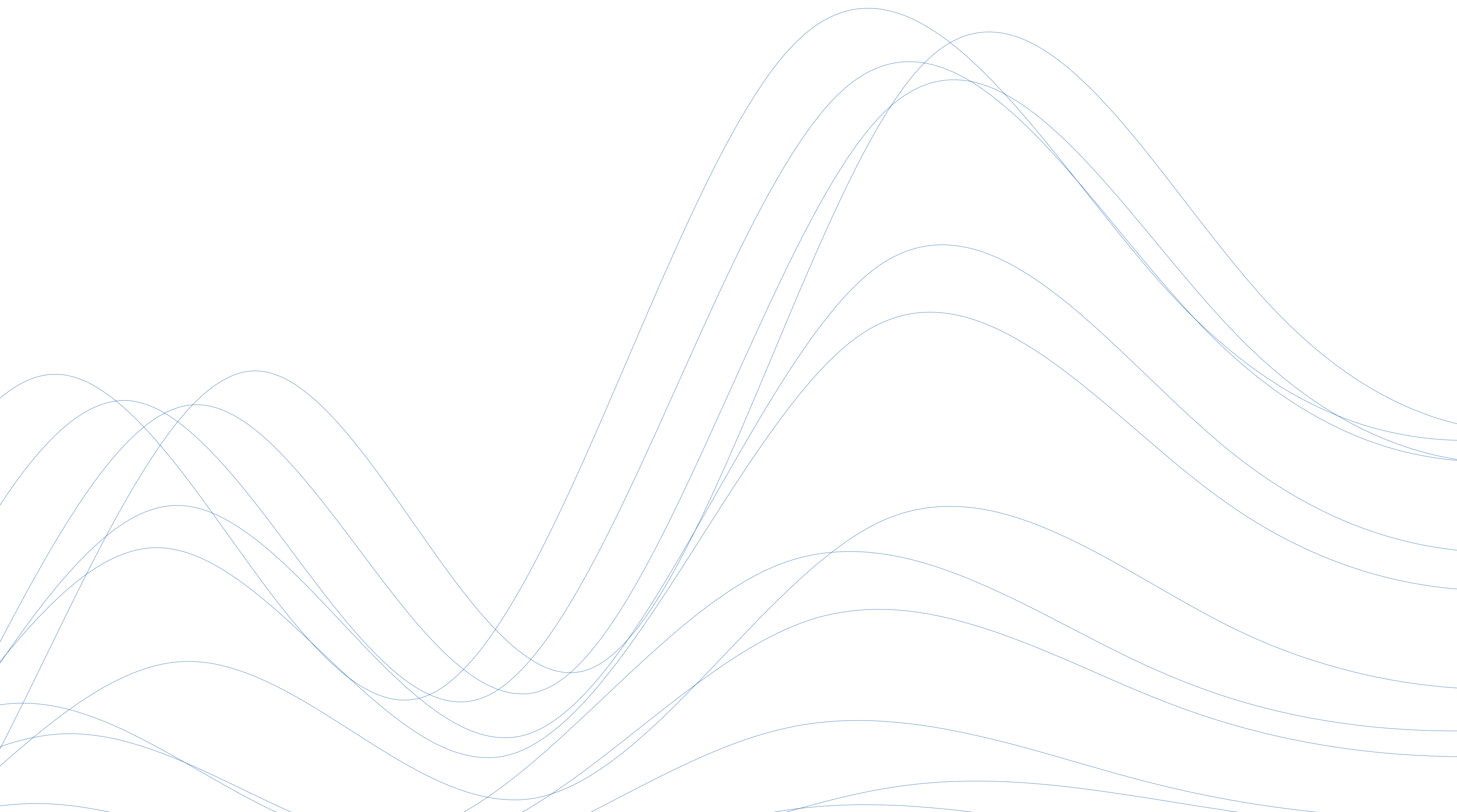
- The transfer of trust property by a trustee to a bona fide purchaser for value without notice (i.e. an "equity's darling") extinguishes or overrides the proprietary equitable interest of the trust beneficiary, even if the trustee did so in the breach of trust.
- The claimant's proprietary equitable interest in the trust property is not revived even if the bona fide purchaser for value without notice later becomes aware that the property was transferred in a breach of trust. However, if the trustee re-acquired the property, the trustee would still be holding the property on trust for the beneficiary.
- A claim in knowing receipt and a claim for dishonest assistance is not comparable. The former is closely linked to a proprietary claim for the return of the property, whereas the latter is ancillary to the liability of the trustee while the transferee would be liable as an assister.
- A claim in knowing receipt cannot succeed when the claimant's proprietary interest has been extinguished or overridden by the time of the defendant's knowing receipt of the property. This result is not altered by the defendant's knowledge that the transfer was in breach of trust.
- The extinguishing or overriding of a proprietary equitable interest by the time the recipient receives the property defeats a proprietary claim. It would be logically inconsistent to allow a knowing receipt claim to succeed but a proprietary claim to fail given the close link between the two types of claims.

Takeaways

The UK Supreme Court's judgment clarifies the requirements for a claim in knowing receipt, which is a common cause of action included in claims against financial institutions. However, a few uncertainties surrounding such claim in equity is left unsolved (as they were not issues before the UK Supreme Court in this case) and will require subsequent court guidance, including the level of knowledge of a defendant for knowing receipt.

While this decision is not strictly binding on Hong Kong courts, the decision is likely to be highly persuasive and it is expected that the same principles would be followed in Hong Kong.

After more than 10 years of litigation, Saad failed to recover the Shares from Samba, who received them knowing that they were transferred in breach of trust. While trust arrangements could bring benefits to the settlors and beneficiaries, this decision reminds companies and individuals to consider the risk of holding assets on trust, particularly concerning assets that can be transferred to a jurisdiction that does not recognise beneficial ownership.



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