

## Commercial litigation newsletter – December 2023



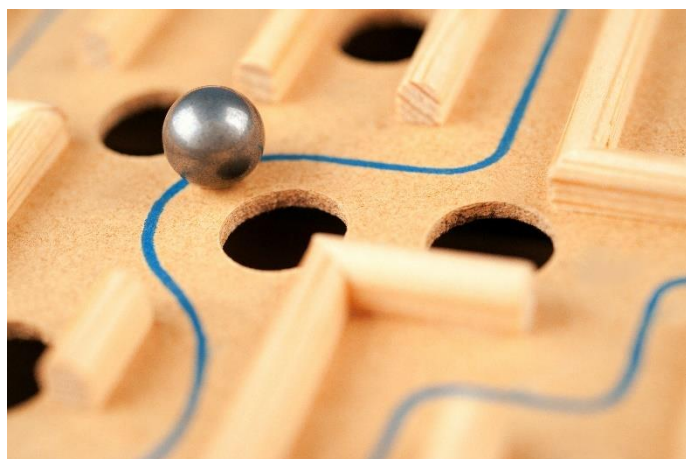
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## The new year ahead - new regulatory regime for insurers in Hong Kong

### The risk-based capital regime

Earlier this year in 2023, the Insurance (Amendment) Bill 2023 was passed, one key feature of which is the adoption of a risk-based capital ("**RBC**") regime for the insurance industry, in line with the international standard set out by the International Association of Insurance Supervisors. The Insurance Authority (the "**IA**") is currently working on the subsidiary legislation for the RBC regime and is targeting to roll out the RBC regime in 2024. In fact, some insurers, such as AIA Hong Kong and Sun Life Hong Kong, have already obtained the IA's approval to early adopt the RBC regime.

The RBC regime will replace the current rule-based capital regime under the Insurance Ordinance (Cap 41) (the "**IO**"). According to the existing regime, an insurer's capital adequacy is assessed based on solvency margin, which focuses on the ratio between asset value and liability value. On the other hand, the RBC regime will take into account both quantitative (including capital adequacy and valuation assessment) and qualitative (including corporate governance, risk and solvency assessment) dimensions in order to evaluate the capital required for a particular insurer. This will not only allow certain degrees of flexibility to insurer by giving credits to risk management taken by management, but it can also strengthen policyholder protection by ensuring that the actual risk exposure of a particular insurer is reflected.



### Other updates to the IO

In addition to the RBC, the other major changes to the IO introduced by the Insurance (Amendment) Bill 2023 include new intervention powers of IA, new concept of "designated insurers" and new distinction between majority and minority controllers.

#### New intervention powers of IA

Under the existing IO, the IA has wide regulatory powers, which include *inter alia*:

- (a) A wide range of intervention powers under sections 27 to 35, such as power to impose restriction on new business, and to appoint advisors/managers
- (b) Power to conduct inspection or investigation without warrant (section 41B and 41D)
- (c) Power to take disciplinary action, and revocation/suspension of licence (section 41P)

The existing intervention powers under sections 27 to 35 may only be exercised if one of the few grounds are satisfied, including where (a) the IA is of the view that the insurer may be unable to meet its liabilities or to fulfil the reasonable expectations of policyholders, (b) it appears to the IA that the insurer has failed to satisfy obligation under IO/furnished misleading or inaccurate information to IA, or (c) the IA is not satisfied that adequate arrangements are in force or will be made for the reinsurance of risks against which persons are insured by the insurer in the course of carrying on business. In respect of the residual powers under s.35 (such as the power to appoint of advisors/managers), they can only be exercised if the exercise of powers under sections 27 to 34 are unable to appropriately safeguard the interests of policyholders.

After the amendments to the IO come into effect, IA will be empowered with new intervention powers, such as requirement to provide written report on any matter relating to the insurer. Furthermore, certain powers, such as the power to require submissions of report, power or to order actuarial investigations, can now be exercised if the IA is of the view that it is

desirable for mitigating or controlling the risks posed to or by the business of the insurer.

### **New concept of "designated insurers"**

The existing IO distinguishes insurers that are incorporated in Hong Kong and that are incorporated in other jurisdictions.

Under the new regime, it will allow the IA to designate insurers carrying on the majority of their business in/form Hong Kong, and such designated insurer will have to comply with the same regulatory regime as Hong Kong insurers.

### **New distinction between majority and minority controllers**

The current IO defines shareholder controllers as persons who could exercise 15% or more of the voting power in the insurer.

The new regime will break down shareholder controllers into "majority" and "minority" shareholder controllers, who could respectively exercise 50% or more and 15% or more of the voting power in the insurer. Approval from the IA is required to become a majority/minority shareholder controller of an authorised insurer, except that no approval is needed (but notification is needed) if a person is transforming himself from a majority shareholder controller to a minority shareholder controller.

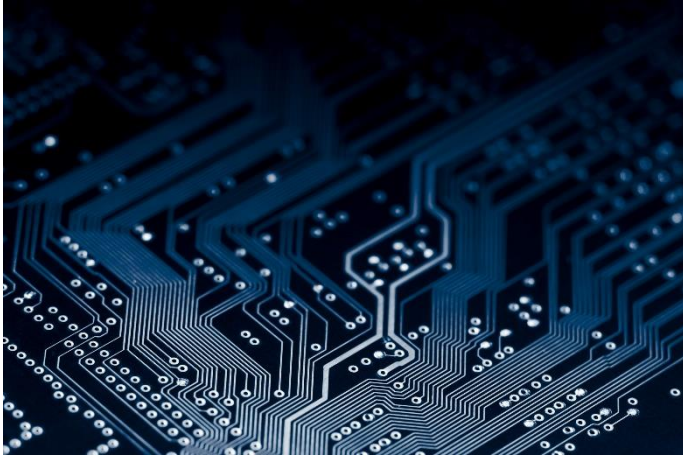


### **Conclusion**

We notice the IA has become more active in exercising its supervisory powers under the IO. In addition to introducing the fundamental change to the RBC regime in Hong Kong, the Insurance (Amendment) Bill 2023 also introduces various new intervention powers to the IA. It will be interesting to see how these changes will shape the insurance industry in Hong Kong.

This article was written by partner **Emily Li** and associate **Karen Cheng**.

## Be prepared: the up and coming of the DAOs and its legal hurdles



### What are DAOs (decentralised autonomous organisations)?

There is not yet a single definition of a DAO, due to the all sorts of ways in which it can be structured. In extremely general terms, they are structures that are collectively owned and managed by all of their members. There will be no centralised leadership/management, offering a free and liberal environment for people to collaborate and invest fundings for a designated purpose. All activities

across the structure are open and transparent; regulate and operate based on its "smart contract".

### How does DAO work?

The foundation of a DAO is its "smart contract", which terms define the codes/rules of the structure and holds its treasury. Once the "smart contract" takes effect in the system, no one can change the rules except by a general vote. No one can do anything (including spending money in the treasury) that are not covered and/or allowed by the terms and/or logic of the "smart contract". Hence, all decisions are made collectively and payments are automatically authorized when votes pass and/or allow by the code.

With DAOs, there is no need to impose trust on anyone, as the 100% transparent codes (instead of relying on a shareholders' agreements and/or directions given by the board) would verify all activities that happen under the sun. To demonstrate its difference with a traditional corporate structure:

| DAO                                                                                                                                                 | A traditional company                                                                                                                                                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| No hierarchy and fully democratised.                                                                                                                | With hierarchy.                                                                                                                                                           |
| Separation of the roles of shareholders and directors.                                                                                              | There is no separation as all decisions would generally be made by the members in view of their respective "tokens" (or shareholdings in similar terms) in the structure. |
| Any changes to be implemented into the structure would require members' votes.                                                                      | Subject to the relevant shareholdings/ directorship, changes can be made by a small group people (usually the board of directors).                                        |
| The results originate from the voting would be implemented automatically without the need of delegating to people and relying on their performance. | If there is any decision made via voting, the result would need to be implemented by delegating the job to juniors and/or other people.                                   |
| Services are offered automatically and in a decentralised way.                                                                                      | Services require human handling, or via instructions given out by central control panel.                                                                                  |
| All activities are usually transparent and fully public.                                                                                            | Activities are usually private, and not public.                                                                                                                           |
| Voting rights usually originate from tokens.                                                                                                        | Voting rights originate from shareholdings.                                                                                                                               |
| The acquisition of tokens are relatively simpler than shares, which could be disposed of with minimal requirement and/or none.                      | Transfer of shareholdings is subjected to the company's articles of association.                                                                                          |

But as the "smart contract" terms and/or codes are transparent and public, this would expose the structure to potential attacks that are tailor made in view of the relevant codes. It would also be much easier for people to copy and/or steal away your trade secret.

Countries like the United States, German and some European jurisdictions have commenced to draft legislations that are tailor made for the DAOs structures. Some legislations allow DAO to be formed as a limited liability company or at least apply some sort of legal framework for this innovation.



### No more disputes with DAO?

Despite the aforesaid jurisdictional development, the legal framework (in particular legal capacity to enter into a contract, to sue and/or to be sued) is still far from maturity. One would expect that, due to the lack of experience of the legal industry and/or court, it would be pretty challenging to sue a DAO under the current regime. Complicated legal questions as to which court has jurisdiction and/or where is the DAOs' assets lie (if they are virtual assets like crypto-currency) residing at; and what kind of procedures would need for enforcement of any court orders (if one manages to obtain one). It is therefore expected that people would remain cautious and careful when being approached by a DAO in relation to any business opportunities.

While it appears that decentralisation would minimise the upcoming of corporate disputes like: shareholders' argument, unfair prejudice of minority shareholders and/or directors' fraudulent acts. It is also believed that decentralisation of the corporate structure would cause a lot of deadlocks in making decisions. In such circumstances, the intact of the operation of a DAO may cause damages to the token-holders' interests and fail to fulfill their expectations when entering into the structure.

Also, in the event that the DAOs are insolvent, people are uncertain about the proper ways in handling its liabilities and/or assets? In what way could the creditors' rights be protected and which court would have jurisdictions to appoint their liquidators? This is yet to be seen.

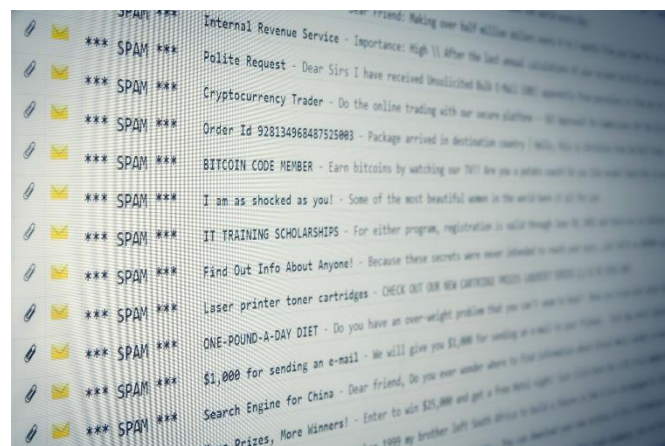
This article was written by managing associate **Stephanie Poon.**

## Toyota Boshoku Europe N.V.: assessment of evidence in email scam cases

### Introduction

Email has changed the game for scammers. The convenience and anonymity of email, along with the ability it provides for easily contacting thousands of people at once, gives the scammers an easy means to lure potential victims. Tracing and recovery get trickier when scam cases involve multiple layers of recipients. Unlike the first- layer recipients where the element of fraud is usually more obvious, the second-layer recipients and beyond may contest the claim by putting forward the bona fide purchaser defence and change of position defence.

These two defences were put forward by the 8<sup>th</sup> Defendant (D8) in the recent case of *Toyota Boshoku Europe N.V. v. Kingsville (HK) Enterprises Ltd and Others* [2023] HKCFI 1393 to oppose the continuation of the injunction. The Court examined the evidence adduced by D8 in great detail in order to determine whether the injunction should be continued.



### Background

The Plaintiff, Toyota Boshoku Europe N.V., is the victim of a large-scale fraud in which approximately HK\$500 million was paid to various companies as a result of scammers impersonating as the plaintiff's CEO and President, and causing the plaintiff's general manager of finance to believe that funds were needed for a secret and urgent acquisition.

The plaintiff has already obtained interlocutory proprietary and *Mareva* injunctions against 48 defendants in another proceedings (HCA2091/2019), which comprised of 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> layers recipients of the Plaintiff's funds.

In the present case, the Plaintiff sought to trace the proprietary funds against the "next layer recipients" and D8 is a 3<sup>rd</sup> layer recipient who received two sums of traceable proprietary funds in the total amount of US\$274,986.08 on 19 August 2019 (the "**Funds**").

### Defences raised by D8

D8 opposed the continuation of the injunction on the following grounds:

- (a) Bona fide purchaser defence: It is a bona fide recipient of the Funds through a transaction conducted in its wholesale wine business.
- (b) Change of position defence: It has so changed its position by making partial payment for the wine purchased from its wine supplier so it would be inequitable to require it to make restitution.

### The Court's ruling

#### Issue 1 - Whether D8 was a bona fide purchaser without notice?

Le Pichon DHCJ reiterated that the transaction cannot be looked at in isolation but shall be assessed in a more structured context of the entire business line (in the present case, trading in wine) and the specified transactions involved.

D8 replied on the following matters to show that it was operating a legitimate wholesale trading business:

- (a) It operates bank accounts for the trading business and relevant bank statements have been produced;
- (b) It is the lessee of a Container Yard with storage and office space in Yuen Long from which it conducts its trading business and 3 lease agreements have been produced;
- (c) 3 employees are hired by D8 and MPF records for the period from July 2021 to June 2022 have been produced; and

- (d) D8's accounts for the financial years ending 21 December 2018 and 2019 shows that D8 has been paying income tax.

After a detailed examination of the evidence adduced by D8 in support of the above matters, the Court was unconvinced that D8 was carrying on a bona fide business of wholesale trading in wine. Issues/comments on the evidence raised by the Court include:

- (a) D8 maintained 3 bank accounts (all with positive balance) with the Nanyang Commercial Bank ("NCB"), all of which were closed on 10 December 2019 "for reasons unknown". The Court found it "inexplicable" that NCB was not asked to provide the reason for the closure of the NCB accounts. In addition, no evidence is produced to show that D8 had extant bank accounts with other banks after the closure of the NCB accounts.
- (b) The leases of the Container Yard make no mention of any refrigeration equipment/facility being provided, which should be required if D8 is operating a genuine frozen meat wholesale business.
- (c) The transactions concerned took place in August 2019 so the MPF records for the period from July 2021 to June 2022 are irrelevant.
- (d) It is odd that no trade receivables and/or trade payables are shown in D8's accounts for the year ended 2018.
- (e) The annual rental for the Container Yard has been grossly understated in D8's accounts.
- (f) It is inaccurate, if not misleading, for D8's accounts to describe its principal activities as confined to frozen meat trading when in 2018 just under 18% of its total costs was attributed to the purchase of wine made in September 2018 and D8's orders with QuintMas (D8's sole wine supplier) represented over 18% of the total value of purchases made by D8 in 2019.
- (g) Very little evidence (only 21 pages of documents relating to 3 transactions conducted in 2021 and 1 transaction conducted in 2022) was produced to substantiate D8's wholesale trading business and none of these transactions took place in 2019 when the Funds were transferred.

- (h) There was no explanation of D8's sudden branching out into the wine field and no evidence is produced in relation to the experience and knowledge of D8's sole director and shareholder in the wine trading field.

- (i) It is surprising that D8 did not maintain a log or chronological record of the incoming orders for wine for accounting purposes.
- (j) There is no evidence or internet footprint showing the particular wines D8 carries and their vintages.
- (k) The invoices in question only specified the name of the purchaser without any address, contact number and payment terms.
- (l) It is remarkable that D8 does not appear to maintain a record of its customers (whether repeated or one-off customers).

## Issue 2 - Whether there was a change of position in good faith?

D8 made an alternative defence that it altered its position in good faith since its receipt of the Funds from the 2<sup>nd</sup> layer recipient in that the Funds have been applied in partial payment for the wines D8 ordered in July 2019.

The Court considered that D8 has failed to demonstrate that as a result of its receipt of the Funds it engaged in some extraordinary expenditure. What D8 has done was merely to make a payment in the ordinary course of business so it does not come within the defence of change of position as explained by Lord Goff in *Lipkin Gorman (a firm) v Karpnale Limited* [1991] 2 AC 548.

In light of the above, the Court ordered that the injunction be continued.

## Conclusion

The decision provided helpful guidance on the Court's approach to assessing evidence for establishing a bona fide purchaser defence and change of position defence in email scam cases. It also reaffirms the Court's willingness to grant interim remedies such as injunctions to assist victims in preserving assets and maximising their chance of recovery.

This article was written by managing associate **Karis Yip**.

## News update

### Webinar

Please contact us if you would like to view our recent commercial litigation webinars:

| Date              | Speakers                                                                        | Topic                                                       |
|-------------------|---------------------------------------------------------------------------------|-------------------------------------------------------------|
| 13 September 2023 | Ian Childs (Partner, Litigation) and Karis Yip (Managing associate, Litigation) | 10 things you need to know about Hong Kong's employment law |
| 30 May 2023       | Stephanie Poon (Managing associate, Litigation)                                 | 你应该知道的香港遗产法的法理与案例                                           |

### Previous editions

| Date            | Author                                                                                                                                       | Title                                                           |
|-----------------|----------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| 15 May 2023     | Emily Li, Zoe Zhou (Managing partner, Wei Tu Law Firm*)<br>Karis Yip, Stephanie Poon,<br>Xueqing Wan (Counsel, Wei Tu Law Firm*) and Ken Chu | <a href="#">Commercial litigation newsletter - May 2023</a>     |
| 27 October 2022 | Emily Li, Karis Yip and Stephanie Poon                                                                                                       | <a href="#">Commercial litigation newsletter - October 2022</a> |
| 29 July 2022    | Emily Li, Karis Yip and Stephanie Poon                                                                                                       | <a href="#">Commercial litigation newsletter - July 2022</a>    |
| 26 April 2022   | Emily Li, Karis Yip and Stephanie Poon                                                                                                       | <a href="#">Commercial litigation newsletter - April 2022</a>   |

### Corporate and Commercial Disputes Hub

Please visit the [Stephenson Harwood Corporate and Commercial Disputes Hub](#) to see latest updates from our team.

## Office news

In November, members of the Stephenson Harwood Hong Kong office took part in two charity initiatives - the Hong Kong Legal Walk, and a clothing drive in support of Christian Action.

### 'Clothing and Green Collection' for Christian Action



The Stephenson Harwood CSR committee organised a clothing and green collection drive to support Christian Action. Thanks to the support from colleagues, the team collected five boxes of clean and good condition clothing, accessories, shoes, handbags, toys and dolls, and baby items.

The collected items were donated to Christian Action, where they are offered for sale at community sales outlets, distributed to service users or vulnerable communities, and exported to developing countries through the charity's green recycling business partners.

### Hong Kong Legal Walk 2023



At the end of November, close to two dozen Stephenson Harwood colleagues hiked up and down the Pak Kong Ancient Trail to raise funds in support of the Hong Kong Legal Walk. Having the chance to check out the impressive St Thomas' Bean 'Vine King' and walk through the 'Bamboo Forest Tunnel' made the arduous hike completely worthwhile.

The Hong Kong Legal Walk aims to unite the Hong Kong legal profession in the common causes of charity and service to local communities. All donations went to MindHK, Eye Fund, Equal Justice and Justice Without Borders.

After completing the two-hour trek, the hikers rewarded themselves by joining other colleagues, friends and family for an authentic Hong Kong style barbecue organised by our SHocial Club at Sai Kung, which is dubbed the 'back garden of Hong Kong' and is known for its fishing villages, beautiful scenery, hiking trails, beaches and islands.

## Get in touch

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We assemble teams of bright thinkers to match our clients' needs and give the right advice from the right person at the right time. Dedicating the highest calibre of legal talent to overcome the most complex issues, we deliver pragmatic, expert advice that is set squarely in the real world.

Our headquarters are in London, with eight offices across Asia, Europe and the Middle East. In addition, we have forged close ties with other high quality law firms. This diverse mix of expertise and culture results in a combination of deep local insight and the capability to provide a seamless international service.

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