

February 2025

Liquidators' victory in fraudulent trading claims



Re: Days Impex Limited (in liquidation) and Days International Limited (in liquidation) [2024] HKCFI 3386

Introduction

The liquidators took out fraudulent trading claims against a former officer of the companies following his criminal convictions of conspiracy to defraud creditors. After a 9-day trial, the Court granted declarations and judgment in favour of the liquidators.

The case is the first reported Hong Kong judgment of a trial on fraudulent trading claims pursuant to section 275 of Cap 32. The Court discussed the elements of the claim in detail and explained the scope of what is recoverable.

Background

The two companies were part of the family group business run by the respondent and his father.

The business group engaged in the import and export business, and the two companies had access to credit facilities from three banks totalling at least HKD 365 million and USD 11 million.

The respondent and his father were convicted of 9 counts of conspiracy to defraud¹ by causing the companies to apply for (and the companies to receive) loans from three banks during March to September 2011 which they knew were not to be used for their intended purpose. Charges 1 to 6 were related to import loans, while charges 7 to 9 were related to export loans. The two were sentenced to 10 years of imprisonment, and the appeals against their convictions in the Court of Appeal² and the Court of Final Appeal³ were refused.

Amongst the evidence is a report prepared by a forensic accountant of the Hong Kong Police Force, which analysed a total of 161 import loan applications (156 of which formed the subject matter of charges 1 to 6 and 5 additional ones which did not form part of any charges).

Charges 1 to 6 were worded in a similar way, each providing that the respondent conspired together with other persons to defraud the bank by dishonestly and falsely (i) representing in the loan applications a genuine supplier; and (ii) submitting false sales invoices; thereby inducing the bank to approve the import loan applications and to release funds.

In convicting the respondent, the jury had to be sure that the prosecution have proved beyond reasonable doubt that: (1) there existed fictitious transactions with no underlying goods; (2) the respondent was a party to the agreement; (3) he intended the agreement to be carried out; and (4) he acted dishonestly.

The fraudulent trading claim

The liquidators took out summonses pursuant to sections 275 and 276 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) for fraudulent trading and misfeasance against the respondent and another director of the companies (who had been acquitted of the charges brought against her in the criminal proceedings) in respect of the 161 import loans. The respondent's father was made bankrupt and had by this time passed away. At the trial, the only application pursued was fraudulent trading against the respondent.

Evidential relevance of the conviction

Section 62 of the Evidence Ordinance (Cap 8) shifts the legal burden of proof to the defendant to prove that he did not commit the acts constituting the criminal offence for which he has been convicted.

The conviction was a subsisting one as it had not been overturned on appeal. In the fraudulent trading proceedings, the respondent was taken to have committed the 9 counts of conspiracy to defraud.

Harris J agreed that the respondent's conviction shifted the legal burden of proof to the respondent to show that:

- (1) the transactions underlying the 156 import loan applications were genuine; and/or
- (2) he was not a party to the conspiratorial agreement to defraud; and/or
- (3) he did not intend the agreement to be carried out; and /or
- (4) he acted honestly.

¹ HCCC 2 of 2014

² CACC 274 of 2015

³ FAMC 7 of 2017

Elements of Fraudulent Trading

The liquidators must show that:

- (1) certain business of the subject company was being carried on with the intention to defraud creditors or for any fraudulent purpose;
- (2) the defendant was knowingly a party to the carrying on of such business in such matter; and
- (3) there must be actual dishonesty and it is necessary to show either an intent to defraud or a reckless indifference whether the creditors were defrauded (including a party shutting their eyes to the obvious).

Were the transactions genuine?

Crucial to the liquidators' case is the Police's forensic accountant report as well as the fund flow analysis carried out by the liquidators. It was found that those are round robin transactions - the import loans were paid to the purported supplier, who in turn paid the remittance agent, who then transferred the money back to the companies as well as other entities in the group. Some of the funds were used to pay off existing loans of the companies. Harris J considered that the analysis points compellingly to the conclusion that there are no genuine transactions.

The respondent had sought to challenge the liquidators' case by explaining the business model of the companies but was unable to answer detailed questions about the transactions. Also, the matters raised by the respondent did not explain the fund flow.

There was no attempt by the respondent in its closing submissions to undermine the fund flow analysis.

Harris J concluded that the 161 transactions were not genuine and the associated import loan applications were fraudulent.

Business carried on with intent to defraud creditors

The respondent explained in his evidence that the companies' business model has evolved to include financing.

Harris J explained that carrying on business is broadly defined and encompassed one transaction provided it can properly be described as a fraud on a creditor perpetrated while carrying on business; there was no dispute that the 161 transactions come within the part of the business activity of the companies as explained by the respondent.

Harris J concluded that the companies were clearly "carrying on business" in the sense required for section 275.

The respondent was a knowingly party

Although the respondent attempted to distance himself from the fax instructions to the remittance agent, it was the respondent's own evidence that he was the head of the accounts and finance department, and he decided which credit line to utilize, which credit line to repay, and the order of repayments.

Harris J concluded that the respondent at least knew that payments were being made by the alleged supplier to the remittance agent, and hence they were not made in respect of genuine transactions, or more likely he was orchestrating the fraudulent scheme to keep the companies afloat.

Harris J was satisfied that the respondent was knowingly a party to the companies carrying on their business in a fraudulent manner.

The respondent raised a number of matters in his defence. This included the argument that the transactions underlying the import loans were genuine and the goods were sold in the Brazilian market. Nevertheless, Harris J observed that the respondent had not adduced any substantive evidence to support the argument even though he was fully aware of the need to do so.

What is recoverable under section 275?

The Court has a discretion to declare that the person found liable *"shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct."*⁴

In respect of what payments the Court is allowed to order, the wording of section 275⁵ and that of the current English legislation⁶ are substantially different. Harris J explained that section 275 gives the Court a wide power to order payment of such sum as it thinks appropriate, which could be more or less than the amount of the relevant debt. However, the Court has to approach the assessment of the amount to be paid in a principled way.

It was common ground between the parties that there must be some nexus between the loss caused to the creditors as a result of the fraudulent trading and the sum payable by the party liable for fraudulent trading. What was in dispute was whether the fact that most of the import loans were used to repay existing debts (hence reducing the companies' benefits) should be taken into account.

Broadly agreeing with the approach in the Singapore decision of *Tendcare Medical Group Holdings Pte Ltd v Gong Ruizhong*⁷, Harris J decided that the correct approach is to assess the amount by reference to the amount of the debts directly attributed to the fraud unless a substantial reason is advanced for doing otherwise, and generally, it would be for the fraudster to do so.

Harris J decided that unless there is a good reason otherwise, the amount is calculated by reference to the amount of the debts incurred attributable to the fraudulent trading less the debts that were repaid, without taking into account any amount of the loans which was used to repay the companies' existing debts. In the present case, it was the 161 import loans minus 12 import loans which were repaid.

Harris J granted declarations that respondent was knowingly a party to the carrying on the business of the companies with intent to defraud creditors, as well as ordered payment of over USD 39 million and interest.

Stephenson Harwood acts for the liquidators in these proceedings.

⁴ Section 275(1) of Cap 32

⁵ The same wording as section 332(1) of the Companies Act 1948

⁶ Section 213 of the Insolvency Act 1986

⁷ [2021] SGHC 80

Takeaway points

Fraudulent trading claims are a rarity because of the high threshold of proving fraud.

This is the first reported Hong Kong judgment of a trial on fraudulent trading. The judgment provided helpful guidance as regards the elements of the claim as well as calculation of the quantum.

Applying the Singapore approach, the Court clarified the quantum for fraudulent trading under the Hong Kong legislation is the amount of the debts directly attributed to the fraud and there is no need to reduce any benefit obtained by the company from the use of the proceeds of fraudulent trading.

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