HCA 2715/2016

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

ACTION NO 2715 OF 2016

BETWEEN

WONG MAN HON FREDERICK	Plaintiff
and	
CHINA TIMES SECURITIES LIMITED	Defendant

Before: Deputy High Court Judge Hunsworth in Chambers

Date of Hearing: 3 February 2017

Date of Judgment: 3 February 2017

Date of Handing Down Reasons for Judgment: 15 February 2017

REASONS FOR JUDGMENT

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1. This is, to say the least, an unusual case, although it arises out of what may be described as vanilla facts. The plaintiff entered into a contract of loan with a company called 360HK Limited, whom I shall refer to as "the lender". Various documents were signed between the plaintiff and the lender, including a loan agreement. These were all signed on 6 September 2016. As part of the security for the loan, the plaintiff agreed to pledge some 30,130,000 shares ("the Shares") he owned in a company called Agritrade Resources Limited ("Agritrade"). The mechanics by which the Shares were to be pledged are set out in a Collateral Agency Agreement ("CAA") entered into between the plaintiff, the defendant and the lender on 6 September 2016.

2. That factual matrix is pleaded in the statement of claim. It appears to have been that

presented to Deputy High Court Judge Sakhrani when an application was made for an *ex parte* injunction in October 2016. Interestingly, however, it seems the loan arrangements were part of a wider financial scheme whereby the plaintiff sought to enter into a securities trading relationship with the defendant in replacement of his previous trading relationship with a company called Kingston Securities. This is evidenced by the various account opening documentation which predated the loan, the documents all being dated 23 August 2016. As these are first in time, it is preferable first to have reference to these documents and their material provisions.

3. The account opening documents are in both Chinese and English. They appear to be the defendant's standard form agreements. The primary agreement is called a Cash Account (Securities Trading) Client Agreement. As the name suggests, this is an agreement which permits a client, in this case the plaintiff, to trade securities with his broker, in this case the defendant. There is nothing unusual in any of the provisions of this agreement which appears to be in standard form for such a securities trading agreement. I make reference to clause 7 of this agreement because this clause became the subject of some debate in the argument before me. It is perhaps worth quoting in full. 7.1 reads:

> "Any securities which are held by the Broker for safekeeping may, insofar as reasonably practicable:
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> (i) (in the case of registrable securities), be registered in the Client's name or in the name of the Broker's nominee, or
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> (ii) be deposited in Hong Kong into a segregated account, designated as a trust/ client account and established and maintained by the Broker or any of its Associates in Hong Kong for the purpose of holding client securities with any authorised financial institution, or any independent custodian approved by the SFC, or any intermediaries licensed for dealing in securities."

4. At the same time, the plaintiff signed other documents which would appear to have formed part of the defendant's account opening procedure. These included a General Risk Disclosure Statement, a document entitled Terms and Conditions For Online Trading, an account opening form on which were recorded the plaintiff's personal details, a document relating to the establishment of a joint account and last but by no means least, a document entitled Supplemental Agreement for Margin Account. This Supplemental Agreement was expressly stated to be supplemental to the Cash Account (Securities Trading) Client Agreement. As its name denotes, it clearly permitted the plaintiff to engage in margin trading.

5. Of particular note in this Supplemental Agreement are two clauses, namely 17 and 18. These are standard clauses in margin trading account agreements. What they do, in effect, is to allow the broker to use any securities belonging to the client for his own purposes,

including, if the broker so decides, the pledging of such securities as security for the broker's own obligations and liabilities.

6. There have been several cases over the years in Hong Kong where brokers have become insolvent and customers have found, to their considerable chagrin, that shares which they thought they owned had been pledged to a bank as security for indebtedness advanced to the broker. Nevertheless, there is nothing to prevent a broker entering into such an arrangement with his client and that is what has happened in this case.

7. Interestingly, as if to highlight the importance of the client understanding the broker's rights, there is a separate document in the account opening documentation in which the provisions relating to the broker being able to use the client's securities for his own purposes are repeated. This has been signed by the plaintiff.

8. Turning back to the loan documentation, there is a loan agreement between the plaintiff and the lender to which the defendant is not a party. It contains no terms or provisions which I would regard as unusual. It does provide, however, for the use of the Shares as collateral security for the repayment of the loan. Mr Manzoni, SC, who appeared on behalf of the defendant, pointed out certain material paragraphs which had the effect, in his submission, of vesting control over the Shares in the lender during the pendency of the loan. The particular paragraphs are clause 1(dd) which relate to portfolio protection arrangements, and clauses 3(a) and 3(d) which contain the material provisions relating to the pledge of the Shares.

9. As the loan agreement was not signed by the defendant, there can be no question of any of its provisions being binding on the defendant; that is a simple application of the law of privity of contract. As Mr Manzoni rightly submitted, the loan agreement is part of the factual matrix but no more.

10. The contractual documentation between the plaintiff and the defendant, other than the account opening materials I have referred to above, consists of the CAA. It is important to have reference to this document because it is the alleged breach of the CAA which is the foundation stone of the plaintiff's claim. The CAA has a number of recitals, the most important of which states that the lender wishes to appoint the defendant as collateral agent to hold the Shares as the lender's agent and to maintain the Shares in a securities brokerage margin account with the defendant in the name of the plaintiff.

11. Clause 1 of the CAA provides for the appointment of the defendant by the lender as such agent and names a specific account which is to be opened to hold the shares. Clause 1 further provides that such account will be in the name of and owned by the

plaintiff.

12. Clause 2 imposes an obligation on the plaintiff to complete such account opening documents as are typically entered into in connection with the establishment of a margin account with a broker in Hong Kong. As we have seen, the plaintiff had already entered into such account opening documents and this clause is therefore more a statement of historical fact than the imposition of a prospective obligation.

13. Clause 3 provides that during the pendency of the loan, the plaintiff is unable to withdraw, transfer, pledge or otherwise deal with the Shares without the prior written consent of the lender. Furthermore, the plaintiff granted, both to the lender and to the defendant, a security interest in his account, which expressly included the Shares, and exclusive control over the account by the defendant and the lender.

14. Very soon after the execution of these documents, it came to the attention of the plaintiff, through his review of the Hong Kong Stock Exchange website, that on Friday, 9 September 2016, the Shares had been transferred from the defendant's security account to Standard Chartered Bank ("SCB").

15. It is common ground between the parties that this had indeed happened. The shares were transferred by the defendant to a custodian with whom it appears to have had an existing custodian arrangement, being an English company called Beaufort Securities Limited ("Beaufort"). SCB in Hong Kong was apparently a sub-custodian for Beaufort and it can be seen 30 million-odd shares in Agritrade were transferred from the defendant to SCB on 8 September 2016.

16. What happened thereafter is not, however, common ground and is a matter of some evidential dispute. It is the plaintiff's case that the shares which were transferred to SCB were subsequently transferred to other financial institutions in Hong Kong, including UBS Securities Hong Kong Limited and Deutsche Bank AG. The plaintiff deduces this from a close analysis of the daily CCASS statements which are issued. Based upon evidence which I shall review in a moment, it is said the irresistible inference the court should draw is that some, or all, of the shares have been sold in the market.

17. The basis of the plaintiff's claim is that the very fact of the transfer of the shares to SCB, or to Beaufort, although that is not specifically pleaded, was a breach of the CAA. This appears at paragraph 16 of the plaintiff's statement of claim dated 11 November 2016. The plaintiff further pleads that the subsequent transfers of the shares from SCB to other financial institutions constituted further breaches of the CAA.

18. I am not sure how this latter plea is made good or whether it is simply parasitic upon

the original plea that the defendant is in breach of the CAA by allowing the Shares to be transferred out of the account in its own name. It does not seem to me that subsequent transfers constitute separate or new breaches of contract. The alleged breach flows from the original transfer of the Shares from the defendant to SCB.

19. In his first affirmation filed in support of the application for an injunction, Mr Wong produces copies of the CCASS statements. He also deposes to the fact that the majority shareholder of Agritrade, being one Ng Say-pek ("Mr Ng"), together with his associate, Mr Ashok Kumar Kumar Sahoo ("Mr Ashok"), between them owned some 521 million-odd shares which are held at an account at SCB. By a series of mathematical deductions, Mr Wong concludes that the Shares which were transferred to SCB by the defendant must necessarily have been transferred to other financial institutions and, as I said, his submission is that the only inference can be that the Shares were sold.

20. There is some inconsistency in the evidence in that there are statements from Beaufort which suggest that far from the Shares being sold, they remain in the possession of Beaufort, at least as at 21 October 2016. I should add that the analysis of the CCASS statements is for a period from 8 September to 15 October 2016. These statements from Beaufort are, as one would expect, addressed to the defendant and they record the holding of the precise number of the Shares in the account with Beaufort. At the same time, the defendant has sent statements of account to the plaintiff. There are two before the court dated 20 and 31 October respectively, in which it is said the defendant has in its portfolio holdings for the plaintiff the precise number of the Shares which are the subject of the CAA.

21. To conclude the historical background, an application was made, *ex parte* without notice, to Deputy High Court Judge Sakhrani on 19 October 2016. The deputy judge granted an order which prohibited the defendant from selling, transferring, pledging or otherwise dealing with the Shares. A further order was made requiring the defendant to inform the plaintiff, in writing, within ten days, of details of all dealings in the Shares.

22. The matter came back before Deputy High Court Judge Sakhrani at the *inter partes* hearing on 28 October 2016. The injunction was not contested at that hearing. Instead, the defendant gave an undertaking in terms of the original injunction order and the injunction order was consequently discharged. Whilst the terms of the order are not patently clear, it seems to me the only logical inference that can be drawn is that the undertaking should continue until further order or until the substantive hearing of the injunction application, which was that which came before me. As for the application for disclosure, this similarly was adjourned to be heard at the same time as the substantive

hearing of the injunction.

23. In his skeleton submissions, Mr Minju Kim, counsel for the plaintiff, sets out six questions which he says are serious questions which are required to be tried. These are as follows:

(1) There is evidence that the Shares are no longer in the SCB account with Beaufort but have been transferred to UBS and Deutsche Bank and further evidence of a sale of tranches of the Shares.

(2) There was no reason for the transfer of the Shares to SCB, about which the plaintiff was never informed nor to which did he ever give consent.

(3) The transfer of the Shares to SCB and/or Beaufort was a breach of the terms of the CAA and the account opening form which restricted the defendant's role to that of a collateral agent.

(4) The defendant's statement to the plaintiff was false when it represented that the Shares were held by the defendant on the plaintiff's behalf. It is said it was false because the Shares had been transferred to SCB which, as I have noted, is common ground as a matter of fact.

(5) The reason for the sale of the Shares is to reduce their value; indeed, the price of the Shares declined in the period between 6 September and 17 October 2016. Such reduction in the value of the Shares would permit the lender to call for increased collateral and it would also permit the lender and/or the defendant to be able to repurchase the Shares in the market at a lower price.

(6) The defendant was in breach of section 148 of the Securities and Futures Ordinance, Cap 571, and provisions of the Securities and Futures (Clients Securities) Rules, Cap 571H.

24. It should be said no defence has yet been filed by the defendant. Instead, an application has been made to strike out the statement of claim. That application is not before me. The defendant did suggest to the court it would be sensible for the judge hearing the substantive hearing of the injunction also to hear the strike-out application. This request was opposed by the plaintiff and a determination made by Deputy High Court Judge Le Pichon that the summonses should be heard separately.

25. Having heard Mr Manzoni's submissions, it seems to me it would have made more sense for all matters to have been heard at the same time. However, that is water under the bridge and it is not, therefore, incumbent upon me to come to any determined

conclusion as to whether the statement of claim is susceptible to being struck out.

26. The basis of Mr Manzoni's attack on the statement of claim is that when one reads the contractual documentation between the plaintiff and the defendant, there was not and could not be any breach of the CAA, even if one accepted at face value the matters complained of in the statement of claim. He emphasised the combined effect of the CAA and the account opening documentation was to vest control over the Shares in the lender and the defendant as the lender's agent. Whatever may have been the plaintiff's wish as to somehow keeping control over the Shares, he had ceded such control by his execution of the contractual documents. Specifically, both the CAA and the Supplemental Margin agreement gave power to the defendant to transfer the Shares to a third party. That being so, the complaint which, as I noted, was the foundation of the statement of claim, namely the transfer of the Shares to SCB was a breach of the CAA, did not, to use the baseball term, reach first base.

27. I have to say I agree with this analysis. On any construction of either the CAA or the account opening documentation, the transfer of the Shares to an authorised financial institution to hold as custodian cannot be a breach of the contractual arrangements between the plaintiff and the defendant.

28. However, I have considered what is the position if I am wrong in this analysis. Even if one assumes that a pleaded breach of the CAA can be made out, one has to ask what loss, as at today, the plaintiff has suffered. As a general matter of law, if a person pledges or mortgages an asset, he retains the legal ownership of this asset but the beneficial ownership vests in the pledgee or mortgagee. What the mortgagor has is what is known as the equity of redemption. On the exercise of the equity of redemption by repayment of the loan for which the asset is pledged as security, the pledgor is entitled to the return of the asset. If the mortgagee or pledgee cannot return the asset for whatever reason, then he is liable to the pledgor for damages equivalent to the value of the asset.

29. It is common ground that the plaintiff has not exercised his equity of redemption. Accordingly, he has no entitlement, as a matter of law, to demand anything of the lender in respect of the pledged asset, in this case being the Shares. To contend otherwise would be to permit the issue of proceedings in which one asserts not an actual claim for breach of contract but a claim for a prospective breach of contract at some unspecified point in the future. This seems to me to be the basic position at law and all the contractual documents between the plaintiff, the lender and the defendant do no more than record these basic legal principles. Of course, as is always the case, the lender tends to draft the security documentation in terms most favourable to himself rather than to the borrower

but, as I have noted above, there is nothing in the loan documentation I have seen which I regard as being in any way unusual.

30. It seems to me this alone is sufficient to dispose of the claim for the injunction. If there is no subsisting cause of action, there cannot be any right to some form of injunctive relief. In addition, it seems to me this is a care beyond peradventure where damages would be an adequate remedy. As I have indicated, the obligation on the lender and on the defendant as the lender's agent is to furnish the Shares to the plaintiff on the exercise by the plaintiff of his equity of redemption when he repays the loan. If they fail to do so, then they are liable to the plaintiff for damages and those damages are readily calculable, being the market value of the Shares as at the date when the loan is repaid.

31. But again, even if I may be wrong in this analysis, I can find, on the evidence, no basis upon which an application for an injunction can be made or can be granted. Ever since the introduction of the CCASS nominee system, it has not been easy to establish who are the true beneficial owners of shares in listed companies in Hong Kong. The various financial institutions and brokers who hold shares may do so wearing many different hats. They may hold simply as custodians or nominees; they may hold as mortgagees; they may hold as trustees for customers and clients. As the account opening documentation between the plaintiff and the defendant discloses, very broad powers are vested in the defendant as broker, allowing it to transfer shares and I have no doubt that similar terms exist in agreements between other brokers and their customers. Similarly, a contractual term allowing custodians or nominees to transfer shares in circumstances where they consider it necessary in their discretion is, in my experience, routine.

32. Having said that, the ingenious attempt to suggest the Shares have been sold because they can be traced into and out of the hands of SCB simply cannot be made good on the evidence. Whilst Mr Ng and Mr Ashok may well have their shares in Agritrade held by SCB in an account, it does not follow that SCB has necessarily registered all, or indeed even some, of those shares in its own name. Given the Listing Rules as to control of listed companies, I suspect financial institutions are careful to ensure they are not seen as being over-mighty shareholders in listed companies in Hong Kong and it may well be that such banks have policies as to the maximum number of shares which they may have registered in their name at any one time.

33. I am not, therefore, satisfied that there is credible evidence before the court to show that the Shares, or any part of them, have been sold. The only credible evidence before the court is, in fact, to the contrary, being the statements from Beaufort which show, at least as at last October, that all of the Shares are held by Beaufort for the account of the

defendant. The defendant has, as I have noted above, similarly confirmed to the plaintiff that it holds the Shares in its portfolio. In the face of this direct evidence, I do not see how it can be suggested these statements are false. Instead, there appears to be something of a far-fetched attempt to manufacture a case of impropriety on the part of the lender and the defendant, of which impropriety I can see, on the evidence before me, no trace.

34. Two other points were raised by Mr Manzoni in support of his application that the injunction should be discharged or, as he more properly put it, his clients should be released from the terms of their undertaking. First, he pointed to a provision in the CAA at clause 6. By virtue of clause 6, both the lender and the plaintiff agree to indemnify the defendant against all claims and demands. Mr Manzoni pointed out that if the plaintiff's action continued against the defendant, the defendant would be able to invoke its right to seek an indemnity from the plaintiff and one was therefore in the classic care of circuity of actions.

35. Clause 6 does provide that the indemnity will not operate in circumstances of fraud, gross negligence or wilful misconduct. Mr Manzoni rightly pointed out that none of those have been pleaded in the statement of claim, although in fairness to Mr Kim, he has not formally had to address the argument as to circuity of action because no defence has as yet been filed.

36. I do not consider it necessary for me to make any finding on the question of circuity of action, although I am sure it will be something which is prayed in aid by the defendant at the strike-out application.

37. Secondly, Mr Manzoni contended there had been material non-disclosure when the original application for an injunction was made to Deputy High Court Judge Sakhrani. The non-disclosure fell into two categories. First, it was said the court was not properly addressed on whether damages would be an adequate remedy. Secondly, it was said the plaintiff had failed to disclose the lack of justification for giving no notice whatsoever to the defendant of his intention to apply for an injunction.

38. I am not persuaded the issue of the adequacy of damages as a remedy would, of itself, constitute a material non-disclosure. It will be in the forefront of any judge's mind to consider that aspect when deliberating on whether to grant an injunction. I am, however, more concerned about the issue of notice. There are numerous authorities which stress that an *ex parte* injunction should only be applied for, without notice, in cases which either require secrecy or extreme urgency. Cases requiring secrecy are self-evident. If a defendant were to be tipped off as to the likelihood of a *Mareva* injunction or an *Anton Piller* order being made, he may well take steps to frustrate the

purpose of such an order by dissipating his assets or destroying the offending material which is the subject of the *Anton Piller* application. Apart from these, it seems to me, however, there can be very few cases in which such extreme urgency is required that no notice whatsoever can be given to the defendant.

39. In the present case, there appears to me to have been no urgency about the application at all. Indeed, in Mr Wong's own affirmation, he says he first became aware of the transfer of the Shares to SCB on 13 September 2016. It was fully a month later before an application was made for an injunction.

40. As I see, in any event, no basis for the continuation of the injunction, the question of no notice being given of the *ex parte* application is perhaps, now, of little significance. I should say, however, that if I had been minded to continue the injunction or had to undergo some balancing of convenience, the fact that an injunction application had been made with no notice to the defendant would have weighed heavily with me in deciding how to exercise my discretion. The court, of course, has a power to discharge an *ex parte* order and to re-grant an injunction. In my view, however, such a power should be used sparingly because it seemingly rewards those who would otherwise, arguably, abuse the process of the court. As I say, however, it is not material in this case given that no basis has been made out for an injunction.

41. In conclusion, it seems to me the appropriate order which should be made is that the defendant is released with immediate effect from the undertaking which it gave to the court and which is recorded in the order of Deputy High Court Judge Sakhrani dated 28 October 2016.

42. In addition, the *inter partes* summons dated 24 October 2016 should, to the extent that any of it remains subsisting after the order of Deputy High Court Judge Sakhrani dated 28 October 2016, be dismissed. This will include the application for ancillary disclosure of documents which was sought by the plaintiff against the defendant.

43. As for costs, I will make the following orders. There shall be no order as to the costs of the *ex parte* application on 19 October 2016. The plaintiff shall pay the costs of the defendant of the hearing on 28 October 2016 and of the hearing of today, 3 February, such costs to be assessed on a party and party basis.

44. There will be a certificate for today's hearing for two counsel and there will be a gross sum assessment with the defendant to serve its draft statement of costs within seven days and the plaintiff to serve its reply within seven days thereafter.

(Nicholas Hunsworth)
Deputy High Court Judge

Mr Minju Kim, instructed by Lam & Co, for the plaintiff

Mr Charles Manzoni, SC leading Mr Thomas Wong, instructed by DLA Piper Hong Kong, for the defendant